Management's Discussion and Analysis (Unaudited)

INTRODUCTION

This discussion and analysis provides an overview of the financial position and results of activities of the University of Virginia for the year ended June 30, 2008. Comparative information for the year ended June 30, 2007, has been provided where applicable. This overview has been prepared by management and should be read in conjunction with the financial statements and the footnotes that follow this section.

The University of Virginia is an agency of the Commonwealth of Virginia and is governed by the University's Board of Visitors. The Commonwealth prepares a separate financial report that incorporates all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The University, consisting of three major divisions, is a component unit of the Commonwealth of Virginia and is included in the Commonwealth's *Comprehensive Annual Financial Report*. The University of Virginia's three divisions are its Academic Division, Medical Center, and the College at Wise.

Academic Division

A public institution of higher learning with 21,057 students and 2,171 full-time instructional and research faculty members in eleven separate schools, the University offers a diverse range of degree programs, including doctorates in fifty-seven disciplines. The University is recognized internationally for the quality of its faculty and for its commitment to the primary academic missions of instruction, research, and public service. The University consistently ranks among the nation's top public colleges and universities, both for its general academic programs and for its strengths in specific disciplines. Its emphasis on the student experience is extraordinary among major public institutions, and its dedication to new advances in research permeates all of its schools and colleges.

Medical Center

The University of Virginia Medical Center is an integrated network of primary and specialty care services ranging from wellness programs and routine checkups to the most technologically advanced care. The hub of the Medical Center is a 589-bed hospital, which is in a state-designated Level 1 trauma center located in Charlottesville. In addition, primary and specialty care are provided at convenient clinic locations throughout central Virginia communities.

College at Wise

Located in southwestern Virginia, the College at Wise is a public liberal arts college with 1,964 students and 95 full-time instructional and research faculty members. It offers twenty-nine majors, including preprofessional programs in dentistry, forestry, law, medicine, physical therapy, and veterinary medicine. Degrees include the bachelor of arts, the bachelor of science, and the bachelor of science in nursing.

FINANCIAL HIGHLIGHTS

For the fiscal year ended June 30, 2008:

- In May 2008, the University issued $231 million of general revenue pledge bonds. The proceeds will be used to acquire and construct a number of important projects that will advance the University's missions. They include the Carter-Harrison Research Building (MR-6), the Hospital Expansion, the Rouss Hall Complex, the South Lawn Project (Arts and Sciences Building), the Observatory Hill Residence Hall, and the Wise Dining and Residence Hall.
- In February 2008, the University terminated one of its three fixed-payer interest swaps. This swap had a notional amount of $50 million and was entered into at zero market value with no payment made or received at execution. With the termination of this swap, the University received a payment of $750,000. For additional information about interest swaps, see Note 2.
- The Board of Visitors adjusted the endowment spending rate from 4.5 percent to 5.0 percent in June 2008 to provide continued growth of restricted and unrestricted funds to its schools and departments for fiscal year 2008–09.
- The Board of Visitors also approved an annual administrative fee on endowment funds equal to 0.5 percent. The fee will generate almost $16 million in 2008–09 to help fund new academic initiatives identified by the Commission on the Future of the University.
- In May 2008, the State Council of Higher Education for Virginia certified that the University met the management standards established under the Restructured Higher Education Financial and Administrative Operations Act. As a result, the University will continue to operate with the increased independence granted by the legislation.
- In 2007, the University obtained legislation to allow the investment of University funds (excluding state appropriations and tuition revenues) in a fuller complement of options beyond the previous portfolio of cash and fixed-income instruments. With this investment legislation effective in fiscal year 2007–08, the University strategically moved long-term health-insurance reserves and certain capital reserves to higher-return long-term investment vehicles. Portions of nongeneral funds available to the University for management under restructuring were invested utilizing the same 2007 investment authority.
- In 2008, the Commonwealth of Virginia instituted budget reductions to help offset lower than expected revenues. The University experienced a reduction of $9.6 million in state support. At the time of this report, the Commonwealth of Virginia had announced further budget reductions for fiscal year 2008–09. The University's new reduction represents an additional $10.6 million.
- The University saw a modest increase in net assets of $284 million. The contributing factors to this increase are outlined in the summary table below.

