



NORTHERN ARIZONA UNIVERSITY



FINANCIAL REPORT 2007-2008

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

UNIVERSITY ADMINISTRATION As of June 30, 2008

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Management and Student
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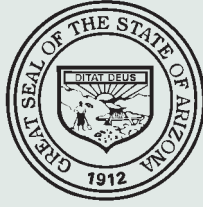
EX-OFFICIO MEMBERS

**The Honorable
Janet Napolitano**
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

WILLIAM THOMSON
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, 2008, 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.

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INDEPENDENT AUDITORS' REPORT

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, 2008, 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.

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, 2008, 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.

As described in Note 1, the University implemented the provisions of the Governmental Accounting Standards Board Statement Nos. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*; 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*; and 50, *Pension Disclosures (an amendment of GASB Statements No. 25 and No. 27)*, for the year ended June 30, 2008, which represents changes in 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

November 20, 2008

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, 2008. 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 fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances.
- The financial statements include a Statement of Cash Flows. This statement 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 9.

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

Financial Highlights

- Total net assets increased \$30.4 million from July 1, 2007 to June 30, 2008 based on total sources of funds of \$400.4 million and \$370.0 million of uses.
- Total sources of revenues increased by \$33.4 million or 9.1 percent while total uses of funds increased \$28.8 million or 8.4 percent.
- Student tuition and fees increased 11.2 percent from the previous year or about \$10.0 million.
- Government grants and contracts revenue increased overall \$1.7 million or 3.1 percent from the prior year.
- Investment income decreased 47.4 percent or \$4.2 million from the previous year.
- State and capital appropriations increased by approximately \$19.9 million from the prior year, a 14.3 percent increase.
- During the fiscal year the University issued \$38.7 million of system revenue refunding bonds, at an average interest rate of 4.93 percent to construct a new student dormitory and expand dining facilities. (see Capital Assets and Debt Administration section.)
- The University changed its method for capitalizing interest. This caused beginning net assets to increase by approximately \$5.7 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS

STATEMENT OF NET ASSETS

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. A summarized comparison of the University's assets, liabilities, and net assets at June 30, 2008 and 2007 (in thousands), is as follows:

	2008	2007 as restated
Current assets	\$ 127,358	\$ 117,048
Noncurrent assets:		
Cash, cash equivalents, investments, and student loans receivable	31,469	25,714
Endowment investments	15,295	16,042
Capital assets – net of accumulated depreciation	429,963	371,866
Other noncurrent assets	416	432
Total noncurrent assets	<u>477,143</u>	<u>414,054</u>
Total assets	<u>604,501</u>	<u>531,102</u>
Long-term liabilities	<u>292,740</u>	<u>252,201</u>
Other liabilities	<u>39,340</u>	<u>36,944</u>
Total liabilities	<u>332,080</u>	<u>289,145</u>
Net assets	<u>\$ 272,421</u>	<u>\$ 241,957</u>

A review of NAU's Statement of Net Assets at June 30, 2008 and 2007 shows that the University's financial position continues to improve. In fiscal year 2008, the University corrected the method it uses to capitalize interest for construction in progress. The University's net assets reported as of June 30, 2007, have been increased by approximately \$5.7 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 \$10.3 million. The most significant increases were due to an increase in overall cash available to invest and an increase in student, departmental, and government and grant receivables. The student receivables are higher mainly due to an increase in overall student tuition and fees including increased participation in NAU payment plans.

Noncurrent assets increased by approximately \$63.1 million over the prior year. The majority of the increases are as follows. Capital assets, representing a majority of noncurrent assets, increased approximately \$58.1 million, net of accumulated depreciation, over the prior fiscal year as the University continued its renovations including the completion of the High Country Conference Center (capital lease), north campus utility expansion, liberal arts renovation, new turf for the Skydome facility, and other improvements to the university capital facilities.

Other noncurrent assets include restricted cash and cash equivalents held by trustee, investments, student loans receivable, endowment investments and other noncurrent assets. These assets increased by a net \$5.0 million. The majority of the increase was due to an increase in restricted cash and cash equivalents held by trustee for capital projects of \$1.8 million, an increase in long term investments of \$3.8 million, and an increase in student loans receivable of \$208 thousand, offset by a decrease in the endowment investments of \$747 thousand. The increase in restricted cash and cash equivalents was due to additional unspent bond proceeds from university debt issuances. Noncurrent investments increased as the University invested more cash for longer terms in US agency securities. The endowment funds decreased due to downward market adjustments. The changes in capital assets are discussed in more detail in the Capital Assets and Debt Administration section.

Long-term liabilities increased by \$40.5 million as of June 30, 2008. 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 include accounts payable, accrued expenses, and deferred revenue. Other liabilities are higher by \$2.4 million, as of June 30, 2008. This increase is mainly due to an increase in accounts payable and accrued expenses.

MANAGEMENT'S DISCUSSION AND ANALYSIS

NET ASSETS

A summarized comparison of the University's net assets at June 30, 2008 and 2007 (in thousands), is as follows:

	2008	2007 as restated
Invested in capital assets, net of related debt	\$ 152,828	\$ 132,589
Restricted:		
Nonexpendable	16,494	16,251
Expendable	22,951	22,401
Unrestricted	80,148	70,716
Total net assets	\$ 272,421	\$ 241,957

Net assets at June 30, 2008 increased in total by \$30.4 million or approximately 12.6 percent from 2007. This is a result of total combined sources of \$400.4 million and total uses of \$370.0 million. The beginning net assets were increased by approximately \$5.7 million due to restatement. See note 1. The University continues to increase its revenue sources and manage operational expenses resulting in positive net asset growth. Certain prior year amounts for endowment net assets have been reclassified for comparison purposes.

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, 2008 and 2007 (in thousands), is as follows:

	2008	2007
Operating revenues:		
Tuition and fees, net of scholarship allowances	\$ 99,151	\$ 89,162
Government grants and contracts	14,625	55,458
Auxiliary enterprises	35,854	38,612
Other	12,712	11,344
Total operating revenues	162,342	194,576
Nonoperating revenues:		
State appropriations	153,579	136,862
Share of state sales tax	16,424	16,913
Grants and contracts	53,307	5,534
Investment income	4,700	8,933
Other nonoperating revenues	545	977
Total nonoperating revenues	228,555	169,219
Total revenues	390,897	363,795
Operating expenses:		
Educational and general	307,994	279,275
Auxiliary enterprises	28,645	33,491
Depreciation	18,926	17,867
Total operating expenses	355,565	330,633
Nonoperating expenses:		
Interest expense on capital asset related debt	12,206	10,506
Other nonoperating expenses	2,209	35
Total expenses	369,980	341,174
Increase before capital appropriations, capital grants and gifts and endowment additions	20,917	22,621
Capital appropriations, capital grants and gifts and endowment additions	9,547	3,232
Increase in net assets	\$ 30,464	\$ 25,853

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 current operations related to educational purposes. Operating revenues are provided as a result of the University's ongoing operations such as tuition and fees, some government grants, and auxiliary enterprises. Operating revenues (not including state appropriations) decreased about \$32.2 million in fiscal year 2008. The decrease in operating revenues is attributable mainly to the reclassification of certain grants revenues to nonoperating as discussed below, and the University outsourcing its bookstore operations in fiscal year 2007. Bookstore revenues accounted for approximately \$4.6 million of operating income in fiscal year 2007. Tuition and fee revenue increased almost \$10.0 million due to increased student enrollment coupled with an increase in board approved tuition rates. Auxiliary enterprise revenues overall decreased partly due to the ceasing of the bookstore operations in the prior year. However this was offset by a net increase in residence life revenues of over \$1.0 million due to additional occupancy and a rate increase. Private gifts revenue is included in both operating and nonoperating revenue, the increase for overall private gifts revenues was \$4.6 million for the year. Nonoperating revenues include state appropriations, investment income, nonoperating government grants and contracts, private gifts, grants and contracts, and share of state sales tax- technology and research initiative funding (TRIF). Nonoperating revenues increased overall by 35.1 percent. State and capital appropriations increased by 14.3 percent or approximately \$20.0 million as additional monies were appropriated to the University in the State's 2008 budget. The share of state sales taxes (TRIF) dipped slightly from 2007 down \$489 thousand from the prior year. Investment income decreased over 47 percent as interest rates declined and overall market conditions for investments, including the endowment and financial aid trust fund, were unfavorable. Included in nonoperating revenues is an increase in nonoperating government grants and private gifts, grants and contracts revenues of \$47.8 million. This change is the result of a reclassification of nonexchange government and private gifts and grants revenues from operating to nonoperating revenues and offsets a decrease in government and private gifts and grants operating revenues of \$41.4 million. The result was a net increase of \$6.4 million (9.8 percent) in total government and private gifts, grants and contracts revenues for the fiscal year.

