

Northern Arizona University

2001-2002 Financial **Report**



Arizona Board of Regents

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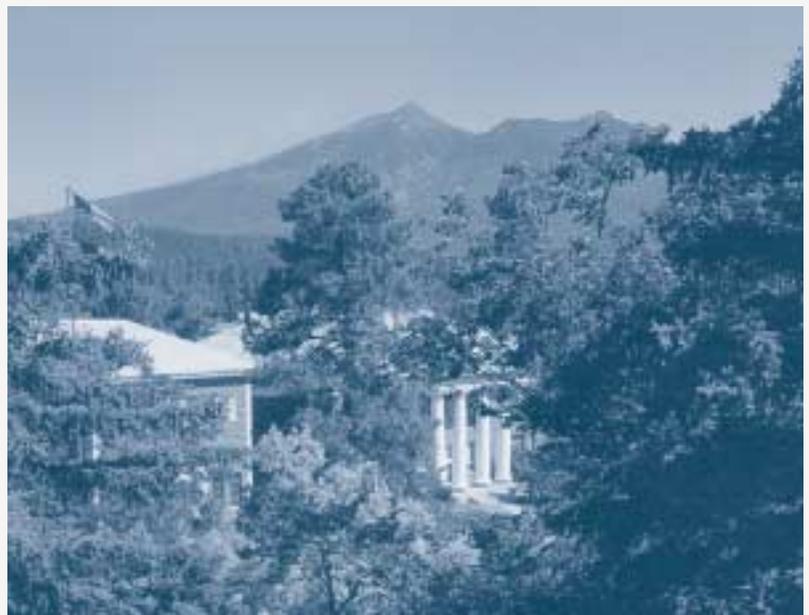
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This financial report is compiled and issued by the
Comptroller's Office
Northern Arizona University
P.O. Box 4069
Flagstaff, AZ 86011-4069

This report is also available online at
www.nau.edu/comptroller

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, 2002, 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 changes in financial position, including 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 and changes in financial position, including cash flows, of the State 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, 2002, and the changes in financial position, including cash flows, of the University for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 2, the University adopted the provisions of GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, for the year ended June 30, 2002, to implement a new financial reporting model.

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 10, 2002

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, 2002. Management has prepared the financial statements and the related footnote 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. Since GASB Statement No. 35 is being adopted for the year ended June 30, 2002, only audited financial information for this year will be reported in the financial statements. For future years, the audited financial statements will include both the current and the prior fiscal year.

The major changes from the statements presented by the University in the past are as follows:

- New reporting standards require three financial statements: 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 replaces the balance sheet. The term "net asset" replaces fund balance. 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 will be shown as a current year expense.
- The Statement of Revenues, Expenses, and Changes in Net Assets replaces the Statement of Changes in Fund Balances and the Statement of Current Operating Funds Revenues, Expenditures and Other Changes. This statement distinguishes between operating and non-operating revenues and expenses, with state appropriations reported as non-operating revenue. Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances.
- Financial statements must include a Statement of Cash Flows prepared using the direct method. The Statement of Cash Flows is a new reporting requirement for public institutions of higher education. 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. The amounts from the prior year have been displayed in the GASB Statement No. 35 format, but are unaudited.

Management's Discussion and Analysis

Financial Highlights

- Student tuition and fees increased slightly from the prior year.
- The University issued \$43.9 million in system revenue refunding bonds, at an average interest rate of 3.63%, to advance refund \$42.6 million of outstanding system revenue bonds.
- Government Grants and Contracts increased 27% or \$10.3 million from the prior year while private grants and contracts decreased by \$3.3 million.
- University auxiliary enterprises revenues, including residence life and the bookstore, increased.

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, 2001 and 2002 (in thousands), is as follows:

	2001 <i>Unaudited</i>	2002
Current assets	\$ 60,562	\$ 60,818
Non-current assets:		
Cash, cash equivalents, investments, and student loans receivable	6,669	6,949
Endowment Investments	9,677	8,848
Capital assets – net of accumulated depreciation	202,104	193,857
Other non-current assets	<u>305</u>	<u>305</u>
Total assets	<u>279,012</u>	<u>270,777</u>
Current liabilities	<u>30,011</u>	<u>30,828</u>
Non-current liabilities	<u>82,586</u>	<u>76,804</u>
Total liabilities	<u>112,597</u>	<u>107,632</u>
Net assets	<u>\$ 166,415</u>	<u>\$ 163,145</u>

A review of the University's Statement of Net Assets at June 30, 2001 and 2002 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 totaled \$44.0 million at June 30, 2002 as compared to \$47.0 million at June 30, 2001. Government grants and contracts receivable increased by \$2.5 million due to increased funding on cost reimbursement projects.

Non-current assets consist primarily of capital assets that decreased by \$8.2 million due mainly to depreciation expense. Current liabilities include accounts payable, accrued expenses, deferred revenue, and the current portion of the University's long-term debt. Current liabilities are higher due to an increase in deferred revenues.

Management's Discussion and Analysis

Noncurrent liabilities consist primarily of the University's long-term debt, which was reduced overall by \$6.0 million as of June 30, 2002.

