

UAH

The University of Alabama in Huntsville

FINANCIAL REPORT

2003

FINANCIAL REPORT 2002 – 2003



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**The University
of Alabama
in Huntsville**

*A System of Excellence
An Affirmative Action/Equal Opportunity Institution*

The University of Alabama in Huntsville

Management's Discussion and Analysis (Unaudited)

This section of The University of Alabama in Huntsville ("the University") annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended September 30, 2003. This discussion has been prepared by University management and should be read in conjunction with the financial statements and the related footnotes. The financial statements, footnotes and this discussion are the responsibility of University management.

Introduction

The University is a public research university that offers 60 degree-granting programs that meet the highest standards of excellence, including 30 bachelor's degree programs, 18 master's degree programs, and 12 Ph.D. programs through its five colleges: Administrative Science, Liberal Arts, Engineering, Nursing, and Science. The University is an autonomous campus within The University of Alabama System ("the System").

The University received \$52.7 million for externally funded projects during fiscal year 2003. Sponsors of research include federal and state agencies, academic institutions, industry and private foundations. Research is conducted within the individual colleges and through the University's 18 independent research centers, laboratories and institutes. Major interdisciplinary research thrusts include: optics; propulsion; space physics and astrophysics; earth system science; information technology; microgravity and materials; modeling and simulation; biotechnology; nanotechnology; and systems engineering.

Located at the southern edge of the Appalachian Mountains, Huntsville is a national center of aerospace and high technology research and development. It is home to the National Aeronautical and Space Administration's Marshall Space Flight Center, the U.S. Army Aviation and Missile Command, and the U.S. Army Space and Strategic Defense Command. The University is strategically located in Cummings Research Park, the second largest university research park in the United States and home to numerous high technology and research companies.

New Accounting Standards

In June 1999, the Governmental Accounting Standards Board (GASB) released 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 released Statement No.35, *Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities*, which applies the new reporting standards to public colleges and universities. The University adopted GASB Statement No. 37, *Basic Financial Statement*

– and Management's Discussion and Analysis – for State and Local Governments: Omnibus, and Statement No. 38, Certain Financial Statement Note Disclosures on October 1, 2001.

Significant changes to the financial statements are as follows:

- Financial statements are presented to focus on the University as a whole. Previously, financial statements focused on individual fund groups.
- The statement of net assets separates current from noncurrent assets and liabilities and classifies net assets into three categories: invested in capital, net of related debt; restricted (nonexpendable/expendable); and unrestricted.
- The statement of revenues, expenses, and changes in net assets distinguishes operating from nonoperating revenues and expenses. Certain significant revenues relied upon for fundamental operational support of the core instructional mission of the University, including state appropriations, private gifts and investment income, are mandated by GASB Statement No. 34 to be reported as nonoperating revenues. Previously, there was not a concept of operating income or loss, and state appropriations and investment income were appropriately matched with the associated expenses.
- The statement of cash flows distinguishes the University's cash flow activity into four categories: operating activities, noncapital financing activities, capital and related financing activities and investing activities. Previously, a cash flow statement was not required.
- Payments made directly to students continue to be classified as scholarship and fellowship expenses. All scholarships and fellowships were previously classified as expenses. Scholarship allowances applied to student accounts are now required to be presented as an offset to tuition and fees, and auxiliary revenue. Scholarship allowances applied to student accounts reduced both operating revenue and operating expense in the statement of revenues, expenses, and changes in net assets.

GASB Statement No.37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus, and Statement No.38, Certain Financial Statement Note Disclosures were also adopted by the University on October 1, 2001. Statement No.37 clarifies guidance to be used in preparing management's discussion and analysis and Statement No.38 modifies, adds and deletes various note disclosure requirements.

Financial and Enrollment Highlights

- Total net assets increased 8.1% primarily due to nonoperating capital projects funded by external sources and increases in tuition and investment income.
- Private gifts and federal funds supported \$4.8 million in capital projects. The University has been successful in obtaining external funding for a number of major capital projects, as follows:
 - ❖ A high bay facility was acquired through a gift purchase. This will significantly enhance the University's research and educational opportunities.
 - ❖ A 65,000 square foot building, Shelby King Hall, was also acquired through a gift purchase.
- Federal operating revenues increased by \$2.2 million, or 5.5% due primarily to additional NASA funding. External funding of \$52.7 million decreased 9.8% as compared to the prior year. In the prior year, the University received over \$9 million in non-recurring federal funds for a capital project, the National Space Science Technology Center Annex.
- Operating revenue increased 6.3% primarily due to increases in tuition revenues, externally funded contracts and grants activity and revenues generated from the operation of the new residence hall and the fitness center.
- Compared to prior year, full time equivalent students increased 6.3% and degrees conferred increased by 5.1%.

Equivalent Full-time Student Enrollment (FTE)

	1999	2000	2001	2002	2003
Undergraduate	3582	3600	3756	3894	4142
Graduate	724	722	714	805	855
Total	4306	4322	4470	4699	4997

FTE calculated using ACHE formula; Undergraduate credit hour production (chp)/15; graduate I chp/12; graduate II chp/9.

Historical Fall Headcount by Earned Hours

	1999	2000	2001	2002	2003
Graduates	1361	1343	1288	1447	1570
Seniors	1327	1251	1395	1335	1327
Juniors	933	985	1052	1034	1106
Sophomores	805	868	882	945	972
Freshmen	2065	1679	1309	1310	1484
Others	383	437	828	974	592
Total	6874	6563	6754	7045	7051

Degrees Conferred

	1999	2000	2001	2002	2003
Bachelor's	674	673	646	735	807
Master's	285	293	311	269	258
Doctorate	31	29	30	34	21
Certificate	19	11	12	11	17
Total	1009	1006	999	1049	1103

- Appropriations for operations of \$37.1 million were received in fiscal year 2003 from the State of Alabama, an increase of approximately \$524,000 or 1.4% from the previous fiscal year.

Statement of Net Assets

The statement of net assets presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The purpose of the statement of net assets is to present a fiscal snapshot of the University to the readers of the financial statements. The statement of net assets presents end-of-year data concerning assets (current and noncurrent), liabilities (current and noncurrent), and net assets (assets minus liabilities).

The statement of net assets provides a summary of assets available to continue the operations of the institution. The statement also shows how much the institution owes vendors, investors and lending institutions. Finally, the statement of net assets provides a picture of the net assets (assets minus liabilities) and the availability for expenditure by the institution.

Net assets are divided into three major categories. The first category, **invested in capital assets, net of related debt**, provides the institution's equity in property, plant and equipment owned by the institution. The next asset category is **restricted net assets**, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources, available for expenditure, is recorded as restricted nonexpendable. Restricted expendable restricted net assets are available for expenditure

by the institution but must be spent for purposes as determined by donors or external entities that have placed a purpose restriction on the use of the assets. The final category is **unrestricted net assets**, which are available to the institution for any lawful purpose of the institution. Many of the University's unrestricted net assets have been designated or reserved for specific purposes such as: repairs and replacement of equipment, capital projects, future debt service, quasi-endowments, insurance reserves, research centers and instructional departments.