Summary of the Increase in Net Assets *(in thousands)*	2008	2007	INCREASE (DECREASE) AMOUNT	PERCENT
Total revenues before investment income	$ 2,153,355	$ 2,135,940	$ 17,415	0.8%
Total expenses	2,112,906	1,950,335	162,571	8.3%
Increase in net assets before investment income	**40,449**	**185,605**	**(145,156)**	**(78.2%)**
Investment income	243,280	721,505	(478,225)	(66.3%)
TOTAL INCREASE IN NET ASSETS	**$ 283,729**	**$ 907,110**	**$ (623,381)**	**(68.7%)**

- Revenues before investment income stayed almost even with the prior year, increasing by less than 1 percent. The main reason for this was a large decrease in capital appropriations revenue, which was abnormally high in 2006–07. Capital appropriations decreased from $128 million in 2006–07 to $6 million in 2007–08. Expenditures increased 8.3 percent, leading to an overall decrease before investment income of $145 million.
- Annual investment income decreased from $722 to $243 million as the University's endowment investments earned a 5.9 percent return for the fiscal year. Market returns were not nearly as high as the 25.2 percent achieved in fiscal year 2006–07.
- The increase in total net assets was $284 million. This represents a modest 5.3 percent increase in net assets (see table below), with almost all of it attributable to investment income.

Overall, the primary factor in the University's net asset growth continues to be the performance of the endowment and its resultant investment income.

USING THE FINANCIAL STATEMENTS

The University's financial report includes five financial statements and related notes:
1. The Statement of Net Assets for the University of Virginia
2. The Combined Statements of Financial Position for the Component Units of the University of Virginia
3. The Statement of Revenues, Expenses, and Changes in Net Assets for the University of Virginia
4. The Combined Statements of Activities for the Component Units of the University of Virginia
5. The Statement of Cash Flows for the University of Virginia

These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) principles, which establish standards for external financial reporting for public colleges and universities. These principles require that financial statements be presented on a consolidated basis to focus on the University as a whole, with resources classified for accounting and reporting purposes into four net asset categories. Please note that although the University's foundations identified under guidance from GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, are reported in the component unit financial statements, this Management's Discussion and Analysis excludes them except where specifically noted.

STATEMENT OF NET ASSETS

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. The difference between total assets and total liabilities—net assets—is one indicator of the current financial condition of the University, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation. A summary of the University's assets, liabilities, and net assets at June 30, 2008, and June 30, 2007, follows.

Summary of the Statement of Net Assets *(in thousands)*	2008	2007	INCREASE (DECREASE) AMOUNT	PERCENT
Current assets	**$ 657,141**	**$ 1,194,340**	**$ (537,199)**	**(45.0%)**
Noncurrent assets				
Endowment and other long-term investments	3,960,739	3,354,704	606,035	18.1%
Capital assets, net	2,015,450	1,811,254	204,196	11.3%
Other	202,904	114,290	88,614	77.5%
Total assets	**6,836,234**	**6,474,588**	**361,646**	**5.6%**
Current liabilities	**418,635**	**558,853**	**(140,218)**	**(25.1%)**
Noncurrent liabilities	**778,845**	**560,710**	**218,135**	**38.9%**
Total liabilities	**1,197,480**	**1,119,563**	**77,917**	**7.0%**
NET ASSETS	**$ 5,638,754**	**$ 5,355,025**	**$ 283,729**	**5.3%**

This summary shows that the University's financial condition continues to strengthen.

CURRENT ASSETS AND LIABILITIES

Current assets, which totaled $657 million as compared to the previous year's $1.2 billion, consist primarily of cash and cash equivalents, short-term investments, and accounts receivable. The decrease in current assets of $537 million, or 45 percent, resulted from a shift of current assets to noncurrent assets. More specifically, current cash and cash equivalents of roughly $400 million were moved into other long-term investments as now permitted by the 2007 legislation. Implementation of the University's first treasury management system facilitated better cash flow projections. As a result, the University was able to maximize its investment earnings while retaining sufficient working capital to meet operating needs.

Current liabilities, which consist primarily of accounts payable, deferred revenue, and the current portion of long-term liabilities, decreased by $140 million, or 25.1 percent. The two major reasons for this change were the elimination of the securities lending program and a reduction in the outstanding commercial paper balance. The commercial paper, as bridge funding, was largely refinanced with the University's bond issuance in May 2008.

From a liquidity perspective, current assets cover current liabilities 1.6 times, an indicator of good liquidity and the ability to weather short-term demands on working capital. This rate of coverage decreased from 2.1 last year. Current assets also cover four months of total operating expenses, including depreciation, a decrease from last year's seven and one-half months of coverage. As mentioned above, the major factor in the reduction of these ratios was a shift from current assets to longer-term investments.

ENDOWMENT AND OTHER INVESTMENTS

Performance. At June 30, 2008, the major portion of the University's endowment was maintained in a long-term investment pool managed by the University of Virginia Investment Management Company (UVIMCO). The annual return for the long-term investment pool this year was 5.9 percent, a decline from last year's unusually high return of 25.2 percent. Included in the calculation of this performance figure are realized and unrealized gains and losses, along with cash income. With this return, total investment income for all funds declined $478 million, or 66.3 percent.

Distribution. The University distributes endowment earnings in a way that balances the annual support needed for operational purposes against the preservation of the future purchasing power of the endowment. The endowment spending-rate policy is approved by the Board of Visitors and is based on total return, not just cash earnings. The total distribution for the University's endowment was $133 million, an increase of $33 million over last year's distribution of $100 million.