Net Assets

A summarized comparison of the University's net assets for the years ended June 30, 2001 and 2002 (in thousands), is as follows:

	2001 <i>Unaudited</i>	2002
Invested in capital assets, net of related debt	\$ 114,393	\$ 112,619
Restricted:		
Nonexpendable	5,518	5,347
Expendable	20,138	19,530
Unrestricted	<u>26,366</u>	<u>25,649</u>
Total net assets	<u>\$ 166,415</u>	<u>\$ 163,145</u>

Net assets at June 30, 2002 decreased overall by \$3.3 million or about 2% from 2001. The decrease is mainly attributed to current year depreciation expense.



Management's Discussion and Analysis

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 non-operating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered non-operating revenues according to generally accepted accounting principles. See the table of Combined Sources and Uses of Funds on pages 10 and 11 for an overview of the composition of revenues and expenses.

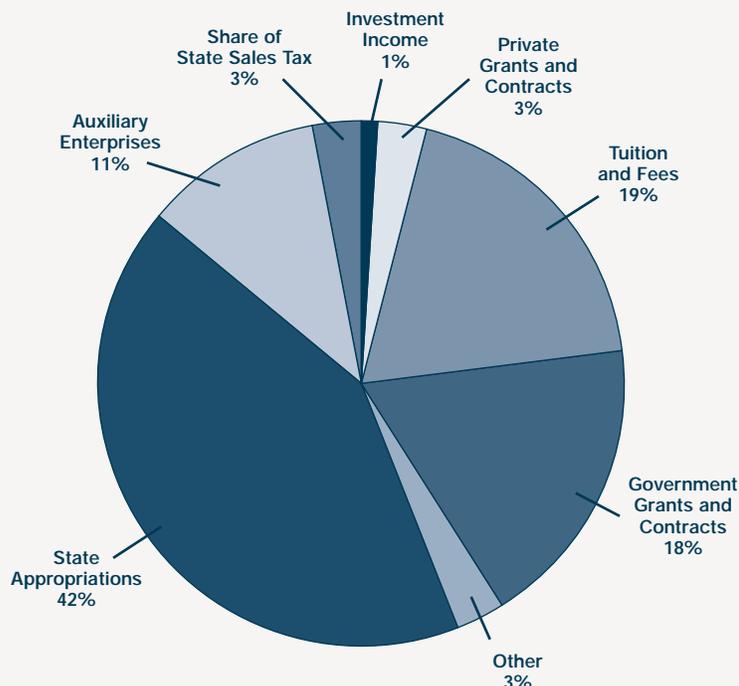
A summarized comparison of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2001 and 2002 (in thousands), is as follows:

	2001 <i>Unaudited</i>	2002
Operating Revenues		
Tuition and fees, net of scholarship allowances	\$ 50,950	\$ 51,197
Government grants and contracts	37,535	47,408
Private grants and contracts	5,698	3,460
Auxiliary enterprises	25,305	27,953
Other	<u>6,934</u>	<u>6,859</u>
Total operating revenues	<u>126,422</u>	<u>136,877</u>
Operating Expenses	<u>240,598</u>	<u>262,705</u>
Non-operating Revenues (Expenses)		
State appropriations	112,704	112,190
Share of state sales tax		7,851
Government grants and contracts	47	433
Private gifts, grants, and contracts	4,938	3,907
Investment income	3,748	1,117
Interest expense on capital asset related debt	(5,246)	(4,028)
Loss on disposal of capital assets		(345)
Other non-operating revenues/expenses	<u>(192)</u>	<u>779</u>
Total non-operating revenues and expenses	<u>115,999</u>	<u>121,904</u>
Other revenues	<u>2,829</u>	<u>654</u>
Increase (decrease) in net assets	<u>\$ 4,652</u>	<u>\$ (3,270)</u>

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 8.3% or about \$10.4 million in 2002. This increase is due to additional auxiliary revenues, tuition and fee revenue increases, and an increase in government grants and contracts of \$9.9 million in 2002 or about 26% from 2001. The government grants and contracts increase is mainly due to grants received from the U.S. Office of Education in the amount of \$4.7 million (primarily for the Gear Up projects) and \$3.0 million in funding from the Bureau of Land Management for the Southwest Forest Initiative project. State appropriations decreased from \$112.7 in fiscal year 2001 to \$112.2 in 2002. Included in state appropriations is \$214,700 for financial aid purposes. Non-operating revenues also include \$7.8 million in state sales tax revenues from Proposition 301 collections that the University began to receive in August of 2001. Investment income decreased due to an unfavorable market fluctuation in interest rates and an unrealized loss primarily on monies invested with the Student Financial Aid Trust Funds.