EXPENSES ANALYSIS

Educational and general expenses continued to account for a majority of the operating expenses. Educational and general expenses increased in fiscal year 2008 by 10.3 percent or \$28.7 million. Significant components of the increase within educational and general expenses were instruction, \$10.5 million; public service, \$1.8 million; academic support, \$2.5 million; student services \$3.9 million, institutional support, \$4.3 million; and operation of maintenance and plant, \$4.7 million. In accordance with identified university priorities and strategic investment in faculty and staff retention, salary and benefit costs grew by \$15.1 million or 7 percent funded by state appropriations as well as university targeted support from both state and local funds. Overall, employee related expenses increased from \$51.7 million in fiscal year 2007 to \$56.0 million in fiscal year 2008, an 8.3 percent increase. The increase in employee related expenses (ERE) of \$4.3 million was due mainly to increases in health insurance costs of \$2.2 million, retirement costs of \$1.0 million, and an increase in employer paid FICA taxes of approximately \$800 thousand. The increase in retirement costs is due to the increase in the Arizona State Retirement System (A.S.R.S.) rates from 8.6 percent to 9.1 percent. Of the \$10.5 million increase in instruction, \$8.0 million is related to salary and benefit increases. Increased demand for services to support enrollment growth can be seen in increased faculty, support staff, and operational dollars in academic support and student services totaling \$6.0 million. The \$1.8 million increase in public service was directly related to increased efforts in community service outreach and cooperative programs in public service endeavors. Student service expenses increased by \$3.9 million of which \$2.1 million was operational support related to enrollment growth. Operations and maintenance and plant increased by \$4.7 million, due to increased utility rates and new building square footage and related operating and maintenance costs of new buildings. The decrease in auxiliary enterprises of \$4.8 million was mainly due to the outsourcing of the University bookstore and the resulting decrease in the operational expenditures. Depreciation expense increased by \$1.1 million or about 5.9 percent as the University constructed new buildings, improvements, and renovations including the new lab and utility infrastructure improvements. Depreciation expense will continue to increase as the University continues to construct new buildings and renovate older ones.

Expenses - By functional classification

A comparative summary of the University's expenses by functional classification for the years ended June 30, 2008 and June 30, 2007, is as follows:

	2008	2007
Operating:		
Instruction	\$ 127,072,806	\$ 116,547,826
Research	21,432,784	21,352,577
Public service	29,333,293	27,508,601
Academic support	29,185,293	26,667,760
Student services	27,835,980	23,906,998
Institutional support	36,675,800	32,384,760
Operation and maintenance of plant	22,610,377	17,874,004
Scholarships and fellowships	13,847,572	13,031,632
Total educational and general expenses	307,993,905	279,274,158
Auxiliary enterprises	28,644,848	33,491,413
Depreciation	18,925,789	17,867,470
Total operating expenses	355,564,542	330,633,041
Nonoperating:		
Interest and other	14,415,340	10,540,639
Total Expenses	\$ 369,979,882	\$ 341,173,680

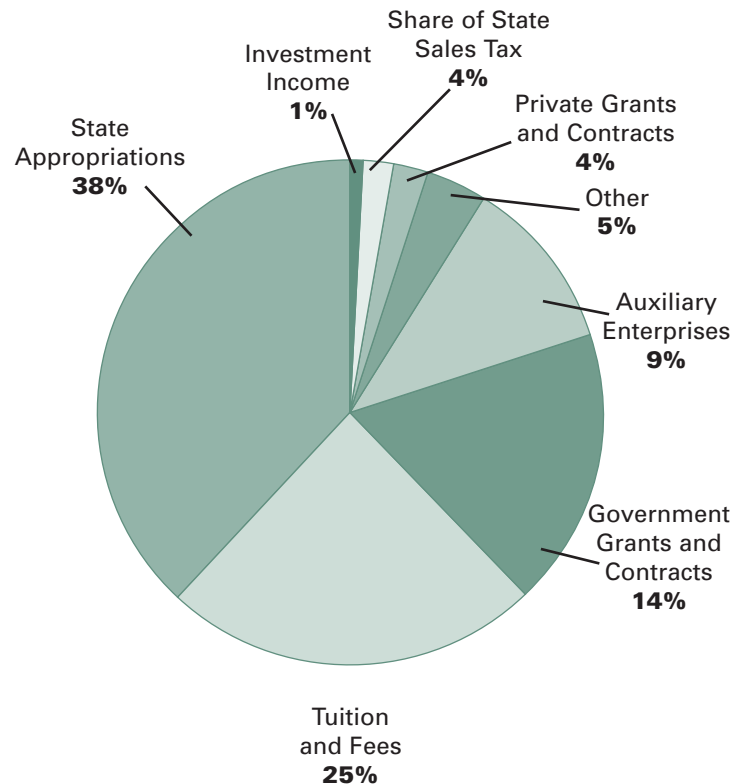
MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2008 and June 30, 2007, is as follows:

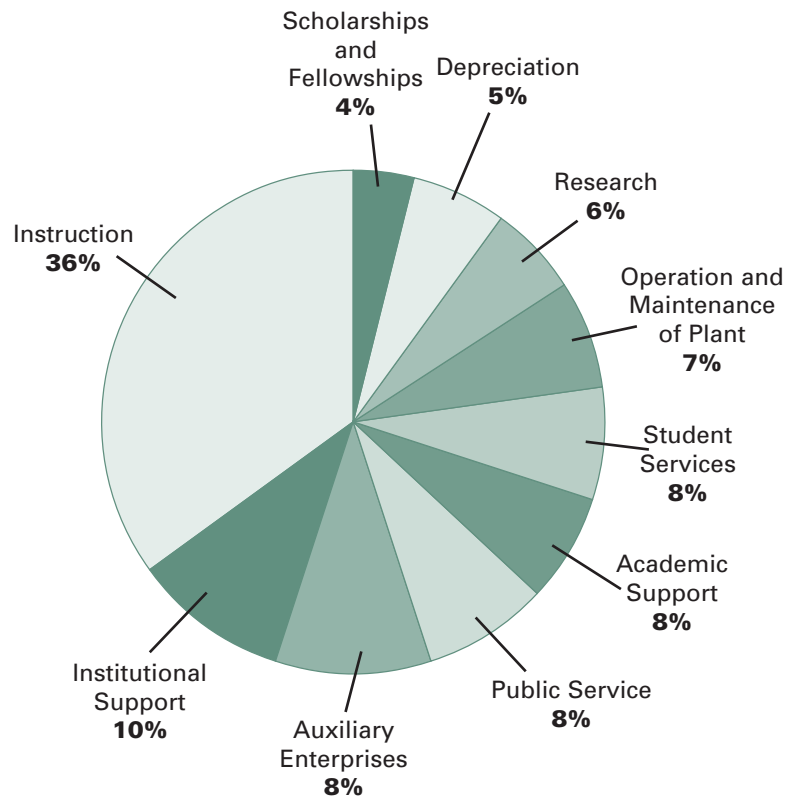
	2008	2007
Operating:		
Personal services and benefits	\$ 231,570,834	\$ 216,465,177
Operations	91,220,347	83,268,762
Scholarships	13,847,572	13,031,632
Depreciation	<u>18,925,789</u>	<u>17,867,470</u>
Total operating	<u>355,564,542</u>	<u>330,633,041</u>
Nonoperating:		
Interest and other	<u>14,415,340</u>	<u>10,540,639</u>
Total expenses	<u>\$ 369,979,882</u>	<u>\$ 341,173,680</u>

