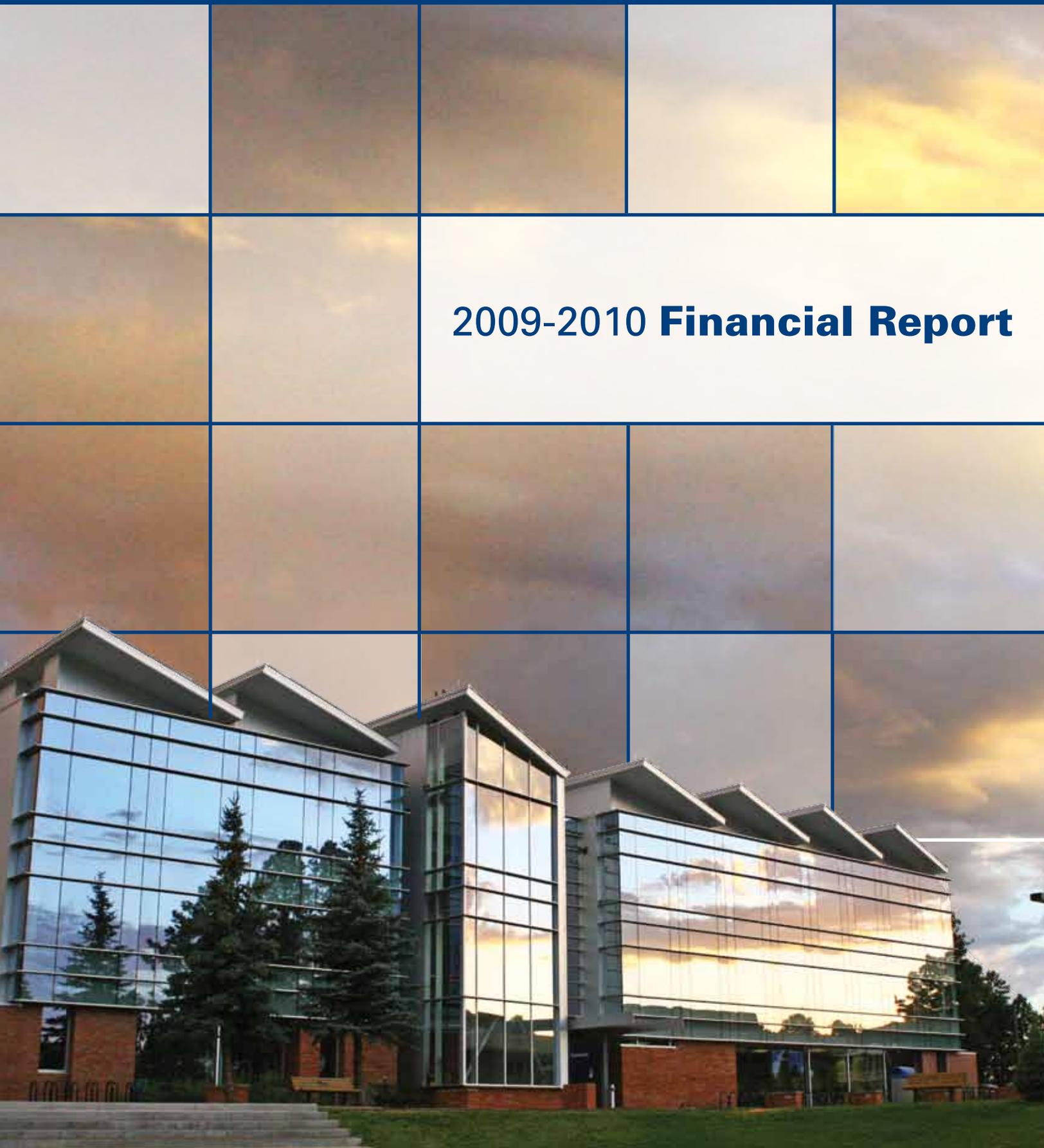




NORTHERN ARIZONA UNIVERSITY

2009-2010 **Financial Report**



# CONTENTS

2	Independent Auditors' Report
4	Management's Discussion and Analysis
14	Financial Statements
19	Notes to Financial Statements

This financial report is compiled and issued by the Associate Vice President for Financial Services/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](http://www.nau.edu/comptroller)



## UNIVERSITY ADMINISTRATION As of June 30, 2010

**John D. Haeger**  
President

**MJ McMahon**  
Executive Vice President

**David Bousquet**  
Vice President for Enrollment  
Management and Student  
Affairs

**Jennus L. Burton**  
Vice President for Finance  
and Administration

**Mason Gerety**  
Vice President for University  
Advancement

**Liz Grobsmith**  
Provost and Vice President  
for Academic Affairs

**Patricia Haeuser**  
Vice President for Planning,  
Budget and Institutional  
Research

**Laura Huenneke**  
Vice President for Research

**Fred Hurst**  
Vice President for Extended  
Campuses

## ARIZONA BOARD OF REGENTS

### APPOINTED

**Ernest Calderón**

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**Ross Meyer**  
Student Regent

### EX-OFFICIO MEMBERS

**The Honorable  
Janice K. Brewer**  
Governor of Arizona

**The Honorable  
Tom Horne**  
Arizona Superintendent  
of Public Instruction

# INDEPENDENT AUDITORS' REPORT



DEBRA K. DAVENPORT, CPA  
AUDITOR GENERAL

**STATE OF ARIZONA**  
OFFICE OF THE  
AUDITOR GENERAL

MELANIE M. CHESNEY  
DEPUTY AUDITOR GENERAL

## Independent Auditors' Report

Members of the Arizona State Legislature

The Arizona Board of Regents

We have audited the accompanying financial statements of the business-type activities and aggregate discretely presented component units of Northern Arizona University as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the aggregate discretely presented component units, is based solely on the reports of the other auditors.

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

As described in Note 1, the University's financial statements are intended to present the financial position, and the changes in financial position and, where applicable, cash flows of only those portions of the business-type activities, major fund, and aggregate discretely presented component units of the State of Arizona that are attributable to the University. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of June 30, 2010, and the changes in financial position and, where applicable, cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

# INDEPENDENT AUDITORS' REPORT

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and aggregate discretely presented component units of Northern Arizona University as of June 30, 2010, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

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

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

Debbie Davenport  
Auditor General

October 20, 2010

# 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, 2010. Management has prepared the financial statements and the accompanying note disclosures along with the discussion and analysis. Responsibility for the completeness and fairness of this information rests with the University's management.

## USING THIS FINANCIAL REPORT

This annual financial report includes the report of independent auditors, management's discussion and analysis, the financial statements in the format referred to below, and notes to the financial statements, which include the summary of significant accounting policies.

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

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

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, the University reports as a component unit those organizations that raise and hold economic resources for the direct benefit of the University or its constituents.

Based on GASB 39, the University identified two component units, the Northern Arizona University Foundation (Foundation), and the Northern Arizona Capital Facilities Finance Corporation (NACFFC).

Information on the component units can be found in this report in the component units' Statement of Financial Position, and Statement of Activities, as well as Note 8.

The Management's Discussion and Analysis focuses only on the University and does not address the component units.

## FINANCIAL HIGHLIGHTS

- Total net assets increased \$56.9 million from July 1, 2009 to June 30, 2010 based on total sources of funds of \$426.2 million and \$369.3 million of uses.
- Total sources of revenues increased by \$18.3 million or 4.5 percent while total uses of funds increased by \$1 million.
- Student tuition and fees increased 12.8 percent from the previous year or about \$14.3 million.
- The University was granted \$10.9 million in Federal Fiscal Stabilization Funds for fiscal year 2010.
- Investment income rebounded from the prior year loss and increased almost \$5.4 million from the previous fiscal year.
- State and capital appropriations decreased by approximately \$7.2 million from the prior year, a 5.3 percent reduction.
- The University Share of State Sales tax revenue decreased \$1.3 million from the previous year, due to the continued economic downturn in the State of Arizona.
- Auxiliary enterprise revenues, bolstered by increased student housing revenues, increased by \$3.8 million, or 9.7 percent.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## STATEMENT OF NET ASSETS

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. A summarized comparison of the University's assets, liabilities, and net assets at June 30, 2010 and 2009 (in thousands), is as follows:

	2010	2009
Current assets	\$ 241,885	\$ 140,795
Noncurrent assets:		
Cash, cash equivalents, investments, and student loans receivable	151,931	70,476
Endowment investments	14,491	12,867
Capital assets – net of accumulated depreciation	507,713	458,426
Other noncurrent assets	382	399
Total noncurrent assets	<u>674,517</u>	<u>542,168</u>
Total assets	<u>916,402</u>	<u>682,963</u>
Long-term liabilities	<u>494,816</u>	<u>325,786</u>
Other liabilities	<u>52,756</u>	<u>45,207</u>
Total liabilities	<u>547,572</u>	<u>370,993</u>
<b>Net assets</b>	<b><u>\$ 368,830</u></b>	<b><u>\$ 311,970</u></b>

A review of NAU's Statement of Net Assets at June 30, 2010 and 2009 shows that the University's financial position continues to improve with an increase in net assets of \$56.9 million.

Current assets consist primarily of cash and investments, government grants and contracts receivable, and accounts receivable. Current assets are generally considered to be convertible to cash within one year. Current assets increased overall by \$101.0 million over the prior fiscal year. The change was the result of an increase in cash and investments from net revenues of approximately \$56.9 million and a shift in investments of approximately \$43.6 million from noncurrent to current investments due to the reclassification of U.S. agency securities callable within one year.

Noncurrent assets increased approximately \$132.0 million over the prior year due to an increase in cash and investments and capital assets. Cash and investments had a net increase of approximately \$81.4 million due to an increase in cash and investments held by trustee from bond proceeds of \$125.0 million and a decrease in noncurrent investments of approximately \$43.6 million due to the reclassification of U.S. agency securities callable within one year.

Capital assets, net of accumulated depreciation, increased approximately \$49.0 million over the prior fiscal year as the University continued with major capital improvement projects, including the completion of the Distance Learning Expansion project, and ongoing construction of the Health and Learning Center and other capital facilities and infrastructure projects. The changes in capital assets are discussed in more detail in the Capital Assets and Debt Administration section.

Long-term liabilities increased by \$169.0 million over the prior fiscal year. The increase is mainly attributed to the issuance of long-term debt which is discussed further in the Capital Assets and Debt Administration section.

Other liabilities, which include accounts payable, accrued expenses, and deferred revenue, increased by \$7.5 million over the prior fiscal year. The increase is mainly attributed to increases in accounts payable of \$5.5 million (primarily construction payables), accrued payroll and employee benefits of \$1.0 million and interest payable of \$1.2 million.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## NET ASSETS

A summarized comparison of the University's net assets at June 30, 2010 and 2009 (in thousands), is as follows:

	2010	2009
Invested in capital assets, net of related debt	\$ 157,565	\$ 150,766
Restricted:		
Nonexpendable	18,253	17,504
Expendable	19,373	18,919
Unrestricted	173,639	124,781
<b>Total net assets</b>	<b>\$ 368,830</b>	<b>\$ 311,970</b>

Net assets at June 30, 2010 increased in total by \$56.9 million or approximately 18.3 percent from 2009. This is a result of total combined sources of \$426.2 million and total uses of \$369.3 million. The University continues to increase its revenue sources and manage operating expenses resulting in positive net asset growth.

## STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the University, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to U.S. generally accepted accounting principles. See the table of Combined Sources and Uses of Funds on pages 12-13 for an overview of the composition of revenues and expenses (sources and uses). A summarized comparison of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2010 and 2009 (in thousands), is as follows:

	2010	2009
Operating revenues:		
Tuition and fees, net of scholarship allowances	\$ 126,414	\$ 112,075
Grants and contracts	19,682	18,208
Auxiliary enterprises	42,745	38,967
Other	10,125	8,827
Total operating revenues	<u>198,966</u>	<u>178,077</u>
Nonoperating revenues:		
State appropriations	128,449	135,600
Share of state sales tax	10,913	12,246
Grants and contracts	64,388	52,348
Federal fiscal stabilization funds	10,935	23,492
Investment income	4,178	(1,192)
Other nonoperating revenues	1,732	0
Total nonoperating revenues	<u>220,595</u>	<u>222,494</u>
Total revenues	<u>419,561</u>	<u>400,571</u>
Operating expenses:		
Educational and general	302,416	305,357
Auxiliary enterprises	29,339	28,716
Depreciation	21,606	20,731
Total operating expenses	<u>353,361</u>	<u>354,804</u>
Nonoperating expenses:		
Interest expense on capital asset related debt	14,450	13,422
Other nonoperating expenses	1,561	117
Total nonoperating expenses	<u>16,011</u>	<u>13,539</u>
Total expenses	<u>369,372</u>	<u>368,343</u>
Increase before capital appropriations, capital grants and gifts and endowment additions	<u>50,189</u>	<u>32,228</u>
Capital appropriations, capital grants and gifts and endowment additions	<u>6,672</u>	<u>7,321</u>
<b>Increase in net assets</b>	<b>\$ 56,861</b>	<b>\$ 39,549</b>

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## REVENUES ANALYSIS

The statement of revenues, expenses, and changes in net assets presents the University's operating, nonoperating, and capital related financial activity during the fiscal year. State appropriations and tuition and fees continue to be the major funding sources for operations related to educational purposes. Operating revenues are provided as a result of the University's ongoing operations such as tuition and fees, government grants, and auxiliary enterprises. Operating revenues (not including state appropriations) increased by \$20.9 million or 11.7 percent from fiscal year 2009. The majority of that increase is attributed to tuition and fee revenue due to higher student enrollment coupled with an increase in board approved tuition rates. Auxiliary enterprise revenues increased by \$3.8 million, a 9.7 percent increase, primarily as a result of a \$2.4 million increase in residence life revenue due to additional occupancy, a new student housing facility, and a board approved rate increase.

Nonoperating revenues decreased overall by approximately 1 percent, or \$1.9 million. In particular, state appropriations, decreased by 5.3 percent, or approximately \$7.2 million as the state reduced the University's appropriations due to budget cuts. The share of state sales taxes-technology and research initiated funding (TRIF) revenues dropped \$1.3 million from the 2009 fiscal year due to a slowing Arizona economy and lower overall sales tax collections. Federal Fiscal Stabilization Funds awarded through the American Recovery and Reinvestment Act totaled \$10.9 million in fiscal year 2010, a decrease of \$12.6 million from the \$23.5 million received in fiscal year 2009. These funds which are set to expire in 2010, were applied for and used by the university for the purpose of supporting the salaries of individuals providing instruction services to students. The decreases in nonoperating revenue were offset by increases in government and private grants and contracts revenue of 23 percent, or \$12 million, primarily due to increases in Federal financial aid funding. Investment income totaled \$4.2 million in 2010 compared to a loss of \$1.2 million in 2009 as overall market conditions for investments improved in fiscal year 2010. Other nonoperating revenue increased by \$1.7 million primarily due to Build America Bond subsidies of \$1.5 million.

## EXPENSES ANALYSIS

Overall, operating expenses decreased by \$1.4 million; a reflection of university-wide budget cuts that impacted all program areas. The budget cuts were accomplished through reductions in operating expenses and reflect a conscious university effort to meet those cuts with limited employee layoffs.

Educational and general expenses, which continued to account for a majority of the operating expenses, were relatively flat in fiscal year 2010, decreasing approximately one percent or \$2.9 million. Significant changes within educational and general expenses were in instruction, a \$4.6 million decrease; operation and maintenance of plant, a \$3.1 million decrease; student services, a \$2.9 million decrease; public service, a \$1.9 million decrease; institutional support, a \$1.8 million increase; and scholarships and fellowships, a \$6.8 million increase. The scholarship and fellowship expense increase of \$6.8 million is directly linked to student enrollment growth and the impact of the economic downturn on need based financial support.

Salary and benefit costs, funded by state appropriations as well as support from both local and restricted funds, decreased by 2.5 percent, or \$6.0 million, due to University-wide furlough and layoff savings.

Depreciation expense increased by \$874 thousand or about 4.2 percent as the University constructed new buildings, improvements, and renovations. Depreciation expense is expected to continue to increase as the University continues to construct new buildings and renovate older ones.

Nonoperating expenses increased by \$2.5 million, or 18.3 percent due primarily to an increased interest expense on new debt of \$1.0 million and bond closing costs of \$1.2 million.

## EXPENSES - BY FUNCTIONAL CLASSIFICATION

A comparative summary of the University's expenses by functional classification for the years ended June 30, 2010 and 2009, is as follows:

	2010	2009
Operating:		
Instruction	\$ 123,076,526	\$ 127,717,088
Research	22,306,171	21,462,563
Public service	26,878,065	28,794,026
Academic support	27,193,695	27,064,158
Student services	25,312,244	28,228,123
Institutional support	37,626,758	35,789,017
Operation and maintenance of plant	16,591,368	19,658,374
Scholarships and fellowships	23,430,855	16,643,819
Total educational and general expenses	<u>302,415,682</u>	<u>305,357,168</u>
Auxiliary enterprises	29,339,433	28,715,955
Depreciation	21,605,636	20,731,251
Total operating expenses	<u>353,360,751</u>	<u>354,804,374</u>
Nonoperating:		
Interest and other	<u>16,011,310</u>	<u>13,538,415</u>
<b>Total expenses</b>	<b><u>\$ 369,372,061</u></b>	<b><u>\$ 368,342,789</u></b>

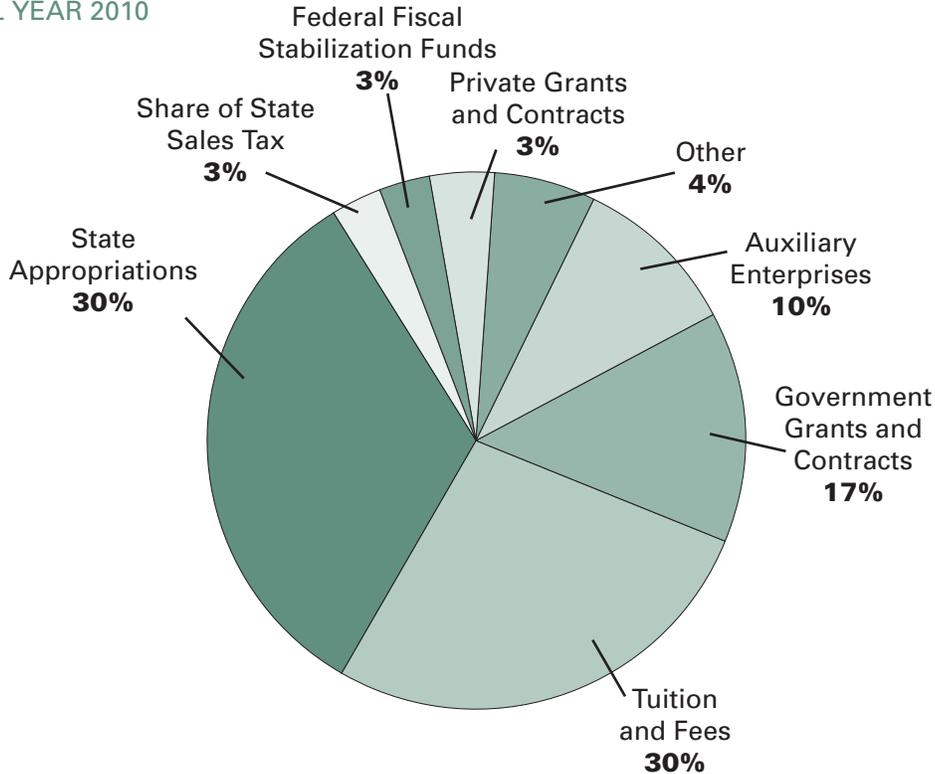
# MANAGEMENT'S DISCUSSION AND ANALYSIS

## EXPENSES - BY NATURAL CLASSIFICATION

In addition to their functional (program) classification, it is also informative to review operating expenses by their natural (object) classification. A comparative summary of the University's expenses by natural classification for the years ended June 30, 2010 and 2009, is as follows:

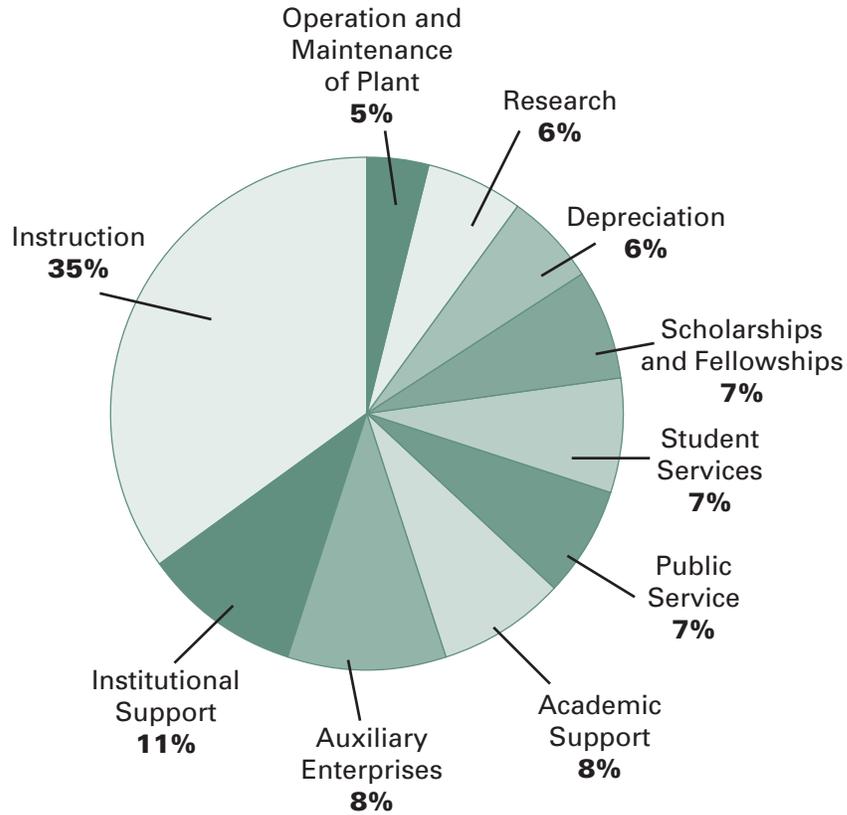
	2010	2009
Operating:		
Personal services and benefits	\$ 231,612,839	\$ 237,591,154
Operations	76,711,421	79,838,150
Scholarships	23,430,855	16,643,819
Depreciation	<u>21,605,636</u>	<u>20,731,251</u>
Total operating	<u>353,360,751</u>	<u>354,804,374</u>
Nonoperating:		
Interest and other	<u>16,011,310</u>	<u>13,538,415</u>
<b>Total expenses</b>	<b><u>\$ 369,372,061</u></b>	<b><u>\$ 368,342,789</u></b>

## TOTAL REVENUES FISCAL YEAR 2010

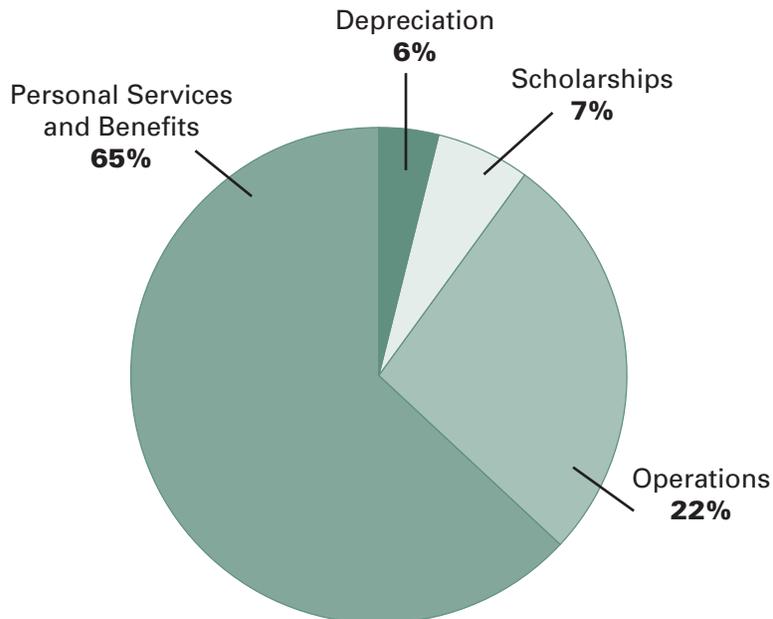


# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OPERATING EXPENSES FUNCTIONAL CLASSIFICATIONS FISCAL YEAR 2010



## OPERATING EXPENSES NATURAL CLASSIFICATIONS FISCAL YEAR 2010



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### Capital Assets at June 30, 2010