Management's Discussion and Analysis

■ Total Revenues



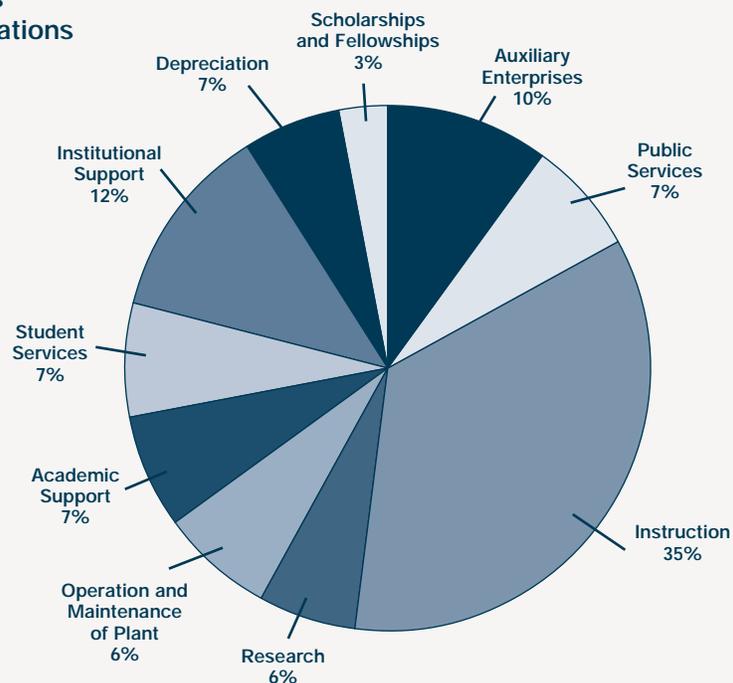
Educational and general expenses continued to account for a majority of the operating expenses. Educational and general expenses increased \$21 million or about 11% over the previous fiscal year. Significant components of the increase within educational and general expenses were instruction, \$6.2 million; public service, \$7.0 million; and institutional support, \$7.0 million. Other operating expenses included depreciation and auxiliary enterprises expenses. Education and general expenses were higher in fiscal year 2002 due to salary and benefit increases, including an \$8.0 million increase in salaries and wages and a \$5.8 million increase in health care benefits.

A comparative summary of the University's expenses by functional classification for the years ended June 30, 2001 and June 30, 2002, is as follows:

	2001 <i>Unaudited</i>	2002
Operating:		
Instruction	\$ 83,567,089	\$ 89,754,211
Research	14,363,932	16,755,758
Public service	12,133,605	19,233,336
Academic support	18,998,302	19,115,055
Student services	17,716,808	18,803,278
Institutional support	24,748,357	31,705,018
Operation and maintenance of plant	15,124,361	14,831,227
Scholarships and fellowships	10,298,494	7,704,493
Auxiliary enterprises	25,328,877	26,298,108
Depreciation	18,318,605	18,504,261
Non-operating:		
Interest and other	<u>5,438,648</u>	<u>4,372,245</u>
Total Expenses	<u><u>\$ 246,037,078</u></u>	<u><u>\$ 267,076,990</u></u>

Management's Discussion and Analysis

Operating Expenses Functional Classifications

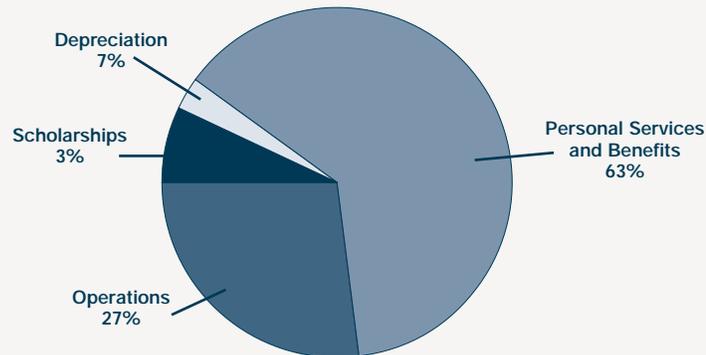


In addition to their functional (program) classification, it is also informative to review operating expenses by their natural (object) classification. A comparative summary of the University's expenses by natural classification for the years ended June 30, 2001 and June 30, 2002, is as follows:

	2001 <i>Unaudited</i>	2002
Operating:		
Personal services and benefits	\$151,454,583	\$165,039,385
Operations	60,526,748	71,456,606
Scholarships	10,298,494	7,704,493
Depreciation	18,318,605	18,504,261
Non operating:		
Interest and other	<u>5,438,648</u>	<u>4,372,245</u>
Total Expenses	<u><u>\$246,037,078</u></u>	<u><u>\$267,076,990</u></u>

Management's Discussion and Analysis

Operating Expenses Natural Classification



Capital Assets and Debt Administration

Capital Assets at June 30, 2002

At June 30, 2002, the University had \$193.9 million invested in capital assets. During the year the University added \$10.8 million in new capital assets and retired \$5.6 million of obsolete assets. In addition, accumulated depreciation increased by \$13.4 million. Details of capital assets for the year ended June 30, 2002 and 2001, is as follows:

	2001 <i>Unaudited</i>	2002
Land	\$ 5,039,193	\$ 5,039,193
Infrastructure	34,154,742	34,681,961
Buildings	248,606,309	251,763,942
Equipment	79,925,914	79,377,681
Library books and media	40,485,561	42,261,227
Construction in progress	193,726	465,636
Accumulated depreciation	(206,301,518)	(219,732,732)
Total capital assets	<u>\$ 202,103,927</u>	<u>\$ 193,856,908</u>

Significant capital additions completed and the resources that funded their acquisitions for fiscal year 2002 were:

- Skydome roof and track renovations, \$814,900, unrestricted net assets
- Library acquisitions, \$1,941,800, unrestricted net assets
- Infrastructure and land improvements, \$527,200, unrestricted net assets
- Southwest Forest Science complex expansion, \$1,162,700, unrestricted net assets and bond proceeds (1997)
- Bury Hall renovation, \$377,000, unrestricted net assets

The University's Capital Improvement Plan, which is updated annually, provides for the issuance of \$31.7 million in system revenue bonds in fiscal year 2003 and an additional \$31.3 million in system revenue bonds in 2004. The plan also includes the issuance of \$26.4 million in Certificates of Participation in fiscal year 2004. These monies will be used for the renovation of existing buildings and new building construction. Projects planned for 2003 include:

Management's Discussion and Analysis

- Campus infrastructure upgrades on south campus to replace utility components
- Gateway Student Success Center that centralizes student advising services
- Modular Swing Space (flexible, temporary space for campus unit relocation during construction and renovation)
- Communication building renovation

The additional debt issuances fit comfortably into the University's debt capacity according to the latest debt study as submitted to the Arizona Board of Regents.