Total Revenues Fiscal Year 2008

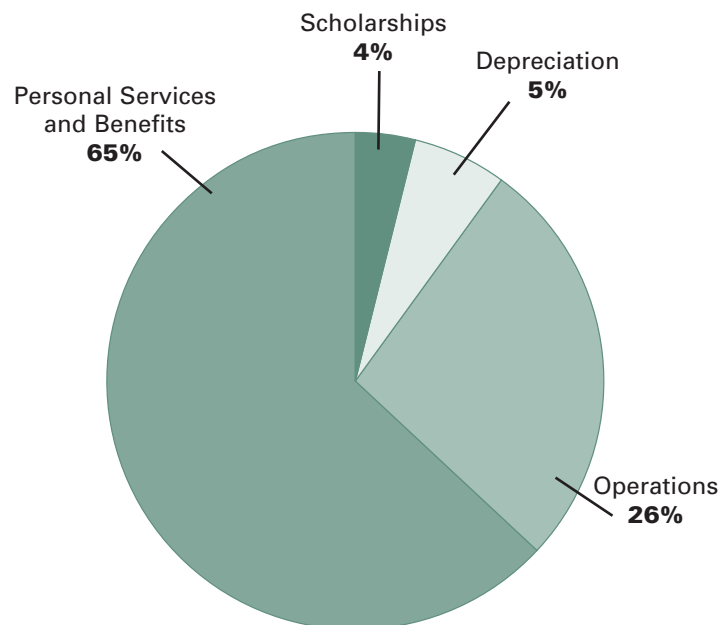


MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating Expenses Functional Classifications Fiscal Year 2008



Operating Expenses Natural Classifications Fiscal Year 2008



MANAGEMENT'S DISCUSSION AND ANALYSIS

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets at June 30, 2008

At June 30, 2008, the University had \$430.0 million invested in capital assets. During the year the University added \$77.5 million in new capital assets and retired \$2 million of obsolete assets. Accumulated depreciation increased by \$17.5 million. In addition, the University corrected its method of capitalizing interest on construction in progress; this caused beginning net assets to increase by approximately \$5.7 million. Details of capital assets at June 30, 2008 and 2007 are as follows:

	2008	2007 as restated
Land	\$ 5,597,637	\$ 5,597,637
Infrastructure	70,740,432	60,708,367
Buildings	474,180,147	442,615,604
Equipment	60,390,267	55,985,283
Library books and media	47,738,831	47,213,973
Construction in progress	45,601,462	16,574,448
Accumulated depreciation	(274,286,051)	(256,829,089)
Total capital assets	\$ 429,962,725	\$ 371,866,223

Significant capital additions completed or in progress, and the resources that funded their acquisitions for fiscal year 2008, were:

- Library acquisitions, \$598,461, unrestricted net assets
- Skydome athletic turf replacement, \$739,250, bond proceeds
- High Country Conference Center, \$11,948,344, lease purchase
- New science lab, \$612,645, certificates of participation
- Liberal Arts 3rd floor renovation, \$1,336,479, bond proceeds
- University Union eatery renovation, \$800,450, bond proceeds
- North campus utility expansion, \$1,237,646, bond proceeds

Projects in progress, or planned to commence in fiscal year 2008 funded from COPS and system revenue bonds include:

- Aspen Crossing Residence Hall
- NAU Yuma Science Lab
- Student dining expansion in University Union
- Cline Library Alarm Upgrade
- Wellness Center upgrade
- Distance Learning expansion
- Recreation Fields expansion
- Infrastructure and utility extensions
- Applied Research and Development building space modification

In accordance with Arizona Revised Statutes § 15-1670, NAU began receiving \$5.9 million in State appropriations annually for lease-purchase capital financing in fiscal year 2008 to fund research infrastructure projects.

At June 30, 2008, the University maintained an A2 rating on outstanding system revenue bonds by Moody's Investors Service and an A+ rating from Standard and Poor's Rating Services. The University's outstanding certificates of participation maintained an A3 rating by Moody's Investors Service and an A rating from Standard and Poor's Rating Services.

Economic Outlook

Arizona has been disproportionately impacted by the burst of the housing bubble and the credit crisis. Two years ago, in 2006, Arizona was the second fastest growing state in the nation in terms of jobs. By 2007, Arizona had slipped to 22nd and after eight months in 2008, Arizona ranks 46th among the 50 states and the District of Columbia. This is principally the result of declines among construction and related businesses. In construction alone, employment is down over 16 percent from a year ago and continues to fall. At its peak in 2005, 63,570 building permits were issued in the Phoenix area. Through August 2008, 10,708 permits were issued and it is estimated that the annual number issued will be around 15,000 or 25 percent of the peak three years earlier.

The impact on Arizona's General Fund is clear with sales taxes, individual income taxes, and corporate income taxes all seeing absolute declines. In Fiscal Year 2006, the State General Fund grew by 20 percent after having grown by 19 percent in the

MANAGEMENT'S DISCUSSION AND ANALYSIS

CAPITAL ASSETS AND DEBT ADMINISTRATION (continued)

Outstanding Debt at June 30, 2008

At June 30, 2008, the University had \$288.9 million in outstanding bonds, certificates of participation, other long-term obligations, and capital leases, an increase of approximately \$39.3 million or 16 percent from fiscal year 2007. This is due to a reduction of \$13.5 million of principal, new borrowings of \$51.1 million and a loss on renegotiation of a capital lease of \$1.7 million.

The table below summarizes the University's outstanding debt from fiscal years 2008 and 2007.

	2008	2007
System revenue and housing bonds	\$ 150,710,000	\$ 122,565,000
Capital leases	49,180,000	35,345,000
Certificates of participation	88,030,000	90,285,000
Other long-term obligations	<u>1,021,862</u>	<u>1,353,959</u>
Subtotal	<u>288,941,862</u>	<u>249,548,959</u>
Less deferred amount on refunding	(2,166,621)	(2,463,910)
Plus bonds premium	<u>5,965,108</u>	<u>5,116,195</u>
Total	<u>\$ 292,740,349</u>	<u>\$ 252,201,244</u>

previous fiscal year. By Fiscal Year 2007, growth had slowed to 6.9 percent and declined by 4.6 percent in Fiscal Year 2008. Although only three months of collections having been recorded in Fiscal Year 2009, the State General Fund saw year-over-year declines of 6.2 percent in July, 11.1 percent in August, and 9.9 percent in September. The Fiscal Year 2009 State General Fund budget for Arizona is approximately \$10 billion. Depending on assumptions made, the shortfall in revenue could range between \$700 million and \$1.1 billion. How that shortage will be filled has not yet been determined.

The Fiscal Year 2009 university system budget estimates that the State General Fund will provide 29 percent of resources (\$1.083 billion), tuition and fees will contribute 27 percent (\$1.024 billion), restricted gifts, grants, and contracts will be the source of 23 percent (\$870.5 million) and unrestricted local funds will amount to 21 percent (\$764.8 million). At Arizona State University, the Fiscal Year 2009 Operating Budget is currently \$800.6 million, \$214.5 million at Northern Arizona University and \$589.6 million at the University of Arizona. These budgets are being expended to educate the largest classes of students the Arizona University System has recorded. In the period 2004-2008, total headcount enrollment grew by 13,047 (11.4 percent) and full time equivalent enrollment grew by 14,059 (13.4 percent). Enrollment growth over the same time period at Arizona State University was 15.3 percent in headcount, 18.8 percent in FTE; at Northern Arizona University was 15.5 in headcount and 16.3 percent in FTE; and at the University of Arizona was 3.0 percent in headcount and 3.5 percent in FTE. The Fall 2008 full time

equivalent undergraduate class is up 4,626 (5.0 percent) over a year earlier and the full time equivalent graduate class is up 1,027 (5.0 percent) as well. 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, 2008

SOURCES

State Appropriations

38.4% **\$ 153,578,450**

Includes legislative appropriations from state of Arizona general revenue for current operations of the University and \$1,240,950 for financial aid.

Tuition and Fees, Net of Scholarship Allowances

24.8% **\$ 99,150,792**

Includes \$65,733,515 to support the operating budget, \$10,947,091 for summer sessions, \$52,240,110 for funding of local budgets, scholarships and retirement of non-housing bond indebtedness less \$29,769,924 for scholarship allowances.

Government Grants and Contracts

14.3% **\$ 57,462,574**

Includes revenues of \$46,770,119 from federal grants and contracts, \$4,550,373 from state grants and contracts, and \$6,142,082 from local government grants and contracts.