At June 30, 2010, the University had \$507.7 million invested in capital assets. During the year the University added \$71.8 million in new capital assets and retired \$5.8 million of obsolete assets. Accumulated depreciation increased by \$16.8 million. Details of capital assets at June 30, 2010 and 2009 are as follows:

	2010	2009
Land	\$ 6,685,920	\$ 5,597,637
Infrastructure	86,650,262	75,900,464
Buildings	549,090,129	531,506,211
Equipment	63,753,494	61,360,810
Library books and media	48,059,442	47,959,438
Construction in progress	63,142,496	29,004,858
Accumulated depreciation	<u>(309,668,859)</u>	<u>(292,902,986)</u>
<b>Total capital assets</b>	<b><u>\$ 507,712,884</u></b>	<b><u>\$ 458,426,432</u></b>

**S**ignificant capital additions completed or in progress, and the resources that funded their acquisitions for fiscal year 2010 were:

- Family Housing Cable and re-roof, \$921,808, unrestricted net assets
- Police Department relocation, \$1,181,604, bond proceeds/unrestricted net assets
- South Recreation Field expansion, \$561,872, bond proceeds
- Infrastructure and utility extensions, \$8,277,416, bond proceeds
- Distance Learning expansion, \$2,767,991, bond proceeds
- Health and Learning Center Project, \$38,478,550, restricted net assets
- Parking infrastructure expansion, \$1,110,913, bond proceeds/unrestricted net assets

Projects in progress, or planned to commence in fiscal year 2010 funded from COPS, system revenue bonds and unrestricted net assets include:

- Skydome renovation
- Liberal Arts renovation
- Hotel Restaurant Management renovation
- North Union renovation
- Native American Center
- Health and Learning project
- Infrastructure and utility extensions

In accordance with Arizona Revised Statutes § 15-1670, NAU receives \$5.9 million in state appropriations annually for lease-purchase capital financing of research infrastructure projects.

## ECONOMIC OUTLOOK

By most economic yardsticks, Arizona is experiencing serious problems. Since 1950, on a decade-over-decade basis, Arizona has ranked either 2nd, 3rd or 4th in the nation for both population and job growth. And in this decade, from 2000 to 2008, Arizona was 2nd in the nation in population growth and 4th in employment growth. But that abruptly changed in 2008 when the state lost 57,400 jobs which was followed in 2009 when the state lost 190,000 jobs, a 7.3 percent decline. Now in 2010 the state is on pace to lose an additional 24,000 jobs, reducing the number another 1.0 percent. Combined over the last 3 years, Arizona is estimated to have lost 271,300 jobs over 30 consecutive months. Though initial population estimates show growth in both 2009 and 2010, that view may change when data from the 2010 Census becomes available at the end of the calendar year. Leading the way in job losses has been the construction industry which lost 53 percent of its employment, 133,000 jobs, since it hit the peak in 2006. With weak, if any, population growth combined with job losses and significant numbers of foreclosed homes, the real estate industry is likely to suffer for many years to come.

The path to recovery for Arizona is particularly rough. Historically Arizona has relied upon population growth and expansion in the real estate industry as the engines of growth. That is unlikely through at least the first half of the next decade. Arizona benefited disproportionately from the expansion of credit in the 1990's and this decade. As businesses and individuals reduce their discretionary spending and cut their debt levels, Arizona can expect to be

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## CAPITAL ASSETS AND DEBT ADMINISTRATION (continued)

### Outstanding Debt at June 30, 2010

At June 30, 2010, the University had \$491.5 million in outstanding bonds, certificates of participation, other long-term obligations, and capital leases, an increase of approximately \$169 million, or 53 percent from fiscal year 2009. This is due to new borrowings of \$179.3 million and principal reductions of \$10.3 million.

The table below summarizes the University's outstanding debt from fiscal years 2010 and 2009.

	2010	2009
System revenue and housing bonds	\$ 360,010,000	\$ 187,270,000
Capital leases	47,775,000	48,560,000
Certificates of participation	83,315,000	85,705,000
Other long-term obligations	<u>359,537</u>	<u>673,666</u>
Subtotal	<u>491,459,537</u>	<u>322,208,666</u>
Less deferred amount on refunding	(1,846,740)	(2,006,681)
Plus bonds premium	<u>5,203,457</u>	<u>5,584,283</u>
<b>Total</b>	<b><u>\$ 494,816,254</u></b>	<b><u>\$ 325,786,268</u></b>

## ECONOMIC OUTLOOK (continued)

disproportionately impacted as well. In the 1990 recession, Arizona lost 11,700 jobs and it took 17 months for those jobs to be recovered. In the 2001 recession, Arizona lost 34,700 jobs and it took 20 months for those jobs to be recovered. As mentioned above, Arizona has lost over 270,000 jobs in the last 30 months. If the end of job losses has been reached and if Arizona can recover jobs as quickly as they have been lost, employment would be back to pre-recessionary levels by the summer of 2013. That implies a 3.7 percent rate of job growth, which is the average experienced from 1990 to 2007. All those assumptions appear optimistic at this point, so it is not unreasonable to expect the recovery in employment to occur in 2014 or 2015.

With those problems, it is not surprising that the state's General Fund is suffering significant problems. In FY2008, revenue collections declined by 4.6 percent which was followed by an 18.2 percent decline in FY2009 and a 10.1 percent decline in FY2010. The declines in revenue were bridged by federal stimulus funds, sale/lease back of property and fund sweeps among other temporary measures. Yet with all that, Arizona was 9th in the nation in FY2010 in the percentage decline in expenditures. Among the 50 states this past fiscal year, the average decline in state expenditures was 6.8 percent. Arizona reported a 10.7 percent decline in expenditures which was exceeded by 8 other states. The challenge which Arizona and most every other state face is the end of federal stimulus funding in FY2012. Arizona voters recently passed a temporary 3 year additional 1 cent tax

increase in the state's transaction privilege (sales) tax. While it is dedicated to primary education and public safety, it does provide additional revenue to the state.

For FY2008, total state appropriations to the Arizona University System reached its peak of \$1.1 billion. That Fall, total headcount enrollment was 122,731. In FY2010, total state appropriations had fallen to \$890.2 million or a 17 percent decline while enrollment had risen to 130,151, a 6 percent increase. State funding in FY2011 is unchanged at \$890.2 million while it appears that each institution will report record enrollment levels for the 2010-11 academic year. The losses in funding have been borne by students and their families through significant increases in tuition and fees. In 2008-09, resident undergraduate tuition and mandatory fees rose between 6.9 and 9.8 percent at the universities followed in 2009-10 by increases ranging from 4.8 to 9.9 percent and then in 2010-11 by increases of 11.6 to 20.4 percent.

Since Northern Arizona University is subject to the same economic variables that affect other financial entities, it is not possible to predict future outcomes. Management is well aware of the challenges ahead and is working diligently to continue to provide quality education and research activities to the State of Arizona and to the nation as a whole.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## COMBINED SOURCES AND USES OF FUNDS For the Year Ended June 30, 2010

### SOURCES

<b>State Appropriations</b> <b>30.1%</b> Includes legislative appropriations from state of Arizona general revenue for current operations of the University and \$1,230,525 for financial aid.	<b>\$ 128,448,625</b>
<b>Tuition and Fees, Net of Scholarship Allowances</b> <b>29.7%</b> Net of \$46,899,206 for scholarship allowances.	<b>\$ 126,413,650</b>
<b>Government Grants and Contracts</b> <b>16.7%</b> Includes revenues of \$60,277,549 from federal grants and contracts, \$3,795,878 from state grants and contracts, and \$7,147,045 from local government grants and contracts.	<b>\$ 71,220,472</b>
<b>Auxiliary Enterprises</b> <b>10.0%</b> Operations of substantially self-supporting activities such as student housing, student unions, and intercollegiate athletics.	<b>\$ 42,744,526</b>
<b>Other Sources</b> <b>4.3%</b> Includes additions to permanent endowments, capital grants and gifts, capital appropriations and other operating and nonoperating miscellaneous revenues.	<b>\$ 18,528,878</b>
<b>Private Gifts, Grants, and Contracts</b> <b>3.0%</b> Includes gifts, grants, and contracts for scholarships, endowments, and plant facility additions.	<b>\$ 12,850,281</b>
<b>Federal Fiscal Stabilization Funds</b> <b>2.6%</b> Fiscal year 2010 pass-through grant from the federal government under the American Recovery and Reinvestment Act.	<b>\$ 10,935,040</b>
<b>Share of State Sales Tax</b> <b>2.6%</b> University's share of state sales tax collections from Proposition 301.	<b>\$ 10,912,971</b>
<b>Investment income</b> <b>1.0%</b> Net earnings and losses from short-term investments of funds not necessary for immediate operating expenses and long-term investment of endowment and bond-retirement sinking funds.	<b>\$ 4,178,233</b>
<b>Total Sources</b>	<b><u>\$ 426,232,676</u></b>

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## COMBINED SOURCES AND USES OF FUNDS For the Year Ended June 30, 2010

### USES

#### **Instruction and Academic Support**

**40.7%**

**\$ 150,270,221**

Instruction, totaling \$123,076,526, includes expenses of academic departments and other organizational units for undergraduate and graduate courses, and for occupational or technical instruction, including academic year, summer sessions, and continuing education.

Academic support, totaling \$27,193,695, includes libraries, audio-visual services, and academic administration.

#### **Student Services and Institutional Support**

**17.0%**

**\$ 62,939,002**

Student services, totaling \$25,312,244 includes areas such as admissions, registrar, minority services, counseling, placement, student aid administration, and health services. Institutional support, totaling \$37,626,758, includes executive management, financial operations, computing support, human resource services, security, and University relations.

#### **Research and Public Service**

**13.3%**

**\$ 49,184,236**

Research, totaling \$22,306,171 consists of activities in 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, totaling \$26,878,065 includes activities that make available to the general public the benefits of the instructional or research activities and include local school consortiums and public broadcasting.

#### **Auxiliary Enterprises**

**8.0%**

**\$ 29,339,433**

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.

#### **Scholarships and Fellowships**

**6.3%**

**\$ 23,430,855**

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.

#### **Depreciation**

**5.9%**

**\$ 21,605,636**

Depreciation expense of capital assets over their useful lives

#### **Operation and Maintenance of Plant**

**4.5%**

**\$ 16,591,368**

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

#### **Other Uses**

**4.3%**

**\$ 16,011,310**

Other uses include \$14,450,002 in interest expense on capital asset-related debt and a \$817,409 loss on disposal of capital assets, and other nonoperating expenses of \$743,899.