Outstanding Debt

At June 30, 2002, the University had \$82.1 million in debt, a decrease of approximately \$5.6 million or 6% from fiscal year 2001. During the year ended June 30, 2002, the University issued \$43,945,000 in system revenue refunding bonds, with an average interest rate of 3.63%, to advance refund \$42,600,000 of the outstanding System Revenue Bonds, Series of 1991, 1992, and 1992A, with an average interest rate of 5.95%. The remaining bonding authorization from the State Legislature for the University was \$62.9 million, as of June 30, 2002. The table below summarizes the University's outstanding debt from fiscal years 2001 and 2002.

	2001 <i>Unaudited</i>	2002
System revenue and housing bonds	\$ 84,260,000	\$ 79,025,000
Capital lease obligations	3,451,288	3,099,464
Less deferred amount on refunding		(886,520)
Total	<u>\$ 87,711,288</u>	<u>\$ 81,237,944</u>

At June 30, 2002, the University maintains 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 will be 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% of projected total expenditures and mandatory transfers. At June 30, 2002, the projected ratio for the University's total debt service to expenditures and mandatory transfers is 3.19%. This is well within the requirement of 8%.

Economic Outlook

The economic position of the University is closely tied to that of the state of Arizona. The 2003 fiscal year state appropriation for the University is \$117.2 million. This represents an increase of \$5.0 million from fiscal year 2002. As part of the Legislative budget for fiscal year 2002-2003, and included in the \$117.2 million, is a \$4.0 million special appropriation from the State General Fund. This amount was appropriated to offset or replace tuition and registration fee revenues that will be used to pay the debt service of the University's future bond issuances.

The Arizona Board of Regents approved a 3.9% tuition increase for resident students and an 8.1% increase for nonresident students for the upcoming year. The University's total student enrollment (headcount) was 19,728 for the Fall 2001 semester. The University anticipates stable enrollment levels for the next academic year. The University expects to remain financially stable through the next fiscal year.

Management's Discussion and Analysis

Sources

Combined Sources and Uses of Funds For the year ended June 30, 2002

State Appropriations

42.5%

\$112,189,639

Includes legislative appropriations from State of Arizona general revenue for current operations of the University, and \$214,700 for financial aid.

Tuition and Fees, Net of Scholarship Allowances

19.4%

\$51,196,902

Includes \$38,332,398 to support the operating budget, \$6,459,525 for summer sessions, \$26,034,474 for funding of local budgets, scholarships, and retirement of non-housing bonded indebtedness, less \$19,629,495 for scholarship allowances.

Government Grants and Contracts

18.1%

\$47,840,975

Includes operating revenues of \$38,390,399 of federal grants and contracts, \$3,761,168 of state grants and contracts, and \$5,689,408 of local government grants and contracts.

Auxiliary Enterprises

10.6%

\$27,952,462

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

Other Sources

3.1%

\$8,291,747

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 non-operating miscellaneous revenues.

Share of State Sales Taxes

3.0%

\$7,850,834

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

Private Gifts, Grants, and Contracts

2.8%

\$7,367,265

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

Investment Income

0.5%

\$1,116,858

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

\$263,806,682

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 non-operating funds are included. Sources and uses are allocated and controlled by budgets.

Management's Discussion and Analysis

■ Uses	Combined Sources and Uses of Funds For the year ended June 30, 2002
<p>Instruction and Academic Support 40.8% Instruction, totaling \$89,754,211, 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 \$19,115,055, includes libraries, audio-visual services, and academic administration.</p>	\$108,869,266
<p>Student Services and Institutional Support 18.9% Student services, totaling \$18,803,278, includes areas such as admissions, registrar, minority services, counseling, placement, student aid administration, and health services. Institutional support, totaling \$31,705,018, includes executive management, financial operations, computing support, human resource services, security, and university relations.</p>	\$50,508,296
<p>Research and Public Service 13.5% 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.</p>	\$35,989,094
<p>Auxiliary Enterprises 9.8% 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.</p>	\$26,298,108
<p>Depreciation 6.9% Depreciation expense of capital assets over their useful lives.</p>	\$18,504,261
<p>Operation and Maintenance of Plant 5.6% 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.</p>	\$14,831,227
<p>Scholarships and Fellowships 2.9% 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.</p>	\$7,704,493
<p>Other Uses 1.6% Other uses include \$4,027,473 in interest expense on capital asset-related debt and a \$344,772 loss on disposal of capital assets.</p>	\$4,372,245
<p>Total Uses</p>	<u>\$267,076,990</u>

Financial Statements

Statement of Net Assets June 30, 2002

ASSETS

Current assets:

