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, 2010. Comparative information for the year ended June 30, 2009, 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 basic financial statements of the Commonwealth. 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 20,895 students and 2,159 full-time instructional and research faculty members in eleven separate schools in 2009–10, the University offers a diverse range of degree programs, including doctorates in fifty-five disciplines. The University is recognized internationally for the quality of its faculty and for its commitment to the primary academic missions of instruction, research, public service, and medical care. 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 570-bed hospital 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 1,986 students and 90 full-time instructional and research faculty. It offers thirty majors and six preprofessional programs, including 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, 2010:

- The University received a 15.1 percent return on its endowment during 2009–10. Overall, the endowment assets increased by $308 million. The University made a 5.5 percent spending distribution to its departments, totaling $136.5 million.
- Through June 30, 2010, the University had been awarded $67 million of funding from federal stimulus (ARRA) grants. Of that total, $58.7 million was awarded during fiscal year 2009–10. $21.8 million of those awards was expended in 2009–10.
- In addition to ARRA grants, the University received $6.7 million in federal stimulus funding that came from the Commonwealth of Virginia, as part of the State Fiscal Stabilization Funds program. That funding was used to offset reductions in state appropriations.
- In June 2010, the University transferred $57.1 million of operational funds to the Commonwealth. Out of that total, $49 million was given in exchange for proceeds of Commonwealth of Virginia debt, and are included as part of capital appropriations revenue. The remainder included remittances to the Commonwealth for suspended VRS payments, and the University's expense for a state furlough day, imposed by the Commonwealth.
- During fiscal year 2009–10, the University surpassed the $2 billion mark of its $3 billion campaign. As of June 30, 2010, the campaign total stood at $2.18 billion.
- As of July 1, 2009, the University's F&A (Facilities and Administrative) rate increased from 51.5 percent to 54.0 percent. The rate increase results from an earlier negotiated agreement with the federal government. That agreement is in effect for fiscal years 2009–10 and 2010–11, after which a new agreement will be negotiated.

The University's net assets increased by $555 million, or 11.6 percent. Some of the contributing factors to this increase are outlined in the summary table below.

Summary of the Change in Net Assets *(in thousands)*	**2010**	**2009**	**INCREASE AMOUNT**	**INCREASE PERCENT**
Total revenues before investment income	$ 2,343,221	$ 2,229,683	$ 113,538	5.1%
Total expenses	2,255,228	2,214,805	40,423	1.8%
Increase in net assets before investment income	87,993	14,878	73,115	491.4%
Investment income	467,024	(850,753)	1,317,777	154.9%
TOTAL CHANGE IN NET ASSETS	**$ 555,017**	**$ (835,875)**	**$ 1,390,892**	**166.4%**

- When net assets change significantly in a given year, either up or down, the predominant factor is the change in market value of investments. That is the case this year, as investment income was a positive $467 million, compared to the unusually high negative investment income of $851 million in fiscal year 2008–09. The University's long-term investments earned a 15 percent positive return for the fiscal year, compared to the abnormally high 21 percent loss in fiscal year 2008–09.
- Revenues before investment income and total expenses increased by a 5.1 and a modest 1.8 percent, respectively.

Overall, the primary factor in the University's net asset growth or decline 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, 2010, and June 30, 2009 (restated), follows.

Summary of the Statement of Net Assets *(in thousands)*	**2010**	**2009**	**INCREASE (DECREASE)**	
			AMOUNT	**PERCENT**
Current assets	**$ 616,343**	**$ 720,512**	**$ (104,169)**	**(14.5%)**
Noncurrent assets				
Endowment and other long-term investments	3,584,120	3,024,517	559,603	18.5%
Capital assets, net	2,522,807	2,305,632	217,175	9.4%
Other	155,866	250,513	(94,647)	(37.8%)
Total assets	**6,879,136**	**6,301,174**	**577,962**	**9.2%**
Current liabilities	**483,535**	**478,348**	**5,187**	**1.1%**
Noncurrent liabilities	**1,037,840**	**1,020,082**	**17,758**	**1.7%**
Total liabilities	**1,521,375**	**1,498,430**	**22,945**	**1.5%**
NET ASSETS	**$ 5,357,761**	**$ 4,802,744**	**$ 555,017**	**11.6%**

CURRENT ASSETS AND LIABILITIES

Current assets, which totaled $616 million as compared with the previous year's $721 million, consist primarily of cash and cash equivalents, short-term investments, and accounts receivable.