A summarized comparison of the University's assets, liabilities and net assets:

Summary of Statements of Net Assets		
	<u>2003</u>	<u>2002</u>
Current assets	\$ 42,633,810	\$ 36,768,566
Noncurrent assets:		
Endowment, life income and other investments	30,096,379	28,012,633
Capital assets, net	119,715,871	115,635,545
Other	1,799,413	2,295,196
Total assets	194,245,473	182,711,940
Current liabilities	21,572,456	19,381,399
Noncurrent liabilities	48,621,057	48,624,203
Total liabilities	70,193,513	68,005,602
Net assets		
Invested in capital assets, net of related debt	71,489,473	68,814,746
Restricted	7,175,037	6,802,645
Unrestricted	45,387,450	39,088,947
Total net assets	\$ 124,051,960	\$ 114,706,338

The University's total net assets increased 8.1%. The University's investments in capital assets, net of related debt, increased \$2.7 million primarily due to acquisition of nonoperating capital projects funded by the federal government and private gifts. The increase in restricted net assets of \$372,392 reflects the increase in market value of investments held for endowment purposes. Unrestricted net assets increased \$6.3 million. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the University's unrestricted net assets have been designated for capital projects, as well as various academic and research programs and initiatives.

Capital Assets

At September 30, 2003, the University had approximately \$230.6 million invested in capital assets and accumulated depreciation of \$110.8 million. Depreciation charges for the current year totaled \$9.2 million compared to \$8.5 million in the prior year.

The following table summarizes the University's capital assets, net of accumulated depreciation, as of September 30:

Capital Assets, Net		
	<u>2003</u>	<u>2002</u>
Land	\$ 3,377,217	\$ 2,226,932
Land improvements and infrastructure, net	1,009,644	859,980
Buildings, net	98,501,835	95,779,512
Equipment, net	12,544,828	12,617,916
Library books, net	4,282,347	4,151,205
Total capital assets, net	\$ 119,715,871	\$ 115,635,545

Major capital expenditures during the year ended September 30, 2003, included the acquisition of Shelby King Hall building and high bay annex of Olin B. King Technology Hall. Funding for these projects was provided by a combination of private gifts and University resources.

Additional information about the University's capital assets is presented in Note 5 to the financial statements.

Bonds, Notes, and Capital Leases

The following table summarizes outstanding long-term debt by type:

Bonds, Notes, and Capital Leases		
	<u>2003</u>	<u>2002</u>
Bonds	\$ 49,836,000	\$ 49,421,000
Mortgages payable	40,237	44,071
Lease obligations	363,092	485,086
Total debt outstanding	\$ 50,239,329	\$ 49,950,157

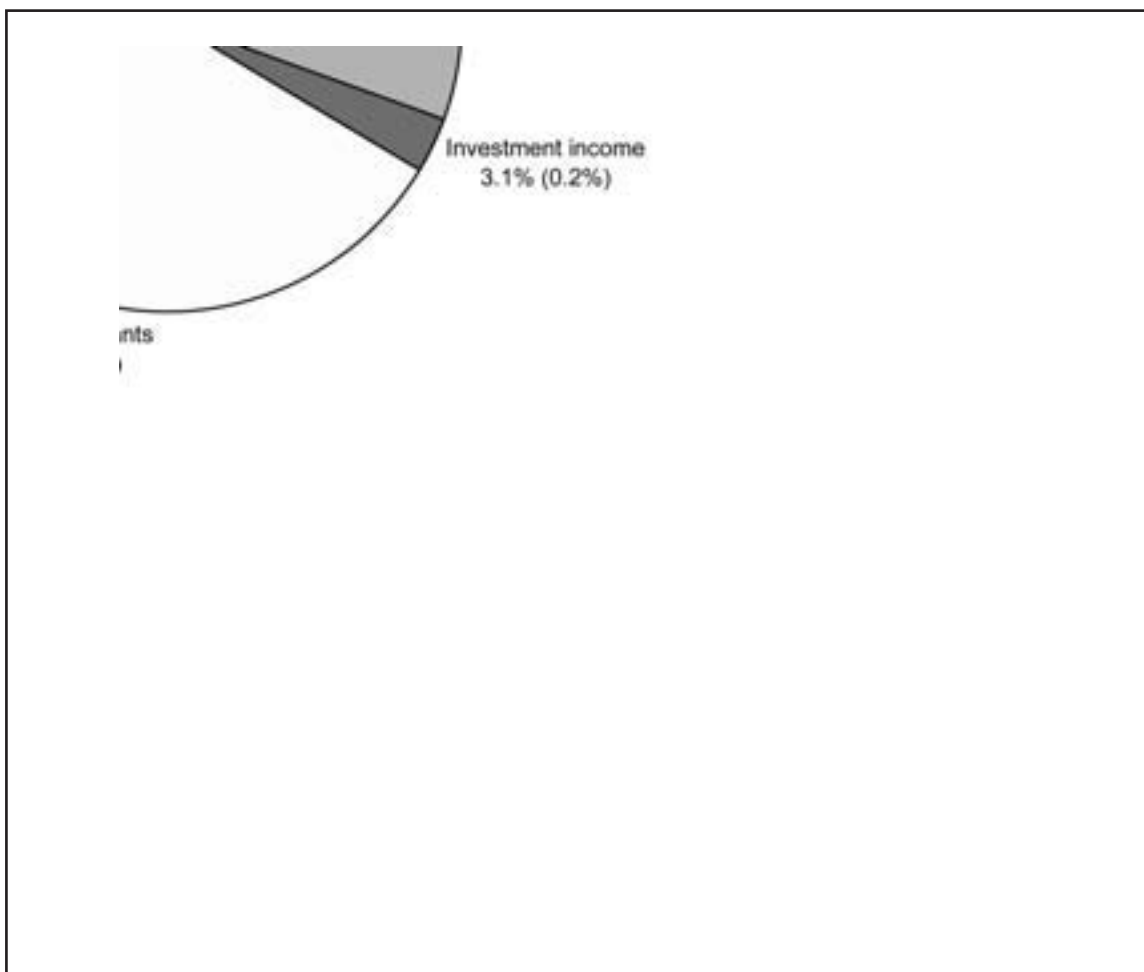
Principal and interest on these revenue bonds are collateralized by a pledge of revenues produced by student housing and student tuition and fees.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total net assets as presented on the statement of net assets are based on the activity presented in the statement of revenues, expenses, and changes in net assets, which presents the University's results of operations. The purpose of the statement is to present the revenues received by the University, both operating and nonoperating, and expenses paid by the University, operating and nonoperating, and any other revenues, expenses, gains and losses received or expended by the University. Annual state appropriations are considered nonoperating revenues according to generally accepted accounting principles, while the funds are used to support the operations of the University.

