



Northern Arizona University

Financial Report

2002-2003



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Arizona Superintendent of Public Instruction

This financial report is compiled and issued by the Comptroller's Office
Northern Arizona University
P.O. Box 4069
Flagstaff, AZ 86011-4069

This report is also available online at
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UNIVERSITY ADMINISTRATION As of June 30, 2003

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Executive Vice President

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Vice President for University Advancement (Interim)

INDEPENDENT AUDITORS' REPORT



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Members of the Arizona State Legislature

The Arizona Board of Regents

We have audited the accompanying financial statements of Northern Arizona University as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the University's financial statements are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of the State of Arizona that is attributable to the transactions of the University. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Northern Arizona University as of June 30, 2003, and the changes in financial position and cash flows of the University for the year then ended in conformity with U.S. generally accepted accounting principles.

The information included in the Management's Discussion and Analysis section listed in the table of contents has not been subjected to the auditing procedures applied in our audit of the financial statements and, accordingly, we express no opinion on such information.

Debbie Davenport
Auditor General

October 24, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

The discussion and analysis of Northern Arizona University's financial statements provides an overview of the university's financial activities for the year ended June 30, 2003.

Management has prepared the financial statements and the accompanying note disclosures along with the discussion and analysis. Responsibility for the completeness and fairness of this information rests with the university management.

Using this Financial Report

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments" which established a new reporting format for annual financial statements.

In November 1999, GASB issued Statement No. 35, "Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities," which applied the new reporting standards to public colleges and universities. This statement requires a comprehensive look at the university as a whole and presents a long-term view of the university's finances. This annual financial report includes the report of independent auditors, management's discussion and analysis, the financial statements in the format referred to below, and notes to the financial statements, which include the summary of significant accounting policies.

The financial statements presented by the university include the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows.

- The Statement of Net Assets presents the financial position of the university at the end of the fiscal year. This statement is classified between current assets/liabilities and non-current assets/liabilities. In addition, capital assets are depreciated over the useful life of the asset and the annual depreciation amount is shown as a current year expense.
- The Statement of Revenues, Expenses, and Changes in Net Assets distinguishes between operating and nonoperating revenues and expenses, with state appropriations reported as nonoperating revenue. Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances.
- The financial statements include a Statement of Cash Flows prepared using the direct method. This statement provides information about the university's sources and uses of cash during the year.

In order to make the Management's Discussion and Analysis (MD&A) section more meaningful this year, the university has included prior year's information for comparative purposes.

Financial Highlights

- Student tuition and fees increased 4 percent from the previous year, or about \$2.1 million.
- Government grants and contracts increased approximately \$600,000 from the prior year while private grants and contracts increased by approximately \$1.4 million.
- University auxiliary enterprise revenues including residence life and the bookstore increased by approximately \$1.8 million.
- Proposition 301 share of state sales tax revenues increased 8.5 percent from the prior year.
- The state appropriation decreased by approximately \$1.0 million.
- During the fiscal year the university issued \$31.7 million of system revenue bonds, at an average interest rate of 4.8 percent, to finance several construction and renovation projects on the Mountain Campus (see Capital Assets and Debt Administration section). As a result of issuing these revenue bonds, interest expense increased by approximately \$1.0 million.

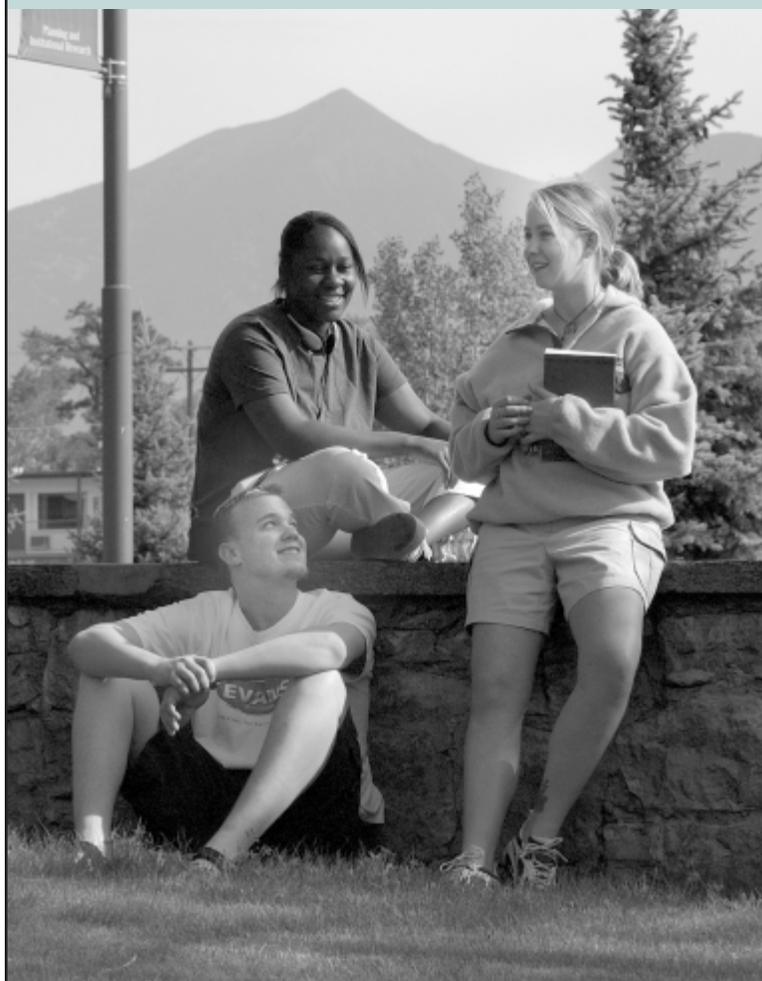


MANAGEMENT'S DISCUSSION AND ANALYSIS

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. A summarized comparison of the university's assets, liabilities, and net assets for the years ended June 30, 2003 and 2002 (in thousands), is as follows:

	2003	2002
Current assets	\$ 62,300	\$ 60,818
Noncurrent assets:		
Cash, cash equivalents, investments, and student loans receivable	31,749	6,949
Endowment investments	9,735	8,848
Capital assets – net of accumulated depreciation	194,522	193,857
Other noncurrent assets	<u>243</u>	<u>305</u>
Total assets	<u>298,549</u>	<u>270,777</u>
Current liabilities	<u>37,745</u>	<u>30,828</u>
Noncurrent liabilities	<u>95,305</u>	<u>76,804</u>
Total liabilities	<u>133,050</u>	<u>107,632</u>
Net assets	<u>\$ 165,499</u>	<u>\$ 163,145</u>



A review of NAU's Statement of Net Assets at June 30, 2002 and 2003 shows that the university's financial position remains stable.

Current assets consist primarily of cash and investments, government grants and contracts receivable, and accounts receivable. Cash and investments remained at approximately \$44.0 million at June 30, 2003 as compared to the prior year.

