The University of Arizona

ANNUAL FINANCIAL REPORT

Year Ended June 30, 2002

THE UNIVERSITY OF ARIZONA®
TUCSON ARIZONA

Cover

Old Main, the University's first building, constructed in 1891, and the courtyard of the Integrated Learning Center, which opened its doors to classes in January 2002

TABLE OF CONTENTS

Introduction & Overview

Financial Statements

Governing Board & Administration


INTEGRATED
LEARNING
CENTER

"The University of Arizona is an economic, cultural, and intellectual treasure of the State and the nation."

North Central Association Evaluation Team Report, 2000

A MESSAGE FROM THE PRESIDENT

Universities operate in the context of the economic environment, just like every other financial enterprise in our society. We can expect our fiscal fortunes to rise and fall with state and federal tax revenues, with the wages of our students and their families, with interest rates and the return on investments, and with the wealth of our benefactors. We are not exempt from the laws of economics.

The economic doldrums that have beset our society for more than a year have adversely effected the unrestricted revenues of the University of Arizona, with negative impact on core operations.

Our in-state tuition remains among the lowest of America's flagship state universities, but we are not immune from the upward pressures on tuition experienced everywhere. Our capacity to raise tuition with concomitant increases in financial aid represents an untapped potential resource.

Commitments to our billion-dollar Campaign Arizona broke all records again this past year despite the losses on Wall Street. We are in our eight-year billion dollar campaign with pledges and contributions raised at both the University and the University of Arizona Foundation reaching $750 million, with three years yet to go.

Research contracts continue to grow, fueling the engines of innovation at our University. According to National Science Foundation data, the University of Arizona is consistently in the top 22 nationally in research expenses, ranking 15th among public universities in the most recent report, and that is very good for the State of Arizona.

Our new students are being welcomed this year to a campus that has been upgraded dramatically at its core; on the campus mall east of Old Main the new Student Union Memorial Center is near completion, the Integrated Learning Center is open to rave reviews, the Main Library has been expanded, the Eddie Lynch Pavilion provides a new dimension to the McKale Memorial Center, and major additions are under construction for the Meinel Optical Sciences Center and the new theatre complex for the Dance Division. New residence halls are being built, and a new facility for Student Health and the Disability Resource Center is under construction. The campus environment for students is undergoing an extraordinary period of improvement!

The University of Arizona is a student-centered institution, and it is also among this nation's pre-eminent research universities. The next wave of construction will focus on the expansion of our research facilities.

These capital improvements are consistent with the theme of focused excellence that guides our strategic planning. We have not been daunted in our long-term aspirations by the disappointing financial performance of the State of Arizona in recent years.

Through good times and bad, the University of Arizona continues to thrive, relying upon the extraordinary dedication of our people when revenues are inadequate. In the short term, our people will keep the momentum building even without the compensation they deserve. In the long term, we must rely upon our contributions to Arizona's prosperity to yield financial returns to the University of Arizona, so our people can be properly rewarded.

Peter Likins
President

INSTITUTIONAL PROFILE

The University of Arizona (University) was established as a land grant institution in 1885, 27 years before the Arizona Territory became a state. The years following World War II and the Korean War, when air conditioning and greater familiarity with the state created an influx of students, were a period of substantial growth for the University. In the late 1950s, enrollment really took off, with the University gaining an average of more than 1200 additional students per year for 17 years. During this period, the foundation was laid for the development of a leading research institution. Today, the University serves nearly 36,000 students through 16 colleges offering 324 degree programs, and is ranked among the leading research universities in the country. As an example, *U.S. News & World Report* ranked 15 University departments and graduate programs in the top 10, 24 in the top 20, and 45 in the top 50, of all U. S. public and private universities.

Enrollment Statistics
Academic Year 2001 – 2002

Undergraduate enrollment – Fall 2001	27,532
Graduate enrollment – Fall 2001	8,215
Degrees awarded – Bachelor's	4,922
Degrees awarded – Advanced	1,944
Tuition for full-time student – Resident	$ 2,490
Tuition for full-time student – Non-resident	$ 10,356

The University's 2,203 full time equivalent instructional faculty and graduate teaching assistants and associates educate a diverse student population. The student population is 52% female, 13% Hispanic, 5.4% Asian or Pacific Islander, 2.6% Black, and 2% Native American. It includes students from all fifty states, and 137 foreign countries. International students totaled 8% of the fall 2001 enrollment, with the largest numbers of foreign students hailing from the People's Republic of China, India, Japan, and Mexico.