Current liabilities, which consist primarily of accounts payable, deferred revenue, and the current portion of long-term liabilities, increased by just $5 million, or 1.1 percent. While the net change in current liabilities was small, some of the individual components had more sizeable changes. Accounts payable was approximately $27 million less in 2009–10, while the commercial paper and current portion of long-term liabilities increased by $14 million and $18 million, respectively. Later cutoffs for June payables explain the decrease in accounts payable. Increases in accrued leave and accrued overtime pay account for the increase to the current portion of long-term liabilities.

From a liquidity perspective, current assets cover current liabilities 1.3 times, an indicator of good liquidity and the ability to weather short-term demands on working capital. This rate of coverage decreased slightly from 1.5 last year. Current assets cover 3.4 months of total operating expenses, including depreciation. For 2009–10, one month of operating expenses is approximately $180 million.

ENDOWMENT AND OTHER INVESTMENTS

Performance. At June 30, 2010, 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 a positive 15.1 percent, compared to a 21.0 percent decline experienced last year. This performance figure includes realized and unrealized gains and losses, along with cash income. With this return, total investment income for all funds was positive $467 million. That represents a substantial recovery from the negative investment income of $851 million sustained in 2008–09.

Distribution. The University distributes endowment earnings in a way that balances the annual funding needed to support the endowed programs against the requirement to preserve 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 $136.5 million, a decrease of $27 million from last year's distribution of $163.5 million. To mitigate the severe decline in market value of the endowment since 2008, the Board of Visitors raised the distribution percentage from 5.0 percent to 5.5 percent for the 2009–10 distribution. This was the first time in the University's history that it saw a drop in the distribution between years; however, the $136.5 million is still the second highest distribution ever.

Endowment investments. The total for endowment investments on the Statement of Net Assets is $2.8 billion, a $300 million increase over the prior year total of $2.5 billion. Most of that increase is attributable to the significant recovery in the investment markets during the year.

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 $896 million, or 32 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 $3.8 billion as of June 30, 2010.

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 obligations.

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.

A number of major capital projects were completed or acquired during 2010. They amounted to $158 million for buildings, and $31 million for infrastructure. The University also added $59 million for capital equipment. The largest project coming to fruition during the year was the South Lawn Arts & Sciences project, which includes a number of buildings. The South Lawn Arts & Sciences Building was still under construction at the end of the fiscal year and will be completed in 2010–11, while both the Gibson and Nau buildings, as well as the Terrace Crossing, were completed during the year. Major renovation projects completed included Jordan Hall, Brown/Withers Hall, and the Carter-Harrison Medical Research Building. Additions to utilities infrastructure included projects for multiple chilled water plants. The University's College at Wise added three new buildings to its campus. They were the Drama Building, Science and Engineering Building, and Residence Hall #3.

There were a number of large projects in progress at June 30, 2010, as the University invested more than $330 million on capital construction in fiscal year 2009–10. Some of the largest projects in progress include the Claude Moore Medical Education Building, the Bavaro Hall School of Education Building, the Medical Center bed expansion and infrastructure project, the Rice Hall Information Technology and Engineering Building, the Physical and Life Sciences Research Building, and the Alderman Road (replacement) residence halls. The College at Wise has the new Dining Hall, Multi-purpose Building, and Smiddy Hall renovation projects under construction.

Financial stewardship requires the effective management of resources, including the use of debt to finance capital projects. As evidence of the University's effective stewardship, 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 ratings were reaffirmed in July 2010 in conjunction with the University's issuance of its Series 2010 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 future 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 issuing a combination of 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 reported as component units held $192 million of long-term debt outstanding at June 30, 2010.

NET ASSETS

The four net asset categories represent the residual interest in the University's assets after liabilities are deducted. The University's net assets at June 30, 2010, and 2009 (restated), are summarized below.

Net Assets *(in thousands)*	2010	2009	INCREASE AMOUNT	INCREASE PERCENT
Invested in capital assets, net of related debt	$ 1,577,969	$ 1,458,203	$ 119,766	8.2%
Restricted				
Nonexpendable	494,201	459,247	34,954	7.6%
Expendable	1,938,361	1,785,372	152,989	8.6%
Unrestricted	1,347,230	1,099,922	247,308	22.5%
TOTAL NET ASSETS	**$ 5,357,761**	**$ 4,802,744**	**$ 555,017**	**11.6%**

Net assets invested in capital assets, net of related debt, represents the University's 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 totaled $1.6 billion at June 30, 2010. It increased by $119.8 million, or 8.2 percent, in the current fiscal year compared with 3.6 percent growth in the previous year. This increase reflects the ongoing and unprecedented investment by the University in buildings and infrastructure. Capitalized assets increased by over $200 million, while related debt increased by almost $100 million, as the University makes strategic use of its debt capacity to fund new assets.