#### **Total Uses**

**\$ 369,372,061**

# FINANCIAL STATEMENTS

## STATEMENT OF NET ASSETS June 30, 2010

### ASSETS

### BUSINESS-TYPE ACTIVITIES

#### Current assets:

Cash and cash equivalents	\$ 102,662,121
Investments	81,272,135
Receivables, net of allowance for uncollectibles:	
Accounts receivable	11,340,336
Accrued interest	793,943
Endowment	20,101
Government grants and contracts	13,617,154
Student loans, current portion	787,112
State appropriation receivable	30,493,439
Other assets	646,265
Inventories	252,321
<b>Total current assets</b>	<b>\$ 241,884,927</b>

#### Noncurrent assets:

Restricted cash and cash equivalents held by trustee for capital projects	\$ 144,663,169
Investments	2,409,646
Student loans receivable, net of allowance	4,858,169
Endowment investments	14,490,976
Other noncurrent assets	382,311
Capital assets, not being depreciated	69,828,416
Depreciable capital assets, net of depreciation	437,884,468
<b>Total noncurrent assets</b>	<b>\$ 674,517,155</b>

#### Total assets

**\$ 916,402,082**

### LIABILITIES

#### Current liabilities:

Accounts payable	\$ 13,445,776
Accrued payroll and employee benefits	11,690,771
Interest payable	3,438,155
Deferred revenue	14,111,004
Accrued compensated absences	4,856,199
Deposits held in custody for others	4,042,992
Current portion of long-term debt funded by:	
University operating revenues	7,948,574
State appropriations and share of state sales tax	2,480,000
<b>Total current liabilities</b>	<b>\$ 62,013,471</b>

#### Noncurrent liabilities:

Deposits held in custody for others	\$ 1,170,631
Long-term debt funded by:	
University operating revenues	351,724,680
State appropriations, share of state sales tax, and lottery revenue	132,663,000
<b>Total noncurrent liabilities</b>	<b>\$ 485,558,311</b>

#### Total liabilities

**\$ 547,571,782**

### NET ASSETS

Invested in capital assets, net of related debt	\$ 157,564,856
Restricted:	
Nonexpendable:	
Scholarships and fellowships	11,206,996
Student loans	7,046,019
Expendable:	
Scholarships and fellowships	4,155,035
Research	13,806,053
Academic department use	1,412,402
Unrestricted	173,638,939
<b>Total net assets</b>	<b>\$ 368,830,300</b>

See Notes to Financial Statements

# FINANCIAL STATEMENTS

## STATEMENT OF FINANCIAL POSITION - Component Units June 30, 2010

	NAU FOUNDATION	NACFFC	TOTAL
<b>ASSETS</b>			
Cash and cash equivalents	\$ 4,892,391	\$ 11,773	\$ 4,904,164
Investments	64,896,867		64,896,867
Accounts receivable	172,059	184,658	356,717
Unconditional promises to give (net of allowance)	7,961,222		7,961,222
Assets held by trustee	4,809,387	136,854	4,946,241
Property, plant and equipment, net of depreciation	36,975		36,975
Net investment in sales-type lease		47,775,000	47,775,000
Educational broadcasting system licenses	4,529,973		4,529,973
Other assets	1,878,820	1,434,963	3,313,783
<b>TOTAL ASSETS</b>	<u>\$ 89,177,694</u>	<u>\$ 49,543,248</u>	<u>\$ 138,720,942</u>
<b>LIABILITIES</b>			
Accounts payable and accrued liabilities	\$ 60,100	\$ 181,431	\$ 241,531
Bonds payable		47,740,757	47,740,757
Assets held in custody for others	5,422,874		5,422,874
Deferred revenue	7,488,037	21,991	7,510,028
Other liabilities	1,115,506		1,115,506
<b>Total liabilities</b>	<u>\$ 14,086,517</u>	<u>\$ 47,944,179</u>	<u>\$ 62,030,696</u>
<b>NET ASSETS</b>			
Unrestricted	\$ 23,351,599	\$ 1,599,069	\$ 24,950,668
Temporarily restricted	15,403,289		15,403,289
Permanently restricted	36,336,289		36,336,289
<b>Total net assets</b>	<u>\$ 75,091,177</u>	<u>\$ 1,599,069</u>	<u>\$ 76,690,246</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 89,177,694</u>	<u>\$ 49,543,248</u>	<u>\$ 138,720,942</u>

See Notes to Financial Statements

# FINANCIAL STATEMENTS

## STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS For Year Ended June 30, 2010

### REVENUES

	Business-Type Activities
Operating Revenues	
Tuition and fees, net of scholarship allowances of \$46,899,206	\$ 126,413,650
Government grants and contracts	17,705,265
Private grants and contracts	1,977,258
Auxiliary enterprises	
Residence life, net of scholarship allowances of \$3,486,772	27,841,603
Other auxiliaries	14,902,923
Other	10,124,693
<b>Total operating revenues</b>	<u>\$ 198,965,392</u>

### EXPENSES

Operating Expenses	
Educational and general:	
Instruction	\$ 123,076,526
Research	22,306,171
Public service	26,878,065
Academic support	27,193,695
Student services	25,312,244
Institutional support	37,626,758
Operation and maintenance of plant	16,591,368
Scholarships and fellowships	23,430,855
Auxiliary enterprises	29,339,433
Depreciation	21,605,636
<b>Total operating expenses</b>	<u>\$ 353,360,751</u>
<b>Operating loss</b>	<u>\$ (154,395,359)</u>

### NONOPERATING REVENUES AND (EXPENSES)

State appropriations	\$ 128,448,625
Share of state sales tax - technology and research initiative funding	10,912,971
Government grants	53,515,207
Private gifts and grants	10,873,023
Federal fiscal stabilization funds	10,935,040
Net investment income	4,178,233
Interest expense on capital asset related debt	(14,450,002)
Loss on disposal of capital assets	(817,409)
Other nonoperating revenues, net	987,995
<b>Total nonoperating revenues and expenses</b>	<u>\$ 204,583,683</u>

<b>Income before other revenues, expenses, gains or losses</b>	<u>\$ 50,188,324</u>
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Capital appropriations	\$ 5,900,000
Capital grants and gifts	45,500
Additions to permanent endowments	726,791

<b>Increase in net assets</b>	<u>\$ 56,860,615</u>
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### NET ASSETS

Total net assets, July 1, 2009	\$ 311,969,685
Total net assets, June 30, 2010	<u>\$ 368,830,300</u>

*See Notes to Financial Statements*

# FINANCIAL STATEMENTS

## STATEMENT OF ACTIVITIES - COMPONENT UNITS For Year Ended June 30, 2010

	NAU FOUNDATION	NACFFC	TOTAL
<b>CHANGES IN UNRESTRICTED NET ASSETS</b>			
Unrestricted support	\$ 671,168		\$ 671,168
Investment earnings	3,849,629	\$ 2,203,475	6,053,104
Licensing revenue	2,434,365		2,434,365
Rent		33,891	33,891
Other	674,539		674,539
<b>Total unrestricted support</b>	<u>\$ 7,629,701</u>	<u>\$ 2,237,366</u>	<u>\$ 9,867,067</u>
Net assets released from restrictions	8,909,437		8,909,437
<b>Total unrestricted revenues and support</b>	<u>\$ 16,539,138</u>	<u>\$ 2,237,366</u>	<u>\$ 18,776,504</u>
Expenses:			
Scholarships	\$ 1,962,202		\$ 1,962,202
Operating	2,948,156	\$ 33,903	2,982,059
Interest		2,206,985	2,206,985
Educational purposes	3,035,113		3,035,113
Amortization and depreciation	1,028,764	60,282	1,089,046
Other	14,000		14,000
<b>Total expenses</b>	<u>\$ 8,988,235</u>	<u>\$ 2,301,170</u>	<u>\$ 11,289,405</u>
<b>Increase (decrease) in unrestricted net assets</b>	<u>\$ 7,550,903</u>	<u>\$ (63,804)</u>	<u>\$ 7,487,099</u>
<b>CHANGES IN TEMPORARILY RESTRICTED NET ASSETS</b>			
Public contributions	\$ 5,105,988		\$ 5,105,988
Investment earnings	2,270,954		2,270,954
Loss on uncollectible pledges	(517,549)		(517,549)
Other income changes	307,118		307,118
Net assets released from restrictions	(8,909,437)		(8,909,437)
<b>Decrease in temporarily restricted net assets</b>	<u>\$ (1,742,926)</u>		<u>\$ (1,742,926)</u>
<b>CHANGES IN PERMANENTLY RESTRICTED NET ASSETS</b>			
Public contributions	\$ 1,478,945		\$ 1,478,945
Investment earnings	94,421		94,421
Other income changes	26,640		26,640
<b>Increase in permanently restricted net assets</b>	<u>\$ 1,600,006</u>		<u>\$ 1,600,006</u>
<b>INCREASE (DECREASE) IN NET ASSETS</b>	<u>\$ 7,407,983</u>	<u>\$ (63,804)</u>	<u>\$ 7,344,179</u>
<b>NET ASSETS, BEGINNING OF YEAR</b>	<u>\$ 67,683,194</u>	<u>\$ 1,662,873</u>	<u>\$ 69,346,067</u>
<b>NET ASSETS, END OF YEAR</b>	<u>\$ 75,091,177</u>	<u>\$ 1,599,069</u>	<u>\$ 76,690,246</u>

See Notes to Financial Statements

# FINANCIAL STATEMENTS

## STATEMENT OF CASH FLOWS For Year Ended June 30, 2010

	Business-Type Activities
Cash flows from operating activities:	
Tuition and fees	\$ 122,015,892
Grants and contracts	19,336,219
Payments to suppliers and providers of goods and services	(71,162,107)
Payments to employees	(226,362,665)
Payments for scholarships and fellowships	(23,430,855)
Loans issued to students	(989,236)
Collection of loans to students	932,390
Auxiliary enterprise receipts:	
Residence halls	28,554,051
Other auxiliaries	16,811,599
Other receipts	7,903,893
<b>Net cash used for operating activities</b>	<b>\$ (126,390,819)</b>
Cash flows from noncapital financing activities:	
State appropriations	\$ 113,195,946
Share of state sales tax	10,912,971
Federal fiscal stabilization funds	34,426,579
Gifts and grants for other than capital purposes	64,388,230
Federal direct student lending received	139,675,362
Federal direct student lending disbursed	(139,924,367)
Funds held for others received	13,313,373
Funds held for others disbursed	(12,861,444)
Financial aid trust funds	726,791
Other receipts	987,995
<b>Net cash provided by noncapital financing activities</b>	<b>\$ 224,841,436</b>
Cash flows from capital financing activities:	
Capital appropriations	\$ 5,900,000
Proceeds from issuance of capital debt	179,285,000
Proceeds from sale of capital assets	120,638
Capital grants and gifts received	500,000
Purchases of capital assets	(71,784,636)
Principal paid on capital debt and leases	(10,034,129)
Interest paid on capital debt and leases	(13,445,956)
<b>Net cash provided by capital financing activities</b>	<b>\$ 90,540,917</b>
Cash flows from investing activities:	
Proceeds from sales and maturities of investments	\$ 85,487,483
Interest on investments	4,243,092
Purchase of investments	(122,138,506)
<b>Net cash used for investing activities</b>	<b>\$ (32,407,931)</b>
Net increase in cash and cash equivalents	\$ 156,583,603
Cash and cash equivalents - beginning of year	90,741,687
Cash and cash equivalents - end of year	<u>\$ 247,325,290</u>
Reconciliation of operating loss to net cash used for operating activities:	
Operating loss	\$ (154,395,359)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation expense	21,605,636
Changes in assets and liabilities - cash increase (decrease) related to:	
Receivables:	
Accounts receivable	3,112,455
Government grants and contracts	(2,809,905)
Student loans receivables and accrued interest from student loans	(72,878)
Inventories	52,438
Other assets	(4,638)
Accounts payable	5,734,083
Accrued payroll and employee benefits	1,018,207
Deferred revenue	(644,356)
Accrued compensated absences	13,498
<b>Net cash used for operating activities</b>	<b>\$ (126,390,819)</b>
Significant noncash transactions	
State appropriation receivable	30,493,439

See Notes to Financial Statements

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

## Note 1—Summary of Significant Accounting Policies

### Financial Statement Presentation

The accounting policies of the University conform to U.S. generally accepted accounting principles applicable to public institutions of higher education engaged only in business-type activities adopted by the Governmental Accounting Standards Board (GASB). During the year ended June 30, 2010, the University implemented the provisions of GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets and GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments.

With respect to GASB 51 reporting requirements, the University established an intangible asset policy which includes capitalization thresholds for intangible assets (see Capital Asset section). For fiscal year 2010, one intangible asset (computer software) was determined to meet the capitalization threshold, and costs eligible for capitalization were captured and reported with capital construction in progress (see Note 3) until the project is completed. No retroactive adjustments were required as conditions for retroactive implementation were not met.

GASB 53 had no effect on reported amounts of revenues, expenses or net assets in fiscal year 2010, and required no additional note disclosures.

### Reporting Entity

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 of the State for financial reporting purposes. The accompanying financial statements present the activities of the University and its discretely presented component units, the Northern Arizona University Foundation, Inc. (Foundation) and the Northern Arizona Capital Facilities Finance Corporation (NACFFC).

The Foundation was incorporated as a legally separate not-for-profit corporation in the State of Arizona in January 1959, and operates exclusively for the benefit of Northern Arizona University. The Foundation receives gifts and bequests, administers and invests in securities and property, and disburses payments to and on behalf of the University for advancement of its mission.

NACFFC was incorporated in October 2001, as a legally separate not-for-profit corporation under the laws of the State of Arizona for the purpose of acquiring, developing, constructing, maintaining and operating student housing and other capital facilities and equipment for the use and benefit of the University's students.

Although the University does not control the timing or amount of receipts from the Foundation, or the NACFFC, the restricted resources of both the Foundation, and the NACFFC, can only be used by, or for the benefit of the University or its constituents. Consequently, both the Foundation and the NACFFC are considered component units of the University and are discretely presented in the University's financial statements. For financial reporting purposes, only the statement of financial position and the statement of activities of the component units are included in the University's

financial statements, as required by generally accepted accounting principles for public colleges and universities.