Research Excellence

The University offers an unusually extensive and varied group of research, graduate and professional teaching programs. During the past 25 years the University has emerged as one of the top 22 universities in the nation (top 15 among public universities), according to the National Science Foundation. With its abundance of biological sciences, medical programs and interdisciplinary strengths, the University has tremendous potential for further research expansion.

In 1985, the University was elected to membership in the Association of American Universities, a prestigious group limited to North America's preeminent public and private research universities.

Eminent research programs provide advances in applied and pure knowledge that fulfill the University's obligation to the State and the nation. Such programs attract truly distinguished faculty who serve the University's students through a comprehensive range of undergraduate and graduate programs.

High-quality research programs secure extensive federal and corporate funding that enriches instructional programs by providing tremendous education and research opportunities for the students, as well as helping to provide up-to-date facilities and equipment.

Strengths

A persistent theme in the University's history has been developing strengths based on its unique physical and cultural environment, our areas of comparative advantage. Some examples follow:

- As Arizona's land grant institution, arid land agriculture, mining and geological studies became early focal points of a broad range of research, teaching and public service activities. The College of Agriculture and Life Sciences is dedicated to improving the quality of life for people in Arizona, the nation and the world. The Cooperative Extension has faculty and staff in all of Arizona's counties, on Indian Reservations, and in over 30 communities and research centers.

- The Arizona Health Sciences Center (AHSC) is the State's only academic health sciences center, consisting of the Colleges of Medicine, Nursing, Pharmacy, Public Health, and the School of Health Professions. In conjunction with several independent non-profit health care organizations in Tucson (University Medical Center and University Physicians, Inc.), AHSC provides excellent education, research, and health care to the State and its people.

- AHSC serves as the core of a broad network of health services throughout the State with a focus on excellence in health promotion, health restoration and health maintenance. Ranked as the top program of its kind in the country, the Arizona Telemedicine Program provides faculty and other medical consultation to rural physicians and other health professionals through high-resolution video imaging.

- The clear skies of the Southwest have attracted generations of outstanding astronomers and planetary scientists and the telescopes they need. An assembly of major telescopes and facilities have helped to make the University a world center for astronomy and planetary sciences, with cooperative projects with Germany, Italy and the Vatican. This reputation will be enhanced by the international astrophysical observatory being developed on Mt. Graham, and recent international prominence gained from University designed and built instruments, including cameras placed on Mars and instruments placed on the Hubble telescope.

- The internationally-recognized Optical Science Center is a leader in science and engineering-related optics, and the technologies and industries enabled by optics, including the design and manufacture of laser devices, medical devices and imaging, diagnostic and telecommunications equipment, will continue to enhance the lives of people all over the world.

- Research of past cultures in Arizona has resulted in archaeological leadership in the Southwest setting. As an offshoot, this has lead to leadership in the Classical and Middle East settings as well.

- The many Native American communities in the State have presented the University with opportunities not only to study and help preserve rich cultures but also to assist these communities in their economic and educational development.

- Astronomy and archaeology provided the intellectual basis for development of a new science, dendrochronology. The study of tree rings as indicators of past environments is of increasing importance in identifying world environmental trends.

- The location of the University, near the international boundary with Mexico, and the special social, economic, legal and political circumstances of the border zone provide outstanding educational, research and service opportunities in various Hispanic language, literature, and cultural programs.

- The recently completed Integrated Learning Center, featured on the cover, provides for the integration of students, instructors, advisors, and librarians in a resource-rich environment of classrooms, study facilities, and the library, all equipped with state-of-the-art technology. In this new facility, students receive instruction and advice about academic matters and complete much of their classroom, individual and group study. The Integrated Learning Center goes far toward realizing our vision of the foundational educational experience.

