# UNIVERSITY OF ALASKA

(A Component Unit of the State of Alaska)

Financial Statements

June 30, 2003 and 2002

(With Independent Auditors' Report Thereon)

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University of Alaska
(A Component Unit of the State of Alaska)
Financial Statements
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**Introduction**

The following discussion and analysis provides an overview of the financial position and activities of the University of Alaska (university) for the years ended June 30, 2003 (fiscal year 2003) and June 30, 2002 (fiscal year 2002), with selected comparative information for the year ended June 30, 2001. This discussion has been prepared by management and should be read in conjunction with the financial statements including the notes thereto, which follow this section.

**Using the Financial Statements**

The university's financial report includes three basic financial statements: the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows. These statements are prepared in accordance with generally accepted accounting principles and Governmental Accounting Standards Board (GASB) pronouncements. During fiscal year 2002, the university implemented GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis – for Public Colleges and Universities,* and applied the statement effective July 1, 2000. The statement establishes standards for external financial reporting for public colleges and universities and requires that financial statements be presented on a consolidated basis to focus better on the university as a whole. Resources are classified into three net asset categories – unrestricted, restricted, and invested in capital assets, net of related debt.

**Statement of Net Assets**

The statement of net assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities (net assets) is one indicator of the financial condition of the university, while the change in net assets is an indicator of whether the financial condition has improved or declined during the year. A summarized comparison of the university's assets, liabilities and net assets at June 30, 2003 and 2002 follows (in thousands):

| | 2003 | 2002 |
|---|---|---|
| Assets: | | |
| Current assets | $ 107,186 | $ 89,340 |
| Other assets | 173,719 | 154,987 |
| Capital assets, net of depreciation | 703,855 | 651,268 |
| Total assets | 984,760 | 895,595 |
| Liabilities: | | |
| Current liabilities | 74,547 | 62,551 |
| Noncurrent liabilities | 127,699 | 98,412 |
| Total liabilities | 202,246 | 160,963 |
| Net assets | | |
| Invested in capital assets, net of debt | 602,274 | 564,771 |
| Restricted – expendable | 31,102 | 32,631 |
| Restricted – nonexpendable | 108,303 | 100,716 |
| Unrestricted | 40,835 | 36,514 |
| Total net assets | $ 782,514 | $ 734,632 |

A review of the university's statement of net assets shows an increase in working capital (current assets less current liabilities) over the past year from $26.8 million to $32.6 million. Working capital at year end represents 23 days of operating expenses, as compared to 20 days in 2002. The improvement can be attributed to a reduced level of spending in anticipation of increases in benefit rates for health care and anticipation of less growth in annual state appropriations in future years.

Net accounts receivable increased 19 percent, from $62.9 million at June 30, 2002, to $74.9 million at June 30, 2003. This growth is primarily due to the increase in receivables from cost reimbursable construction contracts, which grew from $8.9 million in 2002 to $22.3 million in 2003. Nearly all of the construction in progress at year end is funded by state capital appropriations or federal grant awards and management expects full collection from these sources. The other components of accounts receivable consist of those from operations, such as tuition and fees and sponsored programs (primarily research). Days of operating revenue in accounts receivable from operations decreased from 80 in 2002 to 70 in 2003. Management is continuing to work on improving the billing and collection process. See Note 4 of the financial statements for accounts receivable detail.

The increase in accounts payable from $10.8 million at June 30, 2002 to $20.7 million and June 30, 2003 is a reflection of the significant capital construction activity in process at year end. Accounts payable for construction activity constitutes about half, or $10.4 million, of the accounts payable balance at June 30, 2003. The remaining accounts payable balance represents amounts due for recurring supplies and services for operations.

Unrestricted net assets increased $4.3 million from June 30, 2002 to June 30, 2003. At year end, $29.0 million is designated by the Board of Regents or management for specific purposes. See Note 2 of the financial statements for a detailed list of these designations.

**Statement of Revenues, Expenses and Changes in Net Assets**

The statement of revenues, expenses and changes in net assets presents the results of operations for the university as a whole. Revenues, expenses and other changes in net assets are reported as either operating or nonoperating. Significant recurring sources of university revenue, state appropriations and investment earnings, are defined by GASB Statement No. 35 as nonoperating. A summarized comparison of the university's revenues, expenses and changes in net assets for the years ended June 30, 2003 and 2002 follows (in thousands):

| | 2003 | 2002 |
|---|---|---|
| Operating revenues | $ 275,126 | $ 244,303 |
| Operating expenses | (528,148) | (497,054) |
| Operating loss | (253,022) | (252,751) |
| Net nonoperating revenues | 221,264 | 195,723 |
| Loss before other revenues, expenses, gains, or losses | (31,758) | (57,028) |
| Other revenues, expenses, gains or losses | 79,640 | 44,556 |
| Increase (decrease) in net assets | 47,882 | (12,472) |
| Net assets at beginning of year | 734,632 | 747,104 |
| Net assets at end of year | $ 782,514 | $ 734,632 |

The Statement of Revenues, Expenses and Changes in Net Assets reflects an overall increase in net assets of 6.5 percent, or $47.9 million. Major factors contributing to this change are discussed below.

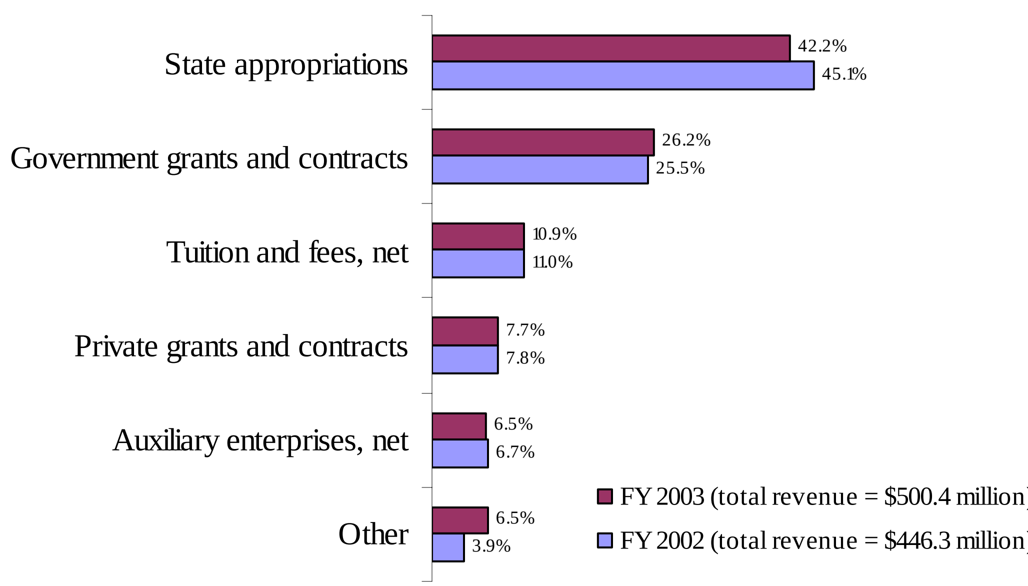
The primary factor for the increase in net assets is attributed to the excess of $79.6 million from revenue recognized from capital funding sources over depreciation expense of $59.7 million on capital assets. Revenue is recognized as expenditures for capital projects occur. Significant capital activity in 2003 is discussed in the *Capital and Debt Activities* section which follows.

Endowment proceeds and investment income contributed positively to the increase in net assets by providing $11.8 million in 2003 as compared to a loss of $1.8 million in 2002. A significant component of this change is from increased sales of trust land, timber and mineral interests, the net proceeds of which are required to be deposited to the land grant endowment trust fund. The other major component is investment income, generated from the endowment principal invested in a consolidated fund managed by the University of Alaska Foundation. Total return from the consolidated fund was approximately 1 percent as compared to a loss of 7 percent in the prior year.

State of Alaska general fund appropriations continue to be the major source of revenue for the university, providing $211.1 million in 2003, as compared to $201.6 million in 2002. Historically, the Legislature has funded the university at an amount equal to or above the prior period's appropriation.