Auxiliary Enterprises

8.9% **\$ 35,854,420**

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

Other Sources

4.8% **\$ 19,276,514**

Includes additions to permanent endowments, capital grants and gifts, and other operating miscellaneous revenues.

Share of State Sales Tax

4.1% **\$ 16,424,200**

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

Private Gifts, Grants, and Contracts

3.5% **\$ 13,996,352**

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

Investment Income

1.2% **\$ 4,700,238**

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

Total Sources

\$ 400,443,540

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, 2008

USES

Instruction and Academic Support

42.2% **\$ 156,258,099**

Instruction, totaling \$127,072,806, 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 \$29,185,293, includes libraries, audio-visual services, and academic administration.

Student Services and Institutional Support

17.5% **\$ 64,511,780**

Student services, totaling \$27,835,980 includes areas such as admissions, registrar, minority services, counseling, placement, student aid administration, and health services. Institutional support, totaling \$36,675,800, includes executive management, financial operations, computing support, human resource services, security, and University relations.

Research and Public Service

13.7% **\$ 50,766,077**

Research, totaling \$21,432,784 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 \$29,333,293 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

7.7% **\$ 28,644,848**

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.

Operation and Maintenance of Plant

6.1% **\$ 22,610,377**

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.

Depreciation

5.1% **\$ 18,925,789**

Depreciation expense of capital assets over their useful lives.

Other Uses

3.9% **\$ 14,415,340**

Other uses include \$12,206,143 in interest expense on capital asset-related debt, a \$1,760,417 loss on renegotiation of a capital lease, and a \$448,780 loss on disposal of capital assets.

Scholarships and Fellowships

3.8% **\$ 13,847,572**

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.

Total Uses

\$ 369,979,882

FINANCIAL STATEMENTS

STATEMENT OF NET ASSETS

June 30, 2008

ASSETS

Business-Type Activities

Current assets:

Cash and cash equivalents	\$ 86,226,831
Investments	13,041,568
Receivables, net of allowance for uncollectibles:	
Accounts receivable	12,076,607
Accrued interest	951,006
Endowment - land sale	9,050
Government grants and contracts	13,700,850
Student loans, current portion	775,876
Other assets	306,192
Inventories	270,450
Total current assets	\$ 127,358,430

Noncurrent assets:

Restricted cash and cash equivalents held by trustee for capital projects	\$ 16,077,958
Investments	10,359,075
Student loans receivable, net of allowance	5,031,646
Endowment investments	15,294,928
Other noncurrent assets	415,676
Capital assets, not being depreciated	51,199,099
Depreciable capital assets, net of depreciation	378,763,626
Total noncurrent assets	\$ 477,142,008

Total assets

\$ 604,500,438

LIABILITIES

Current liabilities:

Accounts payable	\$ 9,012,407
Accrued payroll and employee benefits	9,933,621
Interest payable	2,210,087
Deferred revenue	10,122,921
Accrued compensated absences	4,720,047
Deposits held in custody for others	2,357,874
Current portion of long-term debt funded by:	
University operating revenues	6,604,081
State of Arizona appropriations/share of state sales tax	2,325,000
Total current liabilities	\$ 47,286,038

Noncurrent liabilities:

Deposits held in custody for others	\$ 982,207
Long-term debt funded by:	
University operating revenues	198,106,268
State of Arizona appropriations/share of state sales tax	85,705,000
Total noncurrent liabilities	\$ 284,793,475

Total liabilities

\$ 332,079,513

NET ASSETS

Invested in capital assets, net of related debt	\$ 152,827,837
Restricted:	
Nonexpendable:	
Scholarships and fellowships	9,833,907
Student loans	6,659,729
Expendable:	
Scholarships and fellowships	5,128,392
Research	10,576,173
Academic department use	7,246,201
Unrestricted	80,148,686
Total net assets	\$ 272,420,925

See Notes to Financial Statements

FINANCIAL STATEMENTS

STATEMENT OF FINANCIAL POSITION - Component Units June 30, 2008

	NAU FOUNDATION	NACFFC	TOTAL
ASSETS			
Cash and cash equivalents	\$ 36,632	\$ 9,032	\$ 45,664
Investments	72,157,493		72,157,493
Accounts receivable	244,545	298,658	543,203
Unconditional promises to give (net of allowance)	9,474,471		9,474,471
Assets held by trustee	5,183,826	1,517,319	6,701,145
Property, plant and equipment, net of depreciation	73,950		73,950
Net investment in sales-type lease		49,180,000	49,180,000
Educational broadcasting system licenses	5,570,040		5,570,040
Other assets	1,918,062	1,553,624	3,471,686
TOTAL ASSETS	<u>\$ 94,659,019</u>	<u>\$ 52,558,633</u>	<u>\$ 147,217,652</u>
LIABILITIES			
Accounts payable and accrued liabilities	\$ 175,681	\$ 1,724,601	\$ 1,900,282
Bonds payable		49,138,694	49,138,694
Assets held in custody for others	5,845,246		5,845,246
Deferred revenue	9,808,120	20,128	9,828,248
Other liabilities	964,873		964,873
Total liabilities	<u>\$ 16,793,920</u>	<u>\$ 50,883,423</u>	<u>\$ 67,677,343</u>
NET ASSETS			
Unrestricted	\$ 18,463,562	\$ 1,675,210	\$ 20,138,772
Temporarily restricted	22,845,395		22,845,395
Permanently restricted	36,556,142		36,556,142
Total net assets	<u>\$ 77,865,099</u>	<u>\$ 1,675,210</u>	<u>\$ 79,540,309</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 94,659,019</u>	<u>\$ 52,558,633</u>	<u>\$ 147,217,652</u>

See Notes to Financial Statements

FINANCIAL STATEMENTS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS For Year Ended June 30, 2008

REVENUES

Business-Type Activities

Operating Revenues	
Tuition and fees, net of scholarship allowances of \$29,769,924	\$ 99,150,792
Government grants and contracts	14,625,086
Private grants and contracts	3,527,087
Auxiliary enterprises	
Residence life, net of scholarship allowances of \$2,450,359	22,804,061
Other auxiliaries	13,050,359
Other	9,185,226
Total operating revenues	<u>\$ 162,342,611</u>

EXPENSES

Operating Expenses	
Educational and general:	
Instruction	\$ 127,072,806
Research	21,432,784
Public service	29,333,293
Academic support	29,185,293
Student services	27,835,980
Institutional support	36,675,800
Operation and maintenance of plant	22,610,377
Scholarships and fellowships	13,847,572
Auxiliary enterprises	28,644,848
Depreciation	18,925,789
Total operating expenses	<u>\$ 355,564,542</u>
Operating loss	<u>\$ (193,221,931)</u>

NONOPERATING REVENUES AND (EXPENSES)

State appropriations	\$ 153,578,450
Share of state sales tax - technology and research initiative funding	16,424,200
Government grants and contracts	42,837,488
Private gifts, grants, and contracts	10,469,265
Investment income	4,700,238
Interest expense on capital asset related debt	(12,206,143)
Loss on disposal of capital assets	(448,780)
Loss on renegotiation of capital lease	(1,760,417)
Other nonoperating revenues	545,046
Total nonoperating revenues and expenses	<u>\$ 214,139,347</u>

Income before other revenues, expenses, gains or losses	<u>\$ 20,917,416</u>
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Capital appropriations	\$ 5,900,000
Capital grants and gifts	2,996,703
Additions to permanent endowments	649,539

Increase in net assets	<u>\$ 30,463,658</u>
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NET ASSETS

Total net assets, July 1, 2007, as restated (Note 1)	\$ 241,957,267
Total net assets, June 30, 2008	<u>\$ 272,420,925</u>