Endowment investments. The total for endowment investments on the Statement of Net Assets is $3.2 billion, a very slight increase from last year's $3.1 billion.

From a net assets perspective, earnings from the endowment, while expendable, are mostly restricted as to use by the donors. It is important to note that of the University's endowment funds, only $945 million, or 30 percent, is classified as unrestricted net assets. From this unrestricted endowment, a significant portion of the income is internally designated by the University for scholarships, fellowships, professorships, and research activities.

Including endowment investments held by the seven related foundations reported as component units, the combined University system endowment was approximately $4.6 billion as of June 30, 2008.

CAPITAL AND DEBT ACTIVITIES

One of the critical factors in sustaining the quality of the University's academic and research programs and residential life is the development and renewal of its capital assets. The University continues to implement its long-range plan to modernize its older teaching and research facilities, construct new facilities, and fund its deferred maintenance.

Capital additions before depreciation were $368 million in 2008. Capital additions primarily consist of replacement, renovation, and new construction of academic, research, and health care facilities, as well as significant investments in equipment, including information technology.

Projects that were in progress at June 30, 2008, included the South Lawn Project, the Carter-Harrison Research Building for the School of Medicine, the Claude Moore Medical Education Building, the Emily C. Couric Clinical Cancer Center, the Claude Moore Nursing Education Building, the Bavaro Hall Curry School of Education Building, the Medical Center Bed Expansion and Infrastructure project, the College at Wise's Arts Center and Crockett Hall, and the Heating Plant Environmental Complex.

Other projects in the design stage at June 30, 2008, include the New Cabell Hall Replacement Building (South Lawn Phase II), the Rugby Administrative Building, and the Klöckner Stadium and Baseball Stadium expansions.

Financial stewardship requires the effective management of resources, including the use of debt to finance capital projects. As evidence of the University's creditworthiness, the University has received the highest long-term and short-term debt ratings from all three major rating agencies, including Moody's Investors Service (Aaa/P-1), Standard and Poor's (AAA/A-1+), and Fitch Ratings (AAA/F1+). These long-term bond ratings were affirmed in May 2008 in conjunction with the University's issuance of its Series 2008 General Revenue Pledge Bonds. The University of Virginia is one of only two public institutions with the highest long-term debt ratings from all three agencies. Besides being an official acknowledgment of the University's financial strength, these ratings enable the University to obtain debt financing at optimum pricing. In addition to issuing its own bonds, the University utilizes its commercial paper program for short-term bridge financing.

The University's debt portfolio contains a strategic mix of both variable- and fixed-rate obligations. The University achieves this mix through a combination of issuing fixed- and variable-rate debt, including commercial paper. It also adjusts its debt mix through the use of interest rate swaps executed according to its board-approved interest rate risk management policy. The seven foundations now required by GASB Statement No. 39 to be reported as component units held $325 million of long-term debt outstanding at June 30, 2008.

NET ASSETS

Net assets represent the residual interest in the University's assets after liabilities are deducted. The University's net assets at June 30, 2008, and 2007, are summarized below.

Net Assets *(in thousands)*	2008	2007	INCREASE AMOUNT	INCREASE PERCENT
Invested in capital assets, net of related debt	$ 1,407,246	$ 1,226,529	$ 180,717	14.7%
Restricted				
Nonexpendable	429,619	369,874	59,745	16.2%
Expendable	2,254,581	2,214,572	40,009	1.8%
Unrestricted	1,547,308	1,544,050	3,258	0.2%
TOTAL NET ASSETS	**$ 5,638,754**	**$ 5,355,025**	**$ 283,729**	**5.3%**

Net assets invested in capital assets, net of related debt, represents the University's equity in capital assets net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets. Net capital assets increased $181 million, or 14.7 percent, in the current fiscal year compared with 9.8 percent growth in the previous year.

Restricted nonexpendable net assets comprise the University's permanent endowment funds.

Restricted expendable net assets are subject to externally imposed restrictions governing their use. This category of net assets includes permanent endowment fund earnings that can be spent, but only in accordance with restrictions imposed by external parties. This net assets category increased $40 million, or 1.8 percent. The smaller than usual increase was primarily due to the lower than usual investment performance of the University's endowment and the unprecedented use of these funds for facilities construction.

Unrestricted net assets are not subject to externally imposed stipulations. The majority of the University's unrestricted net assets have been designated for various instruction and research programs and initiatives, as well as capital projects. This year, unrestricted net assets increased by just 0.2 percent, or $3 million. Increases in unrestricted funds are particularly important since these are used primarily for the instructional and public service missions of the University.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses, and Changes in Net Assets presents the University's results of activities for the year. Presented below is a summarized statement of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2008, and June 30, 2007.