Noncurrent assets, consisting primarily of capital assets, increased slightly over the fiscal year. The changes in capital assets are discussed in more detail in the Capital Assets and Debt Administration section. Remaining noncurrent assets increased due to the additional cash held in trust from the bond proceeds.

Current liabilities include accounts payable, accrued expenses, deferred revenue, and the current portion of the university's long-term debt. Current liabilities are higher mainly due to a \$3.0 million increase in accounts payable, and a \$3.7 million increase in current portion of long-term debt. The increase in accounts payable was due to the use of bond proceeds for construction projects. The increase in the current portion of long-term debt is due to the issuance of \$31.7 million in bonds.

Noncurrent liabilities increased by \$18.5 million as of June 30, 2003. The increase is attributed to the issuance of bonds in the amount of \$31.7 million, which is discussed further in the Capital Assets and Debt Administration section.

MANAGEMENT'S DISCUSSION AND ANALYSIS

NET ASSETS

A summarized comparison of the university's net assets for the years ended June 30, 2003 and 2002 (in thousands), is as follows:

	2003	2002 as adjusted
Invested in capital assets, net of related debt	\$ 90,861	\$ 112,619
Restricted:		
Nonexpendable	12,728	12,088
Expendable	32,872	12,789
Unrestricted	<u>29,038</u>	<u>25,649</u>
Total net assets	<u>\$ 165,499</u>	<u>\$ 163,145</u>

Net assets at June 30, 2003 increased overall by \$2.4 million or about 1.5 percent from 2002. This was due to increased revenues and university reductions in budgetary expenditures. The 2002 information has been adjusted to classify restricted student loan balances consistent with fiscal year 2003. The 2002 net asset balances, as adjusted, have not been audited.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to U.S. generally accepted accounting principles. See the table of Combined Sources and Uses of Funds on pages 10-11 for an overview of the composition of revenues and expenses. A summarized comparison of the university's revenues, expenses, and changes in net assets for the years ended June 30, 2003 and 2002 (in thousands), is as follows:

	2003	2002
Operating Revenues		
Tuition and fees, net of scholarship allowances	\$ 53,272	\$ 51,197
Government grants and contracts	47,926	47,408
Auxiliary enterprises	29,770	27,953
Other	<u>12,541</u>	<u>10,319</u>
Total operating revenues	<u>143,509</u>	<u>136,877</u>
Operating Expenses:		
Educational and general	216,080	217,903
Auxiliary enterprises	30,007	26,298
Depreciation	<u>17,468</u>	<u>18,504</u>
Total operating expenses	<u>263,555</u>	<u>262,705</u>
Nonoperating Revenues (Expenses):		
State appropriations	111,187	112,190
Share of state sales tax	8,520	7,851
Grants and contracts	4,649	4,340
Investment income	1,545	1,117
Interest expense on capital asset related debt	(5,022)	(4,028)
Other nonoperating revenues/expenses	<u>610</u>	<u>434</u>
Total nonoperating revenues and expenses	<u>121,489</u>	<u>121,904</u>
Capital and endowment additions	<u>911</u>	<u>654</u>
Increase (decrease) in net assets	<u>\$ 2,354</u>	<u>\$ (3,270)</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

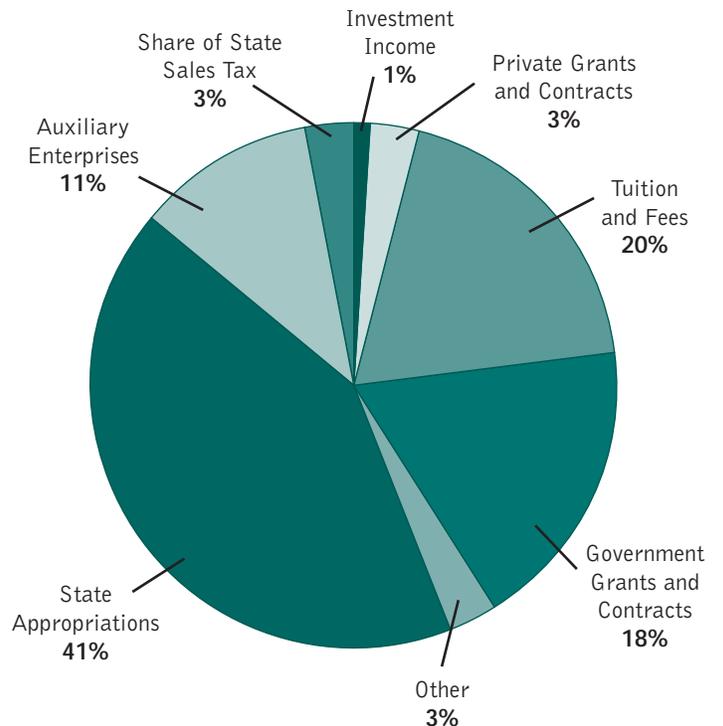
REVENUES ANALYSIS

State appropriations and tuition and fees continue to be the major funding sources for current operations related to educational purposes. Operating revenues (not including state appropriations) increased 5 percent or about \$6.6 million in 2003. This increase is due to additional auxiliary revenues, tuition and fee revenue increases, and an increase in private grants and contracts (shown as other operating revenues in the statement on page 5). Tuition and fees increased from 2002 by approximately \$2.1 million mainly due to a rate increase. State appropriations decreased from \$112.2 million in fiscal year 2002 to \$111.2 million in 2003. Included in state appropriations is \$207,150 for financial aid purposes. Non-operating revenues also include \$8.5 million in state sales tax revenues from Proposition 301 collections. Investment income increased due to more favorable market conditions. Included in the investment income is an accrued loss of \$634,267 due to the failure of National Century Financial Enterprises, an investment held by the Local Government Investment Pool administered by the State Treasurer's Office.

EXPENSES ANALYSIS

Educational and general expenses continued to account for a majority of the operating expenses. Educational and general expenses decreased in fiscal year 2003 by \$1.8 million due to university budget reductions and reallocations. Significant components of the decrease within educational and general expenses were student services, \$1.5 million, and institutional support, \$3.3 million.