See Notes to Financial Statements

FINANCIAL STATEMENTS

STATEMENT OF ACTIVITIES - Component Units For Year Ended June 30, 2008

	NAU FOUNDATION	NACFFC	TOTAL
CHANGES IN UNRESTRICTED NET ASSETS			
Unrestricted support	\$ 425,782	\$	\$ 425,782
Investment earnings	(208,549)	1,811,553	1,603,004
Licensing revenue	6,335,005		6,335,005
Rent		11,148,839	11,148,839
Capital lease revenue		12,400,000	12,400,000
Gain on lease renegotiation		1,760,417	1,760,417
Other	708,736		708,736
Total unrestricted support	<u>\$ 7,260,974</u>	<u>\$ 27,120,809</u>	<u>\$ 34,381,783</u>
Net assets released from restrictions	7,681,421		7,681,421
Total unrestricted revenues and support	<u>\$ 14,942,395</u>	<u>\$ 27,120,809</u>	<u>\$ 42,063,204</u>
Expenses:			
Scholarships	\$ 1,446,309	\$	\$ 1,446,309
Operating	4,005,862	128	4,005,990
Interest		1,863,223	1,863,223
Educational purposes	3,163,570		3,163,570
Amortization and depreciation		43,097	43,097
Assets expensed under capital lease agreement		23,990,358	23,990,358
Loss on bond refunding		1,010,326	1,010,326
Other		2,345,817	2,345,817
Total expenses	<u>\$ 8,615,741</u>	<u>\$ 29,252,949</u>	<u>\$ 37,868,690</u>
Increase in unrestricted net assets	<u>\$ 6,326,654</u>	<u>\$ (2,132,140)</u>	<u>\$ 4,194,514</u>
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS			
Public contributions	\$ 6,631,167		\$ 6,631,167
Investment earnings	(970,649)		(970,649)
Other income changes	(158,766)		(158,766)
Net assets released from restrictions	(7,681,421)		(7,681,421)
Decrease in temporarily restricted net assets	<u>\$ (2,179,669)</u>		<u>\$ (2,179,669)</u>
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS			
Public contributions	\$ 4,166,734		\$ 4,166,734
Investment earnings	(2,046,736)		(2,046,736)
Other income changes	243,192		243,192
Increase in permanently restricted net assets	<u>\$ 2,363,190</u>		<u>\$ 2,363,190</u>
INCREASE IN NET ASSETS	<u>\$ 6,510,175</u>	<u>\$ (2,132,140)</u>	<u>\$ 4,378,035</u>
NET ASSETS, BEGINNING OF YEAR	<u>\$ 71,354,924</u>	<u>\$ 3,807,350</u>	<u>\$ 75,162,274</u>
NET ASSETS, END OF YEAR	<u><u>\$ 77,865,099</u></u>	<u><u>\$ 1,675,210</u></u>	<u><u>\$ 79,540,309</u></u>

See Notes to Financial Statements

FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS For Year Ended June 30, 2008

	Business-Type Activities
Cash flows from operating activities:	
Tuition and fees	\$ 80,513,403
Grants and contracts	16,197,566
Payments to suppliers and providers of goods and services	(90,245,221)
Payments to employees	(211,109,784)
Payments for scholarships and fellowships	(13,847,572)
Loans issued to students	(1,331,586)
Collection of loans to students	1,558,877
Auxiliary enterprise receipts:	
Residence halls	22,382,140
Other auxiliaries	10,252,528
Other receipts	8,820,465
Net cash used for operating activities	<u>\$ (176,809,184)</u>
Cash flows from noncapital financing activities:	
State appropriations	\$ 153,578,450
Share of state sales tax	16,424,200
Gifts and grants for other than capital purposes	53,306,753
Federal direct student lending received	93,488,723
Federal direct student lending disbursed	(93,488,723)
Financial aid trust funds	649,539
Other receipts	545,046
Net cash provided by noncapital financing activities	<u>\$ 224,503,988</u>
Cash flows from capital financing activities:	
Capital appropriations	\$ 5,900,000
Proceeds from issuance of capital debt	39,921,313
Proceeds from sale of capital assets	33,884
Capital grants and gifts received	2,552,499
Purchases of capital assets	(64,660,751)
Principal paid on capital debt and leases	(13,462,514)
Interest paid on capital debt and leases	(11,847,917)
Net cash used for capital financing activities	<u>\$ (41,563,486)</u>
Cash flows from investing activities:	
Proceeds from sales and maturities of investments	\$ 25,712,558
Interest on investments	5,077,350
Purchase of investments	(33,053,100)
Net cash provided by investing activities	<u>\$ (2,263,192)</u>
Net increase in cash and cash equivalents	\$ 3,868,126
Cash and cash equivalents - beginning of year	98,436,663
Cash and cash equivalents - end of year	<u>\$ 102,304,789</u>
Reconciliation of operating loss to net cash used for operating activities:	
Operating loss	\$ (193,221,931)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation expense	18,925,789
Changes in assets and liabilities - cash increase (decrease) related to:	
Receivables:	
Accounts receivable	(4,513,457)
Government grants and contracts	(1,373,090)
Student loans receivables and accrued interest from student loans	216,810
Inventories	18,274
Other assets	1,107,319
Accounts payable	956,855
Accrued payroll and employee benefits	1,593,533
Deferred revenue	(470,551)
Deposits held in custody for others	(233,377)
Accrued compensated absences	184,642
Net cash used for operating activities	<u>\$ (176,809,184)</u>
Significant noncash transactions	
Assets acquired through capital lease	12,400,000
Loss on renegotiation of capital lease	(1,760,417)

See Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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, 2008, the University implemented the provisions of GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues, and GASB Statement No. 50, Pension Disclosures (an amendment of GASB Statements No. 25 and No. 27). GASB Statements No. 45, 48, and 50 require disclosure in the notes to financial statements, and had no effect on reported amounts of revenues, expenses or net assets.

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 securities and property, and disburses payments to and on behalf of the University or 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, 2008, the Foundation distributed \$5.5 million to the University for restricted and unrestricted purposes.

The University also amended its lease with the NACFFC due to renegotiation of the Pine Ridge/McKay Village lease and recorded a capital lease for the High Country Conference Center as described in Note 4.

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 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

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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.

Prior Year Capitalized Interest Correction

In fiscal year 2008, the University made a correction to the method it uses to calculate capitalized interest for construction in progress. The correction was made to capitalize additional interest expense in prior years. The cumulative effect of corrections for fiscal years 2003 through 2007 was to increase capital assets net of accumulated depreciation in the amount of \$5,658,837. The cumulative adjustment was recorded as a restatement of the University's net assets reported as of June 30, 2007 as follows:

Net assets, beginning of year, as previously reported	\$236,298,430
Cumulative effect of change in capitalization threshold	5,658,837
Net assets, beginning of year, as restated	<u>\$241,957,267</u>

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, 2008, are reported less allowances for both estimated uncollectible amounts and collection costs of \$1,523,500 and \$1,503,500, respectively.

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

Capital Assets

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

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

500 hours of sick leave are paid a formulated benefit amount. The University makes contributions each pay period to the State's Retiree Accumulated Sick Leave Fund and the State makes benefit payments directly to the retired employees from the fund. Consequently, the University has not accrued a liability for these sick leave benefits.

Investment Income

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

Scholarship Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. A scholarship discount and allowance is the difference between the stated charge for goods and services provided by the University and the amount that is paid by students or third parties making payments on behalf of the student.

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

Note 2—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 and constitute the University's investment policy.

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, 2008, cash on hand was \$21,371, the carrying amount of the University's deposits was (\$612,571) and the bank balance was \$1,111,393. 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, 2008, \$1,011,393 of the University's bank balance was uninsured with collateral held by the pledging financial institution.

Investments	Amount
State Treasurer's investment pool	\$ 86,371,090
U.S. agency securities	22,973,155
Student Financial Aid Trust Fund	10,717,400
Bond Trustee Funds:	
Government Money Market Mutual Fund	15,871,618
State Treasurer's investment pool	206,340
Investments with NAU Foundation	5,451,957
	<u>\$ 141,591,560</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

Beyond the requirements established by ABOR, the University does not have a formal policy with respect to credit risk. At June 30, 2008, credit risk for the University investments were as follows:

Investment Type	Rating	Rating Agency	Amount
U.S. agency securities	AAA	Standard and Poors	\$ 22,973,155
State Treasurer's investment pool	unrated	N/A	86,371,090
Student Financial Aid Trust Fund, debt securities	unrated	N/A	2,949,529
Bond Trustee Funds:			
Government Money Market Mutual Fund	AAA	Standard and Poors	15,871,618
State Treasurer's investment pool	unrated	N/A	206,340
Investments with NAU Foundation	unrated	N/A	5,451,957
			<u>\$ 133,823,689</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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

The Student Financial Aid Trust Fund was established in accordance with A.R.S. §15-1642 for the purpose of providing aid to students with verifiable financial need. The three state universities participate in the Trust Fund, which is held with and managed by the University of Arizona in accordance with ABOR policy. 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, 2008, the University had \$22,973,155 of U.S. agency securities that were uninsured and held by the counterparty not in the University's name and \$15,871,618 of mutual funds in trustee accounts that were uninsured and held by the counterparty not in the University's name.