Summary of the Statement of Revenues, Expenses, and Changes in Net Assets *(in thousands)*	2008	2007	INCREASE (DECREASE) AMOUNT	INCREASE (DECREASE) PERCENT
Operating revenues	**$ 1,716,674**	**$ 1,605,214**	**$ 111,460**	**6.9%**
Operating expenses	**2,081,999**	**1,921,156**	**160,843**	**8.4%**
Operating loss	**(365,325)**	**(315,942)**	**(49,383)**	**15.6%**
Nonoperating revenues (expenses)				
State appropriations	183,020	170,439	12,581	7.4%
Gifts	147,269	148,073	(804)	(0.5%)
Investment income	243,280	721,505	(478,225)	(66.3%)
Pell grants	5,271	4,384	887	20.2%
Other net nonoperating expenses	(30,907)	(29,179)	(1,728)	5.9%
Net nonoperating revenues	**547,933**	**1,015,222**	**(467,289)**	**(46.0%)**
Income before other revenues, expenses, gains, or losses	**182,608**	**699,280**	**(516,672)**	**(73.9%)**
Capital appropriations, gifts, and grants	42,048	188,880	(146,832)	(77.7%)
Additions to permanent endowments	59,073	18,950	40,123	211.7%
Total other revenues	**101,121**	**207,830**	**(106,709)**	**(51.3%)**
Increase in net assets	**283,729**	**907,110**	**(623,381)**	**(68.7%)**
Net assets, beginning of year	5,355,025	4,447,915	907,110	20.4%
NET ASSETS, END OF YEAR	**$ 5,638,754**	**$ 5,355,025**	**$ 283,729**	**5.3%**

Under GASB principles, revenues and expenses are categorized as either operating or nonoperating. Significant recurring sources of the University's revenues, including state appropriations, gifts, and investment income, are considered nonoperating, as defined by GASB Statement No. 34. Consequently, the operating loss of $365 million does not consider these revenue sources. Adding the net nonoperating revenues of $548 million for the fiscal year offsets the operating loss and results in an adjusted income amount of $183 million. This provides a more accurate picture of the University's total scope and results of operations.

REVENUES

The University strives to maintain a diverse stream of revenues, which allows it to weather difficult economic times.

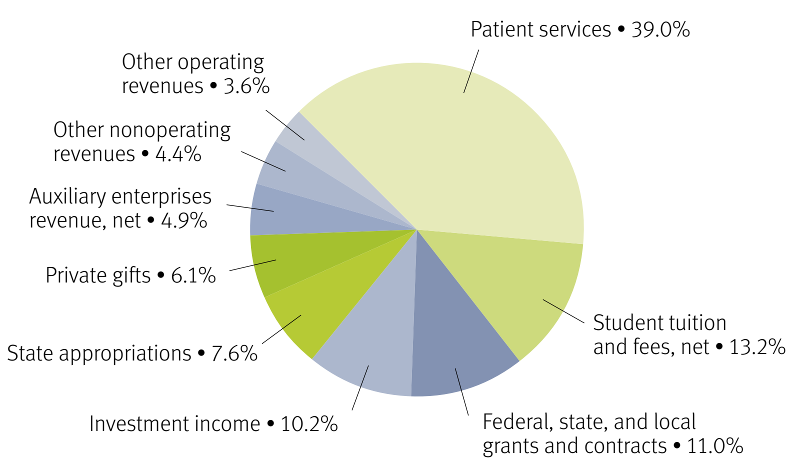
SUMMARY OF REVENUES, TOTAL UNIVERSITY

A summary of the University's revenues, for the years ended June 30, 2008, and 2007.

Summary of Revenues *(in thousands)*	2008			2007			TOTAL INSTITUTION INCREASE (DECREASE)	
	ACADEMIC DIVISION & WISE	MEDICAL CENTER	TOTAL INSTITUTION	ACADEMIC DIVISION & WISE	MEDICAL CENTER	TOTAL INSTITUTION	AMOUNT	PERCENT
Operating revenues								
Student tuition and fees, net	$ 316,332	$ —	$ 316,332	$ 290,748	$ —	$ 290,748	$ 25,584	8.8%
Federal, state, and local grants and contracts	263,185	—	263,185	239,936	—	239,936	23,249	9.7%
Nongovernmental grants and contracts	38,965	—	38,965	39,174	—	39,174	(209)	(0.5%)
Sales and services of educational departments	21,743	—	21,743	18,119	—	18,119	3,624	20.0%
Auxiliary enterprises revenue, net	116,644	—	116,644	112,331	—	112,331	4,313	3.8%
Other operating revenues	—	24,967	24,967	211	22,294	22,505	2,462	10.9%
Patient services	—	934,838	934,838	—	882,401	882,401	52,437	5.9%
Total operating revenues	**$ 756,869**	**$ 959,805**	**$1,716,674**	**$ 700,519**	**$ 904,695**	**$1,605,214**	**$ 111,460**	**6.9%**
Nonoperating revenues								
State appropriations	$ 183,020	$ —	$ 183,020	$ 170,439	$ —	$ 170,439	$ 12,581	7.4%
Private gifts	146,411	858	147,269	142,252	5,821	148,073	(804)	(0.5%)
Investment income	209,843	33,437	243,280	663,364	58,141	721,505	(478,225)	(66.3%)
Other nonoperating revenues	128,515	(22,123)	106,392	187,214	25,000	212,214	(105,822)	(49.9%)
Total nonoperating revenues	**$ 667,789**	**$ 12,172**	**$ 679,961**	**$1,163,269**	**$ 88,962**	**$1,252,231**	**$(572,270)**	**(45.7%)**
TOTAL REVENUES	**$1,424,658**	**$ 971,977**	**$2,396,635**	**$1,863,788**	**$ 993,657**	**$2,857,445**	**$ (460,810)**	**(16.1%)**