Total Revenues Fiscal Year 2003



Expenses - By functional classification

A comparative summary of the university's expenses by functional classification for the years ended June 30, 2003 and June 30, 2002, is as follows:

	2003	2002
Operating:		
Instruction	\$ 90,284,592	\$ 89,754,211
Research	18,080,532	16,755,758
Public service	19,541,187	19,233,336
Academic support	19,622,315	19,115,055
Student services	17,310,914	18,803,278
Institutional support	28,386,305	31,705,018
Operation and maintenance of plant	13,991,319	14,831,227
Scholarships and fellowships	8,862,509	7,704,493
Total educational and general expenses	<u>216,079,673</u>	<u>217,902,376</u>
Auxiliary enterprises	30,007,017	26,298,108
Depreciation	17,467,988	18,504,261
Total operating expenses	<u>263,554,678</u>	<u>262,704,745</u>
Nonoperating:		
Interest and other	<u>5,540,139</u>	<u>4,372,245</u>
Total Expenses	<u>\$ 269,094,817</u>	<u>\$ 267,076,990</u>

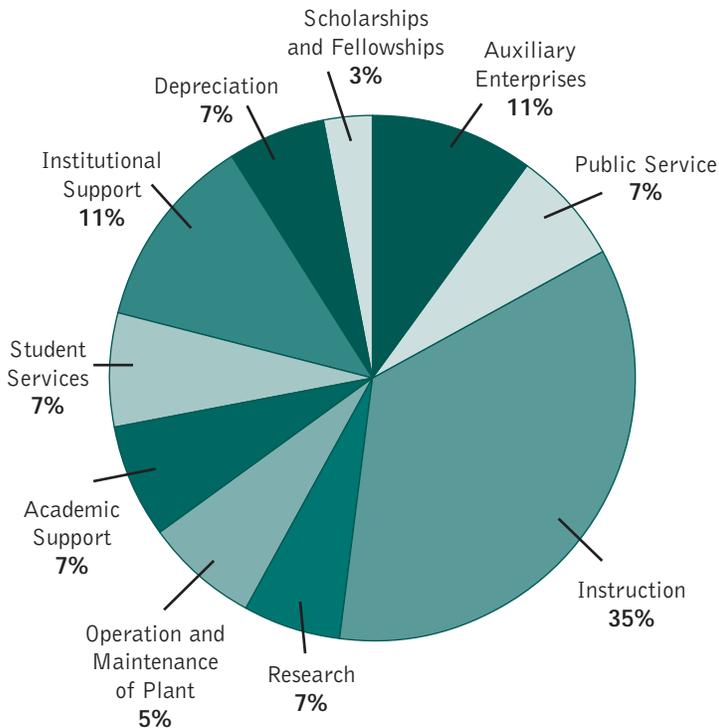
MANAGEMENT'S DISCUSSION AND ANALYSIS

Expenses - By natural classification

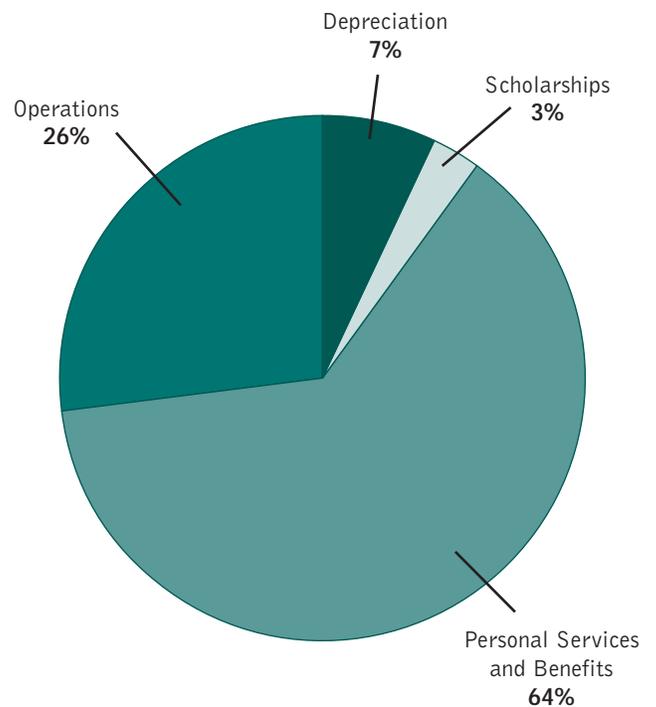
In addition to their functional (program) classification, it is also informative to review operating expenses by their natural (object) classification. A comparative summary of the university's expenses by natural classification for the years ended June 30, 2003 and June 30, 2002, is as follows:

	2003	2002
Operating:		
Personal services and benefits	\$ 169,118,948	\$ 165,039,385
Operations	68,105,233	71,456,606
Scholarships	8,862,509	7,704,493
Depreciation	17,467,988	18,504,261
Nonoperating:		
Interest and other	<u>5,540,139</u>	<u>4,372,245</u>
Total Expenses	<u>\$ 269,094,817</u>	<u>\$ 267,076,990</u>

Operating Expenses
Functional Classifications
Fiscal Year 2003



Operating Expenses
Natural Classifications
Fiscal Year 2003



MANAGEMENT'S DISCUSSION AND ANALYSIS

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets at June 30, 2003

At June 30, 2003, the university had \$194.5 million invested in capital assets. During the year the university added \$18.9 million in new capital assets and retired \$6.4 million of obsolete assets. In addition, accumulated depreciation increased by \$11.9 million. Details of capital assets for the years ended June 30, 2003 and 2002, are as follows:

	2003	2002
Land	\$ 5,283,663	\$ 5,039,193
Infrastructure	39,687,569	34,681,961
Buildings	257,574,458	251,763,942
Equipment	76,602,924	79,377,681
Library books and media	43,436,044	42,261,227
Construction in progress	3,522,704	465,636
Accumulated depreciation	<u>(231,584,875)</u>	<u>(219,732,732)</u>
Total capital assets	<u>\$ 194,522,487</u>	<u>\$ 193,856,908</u>

Significant capital additions completed or commenced, and the resources that funded their acquisitions for fiscal year 2003, were:

- Library Acquisitions, \$1,325,300, unrestricted net assets
- 23 acres of undeveloped forest land, \$240,000, gift
- Campus infrastructure upgrades, \$4,990,000, unrestricted net assets and bond proceeds
- Gateway Student Success Center, \$2,778,700, bond proceeds
- Modular Swing Space, \$2,971,600, bond proceeds (construction in progress)
- Communication building renovation, \$2,139,700, bonds (construction in progress)

The university's Capital Improvement Plan, which is updated annually, provides for the issuance of approximately \$31.0 million in system revenue bonds in fiscal year 2004. These monies will be used for the renovation of existing buildings and new building construction.

Projects planned to commence in fiscal year 2004 funded from fiscal years 2003 and 2004 system revenue bonds include:

- Campus infrastructure upgrades
- New College of Business Administration building
- Continued Modular Swing Space (flexible, temporary space for campus unit relocation during construction and renovation)
- Communication building renovation completion

In June 2003, House Bill No. 2529, the Research Infrastructure bill was passed. This bill will provide \$5.9 million annually for debt service in fiscal years 2008 through 2031 to fund research infrastructure projects.