Opportunities and Challenges

The University has been meeting the needs of the people of the State through numerous new programs in business, engineering, and natural and medical sciences. Given continuing increases in population and the potential for economic growth, the State will increasingly face problems and opportunities in areas as diverse as water resource management, transportation, education, land use planning, technology development and transfer, and the provision of jobs for a growing population. The University has assisted in attracting corporations to the State and, through its faculty and graduates, has stimulated important business enterprises, especially in optics and biotechnology. The latter has unique potential now, based on the University's strong programs in medicine, agriculture and science, and on rapidly expanding federal funding for biotechnology research.

The State is projecting rapid growth in college enrollment over the next ten years, and the University is making every effort to meet those needs, while preserving our standards of excellence and maintaining a leadership position in higher education.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

In 1999, the Government Accounting Standards Board (GASB), which establishes accounting and reporting requirements for public colleges and universities, issued Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments," and Statement No. 35, "Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities." The new standards require that financial statements be presented on a consolidated basis to focus greater attention on an institution as a whole. Previously, financial statements focused on the accountability of individual fund groups within the institution.

As prescribed by these statements, the University adopted the new reporting standards in fiscal year 2002. Since this is a transition year for the new format, only one year of information is presented in the audited financial statements. In future years, comparative numbers will be presented in the statements.

The following discussion and analysis provides an overview of the financial position and activities of the University for the year ended June 30, 2002. Information for the year ended June 30, 2001, restated based on the new standards, is also provided. This information has not been audited and is presented for comparative purposes only.

This discussion has been prepared by management and should be read in conjunction with the financial statements and the accompanying notes, which follow this section.

Using the Financial Statements

Under the new standards, the University's financial report includes three statements: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows.

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. Assets and liabilities are classified as either current or noncurrent. Current liabilities are obligations that will be paid within one year of the statement date. Current assets are those resources available to satisfy current liabilities. The difference between total assets and total liabilities, referred to as net assets, is one indicator of the financial condition of the University. Generally, assets and liabilities are measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

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. Under the new reporting standards, State appropriations, contributions and investment income are considered nonoperating revenues. This change in reporting format results in an operating loss on the statement. The total change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year.

The Statement of Cash Flows provides information about the University's sources and uses of cash during the year. This statement provides cash flow information that helps users evaluate the University's ability to meet obligations and assess the University's need to obtain external financing.

Other significant changes to the financial statements include the following:

- Depreciation of capital assets: Buildings, improvements, equipment and library materials are now depreciated over their useful lives. Land and construction-in-progress are not depreciated. (See Note 5 of the financial statements.) The annual depreciation is recorded as an operating expense in the Statement of Revenues, Expenses and Changes in Net Assets and lowers the value of capital assets on the Statement of Net Assets.

- Scholarship allowances: Scholarships and fellowships applied to student accounts are now shown as a reduction to student tuition and residence fee revenues. Previously these amounts were reflected as an increase to both revenue and expense. Stipends and other payments made directly to students continue to be presented as scholarship and fellowship expenses.

- Compensated absences: Vacation leave earned and accrued by employees as of June 30, 2002, as adjusted for limitations, is recorded as a liability on the Statement of Net Assets. The change in this liability from year to year is recorded as an operating expense in the Statement of Revenues, Expenses and Changes in Net Assets.

Condensed Financial Statement Information

Statement of Net Assets

A summarized comparison of the University's assets, liabilities and net assets (in thousands of dollars) at June 30, 2002, and an unaudited restatement at June 30, 2001, is as follows:

	2002	2001	% Change
Current assets	$ 289,382	$ 195,598	47.9
Noncurrent assets other than capital assets	344,156	331,481	3.8
Capital assets	915,247	833,726	9.8
Total assets	**$ 1,548,785**	**$ 1,360,805**	**13.8**
Current liabilities	$ 258,371	$ 151,188	70.9
Noncurrent liabilities other than debt	76,544	82,521	(7.2)
Long-term debt	507,396	439,631	15.4
Total liabilities	**$ 842,311**	**$ 673,340**	**25.1**
Net assets			
Invested in capital assets, net of related debt	$ 405,336	$ 383,374	5.7
Restricted - nonexpendable	69,092	76,448	(9.6)
Restricted - expendable	112,537	115,579	(2.6)
Unrestricted	119,509	112,064	6.6
Total net assets	**$ 706,474**	**$ 687,465**	**2.8**

Overall, the University's financial position improved in fiscal year 2002. Net assets increased by $19 million, or 3%, primarily due to a $22 million increase in the University's investment in capital assets. Capital asset activity is discussed further under Capital and Debt Analysis, which begins on page 9.