For financial reporting purposes, the Foundation and the NACFFC follow the Financial Accounting Standards Board (FASB) statements for not-for-profit organizations. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. Accordingly, those financial statements have been reported on separate pages following the respective counterpart statements of the University. The Foundation and the NACFFC have a June 30 year end. Complete financial statements as originally presented for the Foundation and the NACFFC can be obtained from the Northern Arizona University Comptroller's Office, P.O. Box 4069, Flagstaff, AZ 86011.

During the year ended June 30, 2010, the Foundation distributed \$4.3 million to the University for restricted and unrestricted purposes.

### Basis of Accounting

The University's financial statements are 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 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 University has chosen the option not to follow FASB Statements and Interpretations issued after November 30, 1989.

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

The statement of net assets provides information about the assets, liabilities, and net assets of the University at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to external donor restrictions or availability of assets to satisfy University obligations. Invested in capital assets net of related debt, represents the value of capital assets, net of accumulated depreciation, less any outstanding debt incurred to acquire or construct the assets. Nonexpendable restricted net assets are gifts that have been received for endowment purposes, the corpus of which cannot be expended and monies that are restricted for the purpose of issuing student loans. Expendable restricted net assets represent grants, contracts, gifts, and other resources that have been externally restricted for specific purposes. Unrestricted net assets include all other net assets, including those that have been designated by management to be used for other than general operating purposes.

The statement of revenues, expenses, and changes in net assets provides information about the University's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and additions to endowments. Operating revenues and expenses

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

are those that generally result from exchange transactions generated from providing instructional, research, public, and auxiliary services, which are consistent with the University's mission. Accordingly, revenues such as tuition and fees, sales and services of auxiliary enterprises and most government and nongovernment research grants and contracts are considered operating. Certain significant revenue streams relied upon for operations are recorded as nonoperating revenues, as defined by GASB Statement No. 35, including state appropriations, nonexchange grants, gifts, and investment income. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. Other expenses, such as interest expense on debt, are considered to be nonoperating expenses.

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

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

## Cash and Cash Equivalents

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

## Investments

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

## Receivables

Student loans and accounts receivable as of June 30, 2010, are reported less allowances for both estimated uncollectible

amounts and collection costs of \$1,102,100 and \$3,822,000 respectively.

The fiscal year 2010 appropriation to Arizona Board of Regents for the support and maintenance of institutions under its jurisdiction were deferred in the amount of \$200 million to fiscal year 2010 with payment to be no later than October 1, 2010. Northern Arizona University's portion of the deferred appropriation payment of \$30,493,439 was recorded as a receivable in fiscal year 2010.

Through the American Recovery and Reinvestment Act of 2009, the State of Arizona applied for and was awarded State Fiscal Stabilization Funds (SFSF) from the U.S. Department of Education. For fiscal year 2010, the Governor awarded Northern Arizona University \$10,935,040 in SFSF. The SFSF funds are set to expire in fiscal year 2010.

## Inventories

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

## 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, and compensatory time are paid to employees. Accordingly, vacation benefits and compensatory time are accrued as a liability in the financial statements.

Generally, sick leave benefits provide for ordinary sick pay and are cumulative but are forfeited upon termination of employment. Because sick leave benefits do not vest with employees, a liability for sick leave benefits is not accrued in the financial statements. However, upon retirement, employees who have accumulated at least 500 hours of sick

## 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 thousand	Straight Line	20 years
Buildings	All	Straight Line	40 years
Infrastructure	All	Straight Line	20-40 years
Land	All	None	
Equipment	\$5 thousand	Straight Line	5-15 years
Library books and media	All	Straight Line	10 years
Intangible assets:			
Computer software > \$10 million	\$10 million	Straight Line	10 years
Computer software < \$10 million	\$1 million	Straight Line	5 years
All other (1)	\$100 thousand	Straight Line	(1)

(1)Includes websites, non-software licenses & permits, patents, copyrights and trademarks, rights-of-way and easements, natural resource extraction rights and other intangible assets. In general, the estimated useful life is the shorter of the legal or the estimated useful life.

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

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 does not have 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 fees revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. A scholarship discount and allowance is the difference between the stated charge for goods and services provided by the University and the amount that is paid by students or third parties making payments on behalf of the student.

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

## Note 2—Deposits and Investments

Arizona Revised Statutes (A.R.S.) § 15-1668 require that deposits of the University not covered by federal deposit insurance, be secured by government bonds or by a safekeeping receipt of the institution accepting the deposit. Further, policy regarding deposits is provided by the Arizona Board of Regents (ABOR). Deposits can be made only at depository banks approved by the Board. A.R.S. and ABOR policies constitute the University's policy regarding custodial credit risk for deposits.

There is no statutory requirement that governs university investment activities. A.R.S. § 15-1625 gives the ABOR jurisdiction and control over the universities, and A.R.S. § 15-1626 allows ABOR to authorize the universities to adopt regulation, policies, rules, or measures as deemed necessary. ABOR investment policies require that the University invest only in the State Treasurer's Local Government Investment Pool, collateralized time certificates of deposit and repurchase

agreements, U.S. Treasury securities, and obligations of other agencies sponsored by the federal government. In addition, ABOR has authorized the University to establish an investment committee. The investment committee establishes investment policies and makes investment decisions. ABOR policies guide the investment committee decisions. The University's deposit and investment policies mirror that of the ABOR policies.

The bond indentures constitute the investment policy for University monies held with bond trustees. The bond indentures authorize the bond trustees to invest in obligations of or guaranteed by the federal government or any agency or instrumentality thereof, municipal obligations, collateralized certificates of deposit with federally insured banks, trust companies, savings and loan associations within the State of Arizona, or repurchase agreements.

## Deposits

At June 30, 2010, cash on hand was \$16,634, the carrying amount of the University's deposits was \$32,664,690 and the bank balance was \$35,426,141. Beyond the requirements established by A.R.S. and ABOR, the University does not have a policy that specifically addresses custodial credit risk. At June 30, 2010, \$34,926,141 of the University's bank balance was uninsured with collateral held by the pledging financial institution.

## Investments

	Amount
U.S. agency securities	\$ 83,276,390
State Treasurer's Investment Pool 5	20,574,146
Bond Trustee Funds:	
Government Money Market Mutual Fund	144,663,169
Money Market Funds	48,491,539
Student Financial Aid Trust Fund	11,008,725
Investments with NAU Foundation	4,802,754
	<u>\$ 312,816,723</u>

The State Board of Investment provides oversight for the State Treasurer's investment pools. The fair value of the University's investment in the pool approximates the value of the University's pool shares and the University's shares are not identified with specific investments.

## Credit Risk

University policy requires negotiable certificates of deposit; corporate bonds, debentures, and notes; banker acceptances; and State of Arizona bonds carry a minimum rating of BBB or better from Standard and Poor's Rating Service. At June 30, 2010, credit risk for the University investments were as follows:

Investment Type	Rating	Rating Agency	Amount
U.S. agency securities	AAA	Standard and Poors	\$ 83,276,390
State Treasurer's investment pool 5	AAAf/S1+	Standard and Poors	20,574,146
Bond Trustee Funds:			
Government Money Market Mutual Fund	AAAm	Standard and Poors	144,663,169
Moeny Market Mutual Funds	AAAm	Standard and Poors	48,491,539
Student Financial Aid Trust Fund, debt securities	unrated	N/A	4,488,776
Investments with NAU Foundation, debt securities	unrated	N/A	1,396,182
			<u>\$ 302,863,202</u>

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

U.S. agency securities include Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation, Federal Home Loan Bank, and the Federal National Mortgage Association securities.

The Arizona Student Financial Aid Trust Fund (ASFAT) was established in accordance with A.R.S. §15-1642 for the purpose of providing aid to students with verifiable financial need. The University of Arizona holds and manages the University's share of ASFAT. The University's ownership interest is recorded in the University of Arizona's records.

Trust agreements between the University and the NAU Foundation, Inc. authorize the Foundation to invest certain University restricted and endowment monies according to the Foundation's established investment policies and procedures. The University's portion is not identified with specific investments. The University's ownership interest is recorded in the Foundation's records.

## Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The University does not have a formal policy in regards to custodial credit risk. At June 30, 2010, the University had \$83,276,390 of U.S. agency securities that were uninsured and held by the counterparty not in the University's name.

## Concentration of Credit Risk

University policy limits investments in a single issuer to 5 percent or less of the fair value of the total portfolio. However, securities issued by the federal government or its agencies, sponsored agencies, corporations, sponsored corporations or instrumentalities are exempt from this provision. The following investments represent five percent or more of the University's investments at June 30, 2010: Federal Farm Credit Bank, 8.05 percent; Federal National Mortgage Association, 8.01 percent; and Federal Home Loan Mortgage Corporation securities 6.73 percent.

## Interest Rate Risk

University policy limits the maximum maturity of any fixed or variable rate security to five years. The endowment fund portfolio has no such limitation.

Investment type	Fair Value	Maturity			
		Less than 1 Year	1-5 Years	6-10 Years	More than 10 Years
Government Money Market Mutual Fund	\$ 144,663,169	\$ 144,663,169			
Money Market Mutual Fund	48,491,539	48,491,539			
NAU Foundation	1,369,182	70,828	\$ 747,081	\$ 458,977	\$ 92,296
State Treasurer's Investment Pool 5	20,574,146	20,574,146			
Student Financial Aid Trust Fund	4,488,776		4,488,776		
U.S. agency securities	83,276,390		83,276,390*		
<b>Total</b>	<b>\$ 302,863,202</b>	<b>\$ 213,799,682</b>	<b>\$ 88,512,247</b>	<b>\$ 458,977</b>	<b>\$ 92,296</b>

\*These bonds mature in years 2012 and 2013, but are currently callable. At June 30, 2010 the University held \$83,276,390 or 27 percent of investments in Federal Agency securities, including Federal Farm Credit Bank, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation and Federal Home Loan Banks, which may be considered to be highly sensitive to interest rate fluctuations because borrower repayment terms may vary.

A reconciliation of cash, deposits, and investments to amounts shown on the Statement of Net Assets is as follows:

### Cash, deposits and investments:

Cash on hand	\$ 16,634
Cash in bank	32,664,690
Total investments	312,816,723
	<u>\$ 345,498,047</u>

### Statement of Net Assets:

Cash and cash equivalents	\$ 102,662,121
Current investments	81,272,135
Restricted cash and cash equivalents held by trustee for capital projects	144,663,169
Noncurrent investments	2,409,646
Endowment investments	14,490,976
	<u>\$ 345,498,047</u>

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

## Note 3—Capital Assets

Capital asset activity for the year ended June 30, 2010, was as follows:

	Balance June 30, 2009	Additions	Retirements	Transfers	Balance June 30, 2010
Capital assets not being depreciated:					
Land	\$ 5,597,637	\$ 1,088,283			\$ 6,685,920
Construction in progress	29,004,858	60,979,730	\$	\$ (26,842,092)	63,142,496
Total capital assets not being depreciated	34,602,495	62,068,013		(26,842,092)	69,828,416
Capital assets being depreciated:					
Infrastructure	75,900,464	1,260,116		9,489,682	86,650,262
Buildings and improvements	531,506,211	1,598,898	1,367,390	17,352,410	549,090,129
Equipment	61,360,810	6,290,078	3,897,394		63,753,494
Library books and media	47,959,438	627,474	527,470		48,059,442
Total capital assets being depreciated	716,726,923	9,776,566	5,792,254	26,842,092	747,553,327
Less accumulated depreciation for:					
Infrastructure	28,031,430	2,701,662			30,733,092
Buildings and improvements	176,255,895	13,880,344	848,026		189,288,213
Equipment	44,756,717	3,888,527	3,464,267		45,180,977
Library books and media	43,858,944	1,135,103	527,470		44,466,577
Total accumulated depreciation	292,902,986	21,605,636	4,839,763		309,668,859
Total capital assets being depreciated, net	423,823,937	(11,829,070)	952,491	26,842,092	437,884,468
<b>Capital assets, net</b>	<b>\$ 458,426,432</b>	<b>\$ 50,238,943</b>	<b>\$ 952,491</b>	<b>\$</b>	<b>\$ 507,712,884</b>

**Construction** - The University had major contractual commitments related to various capital projects at June 30, 2010, including the construction of a Health & Learning Center, a Native American Center, major building renovations and major infrastructure up-grades. At June 30, 2010, the University had spent \$61,323,000 on these projects and had remaining contractual commitments with contractors of \$71,488,000. These projects are being financed with a combination of system revenue bond, series 2008 and 2009, revenue bond series 2010, and University reserves.