Cash and cash equivalents	\$ 22,031,505
Investments	21,961,531
Receivables, net of allowance for uncollectibles:	
Accounts receivable	2,830,403
Accrued interest	585,516
Endowment	161,881
Government grants and contracts	8,198,413
Student loans	904,425
Other assets	1,859,064
Inventories	2,284,960
Total current assets	<u>\$ 60,817,698</u>

Non-current assets:

Restricted cash and investments held by trustee	\$ 1,100,658
Investments	1,018,151
Student loans receivable, net of allowance	4,830,943
Endowment investments	8,847,745
Other non-current assets	304,913
Capital assets, not being depreciated	5,504,829
Depreciable capital assets, net of depreciation	188,352,079
Total non-current assets	<u>\$ 209,959,318</u>

Total assets

\$ 270,777,016

LIABILITIES

Current liabilities:

Accounts payable	\$ 4,269,129
Accrued payroll and employee benefits	3,649,063
Interest payable	310,454
Deferred revenue	11,438,591
Accrued compensated absences	4,050,513
Deposits held in custody for others	224,517
Current portion of long-term debt	6,885,708
Total current liabilities	<u>\$ 30,827,975</u>

Non-current liabilities:

Deposits held in custody for others	\$ 480,996
Long-term debt	76,323,279
Total non-current liabilities	<u>\$ 76,804,275</u>

Total liabilities

\$ 107,632,250

NET ASSETS

Invested in capital assets, net of related debt	\$ 112,618,965
Restricted:	
Non-expendable (endowments):	
Scholarships and fellowships	5,346,808
Expendable:	
Scholarships and fellowships	1,131,155
Research	3,759,703
Academic department use	6,123,283
Student loans	6,740,457
Capital projects	488,285
Debt service	1,287,070
Unrestricted	25,649,040
Total net assets	<u>\$ 163,144,766</u>

See Notes to the Financial Statements

Financial Statements

Statement of Revenues, Expenses, and Changes in Net Assets June 30, 2002

REVENUES

Operating Revenues	
Tuition and fees, net of scholarship allowances of \$19,629,495, pledged as security for revenue bonds	\$ 51,196,902
Government grants and contracts	47,407,943
Private grants and contracts	3,460,426
Auxiliary enterprises, includes revenues pledged as security for revenue bonds:	
Bookstore	6,957,989
Residence life, net of scholarship allowances of \$2,622,837	14,115,260
Other auxiliaries	6,879,213
Other	6,858,845
Total operating revenues	<u>\$ 136,876,578</u>

EXPENSES

Operating Expenses	
Educational and general:	
Instruction	\$ 89,754,211
Research	16,755,758
Public service	19,233,336
Academic support	19,115,055
Student services	18,803,278
Institutional support	31,705,018
Operation and maintenance of plant	14,831,227
Scholarships and fellowships	7,704,493
Auxiliary enterprises	26,298,108
Depreciation	18,504,261
Total operating expenses	<u>\$ 262,704,745</u>
Operating loss	<u>\$ (125,828,167)</u>

NON-OPERATING REVENUES AND (EXPENSES)

State appropriations	\$ 112,189,639
Share of state sales tax	7,850,834
Government grants and contracts	433,032
Private gifts, grants, and contracts	3,906,839
Investment income	1,116,858
Interest expense on capital asset related debt	(4,027,473)
Loss on disposal of capital assets	(344,772)
Other non-operating revenues	779,197
Total non-operating revenues and expenses	<u>\$ 121,904,154</u>
Loss before other revenues, expenses, gains or losses	<u>\$ (3,924,013)</u>

Capital grants and gifts	189,631
Additions to permanent endowments	464,074
Decrease in net assets	<u>\$ (3,270,308)</u>

NET ASSETS

Net assets, July 1, 2001, as restated	166,415,074
Net assets, June 30, 2002	<u>\$ 163,144,766</u>

See Notes to the Financial Statements

Financial Statements

Statement of Cash Flows June 30, 2002

Cash Flows from Operating Activities:	
Tuition and fees	\$ 50,083,365
Grants and contracts	49,272,681
Payments to suppliers	(72,050,447)
Payments to employees	(162,395,517)
Payments for scholarships and fellowships	(7,704,493)
Loans issued to students	(1,206,139)
Collection of loans to students	1,266,606
Auxiliary Enterprise charges:	
Residence halls	13,938,115
Bookstore	6,787,459
Other auxiliaries	6,533,376
Other receipts	6,464,516
Net cash used by operating activities	<u>\$ (109,010,478)</u>
Cash Flows from Non-capital Financing Activities:	
State appropriations	112,189,639
Share of state sales taxes	7,850,834
Gifts and grants for other than capital purposes	5,296,930
Federal direct student lending received	53,598,912
Federal direct student lending disbursed	(53,598,912)
Private gifts for endowment purposes	249,374
Funds held for others	66,758
Net cash provided by non-capital financing activities	<u>\$ 125,653,535</u>
Cash Flows from Capital Financing Activities:	
Capital grants and gifts received	156,680
Proceeds from sale of capital assets	129,658
Purchases of capital assets	(10,698,721)
Principal paid on capital debts and leases	(6,931,824)
Interest paid on capital debt and leases	(4,061,823)
Net cash used by capital financing activities	<u>\$ (21,406,030)</u>
Cash Flows from Investing Activities:	
Proceeds from sales and maturities of investments	21,800,000
Interest on Investments	1,928,401
Purchase of Investments	(28,785,496)
Net cash used by investing activities	<u>\$ (5,057,095)</u>
Net Decrease in Cash and Cash Equivalents	(9,820,068)
Cash and Cash Equivalents - Beginning of Year	32,952,231
Cash and Cash Equivalents - End of Year	<u>\$ 23,132,163</u>
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	\$ (125,828,167)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation expense	18,504,261
Changes in assets and liabilities:	
Receivables, net	(2,875,784)
Inventories	117,747
Other assets	(474,566)
Accounts payable and accrued liabilities	152,286
Deferred revenue	1,144,981
Deposits held in custody for others	7,424
Accrued compensated absences	241,340
Net cash used by operating activities:	<u>\$ (109,010,478)</u>