Current assets are more than sufficient to meet current obligations. In comparing the two fiscal years, current assets and current liabilities increased significantly due to the University entering into a securities lending agreement with its custodial bank as described in Note 3 of the financial statements. The University earns a fee for its loan activities, which is included in investment income.

Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the University's unrestricted net assets have been designated for various academic and research programs and initiatives, and for capital projects.

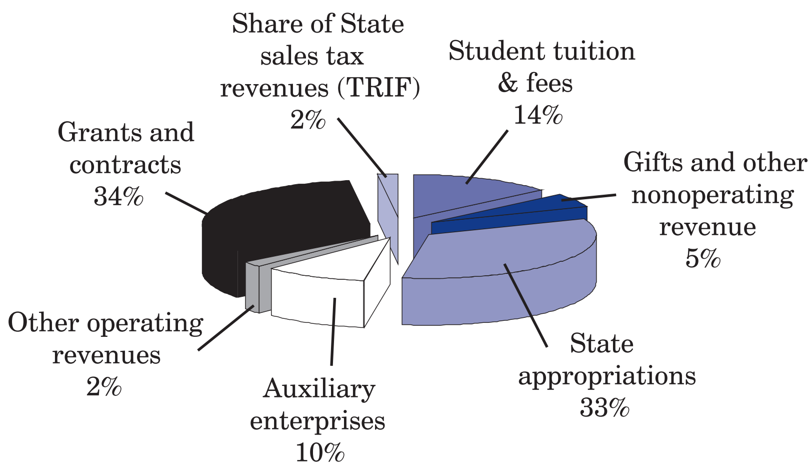
Statement of Revenues, Expenses and Changes in Net Assets

A summarized comparison of the University's operations (in thousands of dollars) for the year ended June 30, 2002, and an unaudited restatement for the year ended June 30, 2001, is as follows:

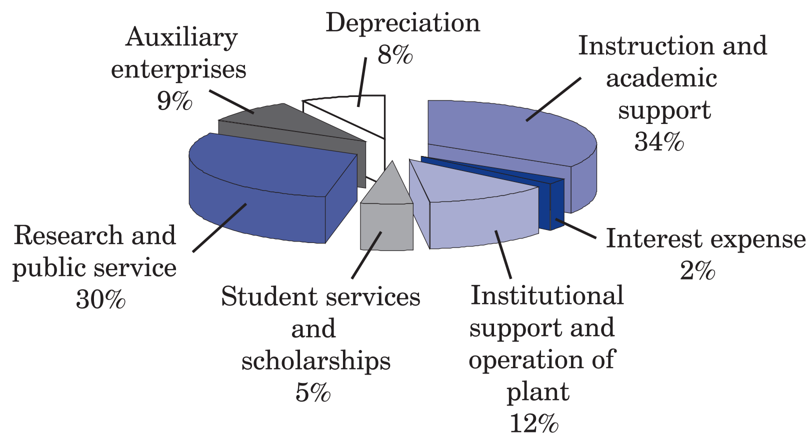
	2002	2001	% Change
Operating revenues			
Student tuition and fees	$ 140,096	$ 126,621	10.6
Grants and contracts	330,083	308,288	7.1
Auxiliary enterprises	95,655	95,877	(0.2)
Other operating revenues	20,151	20,833	(3.3)
Total operating revenues	**$ 585,985**	**$ 551,619**	**6.2**
Operating expenses			
Instruction and academic support	$ 335,433	$ 321,422	4.4
Research and public service	290,688	270,748	7.4
Student services and scholarships	52,513	54,092	(2.9)
Institutional support and operation of plant	114,687	116,762	(1.8)
Auxiliary enterprises	86,344	86,868	(0.6)
Depreciation	77,294	80,372	(3.8)
Total operating expenses	**956,959**	**930,264**	**2.9**
Operating Loss	**$ (370,974)**	**$ (378,645)**	**2.0**
Nonoperating revenues (expenses)			
State appropriations	$ 329,320	$ 333,568	(1.3)
Share of State sales tax revenues (TRIF)	15,799		100.0
Gifts	35,407	38,657	(8.4)
Investment income	3,677	25,881	(85.8)
Interest expense on debt	(21,185)	(22,208)	(4.6)
Other nonoperating revenues	7,953	11,569	(31.3)
Net nonoperating revenues	**$ 370,971**	**$ 406,658**	**(8.8)**
Capital & endowment additions	19,012	19,191	**(0.9)**
Increase in Net Assets	**$ 19,009**	**$ 28,013**	**(32.1)**
Net assets, beginning of year, as restated	**687,465**	**659,452**	**4.2**
Net assets, end of year	**$ 706,474**	**$ 687,465**	**2.8**