Restricted nonexpendable net assets comprise the University's permanent endowment funds. This category totaled $494 million at June 30, 2010. Overall, nonexpendable net assets increased by nearly $35 million. New gifts of $25 million account for most of the increase. An additional $10 million of increase occurred as a write-up in value of a number of endowments whose market value had fallen below their historic dollar value during the 2008 market decline.

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. It totaled $1.9 billion at June 30, 2010. These net assets increased by $153 million, or 8.6 percent. The increase is attributable to the 15.1 percent investment returns on the University's endowment and other investments. That increase is offset by reductions for endowment spending distribution of 5.5 percent, as well as expenditures of previously recorded gifts for capital projects.

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. Unrestricted funds are particularly important because they can be used for any University initiative. Unrestricted net assets totaled $1.3 billion at June 30, 2010. They increased by $247 million, or 22.5 percent. As with restricted funds, much of the increase results from the 15.1 percent return in market value on long-term investments. In addition, the Medical Center realized a significant positive operating margin of about $75 million that contributed to the increase.

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, 2010, and 2009 (restated).

Summary of the Statement of Revenues, Expenses, and Changes in Net Assets *(in thousands)*	2010	2009	INCREASE (DECREASE)	
			AMOUNT	PERCENT
Operating revenues	**$ 1,850,974**	**$ 1,788,824**	**$ 62,150**	**3.5%**
Operating expenses	**2,155,758**	**2,157,848**	**(2,090)**	**(0.1%)**
Operating loss	**(304,784)**	**(369,024)**	**64,240**	**(17.4%)**
Nonoperating revenues (expenses)				
State appropriations	152,115	170,178	(18,063)	(10.6%)
State stabilization (ARRA)	6,657	—	6,657	100.0%
Gifts	131,208	140,078	(8,870)	(6.3%)
Investment income	467,024	(850,753)	1,317,777	154.9%
Pell grants	9,695	7,024	2,671	38.0%
Interest on capital asset related debt	(34,389)	(24,251)	(10,138)	41.8%
Other net nonoperating expenses	(7,892)	(32,706)	24,814	(75.9%)
Net nonoperating revenues (expenses)	**724,418**	**(590,430)**	**1,314,848**	**222.7%**
Income before other revenues, expenses, gains or losses	**419,634**	**(959,454)**	**1,379,088**	**143.7%**
Capital appropriations, gifts, and grants	167,728	74,367	93,361	125.5%
Additions to permanent endowments	24,844	49,212	(24,368)	(49.5%)
Transfers to Commonwealth	(57,189)	—	(57,189)	100.0%
Total other	**135,383**	**123,579**	**11,804**	**9.6%**
Increase (decrease) in net assets	**555,017**	**(835,875)**	**1,390,892**	**166.4%**
Net assets—beginning of year	4,802,744	5,638,619	(835,875)	(14.8%)
NET ASSETS—END OF YEAR	**$ 5,357,761**	**$ 4,802,744**	**$ 555,017**	**11.6%**

Under GASB principles, revenues and expenses are categorized as either operating or nonoperating. Significant recurring sources of the University's revenues, including state appropriations, state stabilization from ARRA funds, and gifts, are considered nonoperating, as defined by GASB Statement No. 34. Consequently, the operating loss of $305 million occurs before the appropriation of these important revenue sources. Adding these revenue sources, which total $290 million for the fiscal year, negates most of the operating loss, and results in an adjusted income amount of negative $15 million. This provides a more accurate picture of the University's scope and results of operations.

REVENUES

The University strives to maintain a diverse stream of revenues, which decreases its dependence on specific revenue types and allows it to adapt during difficult economic times.