A comparison of operating and nonoperating revenues by source for 2003 and 2002 follows:

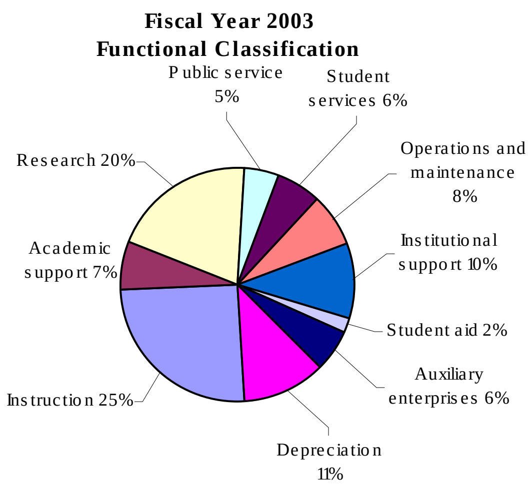
**Operating and Nonoperating Revenues (excluding capital) by Year**

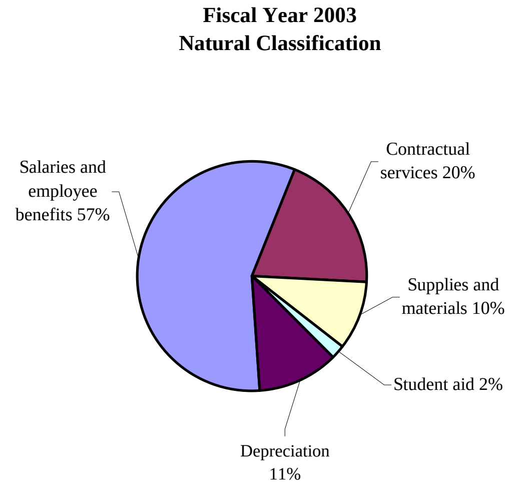


Revenues from federal and other sources for sponsored research and education-related programs increased 14 percent, from $148.8 million in 2002 to $169.9 million in 2003. Facility and administrative cost recovery provided $26.5 million in 2003 as compared to $22.7 million in 2002. Increased funding enables the university to expand existing programs and start new programs, like those in fisheries, data analysis and basic research. In addition to supporting new programs, facility and administrative cost recovery reimburses the university for facilities and administrative costs necessary to operate and support sponsored programs, and provides cash flow to service debt on research facilities.

Student enrollment and tuition rate increases for the 2003 academic year provided for gross student tuition and fee revenue of $59.8 million in 2003 as compared to $54.2 million in 2002. Student full-time equivalent enrollment for Fall 2002 was 16,624, an 8.1 percent increase from the prior Fall period. Tuition rates increased 3.2 percent for 2003, roughly equal to the estimated inflationary impact on the costs of providing higher education.

A comparison of operating expenses by functional and natural classification for the year ended June 30, 2003 follows (see Note 16 of the financial statements for more information):




## Statement of Cash Flows

The statement of cash flows provides additional information about the university's financial results by reporting the major sources and uses of cash. The statement helps users understand or assess:

- How operations and plant and equipment were financed.
- The ability to meet future obligations as they become due.
- The relationship between the change in net assets and the change in cash.

**Fiscal Year 2002**

For comparative purposes, significant comments noted in fiscal year 2002 Management's Discussion and Analysis are summarized below:

The significant factors affecting fiscal year 2002 operating results included a sharp increase in health care costs and lower than normal investment returns, contributing to a $12.5 million decline in net assets. Health claims and administrative costs for non-union and represented employees exceeded the university's defined contribution by $4.4 million in 2002. While health care plan costs continued to rise in fiscal year 2003, increases in employee and employer contributions kept pace with the growth. Effective July 1, 2003, the university began increasing its defined contribution, and employee contributions will increase again in January, 2004.

Investment earnings from the university's operating capital decreased from $5.1 million in 2001 to $2.2 million in 2002 primarily due to a decline in market conditions. In addition, endowment earnings decreased from $5.5 million in 2001 to a negative $1.8 million in 2002, causing the majority of the decrease in expendable restricted net assets. Both of these revenue sources are reported as nonoperating revenue, and provide additional resources necessary to supplement operating revenue and other revenues.

Other major revenue sources include state general fund appropriations, sponsored programs and tuition revenue. State general fund appropriations increased from $190.7 million in 2001 to $201.6 million in 2002. Sponsored programs revenue, primarily from research and education related programs, increased from $128.5 million in 2001 to $148.8 million in 2002. Tuition revenue in 2002 was $54.2 million in 2002 as compared to $50.4 million in 2001. Tuition rates increased by 3.2 percent in 2002 based on the estimated inflationary impact on the cost of providing higher education. Despite increases in these revenue sources in 2002, operating costs exceeded the rise in operating and nonoperating revenues.

Major changes from 2001 to 2002 on the Statement of Net Assets include those with accounts receivable and working capital. Accounts receivable increased 29 percent from June 30, 2001 to June 30, 2002, due to sustained growth in cost reimbursable sponsored programs (primarily research). Working capital declined by $25.4 million from June 30, 2001 to June 30, 2002, due primarily to management's decision to transfer the majority of its short-term investments to longer term securities. See the fiscal year 2003 discussion regarding significant Statement of Net Assets changes for current year changes in accounts receivable and working capital.

**Capital and Debt Activities**

The University of Alaska has continued to modernize its complement of older facilities and to build new facilities to address emerging state needs or enhance the quality of the university's existing academic, research and student service programs.

Net capital additions totaled $104.2 million in 2003, as compared with $50.1 million in 2002 and $45.1 million in 2001. These capital additions primarily comprise replacement, renovation and new construction of academic and research facilities, as well as investments in equipment and information technology. At June 30, 2003, $104.7 million remains unexpended from current and prior year capital appropriations and general revenue bond proceeds, of which $76.9 million is committed to existing construction contracts. The balance is for projects still in design or preconstruction, or is held for contingencies for work in progress. At June 30, 2003, $11.8 million in private gifts and grants for construction of the University of Alaska Museum addition and renovation remain unexpended. Such gifts, held by the University of Alaska Foundation, will be received by the university on a reimbursement basis during construction expected to be complete in January 2005.

Construction in progress at June 30, 2003 totaled $94.2 million. New facility construction in progress includes the University of Alaska Anchorage library, the University of Alaska Museum addition and renovation in Fairbanks, the West Ridge Research Building and Utilidor in Fairbanks, and the Egan Library classroom addition at University of Alaska Southeast, Juneau. Renovation projects at the University of Alaska Fairbanks, primarily those for the Rasmuson Library and Fine Arts complex, comprise a majority of the balance of construction in progress at June 30, 2003.

In August 2003, Moody's Investors Service affirmed its previous university credit rating of A1 with stable outlook. In July 2002, Standard & Poor's affirmed its rating of AA- for bonds backed by its broad general revenue pledge. The University has maintained these ratings since its general revenue issues were first rated in 1992.

At June 30, 2003, total debt outstanding was $100.3 million, comprised of $68.5 million in general revenue bonds, $31.2 million in notes payable, and $0.7 million in lease finance contracts.

On July 31, 2002, the university issued general revenue bonds totaling $33,515,000. Approximately $3.9 million of the bonds were used for redemption of general revenue bonds issued in prior years, while the remainder is being used for capital improvement projects. The capital improvement projects include the University of Alaska Anchorage Community and Technical College Center, the Juneau Readiness Center/UAS Joint Facility, and the University of Alaska Fairbanks West Ridge Research Building and related science facilities.

Bonds were issued in prior years to finance construction of student residences at three campuses, a student recreation center, a research facility to house the International Arctic Research Center, the acquisition and renovation of several properties adjacent to the university's campuses, additions to the university's self-operated power, heat, water and telephone utility systems in Fairbanks, and to refund previously issued general revenue bonds and other contractual obligations in order to realize debt service savings.

The university has traditionally utilized both tax exempt and non-tax exempt equipment lease financings to provide for its capital needs or to facilitate systematic renewals. Short-term lines of credit are available to provide interim cash flow financing for facilities intended to be funded with general revenue bond proceeds.