The following graphs illustrate operating and nonoperating revenues and expenses for the year ended June 30, 2002.

Operating & Nonoperating Revenues



Operating & Nonoperating Expenses



Operating revenues and expenses

In fiscal year 2002, the University's operating revenues increased by $34.4 million, or 6%, over fiscal year 2001. Of the $34.4 million increase, 63% was attributable to increases in grant and contract revenues and 39% was due to increases in tuition and fees. Other revenues decreased by 2%.

Student tuition and fees: Tuition and fees increased over $13 million due to an increase in enrollment of 1,500 students and tuition increases. In-state resident tuition and fees increased by $142, or 6.1%, to $2,490, while out-of-state tuition and fees increased by $552, or 5.6%, to $10,356.

Grant and contract revenues: Grant and contract revenues increased 7% in fiscal year 2002. Revenues vary from year to year for many reasons, including the availability of funding from sponsors and the commencement or closure of particularly large projects. The major change in revenues from Federal sources was primarily due to a 16% increase in funding from the Department of Health and Human Services. Grant and contract revenues from industry increased 75%.

Operating expenses: Operating expenses increased 3% in fiscal year 2002, primarily due to an 8% increase in externally funded research related expenses. Instruction and academic expenses increased 4%, while expenses for student services and scholarships, and institutional support and operation of plant decreased.

Nonoperating revenues and expenses

Share of State sales tax revenues: In November 2000, the voters in Arizona approved Education 2000 (Proposition 301). With the approval came a .6 cent increase in the State sales tax rate, dedicated to K-12 education, community colleges, and the universities. The universities' portion, to be administered by the Arizona Board of Regents, became the Technology and Research Initiative Fund (TRIF). For the University of Arizona, TRIF funds seven initiatives: Access to Higher Education; Workforce - Preparing Math & Science Teachers; Technology Transfer Infrastructure; the Institute for Biomedical Science & Biotechnology; the Internet Technology & Commerce Institute; Optical Science & Technology; and Water Technology.

Investment income: As a result of a downturn in the economy, total investment income declined substantially. Sources of investment income were as follows:

	2002	2001
Pooled operating funds	$ 7,206,000	$12,874,000
Deposits with trustees for capital projects	$ 3,628,000	$ 5,887,000
Endowments	$ (7,157,000)	$ 7,120,000
Total investment income	$ 3,677,000	$25,881,000

Pooled operating funds and deposits with trustees for capital projects are invested in interest bearing securities. The earnings declined due to lower interest rates. Endowments are invested primarily in equity securities. The $14,277,000 decline in endowment investment income reflects the difficult investment environment that existed during the year. The endowment Growth Income Pool declined 7.7%, outperforming its benchmark and the Standard & Poor's 500 stock index. The Growth Income Pool's benchmark, a composite of the S&P 500, Lehman Aggregate, and one-month Treasury Bills, experienced a negative 8.5% return. During this period the Standard & Poor's 500 stock index lost 18%.