SUMMARY OF REVENUES, TOTAL UNIVERSITY

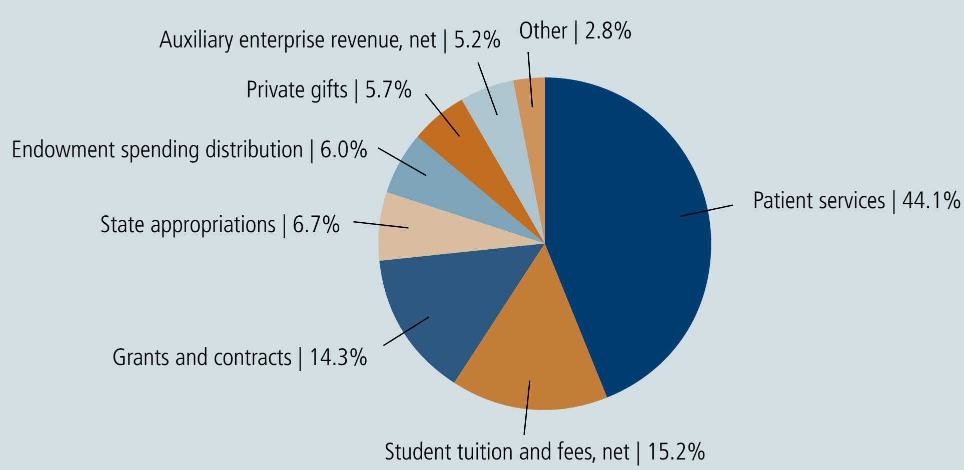
The University's revenues, for the years ended June 30, 2010, and 2009 (restated), are summarized as follows:

Summary of Revenues *(in thousands)*	2010			2009			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	$ 348,436	$ —	$ 348,436	$ 341,881	$ —	$ 341,881	$ 6,555	1.9%
Patient services	—	1,008,858	1,008,858	—	964,346	964,346	44,512	4.6%
Federal, state, and local grants and contracts	281,083	—	281,083	271,793	—	271,793	9,290	3.4%
Nongovernmental grants and contracts	45,649	—	45,649	45,516	—	45,516	133	0.3%
Sales and services of educational departments	18,898	—	18,898	18,090	—	18,090	808	4.5%
Auxiliary enterprises revenue, net	118,002	—	118,002	119,573	—	119,573	(1,571)	(1.3%)
Other operating revenues	—	30,048	30,048	—	27,625	27,625	2,423	8.8%
Total operating revenues	**$ 812,068**	**$1,038,906**	**$1,850,974**	**$ 796,853**	**$ 991,971**	**$1,788,824**	**$ 62,150**	**3.5%**
Nonoperating revenues:								
State appropriations	$ 152,115	$ —	$ 152,115	$ 170,178	$ —	$ 170,178	$ (18,063)	(10.6%)
State stabilization (ARRA)	6,657	—	6,657	—	—	—	6,657	100.0%
Private gifts	130,563	645	131,208	139,312	766	140,078	(8,870)	(6.3%)
Investment income	423,206	43,818	467,024	(788,267)	(62,486)	(850,753)	1,317,777	154.9%
Other nonoperating revenues	140,144	62,123	202,267	130,603	—	130,603	71,664	54.9%
Total nonoperating revenues	**$ 852,685**	**$ 106,586**	**$ 959,271**	**$(348,174)**	**$ (61,720)**	**$(409,894)**	**$1,369,165**	**334.0%**
TOTAL REVENUES	**$1,664,753**	**$1,145,492**	**$2,810,245**	**$ 448,679**	**$ 930,251**	**$1,378,930**	**$1,431,315**	**103.8%**

REVENUES AND OTHER SOURCES OF OPERATIONAL FUNDING

Below is a graph of revenues by source (both operating and nonoperating), which were used to fund the University's operating activities for the fiscal year ended June 30, 2010. As noted earlier, GASB Statement No. 34 requires state appropriations, state stimulus, current gifts, and other significant revenues to be treated as nonoperating revenues. Endowment spending distribution is not current-year revenue, but an appropriation of previously recognized revenue. Nonetheless, it is an important funding source for current operations and is included in the chart below to present a more accurate picture of the University's funding of current operations.