Non-cash activities - During the year ended June 30, 2002, the University issued system revenue refunding bonds to advance refund \$42,600,000 of outstanding system revenue bonds.

See Notes to Financial Statements.

■ Note 1—Summary of Significant Accounting Policies

Financial Statement Presentation

In June 1999, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments. This was followed in November 1999 by GASB Statement No. 35, Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities. The financial statement presentation required by GASB Statements No. 34 and No. 35 provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows, and replaces the fund-group perspective previously required.

The accounting policies of the University conform to generally accepted accounting principles applicable to public institutions of higher education engaged only in business-type activities adopted by the GASB. During the year ended June 30, 2002, the University implemented GASB Statement No. 35, which prescribes a new reporting model for public institutions of higher education within the reporting guidelines of GASB Statement No. 34, as amended by GASB Statement No. 37. The University also implemented GASB Statement No. 38, which prescribes new and revised note disclosures.

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 non-profit 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. 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 and public service 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 are 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, 2002, are reported less allowances for estimated uncollectible amounts and collection costs of \$853,000 and \$937,500, respectively (\$807,000 and \$930,000 in 2001).

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, 2002

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 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.

Notes to Financial Statements

June 30, 2002

■ Note 2—Beginning Balance Restated

As a result of implementing GASB Statement No. 35, the University's aggregate fund balances reported as of June 30, 2001, totaling \$381,066,249 have been restated as beginning net assets of \$166,415,074. The difference is attributable to recording accumulated depreciation on capital assets and accrued compensated absences.

■ Note 3—Cash and Investments

The University may 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, 2002, consist of the following:

	Fair Value
Cash on hand and in bank	\$ (5,482,946)
Investments	23,399,301
Student Financial Aid Trust Fund	5,169,199
State Treasurer's Local Government Investment Pool	26,934,971
Bond Trustee Funds	1,100,658
Investments with NAU Foundation	<u>3,838,407</u>
Total	<u>\$ 54,959,590</u>

The cash overdraft results from the University investing its funds until outstanding checks are cashed. The University's total cash on hand was \$44,300. The carrying amount of the University's total cash in bank was \$(5,527,246) and the bank balance was \$1,605,168, of which \$100,000 was covered by federal depository insurance and the remaining balance of \$1,505,168 was collateralized by U.S. Government obligations held at the Federal Reserve Bank in the University's name.

The \$23,399,301 in investments are 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 Deposit 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

Notes to Financial Statements

June 30, 2002

insured banks, trust companies, or savings and loan associations within the State of Arizona; or repurchase agreements. The bond trustees are authorized to purchase and sell securities. The University's ownership interest is recorded in the trustee's records.

A trust agreement between the University and the NAU Foundation, Inc. authorizes the Foundation to invest certain University restricted and endowment monies according to the Foundation's established investment policies and procedures. At June 30, 2002, the Foundation invested the amount of \$3,838,407 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 4—Capital Assets

Capital asset activity for the year ended June 30, 2002, was as follows:

	Balance June 30, 2001, as restated	Additions	Retirements	Transfers	Balance June 30, 2002
Capital assets not being depreciated:					
Land	\$ 5,039,193				\$ 5,039,193
Construction in progress	193,726	\$ 1,308,401	\$ (129,794)	\$(906,697)	465,636
Total capital assets not being depreciated	5,232,919	1,308,401	(129,794)	(906,697)	5,504,829
Capital assets being depreciated:					
Infrastructure	34,154,742	527,219			34,681,961
Buildings	248,606,309	2,250,936		906,697	251,763,942
Equipment	79,925,914	4,747,480	(5,295,713)		79,377,681
Library books and media	40,485,561	1,941,801	(166,135)		42,261,227
Total capital assets being depreciated	403,172,526	9,467,436	(5,461,848)	906,697	408,084,811
Less accumulated depreciation for:					
Infrastructure	15,534,497	1,088,591			16,623,088
Buildings	108,665,074	6,800,958			115,466,032
Equipment	52,348,566	8,312,735	(4,906,920)		55,754,381
Library books and media	29,753,381	2,301,978	(166,128)		31,889,231
Total accumulated depreciation	206,301,518	18,504,262	(5,073,048)		219,732,732
Capital assets, net	\$202,103,927	\$ (7,728,425)	\$ (518,594)		\$193,856,908

In addition to the accounts payable balance of \$405,825 related to capital assets recorded in the Statement of Net Assets, the estimated cost to complete construction in progress at June 30, 2002, totaled \$14,953,300.