**Other Economic and Financial Conditions**

The following is a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the financial position (net assets) or results of operations (revenues, expenses, and other changes in net assets) of the university.

The university is planning to issue general revenue bonds (Series L) in November 2003 for approximately $11 million. Approximately $2.2 million of the bonds will be used for redemption of general revenue bonds issued in prior years, while the remainder will be used for capital improvement projects at the Fairbanks campus, including the West Ridge Research Building.

Commencing Fall semester 2003, a 10 percent tuition increase has gone into effect for all campuses. At their September 2003 meeting, the Board of Regents approved a 10 percent increase in tuition for resident students (20 percent for non-residents) for the 2004 - 2005 academic year. During the same academic year, the administration will institute a network access fee equal to 2 percent of tuition that will be used to fund information technology network access and maintenance. These actions indicate that the university is actively maximizing other revenue sources to keep pace with an anticipated growth in costs. Such tuition increases will move the university closer to the industry average for instructional expenditures as compared to tuition revenue.

Opening enrollment numbers for Fall semester 2003 show a 6.3 percent increase in full-time equivalent students as compared to the previous Fall semester. Management has set an enrollment growth target of 3 percent for the 2004 - 2005 academic year. The university continues to expand several programs to increase the capacity to recruit and retain students. The suite of online services, such as registration, web payment, financial aid, transcript requests, and online grades, introduced in fiscal year 2003, are currently being expanded to include online degree audit/advising services.

Substantially all regular university employees participate in either the State of Alaska Public Employees' Retirement System (PERS), the State of Alaska Teachers' Retirement System (TRS), or the University of Alaska Optional Retirement Plan (ORP). Based on actuarial studies completed as of June 30, 2002, the university's funded ratio (actuarial value of plan assets to actuarial accrued liability) for PERS was 75 percent, down from 109 percent at June 30, 2001. Unlike PERS, TRS does not maintain individual employer funded ratios, however, the overall TRS funded ratio as actuarially determined at June 30, 2002 was 68 percent, down from 95 percent at June 30, 2001. The declines in the funded ratios can be attributed primarily to rising health care costs for plan participants and declining investment returns. In April 2003, the PERS and TRS boards set the university's contribution rates for fiscal year 2005 at 10.58 percent and 16.0 percent for PERS and TRS, respectively. This is an increase from fiscal year 2004 rates of 5.58 percent and 12.0 percent. See Note 12 of the financial statements for more information regarding pension plans.

The level of annual state appropriation funding is conditional upon the legislative process, which is directly influenced by current economic conditions and other factors. The university continues to seek additional revenues from sources other than state appropriations, to decrease its reliance on state appropriations as a percent of total revenue.

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# Independent Auditors' Report

The Board of Regents
University of Alaska:

We have audited the accompanying basic financial statements of the University of Alaska (University), a component unit of the State of Alaska, as of and for the years ended June 30, 2003 and 2002 as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *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. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Alaska at June 30, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2003 on our consideration of the University of Alaska's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis, on pages 1 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

September 30, 2003

**UNIVERSITY OF ALASKA**
**(A Component Unit of the State of Alaska)**
**Statements of Net Assets**
**June 30, 2003 and 2002**
**(in thousands)**

| | 2003 | 2002 |
|---|---|---|
| **Assets** | | |
| Currents assets: | | |
| Cash and cash equivalents | $ 22,147 | $ 17,178 |
| Short-term investments | 1,215 | 1,147 |
| Accounts receivable, less allowance of $4,118 in 2003 and $4,257 in 2002 | 74,926 | 62,895 |
| Other assets | 1,254 | 1,214 |
| Inventories | 7,644 | 6,906 |
| Total current assets | 107,186 | 89,340 |
| Noncurrent assets: | | |
| Restricted cash and cash equivalents | 21,577 | 9,755 |
| Notes receivable | 5,802 | 5,283 |
| Endowment investments | 81,579 | 75,430 |
| Endowed land and other assets | 38,953 | 40,473 |
| Long-term investments | 20,350 | 19,029 |
| Assets held in trust | 5,458 | 5,017 |
| Capital assets, net of accumulated depreciation | 703,855 | 651,268 |
| Total noncurrent assets | 877,574 | 806,255 |
| Total assets | 984,760 | 895,595 |
| **Liabilities** | | |
| Current liabilities: | | |
| Accounts payable | 20,677 | 10,825 |
| Accrued expenses | 3,576 | 2,893 |
| Accrued payroll | 11,486 | 10,475 |
| Deferred revenue | 3,331 | 3,479 |
| Accrued annual leave | 7,968 | 7,563 |
| Deferred lease revenue - current portion | 1,281 | 1,281 |
| Long-term debt - current portion | 4,354 | 3,903 |
| Insurance and risk management | 19,421 | 19,578 |
| Deposits from students and others | 2,453 | 2,554 |
| Total current liabilities | 74,547 | 62,551 |
| Noncurrent liabilities: | | |
| Capital appropriation advances | 14,684 | 8,946 |
| Deferred lease revenue | 12,490 | 13,771 |
| Long-term debt | 95,961 | 70,025 |
| Security deposits on long-term contracts | 4,564 | 5,670 |
| Total noncurrent liabilities | 127,699 | 98,412 |
| Total liabilities | 202,246 | 160,963 |
| **Net Assets** | | |
| Invested in capital assets, net of related debt | 602,274 | 564,771 |
| Restricted: | | |
| Expendable: | | |
| Restricted funds | 1,551 | 1,830 |
| Student loan funds | 716 | 922 |
| Education Trust of Alaska | 5,463 | 5,028 |
| Capital projects | 3,584 | 4,227 |
| Debt service | 3,283 | 2,509 |
| Endowment | 16,505 | 18,115 |
| Nonexpendable | 108,303 | 100,716 |
| Unrestricted (see Note 2) | 40,835 | 36,514 |
| Total net assets | $ 782,514 | $ 734,632 |

The accompanying notes are an integral part of the financial statements.

**UNIVERSITY OF ALASKA**
**(A Component Unit of the State of Alaska)**
**Statements of Revenues, Expenses and Changes in Net Assets**
**For the Years Ended June 30, 2003 and 2002**
**(in thousands)**

| | 2003 | 2002 |
|---|---|---|
| **Operating revenues** | | |
| Student tuition and fees | $ 59,825 | $ 54,245 |
| less tuition allowances | (5,256) | (5,358) |
| | 54,569 | 48,887 |
| Federal grants and contracts | 115,996 | 97,356 |
| State grants and contracts | 11,775 | 12,542 |
| Local grants and contracts | 3,547 | 3,700 |
| Private grants and contracts | 38,617 | 35,218 |
| Federal appropriations | 2,214 | 1,296 |
| Local appropriations | 705 | 705 |
| Sales and services, educational departments | 3,681 | 3,677 |
| Sales and services, auxiliary enterprises, net of tuition allowances of $1,151 in 2003 and $1,266 in 2002 | 32,283 | 29,685 |
| Other | 11,739 | 11,237 |
| Total operating revenues | 275,126 | 244,303 |
| **Operating expenses** | | |
| Instruction | 134,192 | 124,040 |
| Academic support | 34,279 | 30,443 |
| Research | 107,615 | 97,193 |
| Public service | 24,967 | 22,267 |
| Student services | 31,323 | 28,709 |
| Operations and maintenance | 40,291 | 42,210 |
| Institutional support | 53,529 | 56,132 |
| Student aid | 10,441 | 9,405 |
| Auxiliary enterprises | 31,827 | 28,891 |
| Depreciation | 59,684 | 57,764 |
| Total operating expenses | 528,148 | 497,054 |
| Operating loss | (253,022) | (252,751) |
| **Nonoperating revenues (expenses)** | | |
| State appropriations | 211,152 | 201,596 |
| Investment earnings | 2,411 | 2,188 |
| Endowment proceeds and investment income | 11,745 | (1,812) |
| Interest on debt | (2,936) | (2,886) |
| Other nonoperating expenses | (1,108) | (3,363) |
| Net nonoperating revenues | 221,264 | 195,723 |
| Loss before other revenues, expenses, gains or losses | (31,758) | (57,028) |
| Capital appropriations, grants and contracts | 79,640 | 44,429 |
| Additions to permanent endowments | - | 127 |
| Net increase (decrease) in net assets | 47,882 | (12,472) |
| **Net assets** | | |
| Net assets - beginning of year | 734,632 | 747,104 |
| Net assets - end of year | $ 782,514 | $ 734,632 |

The accompanying notes are an integral part of the financial statements.