MANAGEMENT'S DISCUSSION AND ANALYSIS

CAPITAL ASSETS AND DEBT ADMINISTRATION (continued)

Outstanding Debt at June 30, 2003

At June 30, 2003, the university had \$104.4 million in outstanding debt, an increase of approximately \$22.3 million or 27 percent from fiscal year 2002. This is due to repayment of \$9.4 million of principal and fiscal year borrowings of \$31.7 million. The outstanding university debt is made up of \$101.6 million in bonds and \$2.8 million in capitalized lease obligations. During the year ended June 30, 2003, the university issued \$31.7 million in system revenue bonds, with an average interest rate of 4.8 percent, for various project renovations on the mountain campus. The table below summarizes the university's outstanding debt from fiscal years 2003 and 2002.

	2003	2002
System revenue and housing bonds	\$ 101,645,000	\$ 79,025,000
Long-term obligations and capital leases	<u>2,753,559</u>	<u>3,099,464</u>
Subtotal	<u>104,398,559</u>	<u>82,124,464</u>
Less deferred amount on refunding	<u>(736,687)</u>	<u>(886,520)</u>
Total	<u>\$ 103,661,872</u>	<u>\$ 81,237,944</u>

At June 30, 2003, the university maintained an A2 rating by Moody's Investors Service and an A+ rating from Standard and Poor's Rating Services. Effective in fiscal year 2003, the university was required by Arizona state law to calculate its debt capacity ratio based on the amount of debt service per fiscal year not to exceed 8 percent of projected total expenditures and mandatory transfers. At June 30, 2003, the projected ratio for the university's total debt service to projected expenditures and mandatory transfers was 4.23 percent and is well within the requirement of 8 percent. In November 2003, the university will issue approximately \$31.0 million of system revenue bonds. The system revenue bonds issued in fiscal years 2003 and 2004 fit comfortably into the university's debt capacity according to the latest debt study as submitted to the Arizona Board of Regents.

Economic Outlook

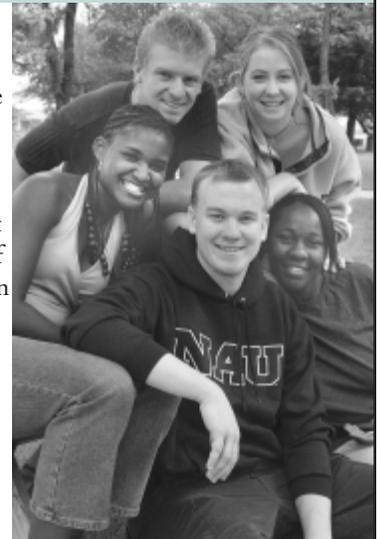
As is the case for most of the country, the state of Arizona continued to experience weak economic conditions in fiscal year 2003. As a result of the distressed economy, the state legislature reduced state appropriations in fiscal year 2003. University management continues to develop long and short term strategic plans to address this and other challenges to the financial health of the institution. At the same time, the Arizona Board of Regents and the three state universities are actively evaluating creative solutions to contain costs and generate new revenues in order to continue providing quality and affordable education.

With current trends in state appropriations continuing to decline, the university is continuing to examine opportunities to increase tuition revenues to offset decreased state support. Meeting the \$100 million goal of the New Century Campaign helps to solidify

the future financial foundation of the university and demonstrates the strong support of our benefactors. Due to increased financial needs to attract and retain talented faculty and staff, the university will request approval from the Arizona Board of Regents for a tuition increase within the next fiscal year.

Since the university is ultimately subject to the same economic variables that affect other financial entities, it is not possible to predict future outcomes. Management is well aware of the challenges ahead and is working diligently to continue to provide quality instruction, research and public service to the state of Arizona and the nation.

As part of the legislative budget for fiscal year 2003, the university received a \$4,000,000 appropriation from the State General Fund. This amount, which the university anticipates will be appropriated in each future fiscal year through the final maturity of the 2003 bonds, was appropriated to offset or replace tuition and registration fee revenues that will be used to pay the debt service on the 2003 bonds.



MANAGEMENT'S DISCUSSION AND ANALYSIS

COMBINED SOURCES AND USES OF FUNDS

For the Year Ended June 30, 2003

SOURCES

State Appropriations

41.0% \$ 111,187,450

Includes legislative appropriations from state of Arizona general revenue for current operations of the university, and \$207,150 for financial aid.

Tuition and Fees, Net of Scholarship Allowances

19.6% \$ 53,271,742

Includes \$34,537,309 to support the operating budget, \$7,201,442 for summer sessions, \$30,757,377 for funding of local budgets, scholarships, and retirement of nonhousing bonded indebtedness, less \$19,224,386 for scholarship allowances.

Government Grants and Contracts

17.9% \$ 48,455,020

Includes operating revenues of \$39,577,422 from federal grants and contracts, \$3,784,164 from state grants and contracts, and \$5,093,434 from local government grants and contracts.

Auxiliary Enterprises

11.0% \$ 29,770,030

Operations of substantially self-supporting activities such as housing, bookstore, student unions, and intercollegiate athletics.

Other Sources

3.6% \$ 9,941,080

Includes interest on loans receivable, commissions, internal services, commissions, conferences, facility user fees, additions to permanent endowments, capital grants and gifts, and other operating and nonoperating miscellaneous revenues.

Private Gifts, Grants, and Contracts

3.2% \$ 8,758,720

Includes gifts, grants, and contracts for scholarships, endowments, and plant facility additions.

Share of State Sales Taxes

3.1% \$ 8,519,908

University's share of state sales tax collections from Proposition 301.

Investment Income

0.6% \$ 1,544,949

Earnings from short-term investments of funds not necessary for immediate operational expenses and long-term investment of endowment and bond-retirement sinking funds.

Total Sources

\$ 271,448,899

Note: The Combined Sources and Uses of Funds is presented to highlight major financial data. The explanations provided are not intended to be all inclusive. This summary is presented to give an overview of total university financial operations. Operating and nonoperating funds are included. Sources and uses are allocated and controlled by budgets.

MANAGEMENT'S DISCUSSION AND ANALYSIS

COMBINED SOURCES AND USES OF FUNDS

For the Year Ended June 30, 2003

USES

Instruction and Academic Support

40.8% **\$ 109,906,907**

Instruction, totaling \$90,284,592, includes expenses of academic departments and other organizational units for undergraduate and graduate courses, and for occupational or technical instruction, including regular academic year, summer sessions, and continuing education. Academic support, totaling \$19,622,315, includes libraries, audio-visual services, and academic administration.

Student Services and Institutional Support

17.0% **\$ 45,697,219**

Student services, totaling \$17,310,914, includes areas such as admissions, registrar, minority services, counseling, placement, student aid administration, and health services. Institutional support, totaling \$28,386,305, includes executive management, financial operations, computing support, human resource services, security, and university relations.

Research and Public Service

14.0% **\$ 37,621,719**

Activities for which the primary objective is the discovery or application of knowledge that may be sponsored by external agencies or separately budgeted by organizational units within the university. Public service activities make available to the general public the benefits of the instructional or research activities and include local school consortiums and public broadcasting.