Total University Revenues and Other Sources of Operational Funding
(in thousands)
$2,287,196



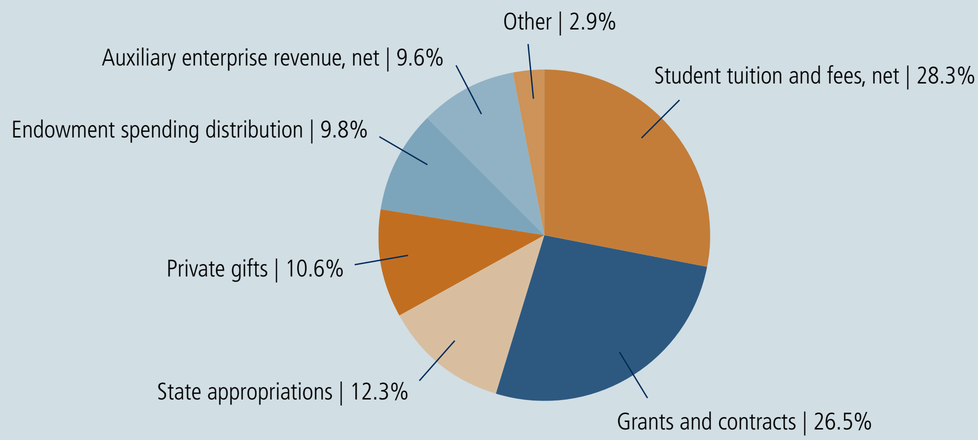
For purposes of this chart, the Medical Center is treated like a self-supporting auxiliary. Patient services revenues accounted for 44.1 percent of the University's revenues and operational funding sources. Student tuition and fees, and grants and contracts, which represent 15.2 percent and 14.3 percent, respectively, are the next largest revenues. After these three sources, the percentage of the total for the remaining sources drops off significantly. State appropriations now account for just 6.7 percent of funding for operations, followed closely by endowment spending distribution and private gifts, at 6.0 percent and 5.7 percent, respectively.

State appropriations decreased by $18 million, and were nearly 11 percent less than last year. The decrease results from additional budget cuts imposed by the state government, as it continues to deal with the sluggish economy. Net tuition and fees increased by $6.6 million, or 1.9 percent. In addition to the Board of Visitors' efforts to minimize tuition increases, the relatively small increase in net tuition and fee revenues is attributable to a significant increase in the scholarship allowance amount. Scholarship discount and allowance is the difference between the stated charge for goods and services provided by the University and the amount paid by students and/or third parties making payments on the students' behalf.

With the implementation of a new Student Information System (SIS), the scholarship allowance to students is now calculated using the direct method, which resulted in an increase of approximately $13 million, or almost 19 percent.

Excluding the Medical Center's data helps provide a clearer picture of the academic revenue streams. Major sources include net tuition and fees at 28.3 percent; grants and contracts at 26.5 percent; state appropriations at 12.3 percent; private gifts at 10.6 percent; and endowment spending distribution at 9.8 percent. Excluding patient revenue, tuition and fees revenue comprises the single largest source of revenue to the University. The ratio of tuition and fees revenue to state appropriations was 2.3 in 2010, compared to a ratio of 2.0 in 2009. At 10.6 percent and 9.8 percent, respectively, private gifts and endowment spending distribution continue to be critical private sources of funding for University operations.

Academic and Wise Revenues and Other Sources of Operational Funding *(in thousands)*
$1,231,952



The University continues to emphasize revenue diversification, along with cost containment, as ongoing priorities. 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 permanent endowments, as well as the spending distribution made from endowments. Spendable current gift revenue totaled $131 million in 2010, a decrease of $8.9 million, or 6.3 percent from the prior year. At the same time, the Campaign for the University of Virginia continued its progress toward its $3 billion target, standing at $2.18 billion as of June 30, 2010. An endowment spending distribution of $136.5 million was made during fiscal year 2009–10. Although that was less than the $163.5 million distribution of the previous year, it was still the second highest ever total distribution.

Revenues for all sponsored programs increased this year by $9 million, or 3.0 percent, to a total of $327 million. However, this total includes $19.3 million in ARRA grants revenue. If that is excluded, then overall sponsored programs revenue would have declined to $308 million, or 2.8 percent less than last year's total of $317 million. The $327 million total includes $71.1 million of Facilities and Administrative (F&A) recoveries. That amount is $5 million more and 7.8 percent higher than last year, and reflects the increase in the University's negotiated F&A rate from 51.5 percent to 54.0 percent, effective July 1, 2009.