Below is a graph of revenues by source (both operating and nonoperating sources), which were used to fund the University's operating activities for the fiscal year ended June 30, 2008. As noted earlier, GASB Statement No. 34 requires state appropriations, gifts, and other significant revenues to be treated as nonoperating revenues.

Total University Revenues • Fiscal Year 2008 *(in thousands)*



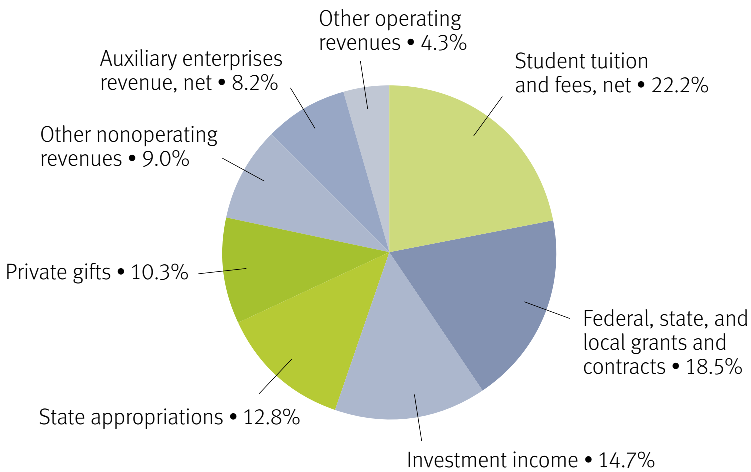
Total Revenue *(in thousands)*
$2,396,635

Patient services revenues accounted for 54.4 percent of the University's operating revenues and 39.0 percent of the operating and nonoperating revenues combined. State appropriations and student tuition and fees, which represent 7.6 percent and 13.2 percent, respectively, of the University's total revenues, are used to fund current operations.

State appropriations increased by $12.6 million, or 7.4 percent. The increases were for faculty and staff salaries, financial aid for students, research support, and operations and maintenance funding for new facilities. Net tuition and fees increased by 8.8 percent, in accordance with the University's six-year plan as submitted to the Commonwealth.

Excluding the Medical Center data provides a clearer picture of the academic revenue stream. Major sources for 2008 included net tuition and fees, 22.2 percent; federal, state, and local grants and contracts, 18.5 percent; investment income, 14.7 percent; state appropriations, 12.8 percent; and private gifts, 10.3 percent. Excluding patient revenue, tuition and fees revenue comprises the single largest source of revenue to the University.

Academic and Wise Revenues • Fiscal Year 2008 *(in thousands)*



Total Revenue *(in thousands)*
$1,424,658

The University continues to emphasize revenue diversification, along with cost containment, as ongoing priorities. This is necessary as the University continues to face significant financial pressure from increased compensation and benefit costs, and escalating technology and energy prices. In 2008, investment income also decreased due to changing market conditions. Private support has been, and will continue to be, essential to maintaining the University's academic excellence. Private support comes in the form of gifts and additions to the permanent endowment. Private gifts were nearly equal to the prior year amount, totaling $147.3 million as the Campaign for the University of Virginia progressed.

Revenues for all sponsored programs increased this year by $23 million, or 8.2 percent, to a total of $302 million in 2008. This increase resulted primarily from the recruitment of one major researcher in the School of Medicine.