Auxiliary Enterprises

11.2% **\$ 30,007,017**

Expenses of organizational units that furnish services to students, faculty and staff, and the general public for a fee directly related to the cost of the service and are managed as essentially self-supporting activities.

Depreciation

6.5% **\$ 17,467,988**

Depreciation expense of capital assets over their useful lives.

Operation and Maintenance of Plant

5.2% **\$ 13,991,319**

Represents expenses for the operation and maintenance of plant, including administration, maintenance and custodial services, landscaping and grounds upkeep, minor repairs and renovation, utilities, and property insurance.

Scholarships and Fellowships

3.3% **\$ 8,862,509**

Scholarships and fellowships are awarded to students enrolled in formal coursework for which the students are not required to perform personal services or repay the awards.

Other Uses

2.0% **\$ 5,540,139**

Other uses include \$5,021,570 in interest expense on capital asset-related debt and a \$518,569 loss on disposal of capital assets.

Total Uses

\$ 269,094,817

FINANCIAL STATEMENTS

STATEMENT OF NET ASSETS

June 30, 2003

ASSETS

Current assets:

Cash and cash equivalents	\$ 23,518,100
Investments	20,598,865
Receivables, net of allowance for uncollectibles:	
Accounts receivable	4,758,308
Accrued interest	582,221
Endowment	507
Government grants and contracts	8,033,034
Student loans	973,839
Other assets	1,758,493
Inventories	2,076,956
Total current assets	\$ 62,300,323

Noncurrent assets:

Restricted cash and investments held by trustee	\$ 25,808,665
Investments	1,039,630
Student loans receivable, net of allowance	4,900,222
Endowment investments	9,735,073
Other noncurrent assets	242,896
Capital assets, not being depreciated	8,806,367
Depreciable capital assets, net of depreciation	185,716,120
Total noncurrent assets	\$ 236,248,973

Total assets

\$ 298,549,296

LIABILITIES

Current liabilities:

Accounts payable	\$ 7,300,969
Accrued payroll and employee benefits	4,125,724
Interest payable	395,119
Deferred revenue	11,010,875
Accrued compensated absences	3,829,081
Deposits held in custody for others	504,499
Current portion of long-term debt	10,579,274
Total current liabilities	\$ 37,745,541

Noncurrent liabilities:

Deposits held in custody for others	\$ 248,345
Long-term debt	95,056,562
Total noncurrent liabilities	\$ 95,304,907

Total liabilities

\$ 133,050,448

NET ASSETS

Invested in capital assets, net of related debt	\$ 90,860,614
Restricted:	
Nonexpendable:	
Scholarships and fellowships	5,838,877
Student loans	6,889,492
Expendable:	
Scholarships and fellowships	1,138,458
Research	4,663,724
Academic department use	8,022,972
Capital projects	18,490,312
Debt service	556,292
Unrestricted	29,038,107
Total net assets	\$ 165,498,848

See Notes to Financial Statements

FINANCIAL STATEMENTS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS For Year Ended June 30, 2003

REVENUES

Operating Revenues	
Tuition and fees, net of scholarship allowances of \$19,224,386, pledged as security for revenue bonds	\$ 53,271,742
Government grants and contracts	47,926,464
Private grants and contracts	4,638,957
Auxiliary enterprises, includes revenues pledged as security for revenue bonds:	
Bookstore	8,128,273
Residence life, net of scholarship allowances of \$2,860,775	14,314,266
Other auxiliaries	7,327,491
Other	7,901,625
Total operating revenues	<u>\$ 143,508,818</u>

EXPENSES

Operating Expenses	
Educational and general:	
Instruction	\$ 90,284,592
Research	18,080,532
Public service	19,541,187
Academic support	19,622,315
Student services	17,310,914
Institutional support	28,386,305
Operation and maintenance of plant	13,991,319
Scholarships and fellowships	8,862,509
Auxiliary enterprises	30,007,017
Depreciation	17,467,988
Total operating expenses	<u>\$ 263,554,678</u>

Operating loss	<u>\$ (120,045,860)</u>
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NONOPERATING REVENUES AND (EXPENSES)

State appropriations	\$ 111,187,450
Share of state sales tax	8,519,908
Government grants and contracts	528,556
Private gifts, grants, and contracts	4,119,763
Investment income	1,544,949
Interest expense on capital asset related debt	(5,021,570)
Loss on disposal of capital assets	(518,569)
Other nonoperating revenues	1,128,872
Total nonoperating revenues and expenses	<u>\$ 121,489,359</u>

Income before other revenues, expenses, gains or losses	<u>\$ 1,443,499</u>
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Capital grants and gifts	\$ 442,702
Additions to permanent endowments	467,881

Increase in net assets	<u>\$ 2,354,082</u>
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NET ASSETS

Total net assets, July 1, 2002	<u>\$ 163,144,766</u>
Total net assets, June 30, 2003	<u>\$ 165,498,848</u>

See Notes to Financial Statements

FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS

For Year Ended June 30, 2003

Cash flows from operating activities:	
Tuition and fees	\$ 51,833,471
Grants and contracts	52,829,025
Payments to suppliers and providers of goods and services	(64,865,389)
Payments to employees	(167,292,585)
Payments for scholarships and fellowships	(8,862,509)
Loans issued to students	(1,475,831)
Collection of loans to students	1,337,138
Auxiliary enterprise charges:	
Residence halls	14,369,563
Bookstore	8,114,304
Other auxiliaries	7,343,353
Other receipts	6,088,619
Net cash used by operating activities	\$ (100,580,841)
Cash flows from noncapital financing activities:	
State appropriations	\$ 111,187,450
Share of state sales taxes	7,822,243
Gifts and grants for other than capital purposes	5,777,191
Federal direct student lending received	55,883,455
Federal direct student lending disbursed	(55,883,455)
Private gifts for endowment purposes	467,881
Funds held for others	2,920
Net cash provided by noncapital financing activities	\$ 125,257,685
Cash flows from capital financing activities:	
Proceeds from issuance of capital debt	\$ 31,700,000
Capital grants and gifts received	58,448
Proceeds from sale of capital assets	150,886
Purchases of capital assets	(18,418,768)
Principal paid on capital debt and leases	(9,425,905)
Interest paid on capital debt and leases	(4,725,054)
Net cash used by capital financing activities	\$ (660,393)
Cash flows from investing activities:	
Proceeds from sales and maturities of investments	\$ 30,003,958
Interest on investments	1,786,521
Purchase of investments	(29,612,328)
Net cash provided by investing activities	\$ 2,178,151
Net increase in cash and cash equivalents	\$ 26,194,602
Cash and cash equivalents - beginning of year	23,132,163
Cash and cash equivalents - end of year	\$ 49,326,765
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	\$ (120,045,860)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation expense	17,467,988
Changes in assets and liabilities:	
Receivables, net	(1,064,861)
Student loans receivable and accrued interest on student loans	(153,367)
Inventories	208,004
Other assets	100,571
Accounts payable and accrued liabilities	3,508,501
Deferred revenue	(427,716)
Deposits held in custody for others	47,331
Accrued compensated absences	(221,432)
Net cash used by operating activities:	\$ (100,580,841)
Noncash transactions	
Gifts of capital assets	\$ 384,254
Unrealized change in fair value of investments	62,229
Amortization of loss on refunding and bond premium	149,834
Losses on disposal of capital assets, net	(518,569)

See Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

Note 1—Summary of Significant Accounting Policies

Financial Statement Presentation

The accounting policies of the university conform to U.S. generally accepted accounting principles applicable to public institutions of higher education engaged only in business-type activities adopted by the Governmental Accounting Standards Board (GASB).