A summarized comparison of the University's revenues, expenses and changes in net assets is as follows:

Summary of Statements of Revenues, Expenses, and Changes in Net Assets		
	<u>2003</u>	<u>2002</u>
Operating revenues:		
Tuition and fees	\$ 28,161,025	\$ 25,169,513
Less: scholarship allowances	6,544,827	5,618,793
Tuition and fees, net	21,616,198	19,550,720
Federal, state and private grants and contracts	45,991,963	44,816,985
Sales and services of educational departments	2,686,355	2,521,637
Auxiliary, net	4,111,973	3,077,019
	74,406,489	69,966,361
Operating expenses	110,479,899	104,808,057
Operating loss	(36,073,410)	(34,841,696)
Nonoperating revenues (expenses):		
State appropriations	37,112,378	36,588,114
Private gifts	1,913,437	2,268,584
Net investment income	3,777,722	291,227
Loss on disposal of capital assets	(121,520)	(448,863)
Interest expense	(2,040,691)	(2,312,987)
Capital state appropriations	-	907,498
Capital gifts and grants	4,777,706	11,288,369
Net nonoperating revenues	45,419,032	48,581,942
Increase in net assets	9,345,622	13,740,246
Net assets, beginning of year	114,706,338	100,966,092
Net assets, end of year	\$ 124,051,960	\$ 114,706,338



The University receives grant and contract revenue from federal, state and local governments and private agencies. These funds are used to further the mission of the University: research, education, and public service. These funds were received in exchange for services performed and are recorded as operating revenues. The following is an illustration of the breakout of the funding sources for operating grant and contract revenue:

Detail of Federal Operating Revenue		
	<u>2003</u>	<u>2002</u>
National Aeronautics and Space Administration	\$ 21,460,686	\$ 19,620,863
Department of Defense	8,522,842	9,325,349
National Science Foundation	3,387,666	3,925,690
Department of Education	4,449,251	3,549,894
Other	4,771,733	3,968,675
Total	\$ 42,592,178	\$ 40,390,471

The following is a comparison of the University's operating expenses:

Operating expenses (by functional classification)		
	<u>2003</u>	<u>2002</u>
Instruction	\$ 31,487,061	\$ 31,218,288
Research	36,256,240	35,142,193
Public service	2,614,994	1,441,379
Academic support	4,224,330	4,030,532
Student services	7,379,666	6,221,870
Institutional support	9,052,078	8,825,261
Operations and maintenance of plant	6,650,125	6,441,468
Scholarships and fellowships	645,259	730,533
Auxiliary enterprises	2,939,869	2,235,883
Depreciation	9,230,277	8,520,650
Total operating expenses	\$ 110,479,899	\$ 104,808,057
Operating expenses (by natural classification)		
Compensation and benefits	\$ 74,400,579	\$ 67,168,614
Supplies and services	26,203,784	28,388,260
Depreciation	9,230,277	8,520,650
Scholarships and fellowships	645,259	730,533
Total operating expenses	\$ 110,479,899	\$ 104,808,057

Economic Factors That Will Affect the Future

The University's state appropriations have not kept pace with the amounts recommended by the Alabama Commission on Higher Education (ACHE). The University is currently funded at about 59% of the ACHE funding recommendation. The current economic projections for the State of Alabama indicate that shortfalls in tax collections that support higher education will continue without tax reform.

The University continues to attract federal grant and contract revenue. Over 70% of the University's federal research revenue comes from two agencies: the National Aeronautical and Space Administration and the Department of Defense. The outcome of the federal budget process has important ramifications for the University's research budget.

The University's achievement in recent years in obtaining private and federal support is a testament to the high regard in which the University is held. The level of support underscores the continued confidence among donors and grantors in the quality of the University's programs and the importance of its mission.

The University must have a balanced array of many categories of facilities to meet its education, research and public service goals and continues to assess its long-term capital requirements. Support for the University's recent capital expenditures has been provided primarily from federal funds, bond issues repaid through student rental and facility fees, and gifts.



To the Board of Trustees of The University of Alabama
and the President of The University of Alabama in Huntsville:

We have audited the accompanying statement of net assets of the business-type activities of The University of Alabama in Huntsville (UAH), one of the campuses of The University of Alabama System which is a component unit of the State of Alabama, and the related statements of revenues, expenses, and changes in net assets and cash flows as of and for the year ended September 30, 2003. These basic financial statements are the responsibility of UAH's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The financial statements of UAH as of and for the year ended September 30, 2002 were audited by other auditors. Those auditors expressed an unqualified opinion in their report dated November 21, 2002, except for note 6 as to which the date was December 19, 2002.

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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements of UAH are intended to present the financial position, changes in financial position, and the cash flows of only that portion of the business-type activities of the financial reporting entity of the University of Alabama System that is attributable to the transactions of UAH. They do not purport to and do not present fairly the financial position of the University of Alabama System as of September 30, 2003 and the changes in financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of UAH as of September 30, 2003, and the respective changes in its financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 21, 2003, on our consideration of UAH's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by 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.

KPMG LLP

November 21, 2003

THE UNIVERSITY OF ALABAMA IN HUNTSVILLE
STATEMENTS OF NET ASSETS
September, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Assets		
Current Assets:		
Cash and cash equivalents	\$ 15,143,060	\$ 12,045,120
Operating investments	14,649,093	9,997,669
Accounts receivable, net	9,259,692	11,627,074
Other current assets	3,581,965	3,098,703
Total current assets	<u>42,633,810</u>	<u>36,768,566</u>
Noncurrent Assets:		
Restricted cash and cash equivalents	602,646	1,358,058
Endowment investments	3,456,836	3,099,598
Investments for capital activities	26,036,897	23,554,977
Capital assets, net	119,715,871	115,635,545
Other noncurrent assets	1,799,413	2,295,196
Total noncurrent assets	<u>151,611,663</u>	<u>145,943,374</u>
Total Assets	<u>\$ 194,245,473</u>	<u>\$ 182,711,940</u>
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable and accrued liabilities	\$ 7,760,487	\$ 8,728,226
Deferred revenues	11,832,449	9,043,212
Current portion of long-term debt	1,618,272	1,325,954
Deposits held for others	361,248	284,007
Total current liabilities	<u>21,572,456</u>	<u>19,381,399</u>
Noncurrent Liabilities:		
Long-term debt	48,621,057	48,624,203
Total noncurrent liabilities	<u>48,621,057</u>	<u>48,624,203</u>
Total Liabilities	<u>70,193,513</u>	<u>68,005,602</u>
Net Assets:		
Invested in capital assets, net of related debt	71,489,473	68,814,746
Restricted:		
Nonexpendable	1,762,703	1,765,500
Expendable	5,412,334	5,037,145
Unrestricted	45,387,450	39,088,947
Total Net Assets	<u>124,051,960</u>	<u>114,706,338</u>
Total Liabilities and Net Assets	<u>\$ 194,245,473</u>	<u>\$ 182,711,940</u>

See accompanying notes to financial statements.