## Note 4—Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2010, was as follows:

	Balance June 30, 2009	Additions	Reductions	Balance June 30, 2010	Due Within One Year
Long-term obligations	\$ 673,666		\$ 314,129	\$ 359,537	\$ 67,690
Capital leases	48,560,000		785,000	47,775,000	850,000
Certificates of participation	85,705,000		2,390,000	83,315,000	2,480,000
Revenue and housing bonds payable	187,270,000	\$ 179,285,000	6,545,000	360,010,000	6,810,000
Less deferred amount on refunding	(2,006,681)		(159,941)	(1,846,740)	(159,941)
Discounts/premiums	5,584,283		380,826	5,203,457	380,825
<b>Total long-term liabilities</b>	<b>\$ 325,786,268</b>	<b>\$ 179,285,000</b>	<b>\$ 10,255,014</b>	<b>\$ 494,816,254</b>	<b>\$ 10,428,574</b>

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

The University's bonded debt and certificates of participation (COPs) consist of various issues that are generally callable at a prescribed date with interest payable semiannually. All issues are at a fixed rate. Bond proceeds primarily pay for acquiring, constructing or renovating 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 and Certificates of Participation at June 30, 2010 (Dollars in thousands)

	Average Interest Rate	Final Maturity	Balance 07/01/2009	Additions	Reductions	Balance 6/30/2010	Current Portion
Bonds:							
1997 System Revenue	5.245%	6/1/2010	\$ 2,895		\$ (2,895)		
2002 System Revenue	4.841%	6/1/2022	6,710		(540)	\$ 6,170	\$ 555
2003 System Revenue	5.325%	6/1/2016	4,860		(625)	4,235	645
2004 System Refunding	4.749%	6/1/2034	36,985		(520)	36,465	3,580
2005 System Revenue	4.685%	6/1/2040	14,585		(240)	14,345	245
2006 System Refunding	4.675%	6/1/2034	42,150		(60)	42,090	60
2007 System Revenue	4.929%	6/1/2037	37,110		(670)	36,440	700
2008 System Revenue	5.041%	6/1/2038	41,975		(995)	40,980	1,025
2009A System Revenue	6.490%	6/1/2039		\$ 108,860		108,860	
2009B System Revenue	5.000%	6/1/2016		5,640		5,640	
2010 Revenue	6.164%	8/1/2030		64,785		64,785	
Subtotal: Par Amount of Bonds			<u>\$ 187,270</u>	<u>\$ 179,285</u>	<u>\$ (6,545)</u>	<u>\$ 360,010</u>	<u>\$ 6,810</u>
Certificates of Participation:							
2004 Certificates of Participation	4.852%	9/1/2030	\$ 35,715		\$ (975)	\$ 34,740	\$ 1,010
2005 Certificates of Participation	4.650%	9/1/2030	38,180		(1,085)	37,095	1,120
2006 Certificates of Participation	4.350%	9/1/2030	11,810		(330)	11,480	350
Subtotal: Par Amount of COPS			<u>\$ 85,705</u>		<u>\$ (2,390)</u>	<u>\$ 83,315</u>	<u>\$ 2,480</u>
Total Par Amount of Bonds and COPS			<u>\$ 272,975</u>	<u>\$ 179,285</u>	<u>\$ (8,935)</u>	<u>\$ 443,325</u>	<u>\$ 9,290</u>
Premium/(Discount) on Sale of Bonds and COPS			5,584		(381)	5,203	381
Deferred Amount on Refundings			(2,007)		160	(1,847)	(160)
<b>Total Bonds Payable and COPS</b>			<u><b>\$ 276,552</b></u>	<u><b>\$ 179,285</b></u>	<u><b>\$ (9,156)</b></u>	<u><b>\$ 446,681</b></u>	<u><b>\$ 9,511</b></u>

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

The following schedule details debt service requirements to maturity for the University's bonds payable at June 30, 2010.

Year ending June 30,	Revenue Bonds	
	Principal	Interest
2011	\$ 6,810,000	\$ 19,610,572
2012	7,080,000	19,347,343
2013	7,400,000	19,028,175
2014	7,450,000	18,696,462
2015	10,505,000	18,345,806
2016-20	60,335,000	82,782,539
2021-25	67,100,000	66,620,006
2026-30	79,860,000	45,840,381
2031-35	70,605,000	23,748,480
2036-40	42,865,000	6,110,309
<b>Total</b>	<b>\$ 360,010,000</b>	<b>\$ 320,130,073</b>

The following schedule details debt service requirements to maturity for the University's certificates of participation payable at June 30, 2010.

Year ending June 30,	Certificates of participation	
	Principal	Interest
2011	\$ 2,480,000	\$ 3,763,533
2012	2,575,000	3,666,356
2013	2,670,000	3,565,760
2014	2,780,000	3,458,106
2015	2,890,000	3,338,977
2016-20	16,455,000	14,661,885
2021-25	20,825,000	10,182,554
2026-30	26,525,000	4,404,922
2031	6,115,000	50,279
<b>Total</b>	<b>\$ 83,315,000</b>	<b>\$ 47,092,372</b>

## Bonds

On December 17, 2009, the University sold \$108,860,000 of Taxable Series 2009A System Revenue Bonds and \$5,640,000 of Tax Exempt Series 2009B System Revenue Bonds for the purpose of construction and improvement of a new Health and Learning Center, demolition and reconstruction of Lumberjack Stadium, improvements to utility extensions for the northeast portion of the University Campus, and various other capital projects. The Taxable Series 2009A Bonds included serial bonds of \$27,290,000 with interest rates ranging from 4.84% to 5.84% and two term bonds of \$26,610,000 and \$54,960,000, with interest rates of 6.587% and 6.687%, respectively that mature on June 1, 2030 and 2039, respectively. The term bonds are subject to annual sinking fund contributions. The Tax Exempt Series 2009B Bonds have an interest rate of 5%. Both bond issues are generally subject to redemption prior to maturity. The 2009 System Revenue Bonds are secured by a first lien on certain gross revenues of the University that primarily consist of student tuition and fees, and certain auxiliary revenues and are on parity with the University's previously issued System Revenue Bonds.

On April 28, 2010, the University sold \$64,785,000 of SPEED (Stimulus Plan for Economic and Educational Development) Revenue Bonds Taxable Series 2010 for the purpose of the Skydome Renovation Project, Liberal Arts Building Renovation Project, Hotel and Restaurant Management School Renovation Project, North Campus Utilities Upgrade Project, and the North Union Building Renovation Project. The Taxable Series 2010 Bonds included serial bonds of \$38,930,000 with interest rates ranging from 4.266% to 6.27%. The 2010 Bonds also included a \$25,855,000 term bond, with an interest rate of 6.593% that matures on August 1, 2030, and is subject to annual sinking fund contributions. The bonds are generally subject to redemption prior to maturity. The 2010 Taxable Bonds are limited obligations that are payable solely from and secured solely by a pledge from the NAU Account of the SPEED Fund which is derived from certain revenues of the Arizona State Lottery not to exceed 80% of annual debt service and other University monies equal to at least 20%, and as much as 100% of annual debt service. To the extent monies of the SPEED Fund are not sufficient to make the debt service payments, the 2010 Taxable Bonds are also secured by a pledge of certain gross revenues, but that pledge is junior and subordinate to the pledge of those gross revenues for the University's System Revenue Bonds.

The Series 2009A and 2010 Bonds were issued as designated Build America Bonds under the provisions of the American Recovery and Reinvestment Act. As such, the University is eligible to receive direct payments from the U.S. Treasury Department equal to 35% of the interest payments on such bonds on each interest payment date. In order to receive such payments, the University must file certain required information with the Federal government between 90 and 45 days prior to the interest payment date. The amount paid to the University by the Federal government may be reduced or eliminated due to such issues as failure by the University to submit the required information, any amounts owed by the University to the federal government, or changes in the law that would reduce or eliminate such payments. The University is currently not aware of any such issues that may adversely affect the amount of payments to be received from the Federal government related to such designated Build America Bonds. For accounting purposes, any direct payments received from the U.S. Treasury Department are recorded as nonoperating revenue.

In prior years, the University defeased certain revenue bonds by either placing the proceeds of new bonds, or cash and investments accumulated in a 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, 2010, \$41,130,000 of such bonds outstanding are considered defeased.

The University has pledged portions of its gross revenues towards the payment of debt related to system revenue bonds, system revenue refunding bonds, and SPEED revenue bonds outstanding at June 30, 2010. The bonds generally provide financing for various capital projects of the University. These pledged revenues include student tuition and fees, certain auxiliary enterprises revenue, investment income, and indirect cost recovery revenue. Pledged revenues do not include state appropriations, gifts, endowment income, or other restricted revenues. At June 30, 2010 pledged revenues totaled \$198.2 million of which 9.4% (\$18.7 million) was required to cover current year debt service. Future pledged revenues required to pay all remaining debt service for the bonds through final maturity of June 1, 2040 is \$680 million.

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

## Capital Leases

On May 19, 2005, the University entered into a lease agreement with Pine Ridge Village/Campus Heights, LLC (PRV/CH). The Company is a subsidiary of the Northern Arizona Capital Facilities Finance Corporation (NACFFC). During the 28-year lease term, the University will make lease payments on two apartment-style student housing complexes, Pine Ridge Village (PRV), and McKay Village (MV). The University recorded a capital lease of \$13.2 million in fiscal 2005 for the PRV complex and a capital lease of \$22.7 million in fiscal year 2007 for the MV complex.

On September 1, 2006, the University entered into a lease agreement with North Campus Facilities L.L.C. (NCF), a subsidiary of the NACFFC. During the 30-year lease term, the University will make lease payments on a 41,000 sq. ft. conference center and 344 space parking garage (High Country Conference Center). The University recorded a capital lease of \$12.4 million in fiscal year 2008 for the High Country Conference Center. Lease payments are based on the debt service schedule of fixed rate bonds with an average coupon rate of 4.89%. Over the course of the project, the University contributed additional funds of \$12 million towards construction costs which were paid to NCF as additional rent, including \$2 million provided by the City of Flagstaff.

## Capital lease commitments to lessors at June 30, 2010 based on present value of lease payments

	Average Interest Rate	Final Maturity	Balance June 30, 2009	Additions	Reductions	Balance June 30, 2010	Current Portion
Pine Ridge/McKay Village	4.61%	6/1/2033	\$ 36,390,000		\$ 545,000	\$ 35,845,000	\$ 600,000
North Campus Facilities LLC	4.89%	6/1/2036	12,170,000		240,000	11,930,000	250,000
Total: Capital Leases			<u>\$ 48,560,000</u>		<u>\$ 785,000</u>	<u>\$ 47,775,000</u>	<u>\$ 850,000</u>

Minimum lease payment commitments, including interest reimbursed to the lessor, for the capital leases described above are summarized in the table below.

Year ending June 30,

	Capital Lease Payments
2011	\$ 2,845,738
2012	3,061,169
2013	3,097,844
2014	3,137,019
2015	3,171,569
2016-20	16,460,067
2021-25	17,484,437
2026-30	18,538,088
2031-35	13,269,138
2036	819,000
Total minimum lease payments	<u>81,884,069</u>
Less amount representing interest	<u>(34,109,069)</u>
<b>Present value of minimum lease payments</b>	<b><u>\$ 47,775,000</u></b>

**Capital Lease Assets** – the book value, accumulated depreciation and net book value for capitalized leased assets as of June 30, 2010 were as follows:

Asset	Book Value	Accumulated Depreciation	Net Book Value
Pine Ridge	\$ 13,225,000	\$ (1,982,391)	\$ 11,242,609
McKay Village	\$ 22,685,000	\$ (2,266,946)	\$ 20,418,054
Conference Center	<u>\$ 24,679,964</u>	<u>\$ (1,844,214)</u>	<u>\$ 22,835,750</u>
<b>Total</b>	<b><u>\$ 60,589,964</u></b>	<b><u>\$ (6,093,551)</u></b>	<b><u>\$ 54,496,413</u></b>

## Operating Leases

The University leases numerous class room facilities for extended campus instruction and a limited number of administrative facilities under long term lease agreements classified as operating leases for accounting purposes. Rental expenses under the terms of operating leases were \$2.4 million for the year ended June 30, 2010. The operating leases have remaining noncancelable terms from 1 to 7 years and provide renewal options. The future minimum payments required under the operating leases at June 30, 2010, were as follows:

Year ending June 30,

2011	\$ 1,662,352
2012	1,105,189
2013	727,488
2014	727,183
2015	617,627
2016 - 2017	941,881
<b>Total minimum lease payments</b>	<b><u>\$ 5,781,720</u></b>

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

## Note 5—Retirement Plans

The University participates in a cost-sharing multiple-employer defined benefit pension, health, and long-term disability plan administered by the Arizona State Retirement System (ASRS) and a defined contribution pension plan available through one of three independent insurance and annuity companies approved by the Arizona Board of Regents.