**UNIVERSITY OF ALASKA**
**(A Component Unit of the State of Alaska)**
**Statements of Cash Flows**
**For the Years Ended June 30, 2003 and 2002**
**(in thousands)**

| | 2003 | 2002 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Student tuition and fees, net | $ 53,911 | $ 48,889 |
| Grants and contracts | 171,403 | 135,735 |
| Sales and services, educational departments | 3,680 | 3,677 |
| Sales and services, auxiliary enterprises | 32,666 | 29,649 |
| Federal appropriations | 2,214 | 1,296 |
| Local appropriations | 705 | 705 |
| Other operating receipts | 10,418 | 8,970 |
| Payments to employees for salaries and benefits | (299,886) | (273,504) |
| Payments to suppliers | (154,653) | (155,547) |
| Payments to students for financial aid | (10,381) | (9,294) |
| Net cash used by operating activities | (189,923) | (209,424) |
| **Cash flows from noncapital financing activities** | | |
| State appropriations | 211,401 | 201,345 |
| Other revenue (payments), net | 170 | (900) |
| Direct lending receipts | 45,418 | 37,719 |
| Direct lending payments | (45,920) | (37,453) |
| Net cash provided by noncapital financing activities | 211,069 | 200,711 |
| **Cash flows from capital and related financing activities** | | |
| Capital appropriations, grants and contracts | 69,335 | 46,669 |
| Proceeds from issuance of capital debt | 33,515 | - |
| Redemption of general revenue bonds | (3,885) | - |
| Purchases of capital assets | (102,479) | (59,648) |
| Principal paid on capital debt and leases | (3,650) | (4,186) |
| Interest paid on capital debt and leases | (3,302) | (2,871) |
| Net cash used by capital and related financing activities | (10,466) | (20,036) |
| **Cash flows from investing activities** | | |
| Proceeds from sales and maturities of investments | 3,776 | 26,311 |
| Purchase of investments | (9,137) | (16,368) |
| Interest received on investments | 709 | 959 |
| Interest and other sales receipts from endowment assets | 10,763 | 4,649 |
| Net cash provided by investing activities | 6,111 | 15,551 |
| Net increase (decrease) in cash and cash equivalents | 16,791 | (13,198) |
| Cash and cash equivalents, beginning of the year | 26,933 | 40,131 |
| Cash and cash equivalents, end of the year | $ 43,724 | $ 26,933 |

| | 2003 | 2002 |
|---|---|---|
| Cash and cash equivalents (current) | $ 22,147 | $ 17,178 |
| Restricted cash and cash equivalents (noncurrent) | 21,577 | 9,755 |
| Total cash and cash equivalents | $ 43,724 | $ 26,933 |

The accompanying notes are an integral part of the financial statements.

**UNIVERSITY OF ALASKA**
**(A Component Unit of the State of Alaska)**
**Statements of Cash Flows**
**For the Years Ended June 30, 2003 and 2002**
**(in thousands)**

| **Reconciliation of operating loss to net cash used by operating activities:** | 2003 | 2002 |
|---|---|---|
| Operating loss | $ (253,022) | $ (252,751) |
| Adjustments to reconcile operating loss to net cash used by operating activities: | | |
| Depreciation expense | 59,684 | 57,764 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | 1,048 | (13,775) |
| Other assets | (40) | (986) |
| Inventories | (738) | 108 |
| Accounts payable | 3,472 | (3,024) |
| Accrued expenses | (236) | 1,377 |
| Accrued payroll | 1,011 | (747) |
| Deferred revenue | (148) | 798 |
| Accrued annual leave | 405 | 488 |
| Deferred lease revenue - current portion | (1,281) | (1,281) |
| Insurance and risk management | (157) | 2,631 |
| Deposits from students and others | 79 | (26) |
| Net cash used by operating activities | $ (189,923) | $ (209,424) |

**Noncash Investing, Capital and Financing Activities:**

**For the Year Ended June 30, 2003**

The university purchased equipment through a lease purchase contract totaling $0.4 million. Payments are scheduled quarterly over the next five years.

The State of Alaska transferred the Tanana Valley Campus Barnette Street facility to the university with a fair market value of $2.7 million.

Additions to capital assets include $7.7 million expended and capitalized but not paid for at year end.

**For the Year Ended June 30, 2002**

The university purchased equipment through a lease purchase contract totaling $0.4 million. Payments are scheduled quarterly for a period of three years.

The university received a gift of real property totaling $0.1 million for a new endowment.

Additions to capital assets include $0.9 million expended and capitalized but not paid for at year end.

The accompanying notes are an integral part of the financial statements.

1. Organization and Summary of Significant Accounting Policies:

Organization and Basis of Presentation:

The University of Alaska (university) is a constitutionally created corporation of the State of Alaska which is authorized to hold title to real and personal property and to issue debt in its own name. The university is a component unit of the State of Alaska for purposes of financial reporting. As an instrumentality of the State of Alaska, the university is exempt from federal income tax under Internal Revenue Code Section 115, except for unrelated business activities as covered under Internal Revenue Code Sections 511 to 514.

In preparing the financial statements, management is required to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the statement of net assets. Actual results could differ from those estimates. The more significant accounting and reporting policies and estimates applied in the preparation of the accompanying financial statements are discussed below.

Governmental Accounting Standards Board (GASB) Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- **Unrestricted Net Assets:** Assets, net of related liabilities, which are not subject to externally-imposed restrictions. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents or may otherwise be limited by contractual agreements with outside parties.
- **Restricted Net Assets:**

  **Expendable** – Assets, net of related liabilities, which are subject to externally-imposed restrictions that may or will be met by actions of the university and/or that expire with the passage of time.

  **Non-expendable** – Assets, net of related liabilities, which are subject to externally-imposed restrictions requiring that they be maintained permanently by the university.
- **Invested in capital assets, net of related debt** – Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Summary of Significant Accounting Policies:

The accompanying financial statements have been prepared on the economic resources measurement focus and the accrual basis of accounting. All significant intra-university transactions have been eliminated. The university reports as a business type activity, as defined by GASB Statement No. 35. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The university has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The university has elected not to apply FASB pronouncements issued after the applicable date.

**Cash and Cash Equivalents**

All highly liquid investments, not held for long-term investment, with original maturities of three months or less are reported as cash and cash equivalents.

**Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or market.

**Investments**

Investments are stated at fair value. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets. Long-term investments include those restricted by outside parties as to withdrawal or use for other than current operations, or are designated for expenditure in the acquisition or construction of noncurrent assets or held with an intent not to be used for operations.

**Capital Assets**

Capital assets are stated at cost when purchased and at fair value when donated. Equipment with a unit value of less than $2,500 is not capitalized. Certain land and other resources acquired through land grants and donated museum collections for which fair value at date of acquisition was not determinable are reported at zero basis in the financial statements.

Depreciation is computed on a straight-line basis with useful lives of building and building components ranging from 12 to 50 years, 10 to 35 years for infrastructure and other improvements, and 4 to 10 years for equipment. Library and museum collections are not depreciated because they are preserved and cared for and have an extraordinarily long useful life.

**Endowments**

Endowments consist primarily of the land grant endowment trust fund established pursuant to the 1929 federal land grant legislation and its related inflation proofing funds. AS 14.40.400 provides that the net income from the sale or use of grant lands must be held in trust in perpetuity. At June 30, 2003 and 2002 the accumulated net earnings and appreciation on investments is $16.5 million and $18.1 million, respectively. These amounts, which are recorded in the restricted expendable net asset category, are available for expenditure in accordance with spending policies established by the Board of Regents in its capacity as trustee. Alaska Statute 14.40.400 provides the Board of Regents with authority to manage the endowments under the total return principles which are intended to preserve and maintain the purchasing power of the endowment principal. The investable resources of the fund are invested in the consolidated fund, a unitized investment fund managed by the University of Alaska Foundation as described in Note 15 below. The annual spending allowance is currently based on five percent of a five-year moving average of the invested balance. Withdrawals of net earnings appreciation to meet the spending allowance are limited to the unexpended accumulated net earnings of the endowments.