EXPENSES

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

SUMMARY OF EXPENSES, TOTAL UNIVERSITY

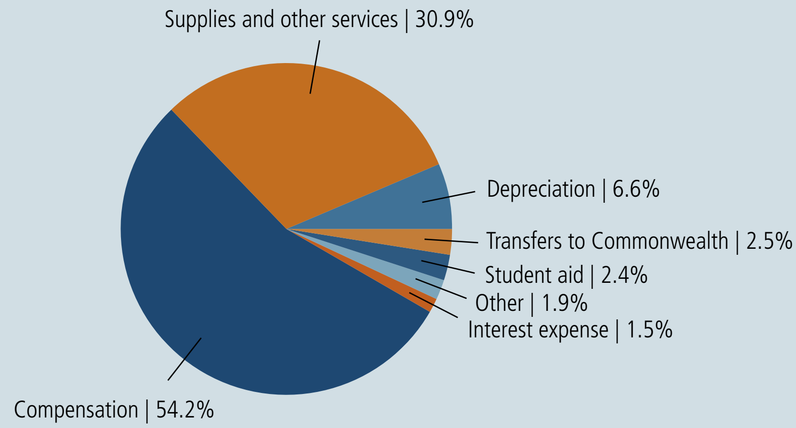
The University's expenses, for the years ended June 30, 2010, and 2009 (restated), are summarized as follows:

Summary of Expenses *(in thousands)*	2010			2009			TOTAL INSTITUTION INCREASE (DECREASE)	
	ACADEMIC DIVISION & WISE	MEDICAL CENTER	TOTAL INSTITUTION	ACADEMIC DIVISION & WISE	MEDICAL CENTER	TOTAL INSTITUTION	AMOUNT	PERCENT
Operating expenses:								
Compensation	$ 795,348	$ 425,791	$ 1,221,139	$ 794,065	$ 421,169	$ 1,215,234	$ 5,905	0.5%
Supplies and other services	254,535	441,187	695,722	265,138	438,924	704,062	(8,340)	(1.2%)
Student aid	55,058	—	55,058	62,750	—	62,750	(7,692)	(12.3%)
Depreciation	95,280	54,052	149,332	89,025	52,313	141,338	7,994	5.7%
Other operating expense	3,559	30,948	34,507	3,653	30,811	34,464	43	0.1%
Total operating expenses	**1,203,780**	**951,978**	**2,155,758**	**1,214,631**	**943,217**	**2,157,848**	**(2,090)**	**(0.1%)**
Nonoperating expenses and other:								
Interest expense	26,976	7,413	34,389	16,574	7,677	24,251	10,138	41.8%
Loss on capital assets	749	706	1,455	3,719	13,360	17,079	(15,624)	(91.5%)
Other nonoperating expense	288	6,149	6,437	7,179	8,448	15,627	(9,190)	(58.8%)
Transfers to Commonwealth	13,755	43,434	57,189	—	—	—	57,189	100.0%
Total nonoperating expenses	**41,768**	**57,702**	**99,470**	**27,472**	**29,485**	**56,957**	**42,513**	**74.6%**
TOTAL UNIVERSITY EXPENSES	**$1,245,548**	**$1,009,680**	**$2,255,228**	**$1,242,103**	**$ 972,702**	**$2,214,805**	**$ 40,423**	**1.8%**

Following is a graphic illustration of expenses (both operating and nonoperating) for the fiscal year ended June 30, 2010.

Total University Expenses
Fiscal Year 2010
(in thousands)

TOTAL EXPENSES *(in thousands)*
$2,255,228

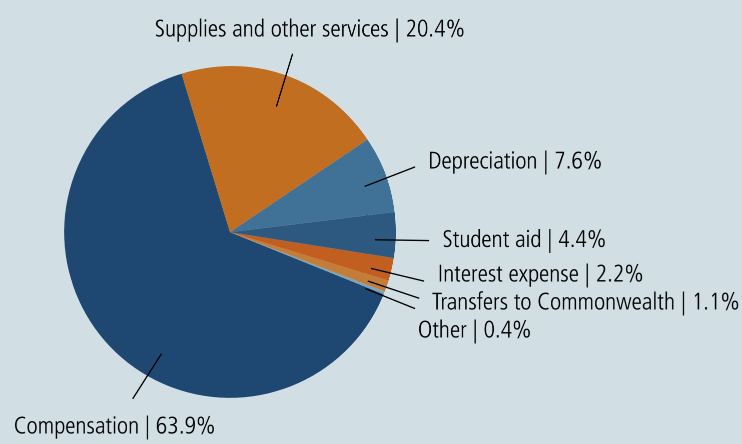


The University's total expenses increased just 1.8 percent or $40 million in 2009–10, reaching almost $2.3 billion. Compensation expenses increased just 0.5 percent, and totaled about $1.2 billion. The University has been able to navigate the state budget cuts without layoffs, instead strategically leaving vacant positions open. At the same time, the Board of Visitors remains committed to its long-term goal of raising faculty, staff, and health care employees' compensation to meet market conditions. This is a critically important issue following three years of no salary increases.