The financial statements of the university include all monies, financial transactions, and activities for which the university has financial accountability. Fiscal responsibility for the university remains with the state of Arizona; therefore, the university is considered part of the reporting entity for the state's financial reporting purposes. The financial statements do not include the financial activities of the Northern Arizona University Foundation, Inc. (Foundation) or the Northern Arizona Capital Facilities Finance Corporation. The foundation and the Northern Arizona Capital Facilities Finance Corporation are nonprofit corporations, controlled by separate boards of directors. The goals of the foundation are to promote the cause of education and the objectives of the university. The Northern Arizona Capital Facilities Finance Corporation was formed for the purpose of building on-campus student housing.

Basis of Accounting

For financial reporting purposes, the university is considered a special-purpose government engaged only in business-type activities. Accordingly, the university's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. State appropriations are recognized as revenue in the year in which the appropriation is first made available for use. Grants and donations are recognized as revenue as soon as all eligibility requirements imposed by the provider are met. All significant transactions resulting from internal activity have been eliminated.

The university follows Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements.

The financial statements include a statement of net assets; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows.

The statement of net assets provides information about the assets, liabilities, and net assets of the university at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to external donor restrictions or availability of assets to satisfy university obligations. Invested in capital assets net of related debt, represents the value of capital assets, net of accumulated depreciation, less any outstanding debt incurred to acquire or construct the assets. Nonexpendable restricted net assets are gifts that have been received for endowment purposes, the corpus of which cannot be expended and monies that are restricted for the purpose of issuing

student loans. Expendable restricted net assets represent grants, contracts, gifts, and other resources that have been externally restricted for specific purposes. Unrestricted net assets include all other net assets, including those that have been designated by management to be used for other than general operating purposes.

The statement of revenues, expenses, and changes in net assets provides information about the university's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and additions to endowments. Generally, revenues generated by the university for instruction, public service, and research are considered to be operating revenues. Other revenues used for instruction and public service, such as state appropriations, are not generated from operations and are considered to be nonoperating revenues.

The statement of cash flows provides information about the university's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as operating, noncapital financing, capital financing, or investing activities.

The university has both restricted and unrestricted resources available for its operations. Generally, the use of these resources is managed at the department level. Restricted resources are primarily externally provided sponsored research grants and contracts, and externally provided student financial aid. When both restricted and unrestricted resources are available for use, typically restricted resources will be used first. University policy is that the funding source to be used is determined by each department based on (1) relative priorities of the department in accordance with university strategic initiatives, (2) externally imposed matching requirements of the restricted grants and contracts, and (3) any pertinent lapsing provisions of the restricted or unrestricted funding resources available for the expense.

Cash and Cash Equivalents

The university considers all short-term, highly liquid investments with maturities of less than three months from the date of acquisition to be cash equivalents. Cash and investments held by trustee, and funds invested through the State Treasurer's Local Government Investment Pool, are also considered cash equivalents.

Investments

Investments are reported at fair value. Fair value typically is the quoted market price for investments.

Receivables

Student loans and accounts receivable as of June 30, 2003, are reported less allowances for both estimated uncollectible amounts and collection costs of \$835,000 and \$930,500, respectively.

Inventories

Inventories are stated at the lower of cost or market. The cost of bookstore inventories is determined by the retail inventory method. The cost of other inventories is determined generally using the first-in, first-out or weighted average cost methods.

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

Capital Assets

Capital assets are reported at actual cost. Donated assets are reported at estimated fair value at the time received. Capitalization thresholds, depreciation methods, and estimated useful lives of capital assets reported in the financial statements are as follows:

	Capitalization Threshold	Depreciation Method	Estimated Useful Life
Building improvements	\$5,000	Straight Line	20 years
Buildings	All	Straight Line	40 years
Infrastructure	All	Straight Line	20-40 years
Land	All	None	
Equipment	2,500	Straight Line	5-15 years
Library books and media	All	Straight Line	10 years

Special Collections

The university does not capitalize its special collections because the items are held for educational and research purposes and not for financial gain. The items are preserved, unencumbered, and protected. It is the university's policy to acquire other items to further or enhance collections with any proceeds from the disposal of special collection items.

Compensated Absences

Compensated absences consist of vacation leave and compensatory time earned by employees based on services already rendered. Employees may accumulate up to 264 hours of vacation depending on years of service and full-time equivalent employment status, but any vacation hours in excess of the maximum amount that are unused at December 31 are forfeited. Upon termination of employment, all unused vacation benefits not exceeding 176 hours (annual accrual amount), depending on years of service and full-time equivalent employment status, are paid to employees. Accordingly, vacation benefits and compensatory time are accrued as a liability in the financial statements.

Generally, sick leave benefits provide for ordinary sick pay and are cumulative but are forfeited upon termination of employment. Because sick leave benefits do not vest with employees, a liability for sick leave benefits is not accrued in the financial statements. However, upon retirement, employees who have accumulated at least 500 hours of sick leave are paid a formulated benefit amount. The university makes contributions each pay period to the state's Retiree Accumulated Sick Leave Fund and the state makes benefit payments directly to the retired employees from the fund. Consequently, the university has not accrued a liability for these sick leave benefits.

Investment Income

Investment income is composed of interest, dividends, and net changes in fair value of applicable investments.

Scholarship Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. A scholarship discount and allowance is the difference between the stated charge for goods and services provided by the university and the

amount that is paid by students or third parties making payments on behalf of the student.

Accordingly, some types of student financial aid such as Pell grants and scholarships awarded by the university are considered to be scholarship allowances. These allowances are netted against tuition and fees and certain auxiliary enterprise revenues in the statement of revenues, expenses, and changes in net assets.