THE UNIVERSITY OF ALABAMA IN HUNTSVILLE
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Operating Revenues		
Tuition and fees	\$ 28,161,025	\$ 25,169,513
Less: scholarship allowances	(6,544,827)	(5,618,793)
Tuition and fees, net	<u>21,616,198</u>	<u>19,550,720</u>
Grants and contracts		
Federal	42,592,178	40,390,471
State	971,415	749,705
Private	2,428,370	3,676,809
Sales and services of educational departments	2,686,355	2,521,637
Auxiliary, net of \$295,868 in 2003 and \$263,207 in 2002 of scholarship allowances	<u>4,111,973</u>	<u>3,077,019</u>
Total Operating Revenues	<u>74,406,489</u>	<u>69,966,361</u>
Operating Expenses		
Compensation and benefits	74,400,579	67,168,614
Supplies and services	26,203,784	28,388,260
Depreciation	9,230,277	8,520,650
Scholarships and fellowships	<u>645,259</u>	<u>730,533</u>
Total Operating Expenses	<u>110,479,899</u>	<u>104,808,057</u>
Operating loss	(36,073,410)	(34,841,696)
Nonoperating Revenues (Expenses)		
State appropriations	37,112,378	36,588,114
Private gifts	1,913,437	2,268,584
Net investment income	3,777,722	291,227
Loss on disposal of capital assets	(121,520)	(448,863)
Interest expense	<u>(2,040,691)</u>	<u>(2,312,987)</u>
Net Nonoperating Revenues	<u>40,641,326</u>	<u>36,386,075</u>
Capital state appropriations	-	907,498
Capital gifts and grants	<u>4,777,706</u>	<u>11,288,369</u>
	<u>45,419,032</u>	<u>48,581,942</u>
Increase in net assets	9,345,622	13,740,246
Net Assets, Beginning of Year	<u>114,706,338</u>	<u>100,966,092</u>
Net Assets, End of Year	<u>\$ 124,051,960</u>	<u>\$ 114,706,338</u>

See accompanying notes to financial statements

THE UNIVERSITY OF ALABAMA IN HUNTSVILLE
STATEMENT OF CASH FLOWS
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash Flows from Operating Activities		
Student tuition and fees	\$ 23,377,659	\$ 20,402,477
Federal grants and contracts	45,352,248	40,112,918
State grants and contracts	1,026,636	738,357
Private grants and contracts	2,566,414	3,621,155
Sales and services of educational and other departmental activities	2,671,506	2,494,752
Auxiliary enterprises	4,311,388	3,290,928
Payments to suppliers	(26,072,616)	(28,956,260)
Payments to employees and related fringes	(74,447,795)	(66,608,920)
Payments for scholarships and fellowships	(1,111,138)	(638,582)
Other receipts, net	-	31,548
Net Cash Used in Operating Activities	<u>(22,325,698)</u>	<u>(25,511,627)</u>
Cash Flows from Investing Activities		
Interest and dividends on investments, net	3,777,722	1,442,394
Proceeds from sales and maturities of investments	7,487,986	6,436,121
Purchase of investments	(14,978,568)	(23,477,308)
Net Cash Used in Investing Activities	<u>(3,712,860)</u>	<u>(15,598,793)</u>
Cash Flows from Capital and Related Financing Activities		
Proceeds from issuance of bonds	21,548,230	8,601,659
Principal refinanced	(20,500,000)	-
Bond issuance cost	(1,048,230)	(385,657)
State capital appropriations	-	907,498
Capital gifts, grants and contracts	3,143,361	9,978,808
Purchase of capital assets	(10,034,271)	(24,601,895)
Principal payments on capital debt	(1,325,673)	(1,140,062)
Interest payments on capital debt	(2,171,254)	(2,120,220)
Net Cash Used in Capital and Related Financing Activities	<u>(10,387,837)</u>	<u>(8,759,869)</u>
Cash Flows from Noncapital Financing Activities		
State educational appropriations	37,112,378	36,588,114
Private gifts	1,913,437	2,268,584
Student direct lending receipts	12,352,405	11,324,798
Student direct lending disbursements	(12,686,538)	(11,324,798)
Amounts received from affiliates	296,158	92,367
Amounts paid to affiliates	(218,917)	(66,232)
Net Cash Provided by Noncapital Financing Activities	<u>38,768,923</u>	<u>38,882,833</u>
Net increase (decrease) in cash and cash equivalents	2,342,528	(10,987,456)
Cash and Cash Equivalents, Beginning of Year	13,403,178	24,390,634
Cash and Cash Equivalents, End of Year	<u>\$ 15,745,706</u>	<u>\$ 13,403,178</u>

See accompanying notes to financial statements

THE UNIVERSITY OF ALABAMA IN HUNTSVILLE
STATEMENT OF CASH FLOWS -- Continued
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	\$ (36,073,410)	\$ (34,841,696)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	9,230,277	8,520,650
Changes in allowance for doubtful accounts	(69,865)	58,010
Changes in assets and liabilities:		
Accounts receivable, net	2,179,990	(748,812)
Other current assets	(465,879)	144,879
Accounts payable and accrued liabilities	83,952	(61,234)
Deferred revenues	2,789,237	1,416,576
Net Cash Used in Operating Activities	<u><u>\$ (22,325,698)</u></u>	<u><u>\$ (25,511,627)</u></u>
Supplemental Noncash Activities Information		
Loss on disposal of capital assets	\$ 121,520	\$ 448,863
Gift of capital assets	4,374,968	213,000
Capital assets acquired with a liability at year end	72,697	1,049,812

See accompanying notes to financial statements

THE UNIVERSITY OF ALABAMA IN HUNTSVILLE
Notes to Financial Statements
Year Ended September 30, 2003

Note 1 – Organization and Summary of Significant Accounting Policies

Financial Reporting Entity - The University of Alabama in Huntsville (the University) is one of three campuses of The University of Alabama System (the System), which is a discretely presented component unit of the State of Alabama. The financial statements of UAH are intended to present the financial position, changes in financial position, and the cash flows of only that portion of the business type activities of the financial reporting entity of The University of Alabama System that is attributable to the transactions of UAH. The financial statements include individual schools, colleges and departments, and certain affiliated operations determined to be a part of the University's financial reporting entity.

Scope of Statements - The University is affiliated with the University of Alabama Huntsville Foundation (UAHF) and the Eminent Scholar Foundation. The University is not financially accountable for these organizations; therefore, they do not constitute component units under the provisions of Government Accounting Standards Board (GASB) Statement No.14, *The Financial Reporting Entity*.

UAHF was organized exclusively for charitable, scientific, and educational purposes in order to benefit the University. It is governed by a 32 member Board of Trustees and is not subject to direct control of the University. UAHF made distributions in support of the University, which totaled approximately \$2,500,000 in 2003 and \$3,900,000 in 2002. Total assets were approximately \$29,730,000 at September 30, 2003 (unaudited), compared to \$27,500,000 in 2002. Total liabilities were approximately \$520,000 at September 30, 2003 (unaudited), compared to \$1,800,000 in 2002. Total net assets were approximately \$29,210,000 at September 30, 2003 (unaudited), compared to \$25,700,000 in 2002.