Student aid is reported net of scholarship discount. While gross student aid expense (before discount) increased by $7 million, net student aid expense (after discount) decreased by $8 million. The $15 million difference is accounted for by the change in the estimate for the discount amount, which went from $78 million in 2008–09 to $93 million in 2009–10. Implementation of a new student system enabled a more accurate methodology this year for calculating the estimated scholarship discount. The University's commitment to providing financial aid support to students continues, as evidenced by the growing costs of the AccessUVa program. On the nonoperating side, interest expense increased by $10.1 million, or 42 percent, to $34.4 million. This increase in debt service was expected, because the University issued $250 million of revenue bonds in 2009. An increase in depreciation expense was also expected, given the large dollar amount of recently completed building and infrastructure projects. Depreciation expense was up $8 million, or 5.7 percent.

Academic and Wise Expenses
Fiscal Year 2010
(in thousands)

TOTAL EXPENSES *(in thousands)*
$1,245,548



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, research, and public service account for 44.2 percent, 14.6 percent, 13.4 percent, and 1.3 percent, respectively, of total operating expenses. When combined, these core mission functions account for 73.5 percent of total operating expenses. The remainder is for costs incurred in support of these core mission functions, including academic support, libraries, student services, institutional support services, and operation and maintenance of facilities.

FUTURE ECONOMIC OUTLOOK

This past year was one of unprecedented change for the University of Virginia. As the University navigates its way through these difficult financial times, it is also seeing a dramatic change in its leadership. The University loses President John Casteen, who has led the University for the last twenty years. In the months to come, both Executive Vice President and Chief Operating Officer Leonard Sandridge and Executive Vice President and Provost Tim Garson will step down from their positions. The remarkable leadership they provided for so long will be difficult to replace. But they leave for the new leadership a University of Virginia that is solidly positioned. In August 2010, the University welcomed Teresa A. Sullivan as its eighth president. She was most recently the provost at the University of Michigan. She has served at some of the best universities in the country. She has been a teacher, a researcher, and in her own words "a mom who's had two sons go through college, so I understand what a college education looks like from the other side too." Her broad experience will serve the University well. President Sullivan faces many challenges, and has set as her top priority the replacement of the two executive vice presidents. Some of her long-term goals are detailed below, in the Long Term section of the Management's Discussion and Analysis.

Short Term

State Budget Crisis. Like most states, the Commonwealth continues to face revenue shortfalls, and the University has absorbed its share of the state's budget reductions. Over the past three years, the University has sustained $36.8 million in budget cuts, which equates to a 25 percent reduction in state appropriations revenue. For the first time in four years, the University does not anticipate a reduction in state appropriations for the 2010–11 fiscal year. However, an additional reduction of $14.8 million has been approved for 2011–12, with further cuts possible.

AccessUVa. Rated in 2010 by the *Princeton Review* as the best financial aid program among public institutions, AccessUVa continues to provide critical need-based financial aid. Since AccessUVa began, we have seen a major increase in the percentage of students qualifying for aid. This factor, along with tuition increases to compensate partially for state budget cuts, causes the cost of AccessUVa to continue to grow. The projected 2010–11 cost of AccessUVa will be around $80 million, which is about $10 million higher than the previous year. To help offset the rising costs, the AccessUVa program has been identified as one of the top institutional priorities for philanthropic support.

American Recovery and Reinvestment Act (ARRA). As of June 30, 2010, the University had been awarded $67 million in ARRA research grants. At September 30, 2010, this amount had risen to $71 million. The receipt of these funds has helped to offset what otherwise would be a decrease in sponsored programs awards. However, with the requirement to spend these funds over the next year or so, the University will face a decrease in research funding by fiscal year 2011–12. In addition to ARRA research grants, the University received $6.7 million in ARRA state stabilization funds. This funding from the Commonwealth helped to partially offset the reduction in state appropriations in fiscal year 2009–10. An additional $21.9 million in state stabilization funding will be received in 2010–11, and will be used for financial aid, to help offset tuition increases. ARRA funding is short-term, and most of it will be spent in 2010–11. Without other funding to replace it, fiscal year 2011–12 will be a very difficult year financially.