Concentration of Credit Risk

The University does not have a formal policy in regards to concentration of credit risk. The University places no limit on the amount that the University may invest in any one issuer. Five percent or more of the University's investments at June 30, 2008, were in Federal National Mortgage Association securities. This investment was 10.21 percent, respectively, of the University's total investments.

Interest Rate Risk

The University does not have a formal policy in regards to interest rate risk.

Investment Type	Fair Value	Maturity			
		Less Than 1 Year	1-5 Years	6-10 Years	More than 10 Years
State Treasurer's investment pool	\$ 86,577,430	\$ 86,577,430			
U.S. agency securities	22,973,155	13,095,005	\$ 9,878,150		
NAU Foundation	5,451,957	638,518	2,701,757	\$ 1,337,113	\$ 774,569
Student Financial Aid Trust Fund	2,949,529			2,949,529	
Government Money Market Mutual Fund	15,871,618	15,871,618			
Total	<u>\$ 133,823,689</u>	<u>\$ 116,182,571</u>	<u>\$ 12,579,907</u>	<u>\$ 4,286,642</u>	<u>\$ 774,569</u>

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	\$ 21,371
Cash in bank	(612,571)
Total investments	<u>141,591,560</u>
	<u>\$ 141,000,360</u>

Statement of Net Assets:

Cash and cash equivalents	\$ 86,226,831
Current investments	13,041,568
Restricted cash and cash equivalents held by trustee for capital projects	16,077,958
Noncurrent investments	10,359,075
Endowment investments	<u>15,294,928</u>
	<u>\$ 141,000,360</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

Note 3—Capital Assets

Capital asset activity for the year ended June 30, 2008, was as follows:

	Balance June 30, 2007, as restated	Additions	Retirements	Transfers	Balance June 30, 2008
Capital assets not being depreciated:					
Land	\$ 5,597,637				\$ 5,597,637
Construction in progress	16,574,448	\$ 67,633,755	\$ 132,623	\$ (38,474,118)	45,601,462
Total capital assets not being depreciated	22,172,085	67,633,755	132,623	(38,474,118)	51,199,099
Capital assets being depreciated:					
Infrastructure	60,708,367	1,141,306		8,890,759	70,740,432
Buildings and improvements	442,615,604	2,702,191	721,007	29,583,359	474,180,147
Equipment	55,985,283	5,442,964	1,037,980		60,390,267
Library books and media	47,213,973	598,461	73,603		47,738,831
Total capital assets being depreciated	606,523,227	9,884,922	1,832,590	38,474,118	653,049,677
Less accumulated depreciation for:					
Infrastructure	23,792,003	2,048,393			25,840,396
Buildings and improvements	151,330,858	11,820,222	430,333		162,720,747
Equipment	40,307,097	3,583,409	964,891		42,925,615
Library books and media	41,399,131	1,473,765	73,603		42,799,293
Total accumulated depreciation	256,829,089	18,925,789	1,468,827		274,286,051
Total capital assets being depreciated, net	349,694,138	(9,040,867)	363,763	38,474,118	378,763,626
Capital assets, net	\$ 371,866,223	\$ 58,592,888	\$ 496,386	\$	\$ 429,962,725

The capital assets June 30, 2007, balances have been adjusted by \$5,658,837 to reflect a correction to the capitalized interest calculation for Fiscal years 2003 through 2007.

Construction - The University had major contractual commitments related to various capital projects at June 30, 2008, including the construction of a new residence hall, a new science lab at NAU Yuma, Recreation Center improvements, the University Union dining expansion and major infrastructure upgrades. At June 30, 2008, the University had spent \$38,263,000 on these projects and had remaining contractual commitments with contractors of \$10,062,424. These projects are being financed with a combination of system revenue bonds (series 2007 & 2008) and University reserves.

Note 4—Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2008, was as follows:

	Balance June 30, 2007	Additions	Reductions	Balance June 30, 2008	Due Within One Year
Long-term obligations	\$ 1,353,959		\$ 332,097	\$ 1,021,862	\$ 348,196
Capital leases	35,345,000	\$ 49,180,000	35,345,000	49,180,000	620,000
Certificates of participation	90,285,000		2,255,000	88,030,000	2,325,000
Revenue and housing bonds payable	122,565,000	38,695,000	10,550,000	150,710,000	5,415,000
Less deferred amount on refunding	(2,463,910)		(297,289)	(2,166,621)	(159,940)
Discounts/premiums	5,116,195	1,226,313	377,400	5,965,108	380,825
Total long-term liabilities	\$ 252,201,244	\$ 89,101,313	\$ 48,562,208	\$ 292,740,349	\$ 8,929,081

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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

Bonds payable at June 30, 2008, are as follows:

Student housing - 5.5%, principal payable annually on April 1 through 2009, revenues of various housing projects pledged for payment.	\$	100,000
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System revenue bonds, Series of 1997 - 6.5%, principal maturing serially on June 1, 2009, through 2010, secured by a first lien on certain gross revenues, on a parity with the Series 2002 system revenue bonds, Series 2003 system revenue bonds, Series 2004 system revenue and refunding bonds, Series 2005 systems revenue bonds, Series 2006 system revenue refunding bonds, and the Series 2007 system revenue bonds.	\$	5,645,000
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System revenue bonds, Series of 2002 - 3% to 4.875%, principal maturing serially on June 1, 2003, through 2022, secured by a first lien on certain gross revenues, on a parity with the Series 1997 system revenue bonds, Series 2003 system revenue bonds, Series 2004 system revenue and refunding bonds, Series 2005 system revenue bonds, Series 2006 system revenue refunding bonds, and the Series 2007 system revenue bonds.	\$	7,230,000
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System revenue bonds, Series of 2003 - 2.5% to 4%, principal maturing serially on June 1, 2005, through 2016, secured by a first lien on certain gross revenues, on a parity with the Series 1997 system revenue bonds, Series 2002 system revenue bonds, Series 2004 system revenue and refunding bonds, Series 2005 system revenue bonds, Series 2006 system revenue refunding bonds, and the Series 2007 system revenue bonds.	\$	5,465,000
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System revenue and refunding bonds, Series of 2004 - 3% to 5.25%, principal maturing serially on June 1, 2005, through 2034, secured by a first lien on certain gross revenues, on a parity with the Series 1997 system revenue bonds, Series 2002 system revenue bonds, Series 2003 system revenue bonds, Series 2005 system revenue bonds, Series 2006 system revenue refunding bonds, and the Series 2007 system revenue bonds.	\$	37,495,000
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System revenue bonds, Series of 2005 - 3% to 5.125%, principal maturing serially on June 1, 2005, through 2040, secured by a first lien on certain gross revenues, on a parity with the Series 1997 system revenue bonds, Series 2002 system revenue bonds, Series 2003 system revenue bonds, Series 2004 system revenue and refunding bonds, Series 2006 system revenue and refunding bonds, and the Series 2007 system revenue bonds.	\$	14,815,000
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System revenue refunding bonds, Series of 2006 - 4% to 5%, principal of \$20,600,000 maturing serially on June 1, 2008, through 2027, and \$21,660,000 maturing in two term bonds on June 1, 2031 and 2034, secured by a first lien on certain gross revenues, on a parity with the Series 1997 system revenue bonds, the Series 2002 system revenue bonds, Series 2003 system revenue bonds, Series 2004 system revenue and refunding bonds, Series 2005 system revenue bonds, and the Series 2007 system revenue bonds.	\$	42,205,000
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Systems revenue bonds, Series 2007 - 4.25% to 5%, principal maturing serially on June 1, 2008, through 2037, secured by a first lien on certain gross revenues, on a parity with the Series 1997 revenue bonds, Series 2002 system revenue bonds, Series 2003 system revenue bonds, Series 2004 system revenue and refunding bonds, Series 2005 system revenue bonds, and Series 2006 system revenue refunding bonds.	\$	37,755,000
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	<u>\$</u>	<u>150,710,000</u>
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NOTES TO FINANCIAL STATEMENTS

June 30, 2008

The following schedule details debt service requirements to maturity for the University's bonds payable at June 30, 2008.