Notes to Financial Statements

June 30, 2002

Note 5—Long-Term Liabilities

Long-term liability activity for the year June 30, 2002, was as follows:

	Balance June 30, 2001	Additions	Retirements	Balance June 30, 2002	Due within one year
Capitalized lease obligations	\$ 3,451,288		\$ (351,824)	\$ 3,099,464	\$ 345,905
Revenue and housing bonds payable	84,260,000	\$1,345,000	(6,580,000)	79,025,000	6,240,000
Less deferred amount on refunding		(886,521)		(886,521)	(149,834)
Optional retirement monies	1,904,285	915,461	(848,702)	1,971,044	449,637
Total long-term liabilities	<u>\$89,615,573</u>	<u>\$1,373,940</u>	<u>\$(7,780,526)</u>	<u>\$83,208,987</u>	<u>\$6,885,708</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, 2002, are as follows:

Student housing bonds (2 issues) - 5.5% to 6.1%, principal payable annually on April 1 through 2009, revenues of various housing projects pledged for payment	\$1,220,000
System revenue refunding bonds, Series of 1992A - 5.375%, principal maturing serially on June 1, through 2008, secured by a first lien on certain gross revenues, on a parity with the Series 1997 system revenue bonds and the Series 2002 system revenue refunding bonds	\$2,960,000
System revenue bonds, Series of 1997 - 5.0% to 6.5%, principal maturing serially on June 1, 2009, through 2017, secured by a first lien on certain gross revenues, on a parity with the Series 1992A system revenue refunding bonds and the Series 2002 system revenue refunding bonds	\$30,900,000
System revenue refunding bonds, Series of 2002 - 3.0% to 4.0%, principal maturing serially on June 1, 2003, through 2008, secured by a first lien on certain gross revenues, on a parity with the Series 1992A system revenue refunding bonds and Series 1997 systems revenue bonds	<u>\$43,945,000</u>
	<u>\$79,025,000</u>

Notes to Financial Statements

June 30, 2002

The following schedule details debt service requirements to maturity for the University's bonds payable at June 30, 2002.

Year Ending June 30,	Revenue Bonds	
	Principal	Interest
2003	\$ 6,240,000	\$ 3,553,110
2004	8,140,000	3,290,450
2005	8,475,000	2,971,510
2006	8,815,000	2,643,685
2007	8,615,000	2,294,710
2008-12	19,755,000	7,459,400
2013-17	<u>18,985,000</u>	<u>2,958,040</u>
Total	<u>\$79,025,000</u>	<u>\$25,170,905</u>

During the year ended June 30, 2002, the University issued \$43,945,000 in system revenue refunding bonds, with an average interest rate of 3.63 percent, to advance refund \$42,600,000 of the outstanding System Revenue Bonds, Series of 1991, 1992, and 1992A, with an average interest rate of 5.95 percent. The revenue refunding bonds, Series of 2002, were issued at a premium of \$795,338. The net proceeds of \$44,331,803 (after payment of \$408,535 in underwriting fees, insurance and other issuance costs) were used to purchase U.S. government obligations. Those securities were deposited in an irrevocable trust with a trustee to provide for all future debt service payments on the refunded bonds. As a result, the refunded debt is considered to be defeased, and the liability for those bond payments has been removed from the financial statements. On June 1, 2002, the monies in the depository trust were used to call the refunded bonds.

Although the recognition of the advance refunding issue resulted in a net decrease in net assets of \$1,345,000 for the year ended June 30, 2002, the University reduced its aggregate debt service payments by \$2,583,074 over the next six and one-half years and obtained an economic gain (i.e., difference between the present values of the old and the new debt service payments) of \$2,526,165.

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, 2002, \$360,000 of such bonds outstanding are considered defeased.

Note 6—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, 2002, active ASRS members and the University were each required by statute to contribute at the actuarially determined rate of 2.49 percent (2.00 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

Notes to Financial Statements

June 30, 2002

years ended June 30, 2002, 2001, and 2000 were \$1,094,343, \$1,108,236 and \$1,080,300, 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, 2002, 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, 2002, plan members and the University were each required by statute to contribute an amount equal to 7 percent of a member's compensation.

Contributions to these plans for the year ended June 30, 2002, are summarized below.

Plan: TIAA/CREF

University	Member	Total
<u>Contributions</u>	<u>Contributions</u>	<u>Contributions</u>
\$2,551,663	\$2,551,663	\$5,103,326

Plan: VALIC

University	Member	Total
<u>Contributions</u>	<u>Contributions</u>	<u>Contributions</u>
\$573,672	\$573,672	\$1,147,344

Plan: Fidelity

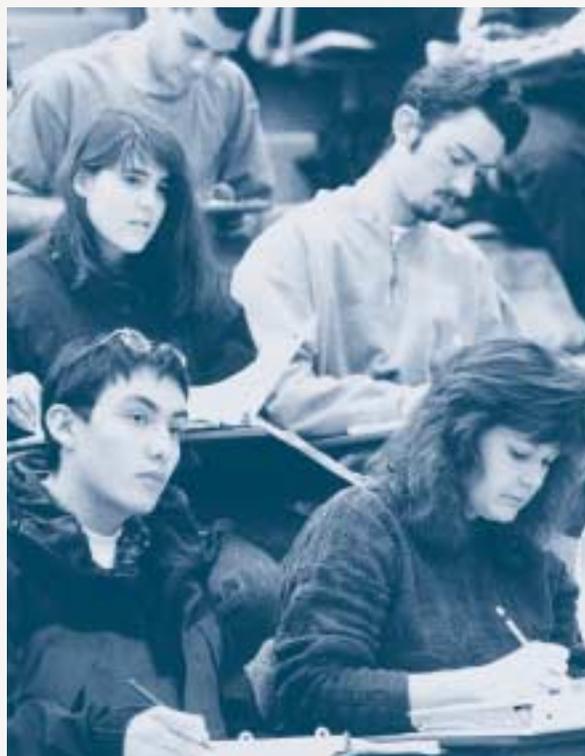
University	Member	Total
<u>Contributions</u>	<u>Contributions</u>	<u>Contributions</u>
\$483,420	\$483,420	\$966,840