The **Eminent Scholar Foundation's** purpose is to operate exclusively for the benefit of the University. It has 5 board members. Total assets and net assets were approximately \$2,420,000 at September 30, 2003 (unaudited), compared to \$2,200,000 in 2002. The foundation did not have any liabilities at September 30, 2003 and 2002.

Basis of Accounting: For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities as defined by GASB Statement No. 35. Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods or services. Accordingly, the financial statements of the University have been prepared in accordance with generally accepted accounting principles, including all applicable effective statements of the GASB and all statements of the Financial Accounting Standards Board through November 30, 1989,

using the economic 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.

GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*, an amendment of Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, was adopted by the University on October 1, 2001. Statement No. 35 established a fundamentally new financial reporting model for all public colleges and universities. Financial reporting requirements include a management’s discussion and analysis; basic financial statements consisting of a statement of net assets, a statement of revenues, expenses and changes in net assets and a statement of cash flows; and notes to the financial statements.

Statement No. 35 requires the recording of depreciation on capital assets, accrual or deferral of revenue associated with certain grants and contracts, accrual of interest expense, accounting for certain scholarship allowances as a reduction of revenue, classification of federal refundable loans as a liability, and capitalization and depreciation of equipment with a sponsor reversionary interest.

GASB Statement No. 37, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus*, and Statement No. 38, *Certain Financial Statement Note Disclosures* were also adopted by the University on October 1, 2001. Statement No. 37 clarifies guidance to be used in preparing management’s discussion and analysis and Statement No. 38 modifies, adds and deletes various note disclosure requirements.

Net Assets – GASB Statement No. 35 reports equity as “Net Assets” rather than “Fund Balance.” Net assets are classified into the following four categories according to external donor restrictions or availability of assets for satisfaction of University obligations:

- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.
- **Restricted:**

Nonexpendable – Net assets subject to externally imposed stipulations that they be maintained permanently by the University. Such assets include the corpus of the University’s permanent endowment funds.

Expendable – Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.

- **Unrestricted:** Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic, research, and capital programs.

Cash and Cash Equivalents: For purposes of the statement of cash flows, the University considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash equivalents representing assets of the University's endowment, life income, and other long-term investments are included in the noncurrent investments category.

Investments: Investments are reported at fair value. Investment income, including changes in the fair value of investments, is reported as revenue (expenses) in the statement of revenues, expenses, and changes in net assets.

Accounts Receivable: Accounts receivable consist primarily of tuition and fees charged to students and amounts due from the federal government, state and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's contracts and grants. Accounts receivable are recorded net of estimated uncollectible amounts.

Capital Assets: Capital assets are recorded at cost at the date of acquisition, or fair value at date of donation in the case of gifts, less accumulated depreciation. For equipment, the University's capitalization policy includes all items with a unit cost of \$2,000 or more and an estimated useful life of greater than one year. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred.

Capital assets acquired through federal grants and contracts where the federal government retains a reversionary interest are capitalized and depreciated. Interest costs, net of any related investment earnings, for certain assets acquired with the proceeds of tax-exempt borrowings are capitalized as a component of the cost of acquiring those assets.

Depreciation of buildings and building improvements (5-50 years), land improvements and infrastructure (10 years), library collection (10 years), and inventoried equipment (5-8 years) is computed on a straight-line basis. The University computes depreciation for certain buildings and building improvements using a componentized method.

Deferred Revenues: Deferred revenues consist primarily of amounts received for fall student tuition and fees that are not earned until the next fiscal year. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

Revenues: The University's policy for defining operating activities as reported on the statement of revenues, expenses, and changes in net assets are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Nearly all of the University's revenues are from exchange transactions. Certain significant revenue streams relied upon for operations are recorded as nonoperating revenues, as defined by GASB Statement No. 35, including state appropriations, gifts and investment income.

Auxiliary enterprise revenues are primarily generated by University Housing.

Revenues received for capital activities are considered neither operating nor nonoperating activities, and are presented after nonoperating activities on the accompanying statement of revenues, expenses, and changes in net assets.

Scholarship Allowances and Student Aid: Scholarship allowances applied to student accounts are recorded as an offset to student tuition and fees and auxiliary revenue. Payments of financial aid made directly to students continue to be classified as scholarship and fellowship expenses. Scholarship allowances applied to student accounts reduced both operating revenue and operating expense in the statement of revenues, expenses, and changes in net assets.

Internal Sales Activities: All internal sales activities to the university departments from sales and service units (motor pool, postal services, telecommunications, etc.) have been eliminated in the accompanying financial statements.

Compensated Absences: The University accrues annual leave for employees at rates based upon length of service and job classification and compensatory time based upon job classification and years worked.

Endowment Spending: For donor restricted endowments, the Uniform Management of Institutional Funds Act, as adopted in Alabama, permits The Board of Trustees of the University of Alabama (the Board) to appropriate an amount of realized and unrealized endowment appreciation as the Board determines to be prudent. The University's policy is to retain the endowment realized and unrealized appreciation within the endowment after the spending rate distributions. The Board approved a spending rate for the fiscal years ended September 30, 2003 and 2002 of 5.0% of a moving three-year average of the market (unit) value.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Income Tax Status: The University has a tax determination letter from the Internal Revenue Service stating that the University qualifies under the provisions of Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes.

Note 2 – Cash

The Board approves, by resolution, all banks or other financial institutions utilized as depositories for University funds. Prior to approval, each proposed depository must provide evidence of its designation by the Alabama State Treasurer as a qualified public depository under the Security of Alabama Funds Enhancement Act (SAFE). From time to time, the Board may request that the depository provide evidence of its continuing designation as a qualified public depository. The enactment of the SAFE program changed the way all Alabama public deposits are collateralized. In the past, the bank pledged collateral directly to each individual public entity. Under the mandatory SAFE program, each qualified public depository (QPD) is required to hold collateral for all its public depositories on a pooled basis in a custody account established for the State Treasurer as SAFE administrator. In the unlikely event a public entity should suffer a deposit loss due to QPD insolvency or default, a claim form would be filed with the State Treasurer who would use the SAFE pool collateral or other means to reimburse the loss.

As of September 30, 2003 and 2002, the University had cash and cash equivalents totaling \$15,745,706 and \$13,403,178, respectively. Included in the amounts are deposits with trustees held for reserves, which totaled \$602,646 in 2003 and \$1,358,058 in 2002.

Note 3 – Investments

The University invests its endowment funds in accordance with applicable limitations set forth in gift instruments, Board guidelines, or applicable laws. Also certain bond indentures require the University to invest the amounts held in specific construction funds, redemption funds, and bond funds in federal securities, eligible certificates, or eligible investments.