Year Ending June 30,	Revenue Bonds	
	Principal	Interest
2009	\$ 5,415,000	\$ 7,113,950
2010	5,550,000	6,840,545
2011	5,785,000	6,563,442
2012	6,030,000	6,342,609
2013	6,305,000	6,065,592
2014-18	31,710,000	25,632,134
2019-23	20,830,000	19,498,799
2024-28	23,110,000	14,200,271
2029-33	28,235,000	8,299,089
2034-38	16,070,000	2,201,286
2039-40	1,670,000	122,274
Total	\$ 150,710,000	\$ 102,879,991

The following schedule details debt service requirements to maturity for the University's certificates of participation payable at June 30, 2008.

Year ended June 30,	Certificates of participation	
	Principal	Interest
2009	\$ 2,325,000	\$ 3,922,768
2010	2,390,000	3,847,206
2011	2,480,000	3,763,533
2012	2,575,000	3,666,356
2013	2,670,000	3,565,760
2014-18	15,095,000	16,054,598
2019-23	18,910,000	12,139,425
2024-28	24,090,000	6,871,243
2029-31	17,495,000	1,031,456
Total	\$ 88,030,000	\$ 54,862,345

Bonds

On July 24, 2007, the University sold System Revenue Bonds Series 2007 for \$38,695,000 dated August 7, 2007 for construction of a new residence hall, expansion of a multi-use dining and activity facility, and other qualified capital projects. The 2007 Bonds include \$19,620,000 of serial bonds with interest rates ranging from 4.25% to 5% and maturity dates ranging from June 1, 2008 to June 1, 2027. The 2007 Bonds also include \$19,075,000 of term bonds, with an interest rate of 5.0% and maturing on June 1, 2032 and 2037 and are subject to annual sinking fund contributions. The bonds maturing on or after June 1, 2018, are subject to optional redemptions without premium on June 1, 2017. The 2007 Bonds were sold with net original issue premium of \$1,226,313. The University realized net proceeds of \$39,503,120 after payment of \$418,193 for issuance costs, underwriter discounts, and bond insurance. The costs associated with this issue were recorded in the current fiscal year. The Series 2007 System Revenue Bonds have an average interest rate of 4.93%.

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, 2008, \$41,190,000 of such bonds outstanding are considered defeased.

The University has pledged portions of its gross revenues towards the payment of debt related to various senior lien system revenue bonds outstanding at June 30, 2008. 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, 2008 pledged revenues totaled \$143.7 million of which 11.9% (\$17.1 million) was required to cover current year debt service. Future pledged revenues required to pay all remaining debt service for system revenue bonds through final maturity of June 1, 2040 is \$253.6 million.

The following schedule details outstanding Certificates of Participation payable at June 30, 2008

Issue	Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
2004 Research Infrastructure	\$ 37,585,000	2030	2.5% - 5.125%	\$ 36,665,000
2005 Research Infrastructure	40,255,000	2030	3.0 - 5.0%	39,235,000
2006 Research Infrastructure	12,445,000	2030	4.0 - 4.5%	12,130,000
	<u>\$ 90,285,000</u>			<u>\$ 88,030,000</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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. The University recorded a capital lease of \$22.685 million in fiscal year 2007 for the MV complex.

In fiscal year 2008, the University recorded a one-time loss on the renegotiation of its lease agreement with Pine Ridge Village/Campus Heights, LLC (PRV/CH) of \$1,760,417. The loss represents the net increase in the University's capital lease obligation resulting from the change to the base rent provision in the amended lease agreement dated May 1, 2008. The renegotiation of the lease agreement with PRV/CH was necessitated by PRV/CH's refinancing of the variable rate demand revenue bonds to which the base lease payments were tied. Under the terms of the amended lease agreement, base lease payments are

tied to the debt service schedule of the newly issued fixed rate bonds at an average coupon rate of 4.61%. As part of the refinancing, additional funds of approximately \$1,435,000 were borrowed to help cover refinancing costs. The additional borrowings and the difference between the bond principal refinanced and amortized lease obligation resulted in the increase to the University's capital lease obligation.

On September 1, 2006, the University entered into a lease agreement with North Campus Facilities L.L.C. (NCF), a subsidiary of the Northern Arizona Capital Facilities Finance Corporation (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, \$11.5 million of which was paid to NCF as additional rent, including \$1.5 million provided by the City of Flagstaff.

Capital lease commitments to lessors at June 30, 2008 based on present value of lease payments

	Average Interest Rate	Final Maturity	Balance June 30, 2007	Additions	Reductions	Balance June 30, 2008	Current Portion
Pine Ridge/McKay Village	4.61%	6/1/2033	\$ 35,345,000	\$ 36,780,000	\$ 35,345,000	\$ 36,780,000	\$ 230,000
North Campus Facilities LLC	4.89%	6/1/2036		12,400,000		12,400,000	390,000
Total: Capital Leases			\$ 35,345,000	\$ 49,180,000	\$ 35,345,000	\$ 49,180,000	\$ 620,000

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

Year ended June 30,

Capital Lease Payments

2009	\$ 2,758,998
2010	2,990,844
2011	3,027,169
2012	3,061,169
2013	3,097,844
2014-18	16,048,632
2019-23	17,090,013
2024-28	18,107,875
2029-33	19,170,800
2034-36	2,462,000
Total minimum lease payments	87,815,344
Less amount representing interest	(38,635,344)
Present value of minimum lease payments	<u>\$ 49,180,000</u>

Capital Lease Assets – the book value, accumulated depreciation and net book value for capitalized leased assets as of June 30, 2008 were as follows:

Asset	Book Value	Accumulated Depreciation	Net Book Value
Pine Ridge	\$ 13,225,000	\$ (1,321,597)	\$ 11,903,403
McKay Village	\$ 22,685,000	\$ (1,133,477)	\$ 21,551,523
Conference Center	\$ 24,421,398	\$ (572,254)	\$ 23,849,144

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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, 2008, active plan members were required by statute to contribute at the actuarially determined rate of 9.6 percent (9.1 percent for retirement and 0.5 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 9.6 percent (8.05 percent for retirement, 1.05 percent for health insurance premium, and 0.5 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
2008	\$ 5,939,553	\$ 774,724	\$ 368,934
2007	\$ 5,051,466	\$ 787,594	\$ 337,824
2006	\$ 3,674,658	\$ 719,647	\$ 314,667

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, 2008, 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, 2008, 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, 2008, are summarized below.

Contributions to Retirement Plans

for the year ended June 30, 2008, are summarized below.

Plan	University Contributions	Member Contributions	Total Contributions
TIAA/CREF	\$ 3,226,744	\$ 3,226,744	\$ 6,453,488
VALIC	\$ 575,731	\$ 575,731	\$ 1,151,462
Fidelity	\$ 1,100,598	\$ 1,100,598	\$ 2,201,196

Note 6—Risk Management

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The University participates in a self-insurance program administered by the State of Arizona, Department of Administration, Risk Management Section. 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, 2008

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, 2008 • Natural Classification

	Personal Services and Benefits	Operations	Scholarships	Depreciation	Total
Functional Classification:					
Instruction	\$ 109,801,316	\$ 17,271,490			\$ 127,072,806
Research	14,977,420	6,455,364			21,432,784
Public service	13,688,231	15,645,062			29,333,293
Academic support	22,565,560	6,619,733			29,185,293
Student services	18,668,608	9,167,372			27,835,980
Institutional support	24,810,465	11,865,335			36,675,800
Operation and maintenance of plant	8,623,218	13,987,159			22,610,377
Scholarships and fellowships			\$ 13,847,572		13,847,572
Auxiliary enterprises	18,436,016	10,208,832			28,644,848
Depreciation				\$ 18,925,789	18,925,789
Total	\$ 231,570,834	\$ 91,220,347	\$ 13,847,572	\$ 18,925,789	\$ 355,564,542

Note 8—Other Matters

Subsequent Event

In July 2008 the University issued approximately \$43.1 million of system revenue bonds for the purpose of constructing a residence life warehouse, expanding the distance learning facility, expanding recreational fields, replacing the turf in the Skydome athletic facility, and various infrastructure improvements. These bonds are secured by a first lien on certain gross revenues and are on parity with the Series 1997 system revenue bonds, Series 2002 system revenue bonds, Series 2003 system revenue bonds, Series 2004 system revenue and refunding bonds, Series 2005 system revenue bonds, Series 2006 system revenue refunding bonds, and the Series 2007 system revenue bonds.