**Operating Activities**

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

**Tuition Allowances**

Student tuition and fee revenues and certain other revenues from students are reported net of tuition allowances in the statement of revenues, expenses and changes in net assets. Tuition allowances are the difference between the stated charge for tuition and room and board provided by the university and the amount paid by the student and/or third parties making payments on the students' behalf.

**Lapse of State Appropriations**

Alaska Statutes provide that unexpended balances of one-year appropriations will lapse on June 30 of the fiscal year of the appropriation; however, university receipts in excess of expenditures may be expended by the university in the next fiscal year. University receipts include student fees, donations, sales, rentals, facilities and administrative cost recovery, auxiliary and restricted revenues. The unexpended balances of capital appropriations lapse upon completion of the project or upon determination that the funds are no longer necessary for the project.

2. Unrestricted Net Assets:

At June 30, unrestricted net assets included the following (in thousands):

| | 2003 | 2002 |
|---|---|---|
| Designated: | | |
| Auxiliaries | $ 9,529 | $ 9,022 |
| Working capital fund | 4,715 | 4,715 |
| Service centers | 4,473 | 3,905 |
| Computing/telecommunications technology | 680 | 942 |
| Deferred maintenance/renovation | 107 | 246 |
| Renewal and replacement funds | 2,578 | 2,047 |
| Quasi-endowment funds | 79 | 79 |
| Employee benefit funds | (7,389) | (7,303) |
| Endowment earnings | 7,108 | 5,973 |
| Encumbrances | 7,159 | 7,954 |
| Total designated | 29,039 | 27,580 |
| Undesignated | 11,796 | 8,934 |
| Total unrestricted net assets | $ 40,835 | $ 36,514 |

Unrestricted net assets include non-lapsing university receipts of $24.2 million at June 30, 2003. Non-lapsing university receipts of $21 million from 2002 were fully expended in 2003.

At June 30, 2003 and 2002, $33.7 million and $30 million, respectively, of auxiliary funds, encumbrances and other unrestricted net assets were pledged as collateral for the university's general revenue bonds, as calculated under the terms of the 1992 General Revenue Bonds Trust Indenture.

3. Cash and Investments:

Alaska Statutes and Board of Regents' policy provide the university with broad authority to invest funds. GASB requires that bank balances and investment securities be disclosed or classified by category of credit risk as follows:

Deposits: Insured or collateralized with securities held by the university or its agent in the name of the university (category 1); collateralized with securities held by the pledging financial institution's trust department or agent in the name of the university (category 2); uncollateralized including collateralized balances for which securities are held by the pledging financial institution or by its trust department or agent but not in the name of the university (category 3).

Investment Securities: Insured or registered, with securities held by the university or its agent in the name of the university (category 1); Uninsured and unregistered, with securities held by the counterparty's (another party to the transaction, i.e. seller or dealer) trust department or agent in the name of the university (category 2); Uninsured and unregistered, with securities held by the counterparty's trust department or agent but not in the name of the university (category 3).

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | Book | Bank | Book | Bank |
| Deposits (in thousands): | | | | |
| Insured or collateralized (Category 1): | | | | |
| Demand deposits | $ 304 | $ 302 | $ 340 | $ 340 |
| Time deposits | 100 | 100 | 100 | 100 |
| Uncollateralized (Category 3): | | | | |
| Demand deposits | (16,721) | 736 | (7,195) | 394 |
| Time deposits | 4,100 | 4,100 | 4,100 | 4,100 |
| Total deposits | $ (12,217) | $ 5,238 | $ (2,655) | $ 4,934 |
| Investment securities: | | | | |
| Insured and registered (Category 1) | | | | |
| Common stock | | $ 2 | | $ 2 |
| Uninsured and unregistered (Category 3) | | | | |
| Repurchase agreements | | 16,399 | | 6,317 |
| Total investment securities | | $ 16,401 | | $ 6,319 |
| Other deposits and investments: | | | | |
| Money market funds | | $ 120 | | $ 262 |
| Commonfund, short and intermediate term funds | | 35,227 | | 29,884 |
| Commonfund, absolute return fund | | 12,816 | | 12,244 |
| Funds held by others: | | | | |
| Endowment funds | | 79,555 | | 73,900 |
| Bond proceeds and redemption funds | | 14,966 | | 2,585 |
| Total other deposits and investments | | $ 142,684 | | $ 118,875 |

Deposits reported in Category 1 by the university were insured by federal depository insurance. Deposits and investments reported in Category 3 were secured under a tri-party agreement with Bank of New York to hold the collateral for the benefit of the university; however, the securities are not held in the name of the university. At June 30, 2003 and 2002, securities with an estimated fair value of $26.4 million and $20.5 million were held as collateral under the tri-party agreement. Time deposits consist of a non-interest bearing deposit in the amount of $4.2 million maintained as a compensating balance in exchange for banking services.

Repurchase agreements represent overnight investments secured under tri-party agreements with various bank trust departments to hold the collateral for the benefit of the university; however, the securities are not held in the name of the university. The Commonfund is a not-for-profit provider of pooled multi-manager investment vehicles for colleges and universities. Endowment funds are managed by the University of Alaska Foundation under a consolidated fund agreement. Bond proceeds and related redemption funds are held by bank trustees in accordance with debt covenants.

Certain funds held in trust for the benefit of the university are not included in the financial statements as the university has only limited control over their administration. These funds are in the custody of independent fiduciaries and at June 30, 2003 and 2002, had an estimated fair value of approximately $5.6 million and $6.4 million, respectively.

4. Accounts Receivable:

Accounts receivable consisted of the following at June 30, 2003 and 2002 (in thousands):

| June 30, 2003 | Gross | Allowance | Net |
|---|---|---|---|
| Student tuition and fees | $ 6,718 | $ (1,368) | $ 5,350 |
| Sponsored programs | 49,014 | (2,600) | 46,414 |
| Auxiliary services and other operating activities | 1,009 | (150) | 859 |
| Capital appropriations, grants and contracts | 22,302 | - | 22,302 |
| State operating appropriation | 1 | - | 1 |
| | $ 79,044 | $ (4,118) | $ 74,926 |
| June 30, 2002 | | | |
| Student tuition and fees | $ 6,067 | $ (1,239) | $ 4,828 |
| Sponsored programs | 50,725 | (2,831) | 47,894 |
| Auxiliary services and other operating activities | 1,142 | (187) | 955 |
| Capital appropriations, grants and contracts | 8,968 | - | 8,968 |
| State operating appropriation | 250 | - | 250 |
| | $ 67,152 | $ (4,257) | $ 62,895 |

5. Assets Held in Trust:

Assets held in trust include operating funds of the Education Trust of Alaska (Trust). The Trust was established pursuant to state statute on April 20, 2001 by the Board of Regents to facilitate administration of the state's Internal Revenue Code (IRC) Section 529 College Savings Program. The program is a nationally marketed college savings program developed in accordance with IRC Section 529 and includes the resources of the university's former Advance College Tuition (ACT) Program. Participant account balances of approximately $714 million and $400 million at June 30, 2003 and 2002, respectively, are not included in the financial statements.

Assets of the Trust are invested in various mutual funds at the direction of T. Rowe Price Associates, Inc., the program manager. The net assets of the Trust, which include a reserve for University of Alaska (UA) Tuition Value Guarantees, are available for payment of program administrative costs, benefits and other purposes of the Trust. Management estimates reserve requirements for the UA Tuition Value Guarantees to be approximately $600,000 and $200,000 at June 30, 2003 and 2002, respectively.