At September 30, 2003 and 2002, the University's investments included custodial credit risk category I investments (investments that are insured or registered, or securities held by the University or its agent in the University's name) and other investments not categorized by risk category as follows:

	<u>2003</u>	<u>2002</u>
Category I:		
Time deposits	\$ 123,123	\$ 121,864
U.S. Treasury and agency obligations	45,113	25,247
Money market	5,354	28,016
Not categorized:		
Mutual funds	7,500,820	7,408,887
System Intermediate Fund	15,620,484	14,926,508
System Prime Investment Fund	17,391,096	11,095,386
Pooled Endowment Fund	3,456,836	3,046,336
Total Investments	<u>\$ 44,142,826</u>	<u>\$ 36,652,244</u>

Certain endowment and similar funds are invested and administered in a common investment pool (Pooled Endowment Fund) established by the Board. At September 30, 2003 and 2002, respectively, the combined investment pool had total investments of approximately \$580,585,000 and \$485,695,000 at fair value, and approximately \$623,912,000 and \$618,089,000 at cost. Assets of the investment pool are pooled on a fair value basis and consist of cash, U.S. Treasury and agency obligations, corporate debt securities, corporate equity securities, mutual funds, and real estate funds. The average annual yields for the fiscal years ended September 30, 2003 and 2002, respectively, excluding gains and losses, on pooled investments amounted to 2.45% and 2.83% of total investments at fair value, or 2.11% and 2.38% of total investments at cost. The average annual yield for the fiscal years ended September 30, 2003 and 2002, respectively, including gains and losses, on pooled investments amounted to 18.74% and -9.79% of total investments at fair value, or 16.12% and -8.21% of total investments at cost. The System report contains further disclosure regarding this common investment pool.

In July 1998, the Board established the Prime Investment Fund, a common investment pool through which the three campuses of the System can invest certain operating funds that are associated primarily with long-term expenses. At September 30, 2003 and 2002, respectively, the combined investment pool had total investments of approximately \$456,144,000 and \$387,063,000 at fair value, and approximately \$449,952,000 and \$443,687,000 at cost. Assets of the Prime Investment Fund are pooled on a fair value basis and consist of U.S. Treasury and agency obligations, corporate debt securities, corporate equity securities, and money market funds. The average annual yield for the fiscal years ended September 30, 2003 and 2002, respectively, excluding gains and losses, on pooled investments amount to 2.75% and 2.94% of the total investments at fair value, or 2.60% and 2.60% of the total investments at cost. The average annual yield for the fiscal years ended September 30, 2003 and 2002, respectively, including gains and losses, on pooled investments amounted to 17.00% and -8.69% at fair value, or 16.07% and -7.67% of the total investments at cost.

In September 2001, the Board established the Intermediate Fund, a common fixed income investment pool through which the three campuses of the System can invest certain operating funds that are associated with anticipated expenses in the two to four year time

frame. At September 30, 2003 and 2002, respectively, the combined investment pool had total investments of approximately \$349,272,000 and \$311,993,000 at fair value, and approximately \$340,563,000 and \$301,476,000 at cost. Assets of the Intermediate Fund are pooled on a fair value basis and consist of U.S. Treasury and agency obligations, corporate debt securities, and money market funds. The average annual yield for the fiscal years ended September 30, 2003 and 2002, respectively, excluding gains and losses, on pooled investments amounts to 4.78% and 5.23% of total investments at fair value, or 4.92% and 5.33% of the total investments at cost. The average annual yield for the fiscal years ended September 30, 2003 and 2002, including gains and losses, on pooled investments amounts to 4.97% and 8.80% of the total investments at fair value, or 5.10% and 8.96% of the total investments at cost.

Note 4 – Accounts Receivable

The composition of accounts receivable is summarized as follows:

	<u>2003</u>	<u>2002</u>
Tuition and fees (net of allowance for doubtful accounts of \$314,945 in 2003 and \$368,306 in 2002)	\$ 2,284,102	\$ 2,037,850
Auxiliary enterprises and other operating activities	50,203	59,023
Federal, state, and private grants and contracts (net of allowance for doubtful accounts of \$237,052 in 2003 and \$253,556 in 2002)	6,881,683	9,513,154
Other	43,704	17,047
Net accounts receivable	<u>\$ 9,259,692</u>	<u>\$ 11,627,074</u>

Note 5 – Capital Assets

Capital assets activity for the years ended September 30, 2003 and 2002 is summarized as follows:

	October 1, 2002	Additions	Retirements	September 30, 2003
Land	\$ 2,226,932	\$ 1,150,285	\$ -	\$ 3,377,217
Land improvements and infrastructure	4,342,795	364,276	-	4,707,071
Buildings and building improvements	145,935,517	7,357,043	-	153,292,560
Equipment	46,927,871	3,498,862	(2,157,116)	48,269,617
Equipment under capital lease	745,040	-	-	745,040
Library books	19,099,451	1,061,658	-	20,161,109
Total cost of capital assets	219,277,606	13,432,124	(2,157,116)	230,552,614
Less accumulated depreciation	103,642,061	9,230,278	(2,035,596)	110,836,743
Capital assets - net	\$ 115,635,545	\$ 4,201,846	\$ (121,520)	\$ 119,715,871

	October 1, 2001	Additions	Retirements	September 30, 2002
Land	\$ 2,176,036	\$ 50,896	\$ -	\$ 2,226,932
Land improvements and infrastructure	4,389,548	98,656	(145,409)	4,342,795
Buildings and buildings improvements	126,511,874	19,423,643	-	145,935,517
Equipment	44,283,270	5,341,650	(2,697,049)	46,927,871
Equipment under capital lease	745,040	-	-	745,040
Library books	18,198,794	900,657	-	19,099,451
Total cost of capital assets	196,304,562	25,815,502	(2,842,458)	219,277,606
Less accumulated depreciation	96,264,395	8,520,650	(1,142,984)	103,642,061
Capital assets - net	\$ 100,040,167	\$ 17,294,852	\$ (1,699,474)	\$ 115,635,545

Note 6 – Long-term Debt

Long-term debt activity for the years ended September 30, 2003 and 2002 is summarized as follows:

Type/Supported by	October 1, 2002	New Debt, net	Principal Repayment	September 30, 2003
Bonds:				
Student housing revenue	\$ 20,321,000	\$ -	\$ 670,000	\$ 19,651,000
General fee revenue	29,100,000	1,335,000	250,000	30,185,000
Mortgage payable	44,071	-	3,834	40,237
Lease obligations	485,086	-	121,994	363,092
Total debts	<u>49,950,157</u>	<u>\$ 1,335,000</u>	<u>\$ 1,045,828</u>	<u>50,239,329</u>
Less current portion	<u>1,325,954</u>			<u>1,618,272</u>
Total long-term debt	<u>\$ 48,624,203</u>			<u>\$ 48,621,057</u>

Type/Supported by	October 1, 2001	New Debt	Principal Repayment	September 30, 2002
Bonds:				
Student housing revenue	\$ 11,466,000	\$ 9,370,000	\$ 515,000	\$ 20,321,000
General fee revenue	29,575,000	-	475,000	29,100,000
Mortgage payable	50,851	-	6,780	44,071
Lease obligations	628,368	-	143,282	485,086
	<u>41,720,219</u>	<u>\$ 9,370,000</u>	<u>\$ 1,140,062</u>	<u>49,950,157</u>
Less current portion	<u>1,140,049</u>			<u>1,325,954</u>
Total long-term debt	<u>\$ 40,580,170</u>			<u>\$ 48,624,203</u>

During the year ended September 30, 2003, new debt was acquired from refinancing bonds that lowered interest rate and avoided future balloon payments. Principal and interest on these revenue bonds are collateralized by a pledge of revenues produced by student housing and student tuition and fees. Debt obligations bear interest at fixed and variable rates ranging from 1.40% to 6%, and mature at various dates through fiscal year 2032.