Note 2—Cash and Investments

Board of Regent's investment policies require that the university invest only in the State Treasurer's Local Government Investment Pool, collateralized time certificates of deposit and repurchase agreements, U.S. Treasury securities, and obligations of other agencies sponsored by the federal government. Gifts and endowments monies may be invested according to conditions stipulated by the donor, but if no conditions are imposed, such monies may be invested under the direction of the university investment committee in such a manner as to obtain the most favorable rate of return and income stability commensurate with safety of principal. Demand deposit accounts with authorized financial institutions are required to be collateralized.

Cash and Investments at June 30, 2003, consists of the following:

	Fair Value
Cash on hand and in bank	\$ 175,522
Investments	21,638,495
Student Financial Aid Trust Fund	5,624,530
State Treasurer's Local Government Investment Pool	22,791,424
Bond Trustee Funds	25,808,665
Donated Land	419,619
Investments with NAU Foundation	4,242,078
Total	\$ 80,700,333

The university's total cash on hand was \$51,530. The carrying amount of the university's total cash in bank was \$123,992 and the bank balance was \$1,386,828, of which \$100,000 was covered by federal depository insurance and the remaining balance of \$1,286,828 was

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

collateralized by U.S. Government obligations held by the counterparty's agent in the agent's account with the Federal Reserve in the university's name.

The \$21,638,495 in investments is invested in securities of the Federal Home Loan Mortgage Corporation, the Federal Home Loan Bank, and the Federal National Mortgage Association that are registered and held by the counterparty's agent in the agent's account with the Federal Reserve Bank. The university's ownership interest is recorded in the bank's records.

The Student Financial Aid Trust Fund was established in accordance with Arizona Revised Statutes §15-1642 for the purpose of providing aid to students with verifiable financial need. The three state universities participate in the Trust Fund, which is held with and managed by the University of Arizona. The university's portion is not identified with specific investments and its ownership interest is recorded in the University of Arizona's records.

The university's investment in the State Treasurer's Local Government Investment Pool represents a proportionate interest in the pool's portfolio; however, the university's portion is not identified with specific investments and is not subject to custodial credit risk. The State Board of Investment provides oversight for the State Treasurer's

pools, and the Local Government Investment Pool Advisory Committee provides consultation and advice to the Treasurer. The fair value of a participant's position in the pool approximates the value of that participant's pool shares.

Bond indentures authorize the bond trustees to invest in obligations of or guaranteed by the federal government or any agency or instrumentality thereof; municipal obligations; collateralized certificates of deposit with federally insured banks, trust companies, or savings and loan associations within the state of Arizona; or repurchase agreements. At June 30, 2003, the bond trustee funds were invested in money market mutual funds that primarily consist of U.S. government securities. The bond trustees are authorized to purchase and sell securities. The university's ownership interest is recorded in the trustee's records. The donated land investment consists of land held in the Cowden Trust on behalf of the university.

Trust agreements between the university and the NAU foundation, Inc. authorize the foundation to invest certain university restricted and endowment monies according to the foundation's established investment policies and procedures. At June 30, 2003, the foundation invested the amount of \$4,242,078 with selected financial institutions. The university's portion is not identified with specific investments and its ownership interest is recorded in the foundation's records.

Note 3—Capital Assets

Capital asset activity for the year ended June 30, 2003, was as follows:

	Balance June 30, 2002	Additions	Retirements	Transfers	Balance June 30, 2003
Capital assets not being depreciated:					
Land	\$ 5,039,193	\$ 244,470			\$ 5,283,663
Construction in progress	465,636	10,789,889		\$ (7,732,821)	3,522,704
Total capital assets not being depreciated	<u>5,504,829</u>	<u>11,034,359</u>		<u>(7,732,821)</u>	<u>8,806,367</u>
Capital assets being depreciated:					
Infrastructure	34,681,961	15,067		4,990,541	39,687,569
Buildings	251,763,942	3,068,236		2,742,280	257,574,458
Equipment	79,377,681	3,469,689	\$ (6,244,446)		76,602,924
Library books and media	42,261,227	1,325,388	(150,571)		43,436,044
Total capital assets being depreciated	<u>408,084,811</u>	<u>7,878,380</u>	<u>(6,395,017)</u>	<u>7,732,821</u>	<u>417,300,995</u>
Less accumulated depreciation for					
Infrastructure	16,623,088	1,208,565			17,831,653
Buildings	115,466,032	6,822,518			122,288,550
Equipment	55,754,381	7,144,919	(5,465,273)		57,434,027
Library books and media	31,889,231	2,291,985	(150,571)		34,030,645
Total accumulated depreciation	<u>219,732,732</u>	<u>17,467,987</u>	<u>(5,615,844)</u>		<u>231,584,875</u>
Capital assets, net	<u>\$193,856,908</u>	<u>\$ 1,444,752</u>	<u>\$ (779,173)</u>		<u>\$ 194,522,487</u>

The estimated cost to complete construction in progress at June 30, 2003, totaled \$78,630,314.

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

Note 4—Long-Term Liabilities

Long-term liability activity for the year June 30, 2003, was as follows:

	Balance June 30, 2002	Additions	Reductions	Balance June 30, 2003	Due Within One Year
Long term obligations and capital leases	\$ 3,099,464		\$ (345,905)	\$ 2,753,559	\$ 358,398
Revenue and housing bonds payable	79,025,000	\$ 31,700,000	(9,080,000)	101,645,000	9,935,000
Less deferred amount on refunding	(886,521)		149,834	(736,687)	(149,834)
Optional retirement monies	<u>1,971,044</u>	<u>841,157</u>	<u>(838,237)</u>	<u>1,973,964</u>	<u>435,710</u>
Total long-term liabilities	<u>\$ 83,208,987</u>	<u>\$ 32,541,157</u>	<u>\$(10,114,308)</u>	<u>\$ 105,635,836</u>	<u>\$ 10,579,274</u>

Bonds - The university's bonded debt consists of various issues of student housing and system revenue bonds that are generally callable with interest payable semiannually. Bond proceeds primarily pay for acquiring, constructing or renovating of capital facilities. System revenue bonds are repaid from pledged gross revenues that primarily consist of student tuition and fees, and certain auxiliary revenues.

Bonds payable at June 30, 2003, are as follows:

Student housing bonds (2 issues) - 5.5 percent to 6.1 percent, principal payable annually on April 1 through 2009, revenues of various housing projects pledged for payment	\$ 1,040,000
System revenue bonds, Series of 1997 - 5.0 percent to 6.5 percent, principal maturing serially on June 1, 2009, through 2017, secured by a first lien on certain gross revenues, on a parity with the Series 2002 system revenue refunding bonds and the Series 2002 system revenue bonds	\$ 30,900,000
System revenue refunding bonds, Series of 2002 - 3.0 percent to 4.0 percent, principal maturing serially on June 1, 2003, through 2008, secured by a first lien on certain gross revenues, on a parity with the Series 1997 system revenue bonds and Series 2002 system revenue bonds	\$ 40,845,000
System revenue bonds, Series of 2002 - 3.0 percent to 5.125 percent, principal maturing serially on June 1, 2003, through 2034, secured by a first lien on certain gross revenues, on a parity with the Series 2002 system revenue refunding bonds and Series 1997 system revenue bonds	\$ 28,860,000
	<u>\$ 101,645,000</u>

The following schedule details debt service requirements to maturity for the university's bonds payable at June 30, 2003.