Under the University's defined benefit plan, the ASRS (through its Retirement Fund) provides retirement (i.e., pension), death, and survivor benefits; the Health Benefit Supplement Fund provides health insurance premium benefits (i.e., a monthly subsidy); and the Long-Term Disability Fund provides long-term disability benefits. Benefits are established by state statute. The System is governed by the Arizona State Retirement System Board according to 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.

The Arizona State Legislature establishes and may amend active plan members' and the University's contribution rates. For the year ended June 30, 2010, active plan members were required by statute to contribute at the actuarially determined rate of 9.40 percent (9.00 percent for retirement and 0.4 percent for long-term disability) of the members' annual covered payroll and the University was required by statute to contribute at the actuarially determined rate of 9.40 percent (8.34 percent for retirement, 0.66 percent for health insurance premium, and 0.4 percent for long-term disability) of the members' annual covered payroll.

The University's contributions for the current and two preceding years, all of which were equal to the required contributions, were as follows.

Years ended June 30,	Retirement Fund	Health Benefit Supplement Fund	Long-Term Disability Fund
2010	\$ 6,222,744	\$ 492,477	\$ 296,901
2009	\$ 6,135,936	\$ 737,234	\$ 382,087
2008	\$ 5,939,553	\$ 774,724	\$ 368,934

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, 2010, plans offered by the Teachers Insurance Annuity Association/College

Retirement Equities Fund (TIAA/CREF), Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments Tax-Exempt Service Company (Fidelity), 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, 2010, 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 Retirement Plans

for the year ended June 30, 2010, are summarized below.

Plan	University Contributions	Member Contributions	Total Contributions
TIAA/CREF	\$ 3,090,981	\$ 3,090,981	\$ 6,181,962
VALIC	\$ 339,084	\$ 339,084	\$ 678,168
Fidelity	\$ 1,284,446	\$ 1,284,446	\$ 2,568,892

## Note 6—Risk Management

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The University participates in a self-insurance program administered by the State of Arizona, Department of Administration, Risk Management Division. A.R.S. §41-621 et seq. provides that losses eligible for coverage and which are not covered by insurance will be paid by the State from the self-insurance program or by a future appropriation from the State Legislature. Loss risks which are not covered by Risk Management and where the University has no insurance coverage, are losses that arise from contractual breaches and are directly attributable to an act or omission, and determined to be a felony by a court of law. With this exception, the University has no significant risk of loss beyond adjustments to future years' premium payments to the State's self-insurance program. All estimated losses for unsettled claims and actions of the State are determined on an actuarial basis and are included in the State of Arizona Comprehensive Annual Financial Report.

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

## Note 7—Expense Classification

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

### For the Year Ended June 30, 2010 • Natural Classification

	Personal Services and Benefits	Operations	Scholarships	Depreciation	Total
Functional Classification:					
Instruction	\$ 109,689,217	\$ 13,387,309			\$ 123,076,526
Research	15,536,442	6,769,729			22,306,171
Public service	14,007,160	12,870,905			26,878,065
Academic support	21,528,294	5,665,401			27,193,695
Student services	18,673,638	6,638,606			25,312,244
Institutional support	25,428,370	12,198,388			37,626,758
Operation and maintenance of plant	7,854,691	8,736,677			16,591,368
Scholarships and fellowships			\$ 23,430,855		23,430,855
Auxiliary enterprises	18,895,027	10,444,406			29,339,433
Depreciation				\$ 21,605,636	21,605,636
<b>Total</b>	<b>\$ 231,612,839</b>	<b>\$ 76,711,421</b>	<b>\$ 23,430,855</b>	<b>\$ 21,605,636</b>	<b>\$ 353,360,751</b>

## Note 8—Discretely Presented Component Units Disclosures

### A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Northern Arizona University Foundation, Inc. (Foundation) and Northern Arizona Capital Facilities Finance Corporation (NACFFC) including its Pine Ridge Village/Campus Heights and North Campus Facilities (limited liability companies) subsidiaries, have been prepared on the accrual basis of accounting.

#### Financial Statement Presentation

Both the Foundation and the NACFFC follow the Statement of Financial Accounting Standards Board (FASB) No. 117, "Financial Statements of Not-for-Profit Organizations." Under FASB Statement No. 117, the Foundation and the NACFFC are required to report information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

- Unrestricted net assets – include assets and contributions that are not restricted by donors or for which such restrictions have expired.
- Temporarily restricted net assets – include contributions for which donor imposed restrictions have not been met (either by the passage of time or by actions of the

Foundation), charitable remainder unitrusts, pooled income funds, gift annuities, and pledges receivable for which the ultimate purpose of the proceeds is not permanently restricted. Donor-restricted contributions are classified as temporarily restricted if restrictions are satisfied in the same reporting period in which the contributions are received.

- Permanently restricted net assets – include contributions, charitable remainder unitrusts, pooled income funds, gift annuities, and pledges receivable which require by donor restriction that the corpus be invested in perpetuity and only the board-approved payout be made available for program operations in accordance with donor restrictions.

#### Cash and Cash Equivalents

Highly liquid investments with an original maturity of three months or less are classified as cash equivalents and are stated at fair value.

#### Investments

The Foundation - Investments, consisting primarily of equity securities, U.S. government securities, and corporate bonds, with readily determinable market values are measured at fair value as of year-end. Donated investments are recorded at their fair values, as determined on the date of donation. Investment income or loss (including realized gains and losses on investments, interest and dividends) and unrealized gains, and losses on investments are recognized

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

in the statement of activities. For management efficiency, investments of the unrestricted and restricted net assets are pooled, except for certain net assets that the board of directors or the donors have designated to be segregated and maintained separately.

## Revenue Recognition

The Foundation - Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at rates commensurate with the risks involved. Amortization of discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for uncollectible contributions receivable is provided based upon management's judgment including such factors as prior collection history.

Contributions received for prospective endowments that have not yet met the minimum requirements for acceptance as an endowment are accumulated in temporarily restricted accounts. The accumulated contributions are transferred to permanently restricted endowment accounts when the minimum requirements are fulfilled.

The NACFFC recognizes rent and lease income as payments become due. Payments received in advance will be deferred until earned.

## Net Investments in Sales-Type Financing Leases

NACFFC - Net investments in sales-type financing leases are stated at the sum of the minimum lease payments less unearned income. Unearned income is amortized over the lease terms, which approximate the related bond terms. No valuation allowance has been established as title to the assets associated with the lease would be transferred back to the Pine Ridge Village/Campus Heights and North Campus Facilities LLC's in the event of default.

## Property, Plant and Equipment

Property, plant, and equipment are recorded at cost or fair value at the date of donation. Replacements, maintenance and repairs that do not improve or extend the lives of the assets are expensed during the period incurred. Assets are depreciated on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	28-30 years
Furniture and equipment	5-10 years

## 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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## Tax Status

The Foundation is a public foundation and is exempt from Federal and State income taxes under Section 501 (c) (3) of the Internal Revenue Code. Accordingly, no provision for Federal or State taxes has been made. Continued tax-exempt status is contingent on future operations being in compliance with the Internal Revenue Code.

The NACFFC is exempt from taxes under the provisions of Section 501(c) (4) of the Internal Revenue Code.

## Bonds Issuance Costs

NACFFC Issuance costs of \$1,114,894 relating to the Pine Ridge Village/Campus Heights Series 2008 Bonds are being amortized on a straight-line basis over the life of the Series 2008 Bonds. Amortization expense for the year ended June 30, 2010 was \$44,596 for issuance costs related to the Series 2008 Bonds.

Issuance costs of \$470,590 relating to the North Campus Series 2006 Bonds are being amortized on a straight-line basis over the life of the Series 2006 Bonds. Amortization expense for the year ended June 30, 2010 was \$15,686 for issuance costs related to the Series 2006 bonds.

## B. ASSETS HELD BY TRUSTEE

The Foundation has an irrevocable right to receive income earned from the trusts' assets held in perpetuity. The Foundation will never receive the trusts' assets. The trust agreements are administered and related assets are invested by an individual or organization other than the Foundation. Initial recognition and subsequent adjustments to the assets carrying value are recognized as public contributions and changes in value of perpetual trusts, respectively, and are classified as permanently restricted. Income earned is reported as increases in unrestricted, temporarily or permanently restricted net assets depending on the nature of the restrictions of each trust.

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NACFFC - Pursuant to the terms of the Trust Indenture, relating to the Series 2006 and 2008 Bonds, proceeds of the Series 2006 and 2008 Bonds were deposited into certain funds and accounts established with the Trustee. Assets held by Trustee consist of various reserves and operating accounts required by the Trust Indenture and totaled \$136,854 at June 30, 2010. These assets are invested in 100% treasury money market funds. Currently all accounts in use by the Trustee are restricted as to use.

## C. Pledges receivable

Pledges receivable consist of the following unconditional promises to give:

Gross amounts due in:	
Less than one year	\$ 2,437,878
One to five years	6,053,459
More than five years	<u>465,013</u>
Gross pledges receivable	8,956,350
Discount to present value	(830,039)
Allowance for uncollectible pledges	<u>(165,089)</u>
Total pledges receivable, net	<u>\$ 7,961,222</u>

A concentration of credit risk exists with the unconditional promises to give at June 30, 2010, as approximately 77% of the gross receivable recognized during fiscal 2010 is from one donor.

The Foundation has a restricted grant totaling \$400,000, which contained donor conditions (primarily matching fund requirements). Since the grant represents a conditional promise to give, it will not be recorded as contribution revenue until the donor conditions are met. Prior to fiscal year 2010, \$300,000 of the conditions had been met; accordingly, contributions revenue was recorded in the years the conditions were met.

Members of the Foundation's Board of Directors have made contributions and pledges to the Foundation in the current and prior years. At June 30, 2010, gross unconditional pledges receivable from these members total approximately \$307,000. During fiscal year 2010, the Foundation recognized contribution revenue from these donors of approximately \$147,000.

## D. Investments

The fair value and cost of the Foundation's investments at June 30, 2010 are as follows:

	Fair Value	Cost
U.S. Government/agency bonds	\$ 7,602,813	\$ 6,845,082
Corporate bonds	16,158,345	15,513,414
Common stock	28,722,012	32,945,256
International equity funds	12,291,722	15,544,933
Money market funds	<u>121,975</u>	<u>121,975</u>
	<u>\$ 64,896,867</u>	<u>\$ 70,970,660</u>

Investments include funds held for the custody of others of \$4,593,089 at June 30, 2010.

The Foundation had a realized investment gain of \$29,756 and unrealized gains on investments of \$4,737,307 for the year ended June 30, 2010. Investment expenses of \$53,138 for the year ended June 30, 2010 have been netted against investment earnings in the statement of activities.

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

## E. Property, Plant and Equipment

Property, plant and equipment are comprised of furniture and equipment and are reported net of accumulated depreciation. Balances as of June 30, 2010 are presented as follows:

### FOUNDATION

	Cost or Donated Value	Accumulated Depreciation	Net Assets
Furniture and equipment	\$ <u>105,719</u>	\$ <u>68,744</u>	\$ <u>36,975</u>

## F. LEASE PURCHASE AND OTHER LEASE AGREEMENTS

On May 19, 2005, NAU entered into a lease purchase agreement with Pine Ridge Village /Campus Heights LLC. During the 28 year lease term, the University will make lease payments on two apartment style student housing complexes, Pine Ridge Village and McKay Village. The LLC recorded a sales-type lease receivable of \$13,225,000 in fiscal year 2005 for the Pine Ridge complex. The agreement also provided for NAU's lease purchase of the McKay Village complex for \$22,685,000 in fiscal year 2007. Upon expiration of the lease, the real property will become the sole property of NAU without further cost.