Maturities and interest on long-term debt, including obligations under capital leases, for the next five years and in subsequent five-year periods are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 1,618,272	\$ 2,316,932	\$ 3,935,204
2005	1,713,518	2,256,996	3,970,514
2006	1,562,099	2,197,086	3,759,185
2007	1,627,284	2,138,274	3,765,558
2008	1,692,485	2,073,672	3,766,157
2009 - 2013	9,631,145	9,218,673	18,849,818
2014 - 2018	10,418,526	6,983,242	17,401,768
2019 - 2023	9,846,000	4,651,276	14,497,276
2024 - 2028	9,925,000	2,008,996	11,933,996
2029 - 2032	2,205,000	239,006	2,444,006
	<u>\$ 50,239,329</u>	<u>\$ 34,084,153</u>	<u>\$ 84,323,482</u>

The following is a detailed schedule of long-term debt:

<u>Description and Purpose</u>	<u>Date Issued</u>	<u>Final Maturity</u>	<u>Interest Rate - %</u>	<u>Original Indebtedness</u>	<u>Outstanding Indebtedness September 30 2003</u>	<u>Outstanding Indebtedness September 30 2002</u>
Bonds Payable:						
Dormitory revenue bonds of 1980	5/1/1980	5/1/2020	3.00	\$ 2,180,000	\$ 1,275,000	\$ 1,330,000
Dormitory revenue bonds of 1981	7/23/1982	5/1/2021	3.00	2,602,000	1,556,000	1,621,000
Student housing revenue bonds Series 1994-A	1/15/1994	6/1/2016	2.50 - 5.00	10,790,000	7,585,000	8,000,000
Revenue bonds-series 1999-A	12/1/1999	12/1/2024	5.10 - 6.00	8,900,000	8,330,000	8,530,000
Student housing revenue bonds Series 2001	12/27/2001	12/1/2031	3.00 - 5.30	9,370,000	9,235,000	9,370,000
Revenue Bonds-Series 1992-A	7/1/1992	12/19/2002	5.55 - 6.00	6,260,000	-	3,950,000
Revenue Bonds-Series 1993-A	5/1/1993	2/3/2003	5.50	16,620,000	-	16,620,000
Revenue Bonds-Series 2002-A	12/19/2002	9/30/2027	1.40 - 4.75	3,965,000	3,965,000	-
Revenue Bonds-Series 2003-A	2/3/2003	9/30/2027	1.45 - 4.70	17,890,000	17,890,000	-
Total Bonds Payable				78,577,000	49,836,000	49,421,000
Mortgage Payable:						
714 Erskine Street property	2/29/1980	5/1/2003	7.00	25,064	-	1,069
713 Erskine Street property	1/30/1990	10/30/2016	8.50	54,027	40,237	41,865
709 Tatom Street Property	10/1/1992	8/1/2003	7.00	11,312	-	1,137
Total Mortgage Payable				90,403	40,237	44,071
Lease Obligations Payable:						
Telephone system	8/10/2000	9/1/2005	6.00	745,040	363,092	485,086
Total Lease Obligations Payable				745,040	363,092	485,086
Total Debt				\$ 79,412,443	\$ 50,239,329	\$ 49,950,157

Note 7 – Self-Insurance

The University participates with other campuses in the System in a self-insurance program for general liability risks. The Board established a separate revocable trust fund for payment of these self-insurance claims under its risk retention program. Annual contributions are made to the trust fund, at an actuarially determined rate, to provide funding for the retained risk. The accompanying statement of net assets includes a reserve of \$254,291 and \$54,116 for general liability at September 30, 2003 and 2002, respectively.

The University also maintains a self-insurance health plan. The University pays Blue Cross/Blue Shield of Alabama a monthly administrative charge in the amount of 6.5% of the claim costs actually paid in the previous month. The accompanying statement of net assets includes a self-insurance reserve of \$547,910 and \$925,545 for health insurance at September 30, 2003 and 2002, respectively. Annual contributions are made to the health plan, utilizing an actuarially determined rate, to provide funding for the reserve.

The changes in the total reported self-insurance liabilities are summarized as follows:

	<u>2003</u>	<u>2002</u>
Balance, beginning of year	\$ 979,661	\$ 1,318,442
Claims paid	(3,768,444)	(3,157,349)
Contributions	3,590,984	2,818,568
Balance, end of year	<u>\$ 802,201</u>	<u>\$ 979,661</u>

Note 8 – Retirement Plan

Most employees of the University participate in the Teachers' Retirement System of Alabama (TRS), a cost sharing, multiple-employer public retirement system. In addition, certain employees meeting eligibility requirements participate in an optional program with the Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA - CREF). TRS is a defined benefit plan while the TIAA - CREF programs are defined contribution plans.

Participants in TRS who retire at age 60 with 10 years of credited service, or after completing 25 years of credited service, regardless of age, are entitled to an annual benefit, payable monthly for life. Service retirement benefits are calculated by three methods with the participants receiving payments under the method which yields the highest monthly benefit. These methods include (1) minimum guaranteed, (2) money purchase, or (3) formula. Under the formula method, participants are allowed 2.0125% of their final average salary (average of three highest years of annual compensation

during the last ten years of service) for each year of service. A participant terminating before reaching retirement age, but after completing 10 years of credited service, is eligible for a vested allowance at age 60 provided accumulated employee contributions are not withdrawn. TRS also provides death and disability benefits.

Covered employees are required by law to contribute to TRS. All regular employees of the University are members of TRS with the exception of temporary employees. The following is a comparative of contribution requirements:

	2003	2002	2001
University contributions	\$2,635,611	\$2,928,956	\$2,968,450
Employee contributions	2,625,111	2,457,178	2,326,371
Total contributions	<u>\$5,260,722</u>	<u>\$5,386,134</u>	<u>\$5,294,821</u>
University contribution rate	5.02%	5.96%	6.38%
Employee contribution rate	5.00%	5.00%	5.00%

The actuarial accrued liability (AAL), which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The actuarial value of assets, which is the actuarial present value of assets, is a standardized disclosure measure of the present value of accumulated assets, adjusted for projected investment performance and contributions. TRS does not make separate measurements of assets and the AAL for individual employers. The AAL at June 30, 2002 (the most recent valuation date) and 2001 for TRS as a whole, determined through actuarial valuations performed as of that date, were approximately \$18,374,174,000 and \$16,291,462,000, respectively. The actuarial valuations of assets at June 30, 2002 and 2001, were approximately \$17,904,881,000 and \$16,703,929,000, respectively, resulting in an underfunded AAL of \$469,293,000 for fiscal year 2002, and an overfunded AAL of \$236,682,000 for fiscal year 2001. Complete financial presentation and disclosure of the financial position and activities of the TRS is presented in the September 30, 2002 annual financial report of the TRS. That report is publicly available and may be attained by contacting TRS.