6. Endowed Land and Other Assets:

Endowed land and other assets consist of real property and timber and other rights. By Acts of Congress in 1915 and 1929, approximately 110,000 acres of land was granted to the territory of Alaska to be held in trust for the benefit of the university. The lands were managed by the territory, and later the state of Alaska. In accordance with a 1982 agreement, the lands were subsequently transferred to the Board of Regents, as trustee. In 1982 and 1988 certain state lands including timber and other rights were transferred to the trust as replacement for lands disposed of or adversely affected during the period of administration by the territory and the state. These lands and property interests were recorded at their fair value as of the date of transfer. The net proceeds from timber, land and other rights are deposited in the land grant endowment trust fund described under Endowments in Note 1 above. At June 30, 2003 and 2002, the approximately 86,000 and 88,000 acres, respectively, were held in trust at no basis because fair value at the date of transfer was not determinable.

7. Capital Assets:

A summary of capital assets follows (in thousands):

| | Balance July 1, 2002 | Additions | Reductions | Balance June 30, 2003 |
|---|---|---|---|---|
| Capital assets not depreciated | | | | |
| Land | $ 24,303 | $ 1,799 | $ 153 | $ 25,949 |
| Construction in progress | 52,942 | 82,007 | 40,737 | 94,212 |
| Library and museum collections | 46,347 | 1,570 | - | 47,917 |
| Other capital assets | | | | |
| Buildings | 714,759 | 40,368 | 43 | 755,084 |
| Infrastructure | 33,515 | - | 1 | 33,514 |
| Equipment | 142,466 | 27,872 | 8,835 | 161,503 |
| Leasehold improvements | 4,845 | - | - | 4,845 |
| Other improvements | 19,950 | 370 | - | 20,320 |
| Total | 1,039,127 | 153,986 | 49,769 | 1,143,344 |
| Less accumulated depreciation: | | | | |
| Buildings | 262,875 | 41,620 | 43 | 304,452 |
| Infrastructure | 19,648 | 1,543 | - | 21,191 |
| Equipment | 93,319 | 14,942 | 8,011 | 100,250 |
| Leasehold improvements | 1,615 | 242 | - | 1,857 |
| Other improvements | 10,402 | 1,337 | - | 11,739 |
| Total accumulated depreciation | 387,859 | 59,684 | 8,054 | 439,489 |
| Capital assets, net | $ 651,268 | $ 94,302 | $ 41,715 | $ 703,855 |

| | Balance July 1, 2001 | Additions | Reductions | Balance June 30, 2002 |
|---|---|---|---|---|
| Capital assets not depreciated | | | | |
| Land | $ 24,982 | $ - | $ 679 | $ 24,303 |
| Construction in progress | 27,873 | 45,357 | 20,288 | 52,942 |
| Library and museum collections | 44,749 | 1,598 | - | 46,347 |
| Other capital assets | | | | |
| Buildings | 696,762 | 17,997 | - | 714,759 |
| Infrastructure | 31,754 | 1,761 | - | 33,515 |
| Equipment | 138,786 | 14,542 | 10,862 | 142,466 |
| Leasehold improvements | 4,845 | - | - | 4,845 |
| Other improvements | 19,271 | 679 | - | 19,950 |
| Total | 989,022 | 81,934 | 31,829 | 1,039,127 |
| Less accumulated depreciation: | | | | |
| Buildings | 227,074 | 35,801 | - | 262,875 |
| Infrastructure | 16,984 | 2,664 | - | 19,648 |
| Equipment | 85,599 | 16,324 | 8,604 | 93,319 |
| Leasehold improvements | 1,372 | 243 | - | 1,615 |
| Other improvements | 7,670 | 2,732 | - | 10,402 |
| Total accumulated depreciation | 338,699 | 57,764 | 8,604 | 387,859 |
| Capital assets, net | $ 650,323 | $ 24,170 | $ 23,225 | $ 651,268 |

8. Long-term Debt:

Debt service requirements at June 30, 2003 were as follows (in thousands):

| Year ended June 30, | Principal | Interest | Total |
|---|---|---|---|
| 2004 | $ 4,354 | $ 3,795 | $ 8,149 |
| 2005 | 4,357 | 3,655 | 8,012 |
| 2006 | 4,369 | 3,512 | 7,881 |
| 2007 | 4,409 | 3,364 | 7,773 |
| 2008 | 4,736 | 3,202 | 7,938 |
| 2009-2013 | 20,563 | 13,826 | 34,389 |
| 2014-2018 | 22,748 | 9,761 | 32,509 |
| 2018-2023 | 22,590 | 5,203 | 27,793 |
| 2024-2028 | 11,549 | 1,383 | 12,932 |
| 2029 | 640 | 16 | 656 |
| | $ 100,315 | $ 47,717 | $ 148,032 |

Long-term debt consisted of the following at June 30, 2003 and 2002 (in thousands):

| | 2003 | 2002 |
|---|---|---|
| Note payable – capital construction 1.826% assisted note to the Alaska Housing Finance Corporation (AHFC) to finance construction of Anchorage campus housing, payable beginning August 1999 to February 2024. In 1996, the university entered into an agreement with AHFC to borrow a total of $33 million, of which $30 million was issued on an assisted basis with interest at 1.826% and an additional $3 million issued on an unassisted basis at 6.0% | $ 28,831 | $ 29,905 |
| Note payable – quasi-endowment funds 5.0% note, secured by a deed of trust, to finance the purchase of two buildings located on University Lake Drive in Anchorage, due serially to May 2022 | 2,357 | 2,430 |
| Revenue bonds payable 1.40% to 5.90% general revenue bonds due serially to 2029, secured by a pledge of unrestricted current fund revenue generated from tuition, fees, recovery of facilities and administrative costs, sales and services of educational departments, miscellaneous receipts and auxiliaries | 68,465 | 41,201 |
| Installment contracts 1.94% to 5.44% installment contracts for the purchase of air traffic control simulation equipment and vehicles due in quarterly installments through June 2008 | 662 | 392 |
| | $ 100,315 | $ 73,928 |

On July 31, 2002, the university issued general revenue bonds (Series K) totaling $33,515,000. The bonds mature on October 1, 2028 and bear interest at rates ranging from 1.4 percent to 5 percent. Subject to annual appropriation, the State of Alaska will reimburse the university for principal and interest on $19,470,000 of the principal amount of the bonds, beginning in fiscal year 2004 and continuing through fiscal year 2029. Annual debt service on this portion of the bonds is approximately $1,340,000.

Series K bond proceeds totaling $29,630,000 are being used for capital improvement projects. The remaining bond proceeds totaling $3,885,000 were used to redeem a portion of 1992 Series C and all of the 1999 Series I general revenue bonds. The current refunding results in an economic gain of approximately $191,000 and the total debt service payments over 10 years increase approximately $248,000.

In prior years, the university defeased housing system revenue bonds and certain general revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Trust assets and related liabilities for the defeased bonds are not included in the university's financial statements. At June 30, 2003 and 2002, outstanding defeased bonds were $0.6 million and $12.7 million, respectively.

Under the terms of the 1992 General Revenue Bonds Trust Indenture, the university is required to maintain a reserve account with a trustee at an amount equal to one-half of the maximum annual debt service. The balance in the reserve account at June 30, 2003 and 2002 was $3.1 million and $2.6 million, respectively.

9. Deferred Lease Revenue:

In fiscal year 1997, the university entered into an agreement to construct a facility and establish the International Arctic Research Center (IARC). The university received $19,215,000 through a Japanese non-profit corporation to support the construction of the IARC in exchange for a commitment to provide research facilities to various Japanese research organizations and agencies for a period of 25 years, including lease extensions. The Japanese research organizations began occupying the IARC in fiscal year 1999. The deferred lease revenue at June 30, 2003 is $13,770,750 and is reduced at the rate of $1,281,000 per year with a corresponding increase to other operating revenue.