Statement of Cash Flows

A summarized comparison of the University's cash flows (in thousands of dollars) for the year ended June 30, 2002, and an unaudited restatement for the year ended June 30, 2001, is as follows:

	2002	2001
Cash provided (used) by		
Operating activities	$ (293,017)	$ (288,473)
Noncapital financing activities	375,313	377,340
Capital financing activities	(85,917)	(97,268)
Investing activities	96,488	(4,818)
Net increase (decrease) in cash	$ 92,867	$ (13,219)
Cash - beginning of year	90,711	103,930
Cash - end of year	$ 183,578	$ 90,711

In fiscal year 2002 University cash increased $93 million. This was primarily due to the liquidation of funds held in trust by various commercial banks to fund upcoming construction expenses.

The University relies on noncapital financing activities such as State appropriations and private gifts to help fund its operating activities. Without this support, the University had a net cash outflow of $293 million in fiscal year 2002. State appropriations and private gifts provided $375 million for operational activities and equipment purchases.

Capital financing activities netted a cash outflow of $86 million. Although the University received $103 million in proceeds from capital debt, $157 million was used to purchase and construct capital assets, and $50 million was used for principal and interest payments on capital debt.

Investing activities netted a cash inflow of $96 million, in sharp contrast to the $5 million outflow of cash in fiscal year 2001. This was primarily the result of two events:

- In order to prepare for cash flow requirements for upcoming construction projects, the University liquidated a net $57 million from funds held in trust.

- Due to market conditions, including the potential for rising interest rates, the University increased the cash and cash equivalent portion of the pooled operating investment fund by $38 million, and longer term investments were reduced by $28 million. The funds in the pool increased $10 million.

Capital and Debt Analysis

The University's capital improvement projects are essential to supporting the University's mission of providing excellent education and research programs. Over the last 10 years, the University experienced a 45.5% increase in freshman admissions. As a result, the demand for classroom facilities and resident dormitories has grown. The demand for research facilities has also risen as University faculty continued their success in obtaining research funding from sponsors. To help plan and manage the wide array of capital needs, the University maintains a Capital Improvement Plan that is approved by the Arizona Board of Regents. The Plan outlines the University's capital improvement strategies for addressing deficiencies in academic and research space, building renewal and replacement projects, and expanding parking and student housing capacities.

Projects completed recently include construction of the Integrated Learning Center, McKale Athletic Performance Center, Strategic Alternative Learning and Teaching Center, and expansions of the Main Library (including Special Collections) and Pima Hall student housing. These facilities, completed at a total cost of approximately $60 million, added over 275,000 square feet of critically needed space.

Projects currently under construction are the Agriculture Research Complex, Sixth Street Parking Garage and Office Building, Student Union and Bookstore Facility, University South Campus Facility, Chilled and Reclaimed Water Utility Expansion, KUAT Digital TV Conversion Project, McKale Center Renovation and Expansion, and Southwest Campus Sewer Augmentation.

During fiscal year 2002, the University issued certificates of participation to partially or wholly finance several new construction projects. These projects include:

- Gittings Dance Hall expansion, with an estimated cost of $10.5 million, will improve the quality of the University's nationally recognized dance program by increasing studios and performance theater space.
- Highland District Infrastructure, with an estimated cost of $7.5 million, will support a planned student services project (see Highland Commons description, below). This project will result in an expansion and upgrade of area utility systems, including electrical, telecommunications, water, sewer and storm drainage.

- Life Sciences improvements, with an estimated cost of $13.1 million, will ensure the University is in compliance with stricter federal regulations and public health science standards by reconfiguring the Arizona Health Sciences Center Animal Facility and replacing the plaza deck above that facility.
- Highland District Student Resident Hall, with an estimated cost of $39.7 million, will provide an additional 764 beds and associated support services for the University's growing student residential population.
- Highland Commons, with an estimated cost of $19.1 million, will significantly enhance student services through construction of a new facility for the Campus Health Services and Disability Resource Center.
- University North Building, with an estimated cost of $5.4 million, will provide for additional needed classroom space in a complex in northwest Tucson that will be jointly occupied with Pima Community College.

These new facilities and infrastructure will provide some relief to the existing space deficiencies and will improve services provided to the campus community. Proposals for additional infrastructure and buildings, including several major research facilities, are currently being reviewed by management. As the University continues to grow and enhance its outstanding research stature, the need for capital improvements will continue to pose strategic and financial challenges.