Note 9—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

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 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 \$698,762 relating to the Pine Ridge Village/Campus Heights Series 2005 Bonds were recorded as a loss on refunding net of accumulated amortization costs (\$73,828). Amortization Expense (\$21, 836) was calculated for Issue Costs on the Series 2005 Bonds up to refunding date on a straight line basis and included in the net loss on refunding.

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, 2008 was \$5,574 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, 2008 was \$15,687 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, 2008

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 \$1,517,319 at June 30, 2008. 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	\$ 2,385,017
One to five years	6,501,415
More than five years	2,017,300
Gross pledges receivable	10,903,732
Discount to present value	(1,276,430)
Allowance for uncollectible pledges	(152,831)
Total pledges receivable, net	<u>\$ 9,474,471</u>

A concentration of credit risk exists with the unconditional promises to give at June 30, 2008, as approximately 73% of the gross receivable and 36% of public contributions recognized during fiscal 2008 is from one donor.

At June 30, 2008, 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. During fiscal year 2008, some of the conditions on the grant were met and the Foundation recorded contribution revenue of \$100,000. Prior to fiscal year 2008, \$200,000 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, 2008, gross unconditional pledges receivable from these members total approximately \$196,000. During fiscal year 2008, the Foundation recognized contribution revenue from these donors of approximately \$159,000.

D. INVESTMENTS

The fair value and cost of the Foundation's investments at June 30, 2008 are as follows:

	Fair Value	Cost
U.S. Government/agency bonds	\$ 14,804,325	\$ 14,603,933
Corporate bonds	9,207,084	9,202,070
Common stock	20,755,776	20,456,555
International equity funds	8,523,543	8,526,021
Real estate investment trust		58
Money market funds	18,866,765	18,862,636
	<u>\$ 72,157,493</u>	<u>\$ 71,651,273</u>

Investments include funds held for the custody of others of \$5,034,694 at June 30, 2008.

The realized losses and unrealized gains on investments were \$ (5,927,462), and \$906,650 for the year ended June 30, 2008. Investment expenses of \$115,515 for the year ended June 30, 2008 have been netted against investment earnings in the statement of activities.

The fair value and cost of the NACFFC's investments at June 30, 2008 is as follows:

	Fair Value	Cost
Investments held by Trustee		
U.S. Treasury money market funds	\$ 1,517,319	\$ 1,517,319
	<u>\$ 1,517,319</u>	<u>\$ 1,517,319</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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, 2008 are presented as follows:

FOUNDATION

	Cost or Donated Value	Accumulated Depreciation	Net Assets
Furniture and equipment	\$ 105,719	\$ 31,769	\$ 73,950

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 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.

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

Total minimum lease payments to be received	\$ 87,719,316
Less: Unearned income	(38,539,316)
Net investment in sales-type lease	\$ 49,180,000

At June 30, 2008, minimum lease payments are as follows:

Year ended June 30,	Amount
2009	\$ 2,846,790
2010	2,988,454
2011	3,024,586
2012	3,058,392
2013	3,094,859
Thereafter	72,706,235
	<u>\$ 87,719,316</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.

The lease purchase agreement also provided for additional rents necessary to complete the cost of the convention center/parking garage complex in excess of the amount funded through the issuance of bonds. Money received from the City of Flagstaff under the terms of an intergovernmental agreement (IGA) was transferred to the construction account on deposit with the trustee, and additional payments from NAU to cover costs of construction was also transferred to the construction account. NAU transferred (including \$1,500,000 from the IGA) \$11,000,000 to the construction account during the year ended June 30, 2008. These transfers were recognized by North Campus Facilities LLC as other rental income in the accompanying financial statements. The IGA, of which North Campus Facilities LLC is not a part, provides for the City of Flagstaff to transfer \$2,000,000 to NAU based on percentage of construction completed. At June 30, 2008, \$500,000 was still due from the City of Flagstaff pending the filing of a Certificate of Completion for the Conference Center.

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

Renegotiation of Pine Ridge Village/Campus Heights LLC Sales-Type Lease and Refunding Series 2005 Bonds

On May 1, 2008, Pine Ridge Village/Campus Heights LLC renegotiated its lease with NAU to facilitate the refunding of the Series 2005 Bonds. The refunding was precipitated by concerns relating to the downgrading of the bond insurer, Financial Guaranty Insurance Company (FGIC), and the resulting increase in interest rates on the variable Bonds.

On May 8, 2008 Pine Ridge Village/Campus Heights LLC issued Series 2008 Bonds to refund the Series 2005 Bonds and terminate the interest rate swap agreement associated with the Series 2005 Bonds. The refunding resulted in a loss on Bond refunding (\$1,010,326) for the net amount of Bond Issue Costs (\$624,935) and net amount of Bond Discount (\$385,391) on the Series 2005 Bonds. There was no premium to repurchase the Series 2005 bonds. The termination of the swap agreement resulted in a termination payment liability (\$749,000), paid on the closing date, which was included with the removal of the asset (Benefit Under Interest Rate Swap \$1,448,225), as the basis for the net Loss Under Interest Rate Swap on the May 15, 2008 refunding date (\$2,197,225).

Under the terms of the amended lease agreement, base lease payments are tied to the debt service schedule of the Series 2008 fixed rate bonds at an average coupon rate of 4.61%. As part of the refinancing, additional bonds were issued to help cover refinancing costs. This resulted in an increase to the sales type lease net receivable in the amount of \$1,760,417 which was recorded as a gain on the lease renegotiation.

Educational broadcast system licenses - The Foundation has been granted several educational broadcast system (EBS) licenses from the Federal Communications Commission (FCC). Additionally, during fiscal year 2008, 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 SFAS No. 116, 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, 2008, the Foundation had only purchased EBS licenses totaling \$5,570,040. This amount is included in licensing revenue in the accompanying statement of activities. The remaining balance of approximately \$9,808,000 is included in deferred revenue in the accompanying statement of financial position.

The Foundation leases the licenses to various companies. The licenses are granted for ten-year terms, which are due to expire through May 2015. 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 \$764,965 for the year ended June 30, 2008.

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

At June 30, 2008, minimum lease payments are as follows:

Year ended June 30,	Amount
2009	\$ 832,951
2010	818,757
2011	830,322
2012	844,928
2013	352,608
Thereafter	379,200
	<u>\$ 4,058,766</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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, 2008:

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. \$ 36,780,000

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. 12,400,000

Total bonds payable	49,180,000
Unamortized bond premium/discount	(41,306)
Bonds payable, net	49,138,694
Less: current maturities	(620,000)
Bonds payable, noncurrent portion, net	<u><u>\$ 48,518,694</u></u>

At June 30, 2008, maturities of bonds payable are as follows:

Year ended June 30,	Amount
2009	\$ 620,000
2010	785,000
2011	850,000
2012	915,000
2013	985,000
Thereafter	45,025,000
	<u><u>\$ 49,180,000</u></u>

Interest expense related to bonds for 2008 was \$2,230,562. This includes a reduction in interest of \$40,401 under the terms of the swap agreement. Of this, \$367,339 was capitalized. Amortization of the bond discount for 2008 was \$30,661 and is included in interest expense in the accompanying financial statements.

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, 2008

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, 2008:

Cash	\$ 240,255
Unconditional promises to give	5,995
Investments	5,034,694
Beneficial interest in perpetual trust	575,603
	<u>5,856,547</u>
Less: accrued expenses	(11,301)
	<u><u>\$ 5,845,246</u></u>

Assets held on behalf of:	
Northern Arizona University	\$ 5,451,957
Parents' Association	281,136
Alumni Association	112,153
	<u><u>\$ 5,845,246</u></u>