Build America Bonds/Debt. In July 2010, the University issued $190 million of new bonds to fund new construction on the Grounds of the University. The Series 2010 Bonds were issued as Build America Bonds (BAB) for purposes of the American Recovery and Reinvestment Act of 2009 with a coupon rate of 5.00 percent. The University will receive a 35 percent interest subsidy payment from the U.S. Treasury on the amount of each interest payment made on the Series 2010 Bonds, resulting in an effective yield to the University of 3.2 percent. This is the second issuance of Build America Bonds by the University. The earlier series of $250 million was issued in 2009 as the first benchmark-sized BAB issued by any entity. By taking advantage of the BAB opportunities, the University has been able to accelerate construction and reduce future interest expense. It is unclear whether the BAB program will extend beyond December 2010.

Endowment and Spending Distribution. With a return of 15 percent, the University's endowment recovered two-thirds of the 21 percent loss it sustained in fiscal year 2008–09. The fiscal year 2009–10 spending distribution of $136.5 million accounted for 6.3 percent of the University's $2.2 billion of operating expenses. At its September 2010 meeting, the University's Board of Visitors approved the fiscal year 2010–11 spending distribution. The board's spending policy calls for an increase in the previous year's distribution by an inflationary factor, as long as the result is between 4 percent on the low end, and 6 percent on the high end, of the market value. In accordance with the policy, the 2010–11 spending distribution will be 3.8 percent higher than the 2009–10 spending amount. Apart from the impact of new gifts and divestments, this will result in an estimated $142 million of spending distribution in fiscal year 2010–11, or about 5.2 percent of the June 30, 2010 endowment market value.

Long Term

New Leadership. President Sullivan joins the University at a time of tremendous financial pressures. The slow economic recovery has resulted in a continued decline in state support that will likely continue into fiscal year 2011–12, if not beyond. President Sullivan and the University's Board of Visitors will focus, in part, on attaining more predictable revenue streams, as they look to develop a "financial model for the future." The president has also launched an initiative to explore a new University budget model. She would like to build a resource allocation model that will allow the deans to plan strategically, that will incorporate incentives to reward good stewardship of resources, and provide accountability for program success and cost management. President Sullivan will also make fund-raising a priority, including a successful conclusion of the ongoing campaign. She has emphasized the need to broaden the base of annual support, which is frequently the source of funding that provides for the most urgent current needs of the deans and schools.

Governor's Commission. Governor Robert McDonnell formed the Commission on Higher Education Reform, Innovation and Investment, an initiative that will look at how the Commonwealth can produce more degrees at affordable prices for citizens of Virginia. Increasing the number of graduates in science and engineering will be especially targeted. While the governor has recently called on the legislature to boost higher education funding, cost containment will be a primary goal of the commission. At its July retreat, the University's Board of Visitors began to consider strategically these issues, and to contemplate a new funding model for the future, focusing in particular on two major sources of revenue, tuition and private funds.

Capital Construction. The University continues to invest in additional buildings and infrastructure. In fiscal year 2009–10, the University added more than $89 million of newly completed buildings, and more than $28 million in completed infrastructure projects. As of June 30, 2010, the University had more than $400 million of capital projects under construction. Several projects have already been or will be completed during the 2010–11 fiscal year, including the Curry School's Bavaro Hall, the Claude Moore Medical Education Building, the Physical and Life Sciences Research Building, the remainder of the South Lawn Arts & Sciences complex, and new Alderman residence halls.

Management Responsibility

October 29, 2010

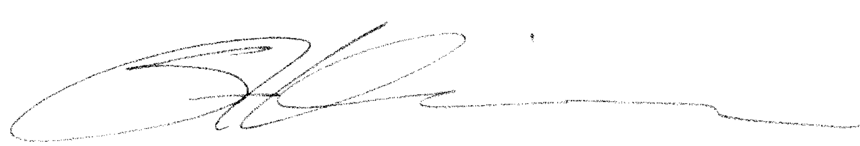
To the President and Board of Visitors of the University of Virginia:

We are pleased to submit the annual Financial Report of the University of Virginia for the year ended June 30, 2010. 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 the reports of independent certified public accountants for the 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 29, 2010

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
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, 2010, 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. The prior year summarized comparative information has been derived from the University of Virginia's 2009 financial statements, and in our report dated November 20, 2009, we expressed an unqualified opinion on the respective financial statements of the University of Virginia.

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 aggregate discretely presented component units of the University of Virginia as of June 30, 2010, 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 38 through 45 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 29, 2010, 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