The University generally finances capital improvements and acquisitions through issuing System Revenue Bonds (SRBs) and Certificates of Participation (COPs). Prior to issuing debt, a debt service plan must be submitted to the Arizona Board of Regents for approval. During the fiscal year, legislation was passed to amend the Issuance of Bonds law (ARS§15-1683) to streamline the State's approval process related to university debt issuances. The amendment establishes a debt ratio limit of 8% (total SRBs and COPs debt service to total operating expenses and debt service). The University's legislative debt ratio at the end of fiscal year 2002 was 3.52%. Detailed debt service information is available in Note 7 of the accompanying notes to the financial statements.

Economic Outlook

As is the case for most of the country, the State of Arizona is experiencing weak economic conditions. University management continues to develop long and short term strategic plans to address this and other challenges to the financial health of the institution. At the same time, the Arizona Board of Regents and the three State universities are actively evaluating creative solutions to contain costs and generate new revenues in order to continue providing quality and affordable education.

The University is increasing its competitiveness in obtaining sponsored research funds by the expansion of laboratory-oriented facilities and by pursuing organizational and programmatic initiatives (e.g., optics, biotechnology, medicine). Although sponsored funds are restricted by the terms and conditions of sponsors, these grants and contracts add greatly to the educational environment of the University and to the economy of the State of Arizona.

For instructional purposes the University is dependent upon State appropriations and tuition and fees, with gifts providing some additional revenues, primarily for scholarships. The main revenue source for government services, including public education, is State sales taxes. Consequently, until either the State economy improves considerably or the State alters the tax base that supports government services, appropriated funds will increase slowly or moderately at best, and may even decline. Since resident tuition is among the lowest of the public universities in the nation, there may be an opportunity to increase tuition, as long as financial aid resources also increase. Gifts represent another potential source of revenues. The University, along with the University of Arizona Foundation, is currently in its fifth year of an eight year campaign to raise one billion dollars in pledges and contributions.

Since the University is ultimately 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 instruction, research and public service, perhaps in a different form, to the State of Arizona and the nation.

STATEMENT OF NET ASSETS

	June 30, 2002 *In thousands of dollars*
Assets	
Current assets	
Cash and cash equivalents (Note 3)	$ 90,812
Securities lending cash collateral (Note 3)	101,730
Short-term investments (Note 3)	37,340
Receivables	
Accounts receivable (net of allowances of $308)	12,628
Government grants receivable	37,101
Student loans (net of allowances of $205)	2,138
Inventories	6,763
Deferred expenses	870
Total current assets	289,382
Noncurrent assets	
Restricted cash and cash equivalents (Note 3)	92,766
Restricted investments with bond trustees (Note 3)	22,856
Long-term investments (Note 3)	58,954
Investments held for others (Note 3)	17,640
Endowment investments (Note 3)	135,348
Student loans (net of allowances of $1,622)	12,548
Deferred expenses	4,044
Capital assets, not being depreciated (Note 5)	129,712
Capital assets, being depreciated, net (Note 5)	785,535
Total noncurrent assets	1,259,403
Total Assets	**$ 1,548,785**
Liabilities	
Current liabilities	
Accounts payable	$ 36,026
Accrued payroll and benefits	12,290
Accrued compensated absences (Note 1)	24,874
Obligations under securities lending (Note 3)	101,730
Deferred revenue and deposits (Note 6)	52,907
Funds held for others	2,327
Current portion of long-term debt (Note 7)	28,217
Total current liabilities	258,371
Noncurrent liabilities	
Deferred revenue and deposits (Note 6)	54,371
Funds held for others	22,173
Long-term debt (Note 7)	507,396
Total noncurrent liabilities	583,940
Total Liabilities	**$ 842,311**
Net Assets	
Invested in capital assets, net of related debt & depreciation	$ 405,336
Restricted for	
Nonexpendable — endowments	69,092
Expendable	
Scholarships and fellowships	25,493
Academic/departmental uses	46,801
Student loans	17,574
Capital projects	13,045
Debt service	9,624
Unrestricted	119,509
Total Net Assets	**$ 706,474**