10. Long-term Liabilities:

Long-term liability activity was as follows (in thousands):

| | Balance July 1, 2002 | Additions | Reductions | Balance June 30, 2003 | Amounts due within one year |
|---|---|---|---|---|---|
| Capital appropriation advances | $ 8,946 | $ 6,949 | $ 1,211 | $ 14,684 | $ - |
| Deferred lease revenue | 15,051 | - | 1,280 | 13,771 | 1,281 |
| Long-term debt | 73,929 | 33,921 | 7,535 | 100,315 | 4,354 |
| Security deposits on long-term contracts | 5,670 | 113 | 1,219 | 4,564 | - |
| | $ 103,596 | $ 40,983 | $ 11,245 | $ 133,334 | $ 5,635 |

| | Balance July 1, 2001 | Additions | Reductions | Balance June 30, 2002 | Amounts due within one year |
|---|---|---|---|---|---|
| Capital appropriation advances | $ 6,678 | $ 2,585 | $ 317 | $ 8,946 | $ - |
| Deferred lease revenue | 16,332 | - | 1,281 | 15,051 | 1,281 |
| Long-term debt | 77,690 | 425 | 4,186 | 73,929 | 3,903 |
| Security deposits on long-term contracts | 5,508 | 162 | - | 5,670 | - |
| | $ 106,208 | $ 3,172 | $ 5,784 | $ 103,596 | $ 5,184 |

11. Capital Appropriations and Construction Commitments:

Major construction projects of the university are funded primarily by State of Alaska appropriations and university revenue bonds. The appropriations are financed through state-issued general obligation bonds or capital project bonds issued by the Alaska Housing Finance Corporation, a component unit of the State of Alaska, while other appropriations are received directly from the state or state agencies.

Unexpended and unbilled capital funds appropriated by the State of Alaska in prior years, which are not reflected as appropriation revenue or receivables on the university's books at June 30, 2003, totaled $94.9 million. In addition, unexpended proceeds of university-issued general revenue bonds designated for construction projects totaled $9.8 million at June 30, 2003.

Construction commitments at June 30, 2003 aggregated $76.9 million. At June 30, 2003, the university had received $14.7 million from State of Alaska capital appropriations and other sources in advance of expenditures.

12. Pension Plans:

Substantially all regular employees participate in either the State of Alaska Public Employees' Retirement System (PERS), an agent multiple-employer public employees' retirement system, the State of Alaska Teachers' Retirement System (TRS), a cost-sharing multiple-employer plan, or the University of Alaska Optional Retirement Plan (ORP), a single-employer defined contribution plan. In addition, substantially all regular employees and faculty classified as temporary participate in the University of Alaska Pension Plan, a supplemental single-employer defined contribution plan. None of the retirement systems or plans own any notes, bonds or other instruments of the university.

Defined Benefit Plans:

State of Alaska Public Employees' Retirement System (PERS)

*Plan Description*

The university contributes to PERS, a defined benefit, agent multiple-employer public employee retirement system established and administered by the State of Alaska (State). PERS provides pension, postemployment health care, death and disability benefits to eligible participants. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature.

Each fiscal year, PERS issues a publicly available financial report which includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907)465-4460.

*Funding Policy and Annual Pension Cost*

Employee contribution rates are 7.5% for peace officers and firefighters and 6.75% for other employees, as required by State statute. The funding policy for PERS provides for periodic employer contributions at actuarially determined rates that, expressed as a percentage of annual covered payroll, are sufficient to accumulate the assets to pay benefits when due.

The university's annual pension cost for the current year and related information is as follows:

| | Pension | Postemployment healthcare | Total |
|---|---|---|---|
| Contribution rates: | | | |
| Employee: | | | |
| Peace officers and firefighters | 5.34% | 2.16% | 7.50% |
| Other employees | 4.80% | 1.95% | 6.75% |
| Employer | 2.90% | 1.18% | 4.08% |
| Annual pension cost | $3,306,428 | $1,340,695 | $4,647,123 |
| Contributions made | $3,306,428 | $1,340,695 | $4,647,123 |
| Actuarial assumptions: | | | |
| Inflation rate | 3.50% | Same | |
| Investment return | 8.25% | Same | |
| Projected salary increase: | | | |
| Inflation | 3.50% | N/A | |
| Productivity and merit: | | | |
| Peace officers and firefighters | 2.50% | N/A | |
| Others | 2.00% | N/A | |
| Health cost trend | N/A | 12.0% | |

The actuarial valuation date was June 30, 2002. The projected unit cost credit method is used and the initial unfunded accrued liability and future gains/losses are amortized as a 25-year fixed period level percentage of pay. Effective June 30, 2002, the asset valuation method recognizes 20 percent of the investment gain or loss in each of the current and preceding four years. This method will be phased in over the next five years. All assets are valued at market value.

During 2003, the annual required contribution (ARC) and the amount contributed by the university for annual pension cost (APC) was $4,647,123. The university has fully funded its pension obligation; therefore, no net pension obligation (NPO) existed at fiscal year end.

Three year trend information follows:

| | Year ended June 30 | APC | Employer contribution rate | Percentage of APC contributed | NPO |
|---|---|---|---|---|---|
| Pension: | 2001 | 2,936,457 | 3.25% | 100% | - |
| | 2002 | 3,006,906 | 2.90% | 100% | - |
| | 2003 | 3,306,428 | 2.90% | 100% | - |
| Postemployment Healthcare: | 2001 | 1,171,050 | 1.30% | 100% | - |
| | 2002 | 1,219,245 | 1.18% | 100% | - |
| | 2003 | 1,340,695 | 1.18% | 100% | - |

In the current fiscal year, the University determined, in accordance with provisions of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* (GASB 27), that no pension liability existed to PERS and there were no previously reported liabilities to PERS.

Pension and Postemployment Healthcare Benefits
(in thousands)

| | Actuarial valuation year ended June 30 | Actuarial value of plan assets | Actuarial accrued liability (AAL) | Unfunded (overfunded) actuarial accrued liability (UAAL) | Funded ratio | Covered payroll | UAAL as a percentage of covered payroll |
|---|---|---|---|---|---|---|---|
| Pension benefits: | | | | | | | |
| | 1999 | 308,959 | 272,389 | (36,570) | 113% | 74,258 | N/A |
| | 2001 | 360,222 | 331,693 | (28,529) | 109% | 93,210 | N/A |
| | 2002 | 301,429 | 402,604 | 101,175 | 75% | 102,892 | 98% |
| Postemployment healthcare benefits: | | | | | | | |
| | 1999 | 125,249 | 110,424 | (14,825) | 113% | 74,258 | N/A |
| | 2001 | 152,517 | 140,438 | (12,079) | 109% | 93,210 | N/A |
| | 2002 | 183,143 | 244,615 | 61,472 | 75% | 102,892 | 60% |
| Total: | | | | | | | |
| | 1999 | 434,208 | 382,813 | (51,395) | 113% | 74,258 | N/A |
| | 2001 | 512,739 | 472,131 | (40,608) | 109% | 93,210 | N/A |
| | 2002 | 484,572 | 647,219 | 162,647 | 75% | 102,892 | 84% |

Valuation data for fiscal year 2000 is not available since the State of Alaska had decided, in accordance with GASB Statement No. 27, not to do a valuation report for that fiscal year.

State of Alaska Teachers' Retirement System (TRS)

*Plan Description*

TRS provides pension, postemployment health care, death and disability benefits to participants. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature.

Each fiscal year, TRS issues a publicly available financial report which includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907) 465-4460.

*Funding Policy*

Employees contribute 8.65% of their base salary as required by State statute. The funding policy for TRS provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. During fiscal year 2003, required employee and employer contribution rates were 8.65% and 11%, respectively. The amounts contributed to TRS by the university during the years ended June 30, 2003, 2002 and 2001 were $4,281,511, $4,196,154, and $4,349,722, respectively, equal to the required employer contributions for each year.

Defined Contribution Plans:

University of Alaska Optional Retirement Plan (ORP)

Faculty classified as regular and certain administrators may make a one-time election to participate in the ORP as an alternative to participation in PERS or TRS. The ORP is an employer funded defined contribution plan which operates in conjunction with a companion mandatory tax-deferred annuity plan. ORP participants are required to make employee contributions to one of the plan's authorized tax-deferred annuity programs at a rate equivalent to the TRS employee contribution rate of 8.65%. The university makes matching employer contributions to one of the plan's authorized employee-selected annuity providers or investment managers at a rate equal to the three-year moving average of the TRS employer contribution rates (11.33% for FY03 and 11.67% for FY02). In fiscal year 2003 and 2002, the university's total covered payroll for the ORP plan was approximately $46.5 million and $40.5 million, respectively. The amounts contributed to ORP by the university during the years ended June 30, 2003, 2002 and 2001 were $5,266,348, $4,729,946, and $4,182,523, respectively. At June 30, 2003 and 2002, plan assets (participants' accounts attributable to employer contributions) had a net value of approximately $38.6 million and $34.4 million, respectively. Each participant is 100% vested at all times.