EXPENSES

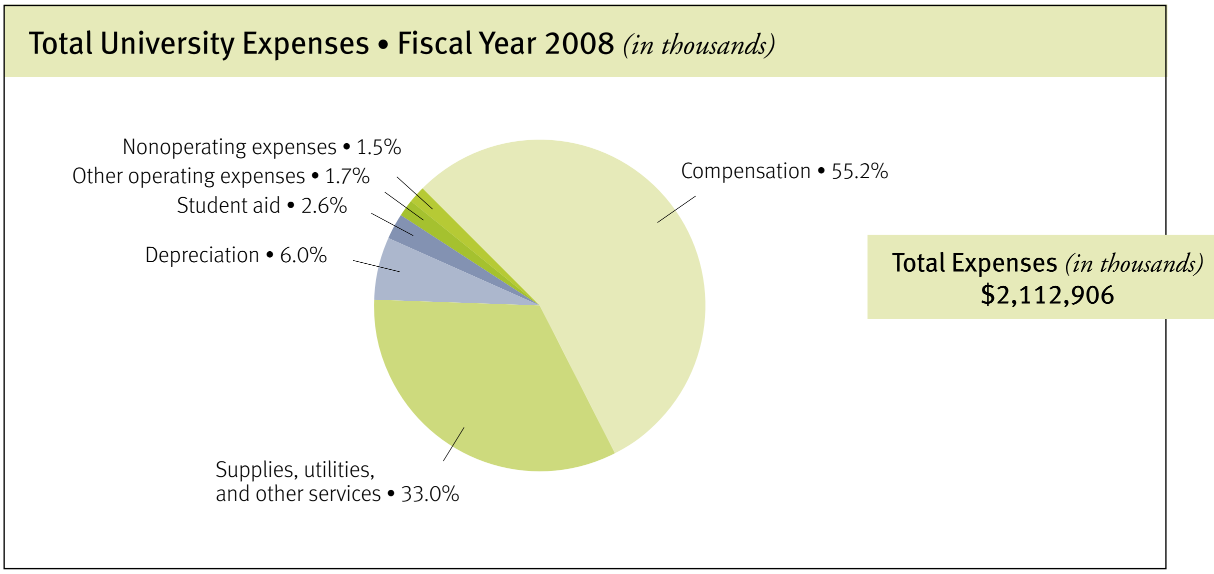
The University continues to be a good steward in the judicious expenditure of funds.

SUMMARY OF EXPENSES, TOTAL UNIVERSITY

A summary of the University's expenses, for the years ended June 30, 2008, and 2007.

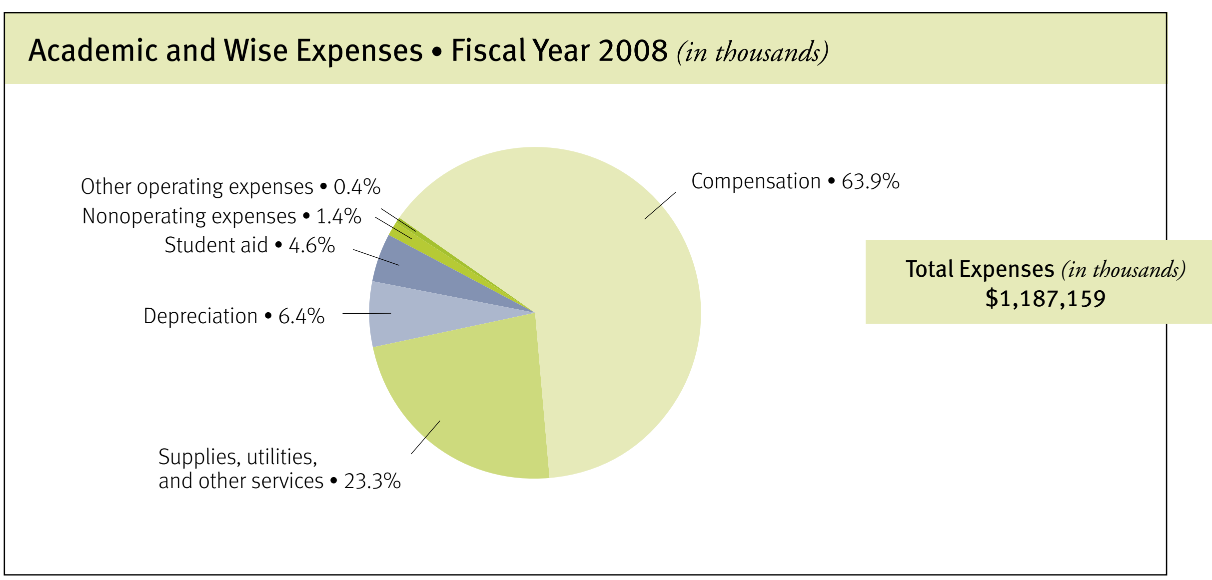
Summary of Expenses *(in thousands)*	2008			2007			TOTAL INSTITUTION INCREASE (DECREASE)	
	ACADEMIC DIVISION & WISE	MEDICAL CENTER	TOTAL INSTITUTION	ACADEMIC DIVISION & WISE	MEDICAL CENTER	TOTAL INSTITUTION	AMOUNT	PERCENT
Operating expenses								
Compensation	$ 758,571	$ 407,523	$ 1,166,094	$ 712,847	$ 376,787	$ 1,089,634	$ 76,460	7.0%
Supplies, utilities, and other services	276,736	421,388	698,124	226,545	395,110	621,655	76,469	12.3%
Student aid	54,768	—	54,768	51,406	—	51,406	3,362	6.5%
Depreciation	76,281	51,273	127,554	73,503	48,267	121,770	5,784	4.7%
Other operating expense	3,987	31,472	35,459	3,848	32,843	36,691	(1,232)	(3.4%)
Total operating expenses	**1,170,343**	**911,656**	**2,081,999**	**1,068,149**	**853,007**	**1,921,156**	**160,843**	**8.4%**
Nonoperating expenses								
Interest expense	12,999	8,214	21,213	17,935	5,954	23,889	(2,676)	(11.2%)
Other nonoperating expense	3,817	5,877	9,694	805	4,485	5,290	4,404	83.3%
Total nonoperating expenses	**16,816**	**14,091**	**30,907**	**18,740**	**10,439**	**29,179**	**1,728**	**5.9%**
TOTAL UNIVERSITY EXPENSES	**$1,187,159**	**$ 925,747**	**$2,112,906**	**$1,086,889**	**$ 863,446**	**$1,950,335**	**$ 162,571**	**8.3%**