Year Ending June 30,	Revenue Bonds	
	Principal	Interest
2004	\$ 9,935,000	\$ 4,595,575
2005	9,425,000	4,222,785
2006	9,295,000	3,866,460
2007	9,105,000	3,503,085
2008	8,245,000	3,147,495
2009-13	18,205,000	12,151,230
2014-18	19,000,000	7,085,813
2019-2034	18,435,000	8,770,306
Total	<u>\$ 101,645,000</u>	<u>\$ 47,342,749</u>

In prior years, the university defeased certain revenue bonds by either placing the proceeds of new bonds, or cash and investments accumulated in the sinking fund, in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the university's financial statements. At June 30, 2003, \$315,000 of such bonds outstanding are considered defeased.

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

Note 5—Retirement Plans

The university participates in one cost-sharing multiple-employer defined benefit pension plan and five defined contribution pension plans.

The Arizona State Retirement System (ASRS) administers a cost-sharing multiple-employer defined benefit pension plan. Benefits are established by state statute and provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board, in accordance with the provisions of A.R.S. Title 38, Chapter 5, Article 2. The ASRS issues a Comprehensive Annual Financial Report that includes its financial statements and required supplementary information. That report may be obtained by writing to the ASRS, 3300 North Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910, or calling (602) 240-2000 or (800) 621-3778.

For the year ended June 30, 2003, active ASRS members and the university were each required by statute to contribute at the actuarially determined rate of 2.49 percent (2 percent retirement and 0.49 percent long-term disability) of the members' annual covered payroll. The university's retirement contributions to the ASRS for the years ended June 30, 2003, 2002, and 2001 were \$1,148,814, \$1,094,343 and \$1,108,236, respectively, which were equal to the required contributions for the year. The Arizona State Legislature establishes and may amend active plan members' and the university's contribution rates.

In accordance with A.R.S. § 15-1628, university faculty, academic professionals, and administrative officers have the option to participate in defined contribution pension plans. These plans are administered by independent insurance and annuity companies approved by the Arizona Board of Regents. For the year ended June 30, 2003, plans offered by the Teachers Insurance Annuity Association/College Retirement Equities Fund (TIAA/CREF), Variable Annuity Life Insurance Company (VALIC), Fidelity Investments Tax-Exempt Service Company (Fidelity), Aetna Life Insurance and Annuity Company (Aetna), and Vanguard Group (Vanguard) were approved by the board. Benefits under these plans depend solely on the contributed amounts and the returns earned on investments of those contributions.



Contributions made by members vest immediately, and university contributions vest after five years of benefit eligible employment. The distribution of member contributions and associated investment earnings are made in accordance with the member's contract with the applicable insurance and annuity company. University contributions and associated investment earnings must be distributed to the member in the form of an annuity paid over a period that is not less than the member's life. The Arizona State Legislature establishes and may amend active plan members' and the university's contribution rates. For the year ended June 30, 2003, plan members and the university were each required by statute to contribute an amount equal to 7 percent of a member's compensation.

Note 6—Risk Management

The university is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The university participates in a self-insurance program administered by the state of Arizona, Department of Administration, Risk Management Section. Arizona Revised Statutes §41-621 *et seq* provides that losses eligible for coverage and not covered by insurance will be paid by the state from the self-insurance program or by a future appropriation from the State Legislature. Loss risks not covered by Risk Management and where the university has no insurance coverage, are losses that arise from contractual breaches and are directly attributable to an act or omission, and determined to be a felony by a court of law. With this exception, the university has no significant risk of loss beyond

adjustments to future years' premium payments to the state's self-insurance program. All estimated losses for unsettled claims and actions of the state are determined on an actuarial basis and are included in the state of Arizona Comprehensive Annual Financial Report.

Contributions to Retirement Plans

for the year ended June 30, 2003, are summarized below.

Plan	University Contributions	Member Contributions	Total Contributions
TIAA/CREF	\$ 2,534,614	\$ 2,534,614	\$ 5,069,228
VALIC	\$ 569,515	\$ 569,515	\$ 1,139,030
Fidelity	\$ 523,672	\$ 523,672	\$ 1,047,344
Aetna	\$ 200,314	\$ 200,314	\$ 400,628
Vanguard	\$ 144,806	\$ 144,806	\$ 289,612

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

Note 7—Expense Classification

The university's operating expenses by natural and functional classification are summarized in the table below:

For the Year Ended June 30, 2003 • Natural Classification

Functional Classification:	Personal Service and Benefits	Operations	Scholarships	Depreciation	Total
Instruction	\$ 78,318,757	\$ 11,965,835			\$ 90,284,592
Research	13,581,473	4,499,059			18,080,532
Public service	8,998,380	10,542,807			19,541,187
Academic support	15,312,124	4,310,191			19,622,315
Student services	13,540,400	3,770,514			17,310,914
Institutional support	21,628,262	6,758,043			28,386,305
Scholarships and fellowships			\$ 8,862,509		8,862,509
Operation and maintenance of plant	6,662,727	7,328,592			13,991,319
Depreciation				\$ 17,467,988	17,467,988
Auxiliary enterprises	11,076,825	18,930,192			30,007,017
Total	\$ 169,118,948	\$ 68,105,233	\$ 8,862,509	\$ 17,467,988	\$ 263,554,678

Note 8—Other Matters

Privatized Housing

The university has entered into a privatized arrangement with a separately incorporated nonprofit entity, the Northern Arizona Capital Facilities Finance Corporation (Corporation), for the purpose of building on-campus student housing. In conjunction with this arrangement, the non-profit entity, with the approval and assistance of the university, has obtained tax-exempt financing to construct a student housing facility. The university is not legally responsible for repayment of the tax-exempt debt, and there is no pledge or guarantee by the university for repayment of the debt. As the corporation is responsible for principal and interest payments on the bonded debt, no liability is reported on the university's financial statements. The housing facility was opened in the fall of 2002 and the daily operations of the facility are managed by the university. On June 30, 2003, there were \$15.4 million of bonds outstanding for this privatized arrangement. Upon final principal repayment of the financing, title to the student housing transfers to the university. This student housing is built on university property that is leased to the nonprofit entity for the term of the bond issue.

Subsequent Events

The university will be issuing approximately \$31.0 million of system revenue bonds in November 2003 for various capital projects and renovations on the main campus. These bonds are secured by a first lien on certain gross revenues and are on parity with the Series 1997 system revenue, 2002 system revenue, and 2002 system revenue refunding bonds.