Upon renegotiation of the lease purchase agreement on May 1, 2008, base lease payments for both housing complexes are tied to the principal and fixed rate interest payments on the Series 2008 Bonds issued by the LLC. Additional rents are provided for in the lease purchase agreement to cover costs incurred by the LLC for bond related costs and professional expenses. These rents are recognized when the qualifying expense is incurred. On September 1, 2006, NAU entered into a lease purchase agreement with North Campus Facilities LLC. During the 30 year lease term, the agreement provides for NAU's lease purchase of the convention center/parking garage complex for \$12,400,000 in fiscal year 2008. Upon expiration of the lease, the real property will become the sole property of NAU without further cost.

At June 30, 2010, minimum lease payments are as follows:

Year ended June 30,	Amount
2011	\$ 3,024,585
2012	3,058,392
2013	3,094,858
2014	3,133,648
2015	3,167,720
Thereafter	<u>66,404,866</u>
	<u>\$ 81,884,069</u>

Additional rents are provided for in the lease purchase agreement to cover costs incurred by North Campus Facilities LLC for bond related costs and professional expenses. These rents are recognized when the qualifying expense is incurred.

Components of the net investment in the lease are as follows:

Total minimum lease payments to be received	\$ 81,884,069
Less: Unearned income	<u>(34,109,069)</u>
Net investment in sales-type lease	<u>\$ 47,775,000</u>

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

Educational broadcast system licenses - The Foundation has been granted several educational broadcast system (EBS) licenses from the Federal Communications Commission (FCC). Additionally, the Foundation entered into an agreement to purchase EBS licenses with funding from an outside corporation. Under the agreement, which is considered an exchange transaction and not a contribution under FASB ASC 958-605, the Foundation will purchase the EBS licenses and then lease the licenses to the outside corporation. In fiscal year 2008, the Foundation received approximately \$15,378,000 from the outside corporation to purchase the licenses. As of June 30, 2010, the cumulative purchased EBS licenses total \$6,785,000. There were no purchases of EBS licenses in fiscal year 2010, however, the Foundation did receive a one time bonus of \$1,300,000. The remaining balance to be purchased plus approximately \$195,000 in interest earned on investments of the advanced funds comprise the deferred revenue balance in the accompanying consolidated statement of financial position. At June 30, 2010, accumulated amortization and amortization expense of \$2,255,072 have been computed using the straight line method over estimated useful lives of 4 to 10 years.

The Foundation leases the licenses to various companies. The licenses are granted for ten-year terms, which are due to expire through February 2018. The terms of the related lease agreements correspond with the terms of the licenses. Most leases have renewal clauses, which provide for a maximum lease term of 30 years. The FCC has certain educational programming requirements. As part of the lease agreements, the lessees are responsible for ensuring that the educational requirements are met. After the educational requirements are met, there is excess frequency capacity that can be used. The

Foundation receives monthly lease payments for the use of the excess capacity. In addition to the monthly payment terms, several leases required the lessee to pay an initial fee. Total revenue received from these agreements was \$2,434,365 for the year ended June 30, 2010.

The future minimum lease payments to be received under these agreements, including the agreement signed subsequent to June 30, are as follows:

At June 30, 2010, minimum lease payments are as follows:

Year ended June 30,	Amount
2011	\$ 1,166,943
2012	1,182,034
2013	644,117
2014	348,612
2015	244,124
Thereafter	<u>503,281</u>
	<u>\$ 4,116,111</u>

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

## G. Bonds Payable

The NACFFC through its Pine Ridge Village/Campus Heights LLC and the North Campus LLC subsidiaries, had the following bonds outstanding at June 30, 2010:

Revenue Serial and Term Bonds in the aggregate original principal amount of \$36,780,000 dated May 8, 2008; interest payable semi-annually at various interest rates ranging from 3.5% to 5%; principal payable annually in various amounts beginning June 1, 2009 through June 1, 2033; secured by property, leases and revenues including the Trust Funds, excluding the Rebate Fund, under terms of the Trust Indenture. \$ 35,845,000

North Campus Lease Revenue Serial and Term Bonds in the aggregate original principal amount of \$12,400,000 dated September 1, 2006; interest payable semi-annually at various interest rates ranging from 4% to 5% based on terms; principal payable annually from June 1, 2009 to June 1, 2036; secured by property, leases and revenues including the Trust Funds, excluding the Rebate Fund, under the terms of the Trust Indenture. 11,930,000

Total bonds payable	47,775,000
Unamortized bond premium/discount	(34,243)
Bonds payable, net	47,740,757
Less: current maturities	(850,000)
Bonds payable, noncurrent portion, net	<u>\$ 46,890,757</u>

At June 30, 2010, maturities of bonds payable are as follows:

Year ended June 30,	Amount
2011	\$ 850,000
2012	915,000
2013	985,000
2014	1,060,000
2015	1,135,000
Thereafter	42,830,000
	<u>\$ 47,775,000</u>

Interest expense related to bonds for 2010 was \$2,206,985, net of related bond premium and discount amortization of \$18,423 and \$14,892 respectively.

Pine Ridge Village Campus Heights (PRV/CH) -The Series 2008 Refunding Bonds maturing on or before June 1, 2018 are not subject to optional redemption prior to maturity. The Series 2008 Refunding Bonds maturing on or after June 1, 2019 are subject to optional redemption prior to maturity on any date on or after June 1, 2018, in whole or in part, in Authorized Denominations, following applicable notice, from such maturities as may be selected by PRV/CH at its option, at a redemption price (expressed as a percentage of the principal amount of the Series 2008 Refunding Bonds to be called for redemption) of 100% plus accrued interest thereon to the date of redemption. Additional bonds may be subject to optional redemption as provided in the trust agreement or related issuing document for such additional bonds.

The Series 2008 Refunding Bonds maturing on June 1, 2028 and June 1, 2033 are subject to mandatory Sinking Fund Installments prior to maturity, in Authorized Denominations, at random, as may be selected by the Bond Registrar, at a redemption price equal to the principal amount of the series 2008 Refunding Bonds to be called for redemption plus accrued interest thereon to the date of redemption but without premium, plus accrued interest as follows:

## Pine Ridge Village Campus Heights

### Series 2008 Refunding Bonds Bonds Due June 1, 2028

Year	Principal Amount to be Redeemed
2027	\$ 2,010,000
2028	2,155,000 (Maturity)

### Series 2008 Refunding Bonds Bonds Due June 1, 2033

Year	Principal Amount to be Redeemed
2029	\$ 2,305,000
2030	2,460,000
2031	2,620,000
2032	2,780,000
2033	2,955,000 (Maturity)

# NOTES TO FINANCIAL STATEMENTS

June 30, 2010

North Campus - The 2006 Bonds maturing on or before June 2016 will not be subject to optional redemption prior to maturity. The 2006 Bonds maturing on or after June 2017 will be subject to optional redemption prior to maturity on any date on or after June 2016 in whole or in part from such maturities as may be selected by the Company at its option at redemption price expressed as percentage of the principal amount of the 2006 Bonds to be called for redemption of 100% plus accrued interest thereon to the date of redemption.

The 2006 Bonds maturing on the following dates will be subject to mandatory sinking fund installments prior to maturity by lot as may be selected by the Trustee at redemption price equal to the principal amount of the 2006 Bonds to be called for redemption plus accrued interest thereon to the date of redemption but without premium on the following dates in the following principal amounts:

## North Campus Facilities

### Bonds Due June 1, 2025

Year	Principal Amount to be Redeemed
2022	\$ 395,000
2023	415,000
2024	435,000
2025	455,000 (Maturity)

### Bonds Due June 1, 2031

Year	Principal Amount to be Redeemed
2026	\$ 480,000
2027	505,000
2028	530,000
2029	555,000
2030	585,000
2031	610,000 (Maturity)

### Bonds Due June 1, 2036

Year	Principal Amount to be Redeemed
2032	\$ 645,000
2033	675,000
2034	710,000
2035	745,000
2036	780,000 (Maturity)

## H. Assets Held in Custody for Others

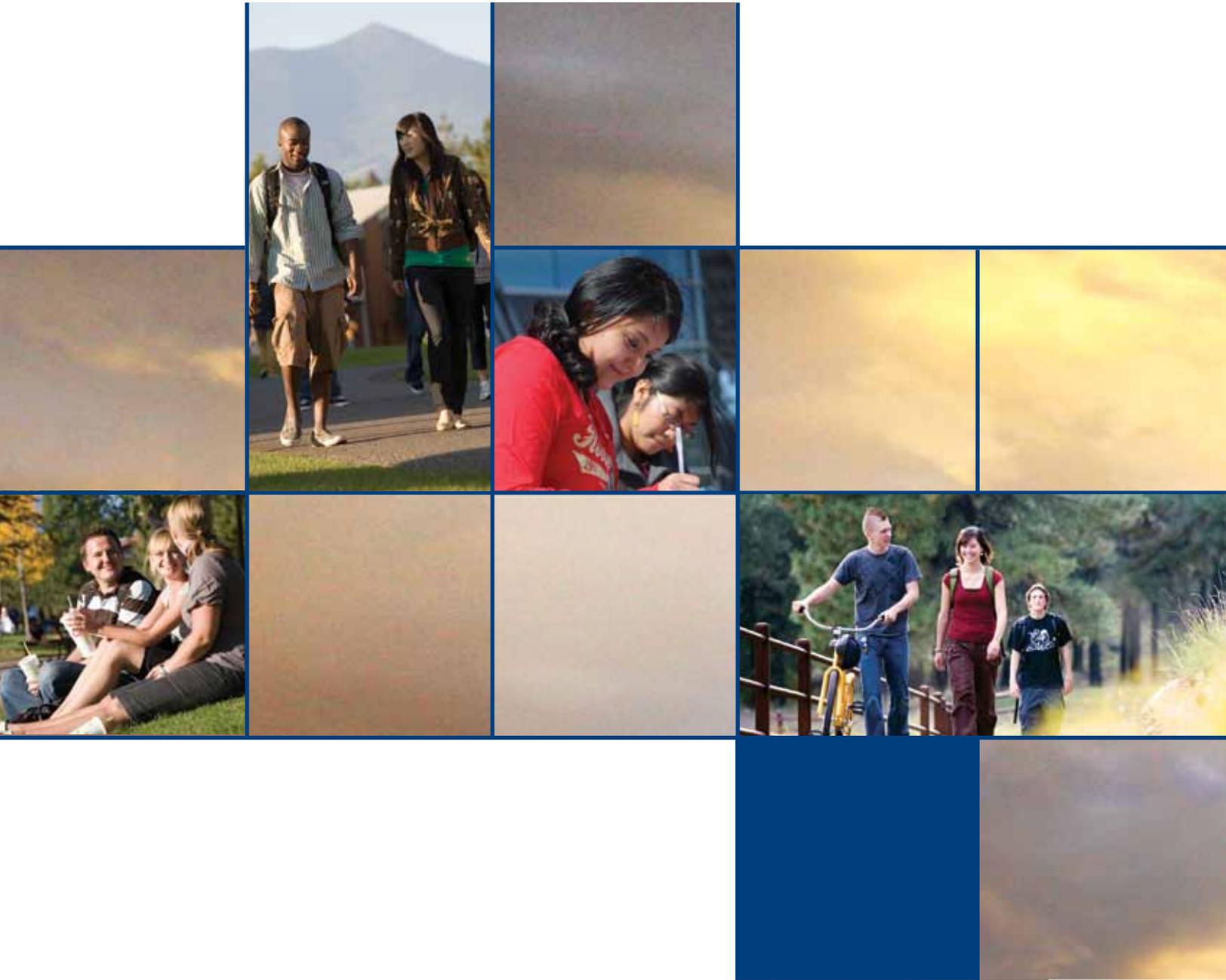
The Foundation maintains certain asset balances on behalf of others, which consists of the following at June 30, 2010:

Cash	\$ 321,037
Unconditional promises to give	1,370
Investments	4,593,089
Beneficial interest in perpetual trust	<u>507,440</u>
	<u>5,422,936</u>
Less: accrued expenses	(62)
	<u>\$ 5,422,874</u>

Assets held on behalf of:

Northern Arizona University	\$ 4,802,754
Parents' Association	293,485
Alumni Association	<u>326,635</u>
	<u>\$ 5,422,874</u>





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