As previously noted, some employees participate in the optional TIAA-CREF programs, which are defined contribution plans. In defined contribution plans, benefits depend solely on amounts contributed plus investment earnings. All full time regular monthly exempt employees are eligible to participate from the date of employment. The University contributes a matching amount up to 5% of total salaries for participating employees. The University's contribution is funded as it accrues and, along with that of employees, is immediately and fully vested. The contribution for fiscal years 2003 and 2002, excluding amounts from employees who are not eligible for matching, was \$3,888,106 and \$3,601,734, which included \$1,585,844 and \$1,487,182 from the University, and \$2,302,262 and \$2,114,552, respectively, from its employees.

The University's total salaries and wages for fiscal years 2003 and 2002 were \$60,743,694 and \$56,619,440, respectively. The total salaries and wages during the fiscal years 2003 and 2002 for covered employees participating in TRS were \$52,502,211 and \$49,143,557, respectively. The total salaries and wages during the fiscal years 2003 and 2002 for covered employees participating in TIAA – CREF were \$33,364,089 and \$30,739,658, respectively.

Note 9 – Post-Employment Benefits

Certain retired employees may elect to continue to participate in the University's group health plan until eligible for Medicare by paying the full cost of the plan premium. Retired employees age sixty-five or older who are eligible for Medicare must enroll in Medicare Coordinated Plan under which Medicare is the primary insurer and the University's health care plan becomes the secondary insurer. Despite the availability of the University's plan, most retirees elect to participate in the Public Education Employees Health Insurance Plan with TRS, in which case the retirees pay their premiums directly to TRS.

Certain retirees may also elect to continue their basic term life insurance coverage and accidental death and dismemberment insurance up to certain maximum amounts. The retirees pay the full amount of the premiums in such cases.

Retirees are eligible for tuition assistance benefits for themselves as well as for their spouse and unmarried dependent children.

Note 10 – Compensated Absences

Certain University employees accrue vacation and sick leave at varying rates depending upon their years of continuous service and payroll classification, subject to maximum limitations. Upon termination of employment, employees are paid all unused accrued vacation at their regular rate of pay up to a designated maximum number of days. The statement of net assets includes accruals of \$2,082,761 and \$2,012,076 as of September 30, 2003 and 2002, respectively, for accrued vacation pay and salary-related payments associated with vacation pay. There is no such accrual recognized for sick leave benefits because no terminal cash benefit is available to employees for accumulated sick leave.

Note 11 – Federal Direct Lending Program

The Federal Direct Student Loan Program (FDSLP) was established under the Higher Education Act of 1965, as amended in the Student Loan Reform Act of 1993. The FDSLP enables an eligible student or parent to obtain a loan to pay for the student's cost of attendance directly through the University rather than through private lenders. The University began participation in the FDSLP on July 1, 1995. As a university qualified to originate loans, the University is responsible for handling the complete loan process, including funds management as well as promissory note functions. The University is not responsible for collection of these loans. For fiscal years ended September 30, 2003 and 2002, the University disbursed approximately \$12,690,000 and \$11,320,000, respectively, under the FDSLP.

Note 12 – Contingencies and Commitments

The University has sovereign immunity and is therefore, in the opinion of System Counsel, immune to ordinary tort actions. The University has consistently been dismissed from lawsuits on the basis of the sovereign immunity doctrine. That doctrine also protects the University from vicarious liability arising from the negligence of its employees. As a matter of policy, the University has chosen to indemnify its employees through a self-insured trust fund against liability arising from the performance of their official duties. There are some exceptions to the sovereign immunity doctrine, most notably federal court cases arising under the federal constitution or federal statutes. The University is engaged in various legal actions in the ordinary course of business. Management does not believe the ultimate outcome of those actions will have a material adverse effect on the financial statements.

Note 13 – Operating Expenses by Function

Operating expenses by functional classification for the years ended September 30, 2003 and 2002 are summarized as follows:

	Year Ended September 30, 2003					Total
	Salaries and Wages	Fringe Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	
Instruction	\$ 22,225,134	\$ 4,981,890	\$ 4,280,037	\$ -	\$ -	\$ 31,487,061
Research	22,569,627	4,959,107	8,727,506	-	-	36,256,240
Public service	1,001,221	178,031	1,435,742	-	-	2,614,994
Academic support	2,851,909	673,148	699,273	-	-	4,224,330
Student services	2,812,121	565,337	4,002,208	-	-	7,379,666
Institutional support	6,467,318	1,660,928	923,832	-	-	9,052,078
Operations and maintenance of plant	2,358,980	561,986	3,729,159	-	-	6,650,125
Scholarships and fellowships	-	-	-	-	645,259	645,259
Auxiliary enterprises	457,384	76,458	2,406,027	-	-	2,939,869
Depreciation	-	-	-	9,230,277	-	9,230,277
Total Operating Expenses	\$ 60,743,694	\$ 13,656,885	\$ 26,203,784	\$ 9,230,277	\$ 645,259	\$ 110,479,899

	Year Ended September 30, 2002					Total
	Salaries and Wages	Fringe Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	
Instruction	\$ 20,861,418	\$ 3,707,554	\$ 6,649,316	\$ -	\$ -	\$ 31,218,288
Research	21,241,122	3,637,854	10,263,217	-	-	35,142,193
Public service	778,776	139,625	522,978	-	-	1,441,379
Academic support	2,694,227	513,540	822,765	-	-	4,030,532
Student services	2,563,510	502,969	3,155,391	-	-	6,221,870
Institutional support	6,016,793	1,477,901	1,330,567	-	-	8,825,261
Operations and maintenance of plant	2,120,025	504,841	3,816,602	-	-	6,441,468
Scholarships and fellowships	-	-	-	-	730,533	730,533
Auxiliary enterprises	343,569	64,890	1,827,424	-	-	2,235,883
Depreciation	-	-	-	8,520,650	-	8,520,650
Total Operating Expenses	\$ 56,619,440	\$ 10,549,174	\$ 28,388,260	\$ 8,520,650	\$ 730,533	\$ 104,808,057

Note 14 – Recently Issued Accounting Standards

The GASB has issued Statement No. 39, *Determining Whether Certain Organizations are Component Units*, effective for the fiscal year ending September 30, 2004. Statement No. 39 may require the University's separate, tax-exempt campus foundations to be presented discretely in the University's financial statements. The University is in the process of determining the impact of this statement.

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