University of Alaska Pension Plan (Pension)

In addition to the other retirement plans, substantially all regular employees and faculty classified as temporary participate in the Pension plan which was established effective January 1, 1982, when the university withdrew from the federal social security program. Effective January 1, 2003, employer contributions for regular employees were 7.65% of covered wages up to a maximum of $42,000 and $87,000 for certain faculty classified as temporary. The plan provides for employer contributions to be invested in accordance with participant-directed investment elections to the plan's fixed income and/or equity funds. Each participant is 100% vested at all times.

In 2003 and 2002, the university's total covered payroll for the Pension plan was approximately $160.9 million and $148.8 million, respectively. The university's costs to fund and administer the plan amounted to approximately $12.3 million, or 7.66% of covered payroll. At June 30, 2003 and 2002, plan assets (participants' accounts) had a net value of approximately $214.5 million and $211.9 million, respectively.

13. Insurance and Risk Management:

The university is exposed to a wide variety of risks including property loss, bodily and personal injury, intellectual property, errors and omissions, aviation and marine. Exposures are handled with a combination of self-insurance, commercial insurance, and membership in a reciprocal risk retention group. The university is self-insured up to the maximum of $2 million per occurrence for casualty claims and $250,000 for property claims. Commercial carriers provide coverage in excess of these amounts. Health care, workers' compensation and unemployment claims are fully self-insured.

Liabilities have been established to cover estimates for specific reported losses, estimates for unreported losses based upon past experience modified for current trends, and estimates of expenses for investigating and settling claims.

Changes in applicable liability amounts follow (in thousands):

| | Balance July 1, 2002 | Provision for Claims | Claims Payment | Balance June 30, 2003 |
|---|---|---|---|---|
| Health | $ 7,563 | $ 28,518 | $ (29,153) | $ 6,928 |
| General liability | 7,885 | 724 | (433) | 8,176 |
| Workers' compensation | 4,012 | 1,463 | (1,295) | 4,180 |
| Unemployment | 118 | 544 | (525) | 137 |
| | $ 19,578 | $ 31,249 | $ (31,406) | $ 19,421 |

| | Balance July 1, 2001 | Provision for Claims | Claims Payment | Balance June 30, 2002 |
|---|---|---|---|---|
| Health | $ 5,378 | $ 26,558 | $ (24,373) | $ 7,563 |
| General liability | 7,401 | 1,130 | (646) | 7,885 |
| Workers' compensation | 4,055 | 1,147 | (1,190) | 4,012 |
| Unemployment | 113 | 520 | (515) | 118 |
| | $ 16,947 | $ 29,355 | $ (26,724) | $ 19,578 |

In fiscal year 2003 insured coverage limits for property claims decreased from $200 million to $100 million. Within the $25 million primary layer of coverage and the $50 million layer in excess of $50 million, the university is uninsured for $7.5 million and $25 million, respectively. Insurance coverage limits for casualty claims decreased from $45 million to $25 million and aviation limits for the flight school and aircraft liability decreased from $500 million to $25 million and $10 million, respectively.

14. Commitments and Contingencies:

Amounts received and expended by the university under various federal and state grants, contracts and other programs are subject to audit and potential disallowance. From time to time the university is named as a defendant in legal proceedings or cited in regulatory actions related to the conduct of its operations. In the normal course of business, the university also has various other commitments and contingent liabilities which are not reflected in the accompanying financial statements. In the opinion of management, the university will not be affected materially by the final outcome of any present legal proceedings, environmental investigations, audit adjustments, or other commitments and contingent liabilities.

15. Related Party Transactions:

The University of Alaska Foundation (Foundation) is a tax-exempt organization formed in 1974 to solicit donations for the exclusive benefit of the University of Alaska. At June 30, 2003 and 2002, the Foundation had net assets totaling $113.1 million and $105.4 million, respectively. The Foundation's financial statements are not combined with the university's financial statements. During 2003 and 2002, the university transferred $115,157 and $980,204, respectively, to the Foundation. For the same periods, distributions and expenditures by the Foundation for the benefit of the university totaled $8.9 million and $7.4 million, of which $8.7 million and $7.1 million were direct reimbursements to the university. At June 30, 2003 and 2002 the Foundation owed the university $1.6 million and $1.4 million, respectively, primarily for reimbursement of grant and contract and scholarship expenditures. The university provides in-kind administrative and accounting support for the Foundation, the costs of which are included as expenditures in the university's financial statements.

The investable resources of the university's land grant endowment trust fund and the Foundation's pooled endowment funds are combined into a consolidated fund (fund) for investment purposes. At June 30, 2003 and 2002, the fair value of the fund was $134.9 million and $129.6 million, respectively. The university's share of this fund was $79.6 million and $73.9 million, which is reflected in endowment investments. The fund is managed by the Foundation's investment committee and treasurer on a total return basis in accordance with an investment policy approved by the Board of Regents. The net assets and related activity for the university's land grant endowment trust's investment in the fund is reflected in the university's financial statements.

16. Functional Classifications with Natural Classifications:

The university's operating expenses by natural classification were as follows (in thousands):

| | Year ended June 30, 2003 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Compensation & Benefits | Contractual Services | Supplies & Materials | Other | Student Aid | Depre-ciation | Total |
| Instruction | $ 106,998 | $ 18,957 | $ 7,882 | $ 355 | $ - | $ - | $ 134,192 |
| Academic support | 24,404 | 5,162 | 4,655 | 58 | - | - | 34,279 |
| Research | 63,465 | 35,726 | 8,415 | 9 | - | - | 107,615 |
| Public service | 15,418 | 8,301 | 1,228 | 20 | - | - | 24,967 |
| Student services | 22,019 | 7,178 | 2,145 | (19) | - | - | 31,323 |
| Operations and maintenance | 20,468 | 8,452 | 10,758 | 613 | - | - | 40,291 |
| Institutional support | 40,655 | 9,136 | 3,852 | (114) | - | - | 53,529 |
| Student aid | - | - | - | - | 10,441 | - | 10,441 |
| Auxiliary enterprises | 7,427 | 12,344 | 11,865 | 191 | - | - | 31,827 |
| Depreciation | - | - | - | - | - | 59,684 | 59,684 |
| | $ 300,854 | $ 105,256 | $ 50,800 | $ 1,113 | $ 10,441 | $ 59,684 | $ 528,148 |

| | Year ended June 30, 2002 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Compensation & Benefits | Contractual Services | Supplies & Materials | Other | Student Aid | Depre-ciation | Total |
| Instruction | $ 96,736 | $ 18,497 | $ 8,715 | $ 92 | $ - | $ - | $ 124,040 |
| Academic support | 21,351 | 4,566 | 4,478 | 48 | - | - | 30,443 |
| Research | 56,391 | 32,170 | 8,656 | (24) | - | - | 97,193 |
| Public service | 13,666 | 7,098 | 1,465 | 38 | - | - | 22,267 |
| Student services | 19,359 | 6,889 | 2,274 | 187 | - | - | 28,709 |
| Operations and maintenance | 19,814 | 9,742 | 12,117 | 537 | - | - | 42,210 |
| Institutional support | 41,347 | 10,921 | 3,379 | 485 | - | - | 56,132 |
| Student aid | - | - | - | - | 9,405 | - | 9,405 |
| Auxiliary enterprises | 6,728 | 10,881 | 11,075 | 207 | - | - | 28,891 |
| Depreciation | - | - | - | - | - | 57,764 | 57,764 |
| | $ 275,392 | $ 100,764 | $ 52,159 | $ 1,570 | $ 9,405 | $ 57,764 | $ 497,054 |