Following is a graphic illustration of expenses (both operating and nonoperating) for the fiscal year ended June 30, 2008.



The University's total expenses exceeded $2 billion for the first time in 2007–08, reaching $2.1 billion. As expected, compensation (salaries and benefits) expenses continue to increase and reached $1.2 billion. As a percentage of total expenses, compensation decreased slightly. However, in dollars, compensation increased by $76 million, or 7.0 percent, as the Board of Visitors continued its goal of raising compensation for faculty, health care workers, and staff.

Student aid expense increased to $55 million, an increase of $3 million, or 6.5 percent, as the University continued its commitment to the AccessUVa program. Depreciation increased by $6 million, or 4.7 percent, as the University's investment in depreciable capital assets continues to grow. Interest expense actually decreased by $3 million to $21 million. However, there will be significant increases in interest expense beginning next year. The University issued $231 million of revenue bonds in May 2008, and based on current debt service schedules, interest expense will be in the $30 million to $35 million range for the next few years.



In addition to their natural (object) classification, it is also informative to review operating expenses by function. A complete matrix of expenses, natural versus functional, is contained in the notes to the financial statements. Expenses for patient services, instruction, and research account for 43.8 percent, 14.7 percent, and 13.5 percent, respectively, of total operating expenses. When combined, these major functions account for 71.9 percent of the total, which is consistent with the mission-critical nature of instruction, research, and patient services for the University.

FUTURE ECONOMIC OUTLOOK

The University faces a time of unprecedented change and challenge. Continued reductions in state support, a worsening state and global economy, and the large number of faculty retirements in the near term are just a few of the significant challenges facing the University. From July 1 to the end of September, the University's Long-Term Pool decreased in value 11 percent, or $434 million. From October 1 to October 24, the Policy Portfolio benchmark decreased an additional 20.52 percent. And yet, in such times, opportunities exist for improvement and positive change. Fortunately, the University remains well positioned financially to continue providing excellent programs and service to its constituents. The University's financial position, as evidenced by the highest credit ratings obtainable, and reaffirmed this year, provides a high degree of accessibility to capital funds on the most competitive terms. The issuance of long-term bonds and the use of its expanded short-term commercial paper program, along with continued efforts toward revenue diversification, will help the University to continue to fund its targeted aspirations.

To help identify these priorities, the president created the Commission on the Future of the University. This commission is cochaired by the executive vice president and chief operating officer and the executive vice president and provost. Its report provides an overview of institutional and Medical Center financial planning, philanthropic capacity and strategies, and the advantages and disadvantages of the current school-based development foundation structure. The Academic Division's long-range plan goes through fiscal year 2015–16 and the Medical Center's extends through fiscal year 2012–13. The commission's three priority areas are the student experience; science, engineering, and technology; and global education. Some of the initiatives and projects underpinning these three priorities are described below:

AccessUVA. In the continued implementation of AccessUVA, as of the 2007–08 academic year, the University will offer 100 percent of demonstrated need to all undergraduates and will provide full grant funding for all undergraduate low-income students. It will replace need-based loans with grants for students reaching their loan cap and continue its financial literacy program. Even though the state has reduced its general fund support, it has not cut its financial aid funding.

Investment in Student Information Technology. In June 2007, the Board of Visitors officially approved an investment in a new student information system. The University chose PeopleSoft Campus Solutions to replace its aging Integrated Student Information System to provide enhanced services to its students and faculty, and to provide stronger security over student data. The admissions module has been successfully implemented and the remaining system modules will be implemented in phases from spring 2009 to fall 2009 as planned.