Plan: Aetna

University	Member	Total
<u>Contributions</u>	<u>Contributions</u>	<u>Contributions</u>
\$212,582	\$212,582	\$425,164

Plan: Vanguard

University	Member	Total
<u>Contributions</u>	<u>Contributions</u>	<u>Contributions</u>
\$105,104	\$105,104	\$210,208



■ Note 7—Risk Management

Pursuant to A.R.S. § 41-621, the University participates in a self-insurance program administered by the State of Arizona, Department of Administration, Risk Management Section. The State's Risk Management Program covers the University, subject to certain deductibles, for risks of loss from injuries to employees; theft of, damage to and

Notes to Financial Statements

June 30, 2002

destruction of property, buildings, and equipment; errors and omissions; natural disasters; and liability for acts or omissions of any nature while acting in authorized governmental or proprietary capacities and in the course and scope of employment or authorization except as prescribed in A.R.S. § 41-621. The University has no additional insurance coverage and losses arising from contractual breaches and losses that arise out of and are directly attributable to an act or omission determined by a court to be a felony are not covered by the State's Risk Management Program. However, during the three years ended June 30, 2002, such losses have not been material to the University's financial statements.

Note 8—Expense Classification

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

Functional Classification:	For the Year Ended June 30, 2002				
	Personal Service and Benefits	Operations	Scholarships	Depreciation	TOTAL
Instruction	\$ 77,120,608	\$12,633,603			\$ 89,754,211
Research	12,292,967	4,462,791			16,755,758
Public service	7,291,331	11,942,005			19,233,336
Academic support	17,004,282	2,110,773			19,115,055
Student services	14,055,910	4,747,368			18,803,278
Institutional support	19,515,564	12,189,454			31,705,018
Scholarships and fellowships			\$7,704,493		7,704,493
Operation and maintenance of plant	7,395,534	7,435,693			14,831,227
Depreciation				\$18,504,261	18,504,261
Auxiliary enterprises	10,363,189	15,934,919			26,298,108
Total	<u>\$165,039,385</u>	<u>\$71,456,606</u>	<u>\$7,704,493</u>	<u>\$18,504,261</u>	<u>\$262,704,745</u>

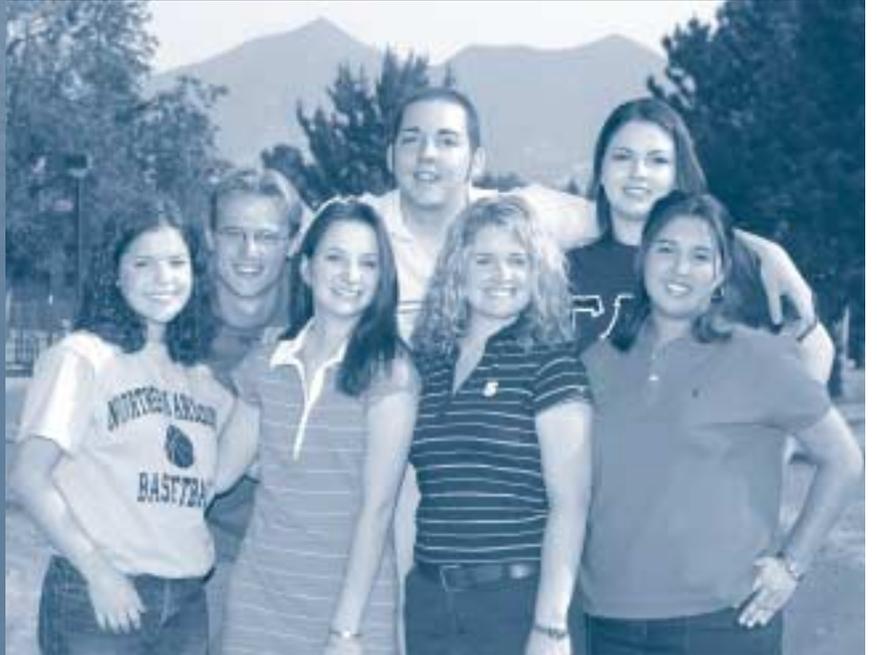
Note 9—Other Matters

Privatized Housing

The University has entered into a privatized arrangement with a separately incorporated non-profit entity (the Northern Arizona Capital Facilities Finance 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. The housing facility was opened in the fall of 2002 and the daily operations of the facility are managed by the University. On June 20, 2002, 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 non-profit entity for the term of the bond issue.

Subsequent Events

The University issued \$31,700,000 of System Revenue Bonds in August 2002 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 1992A, 1997, and 2002 system revenue and system revenue refunding bonds.



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