Deferred Maintenance. In February 2005, the Board of Visitors stated that the University should move to establish ongoing maintenance investments that would protect its education and general physical assets and make one-time investments to reduce the backlog of deferred maintenance to reasonable levels based on industry standards. Within ten years, annual maintenance spending needs to be increased by $15 million. To achieve this, the University is adding $1.5 million each year for the next ten years.

Going Green. The Board of Visitors has mandated that all new construction and major renovation projects comply with the U.S. Green Building Council standards through Leadership in Energy and Environmental Design (LEED) certification. Additionally, the new Grounds Improvement Fund will finance much-needed improvements, including landscape and pedestrian and bicycle accommodations.

Research. The University plans to add 200 new faculty members over the next ten years, with an emphasis on the science and engineering disciplines. In addition, the University has plans for creating new laboratory space and increasing its investment in information infrastructure and computing capacity. Modern research, especially in engineering and the sciences, requires significant new resources in academic computing.

Restructuring and Cash Management Authority. The University received additional financial benefits under its restructuring authority, which will help support the commission's priorities. Nongeneral fund balances previously deposited and invested with the State Treasury were transferred to, and invested by, the University. With additional flexibility provided by investment legislation obtained by the University in the spring of 2007, management now has the ability to prudently invest these funds in equities in addition to the previous portfolio of cash and fixed-income instruments. Restructuring authority must be certified annually by the State Council of Higher Education for Virginia. The University achieved its certification status in May 2008 for fiscal year 2007–08.

From the end of the fiscal year into October 2008, the global financial markets experienced unprecedented fluctuations and credit tightening. State support is not expected to grow next year; in fact, the University is planning for additional reductions. In responding to these economic challenges, the University leadership and its board believe a sound strategic vision and strong leadership will lead the University successfully through these times. The University cannot be all things to all people. Its leaders must make informed choices. The strategies laid out by the Commission on the Future of the University will strengthen the University's core resources while funding selected new efforts. To help ensure adequate funding, the University increased the endowment payout rate to 5 percent for fiscal year 2008–09. In addition, the Campaign for the University of Virginia continues to make progress due to the continued generous support of its patrons.

The University has the strategic vision and the financial plans in place to meet these economic challenges. However, the commission and University leadership recognize these may not be enough. In going back to the institution's founding ideals, management has identified and communicated the underlying core values that will guide its actions now and in the future. These core values are honor and ethics; faculty excellence; innovation and collaboration in the pursuit of knowledge; diversity; leadership for the public good; and education for freedom. These core values will help ensure that shortcuts are not taken, that prudent financial management will continue to be practiced, and that the University will always exist for the public good, just as its founder envisioned. •

Management Responsibility

October 30, 2008

To the President and Board of Visitors of the University of Virginia:

We are pleased to submit the annual Financial Report of the University of Virginia for the year ended June 30, 2008. Management is responsible for the objectivity and integrity of the accompanying financial statements, which have been prepared in conformance with the Governmental Accounting Standards Board 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—for Public Colleges and Universities*. The financial statements, of necessity, included management's estimates and judgments relating to matters not concluded by year-end. Financial information contained elsewhere in the annual Financial Report is consistent with that included in the financial statements.

Management is responsible for maintaining the University's system of internal control that includes careful selection and development of employees, proper division of duties, and written accounting and operating policies and procedures augmented by a continuing internal audit program. Although there are inherent limitations to the effectiveness of any system of accounting controls, management believes that the University's system provides reasonable, but not absolute, assurance that assets are safeguarded from unauthorized use or disposition and that the accounting records are sufficiently reliable to permit the preparation of financial statements that conform in all material respects with generally accepted accounting principles.

The Auditor of Public Accounts for the Commonwealth of Virginia, using independent certified public accountants for the audits of component units, provides an independent opinion regarding the fair presentation in the financial statements of the University's financial position. Their examination was made in accordance with generally accepted government auditing standards and included a review of the system of internal accounting controls to the extent they considered necessary to determine the audit procedures required to support their opinion. The Audit Committee of the Board of Visitors meets periodically and privately with the independent auditors, the internal auditors, and the financial officers of the University to review matters relating to the quality of the University's financial reporting, the internal accounting controls, and the scope and results of audit examinations. The committee also reviews the scope and quality of the internal auditing program.

Respectfully submitted,

Stephen A. Kimata
Assistant Vice President for Finance
and University Comptroller

Yoke San L. Reynolds
Vice President and Chief Financial Officer

Auditor's Opinion

October 30, 2008

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit and Review Commission

Board of Visitors
University of Virginia

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the business-type activities and aggregate discretely presented component units of the University of Virginia, a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2008, which collectively comprise the University of Virginia's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University of Virginia's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the component units of the University of Virginia, which are discussed in Note 1. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the component units of the University of Virginia, is based on the reports of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and discretely presented component units of the University of Virginia as of June 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 44 through 51 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2008, on our consideration of the University of Virginia's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Walter J. Kucharski
Auditor of Public Accounts