See Notes to Financial Statements

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended June 30, 2002 *In thousands of dollars*
Operating Revenues (Note 11)	
Student tuition and fees	
(net of scholarship allowances of $49.3 million)	$ 140,096
Federal grants, contracts and appropriations	260,386
State grants and contracts	14,940
Local grants, contracts and appropriations	2,386
Nongovernment grants and contracts	52,371
Sales and services of educational departments	16,856
Auxiliary enterprises	
(net of scholarship allowances of $1.7 million)	95,655
Other operating revenues	3,295
Total operating revenues	**$ 585,985**
Operating Expenses	
Educational and general	
Instruction	$ 274,596
Research	249,278
Public service	41,410
Academic support	60,837
Student services	21,668
Institutional support	59,934
Operation and maintenance of plant	54,753
Scholarships and fellowships (Note 1)	30,845
Auxiliary enterprises	86,344
Depreciation (Note 5)	77,294
Total operating expenses	$ 956,959
Operating Loss	**$ (370,974)**
Nonoperating Revenues (Expenses)	
State appropriations	$ 329,320
Share of State sales tax revenues	15,799
Gifts	35,407
Investment income	3,677
Interest expense on debt	(21,185)
Other nonoperating revenues, net	7,953
Net nonoperating revenues	$ 370,971
Loss before Capital and Endowment Additions	**$ (3)**
Capital appropriations	$ 4,000
Capital grants, gifts and conveyances	13,494
Additions to permanent endowments	1,518
Total capital and endowment additions	$ 19,012
Increase in Net Assets	**$ 19,009**
Net Assets	
Net Assets - Beginning of year, as restated (Note 1)	687,465
Net Assets - End of year	**$ 706,474**

See Notes to Financial Statements

STATEMENT OF CASH FLOWS

	Year Ended June 30, 2002 *In thousands of dollars*
Cash Flows from Operating Activities	
Tuition and fees	$ 139,136
Grants and contracts	323,648
Payments for salaries, wages and benefits (Note 10)	(628,306)
Payments to suppliers (Note 10)	(211,815)
Payments for scholarships and fellowships	(32,292)
Loans issued to students	(5,235)
Collections on loans to students	5,110
Auxiliary enterprise revenues	96,112
Sales and services of educational departments	17,324
Other receipts	3,301
Net cash used for operating activities	$ (293,017)
Cash Flows from Noncapital Financing Activities	
State appropriations	$ 329,320
Share of State sales tax revenues	14,015
Gifts and grants for other than capital purposes	34,143
Other nonoperating revenues	2,717
Federal Family Education Loans received	84,079
Federal Family Education Loans disbursed	(84,018)
Funds held for others received	47,861
Funds held for others disbursed	(52,804)
Net cash provided by noncapital financing activities	$ 375,313
Cash Flows from Capital Financing Activities	
Proceeds from capital debt, including premiums	$ 102,693
Capital appropriations	4,000
Capital grants and gifts received	6,792
Proceeds from sale of capital assets	7,936
Purchase of capital assets	(157,440)
Principal paid on capital debt and leases	(24,550)
Interest paid on capital debt and leases	(25,348)
Net cash used for capital financing activities	$ (85,917)
Cash Flows from Investing Activities	
Proceeds from sales and maturities of investments	$ 330,689
Interest and dividends on investments	14,727
Purchase of investments	(248,928)
Net cash provided by investing activities	$ 96,488
Net Increase In Cash And Cash Equivalents	**$ 92,867**
Cash and Cash Equivalents	
Cash and cash equivalents - beginning of the year	$ 90,711
Cash and cash equivalents - end of year	**$ 183,578**

See Notes to Financial Statements

STATEMENT OF CASH FLOWS

	Year Ended June 30, 2002 *In thousands of dollars*
Reconciliation of Operating Loss to Net Cash Used for Operating Activities	
Operating loss	$ (370,974)
Adjustments to reconcile operating loss to net cash used for operating activities	
Depreciation expense	77,294
Changes in assets and liabilities	
Receivables, net	(6,559)
Inventories	212
Deferred expenses	(67)
Accounts payable	4,784
Accrued payroll and compensated absences	2,024
Deferred revenue	269
Net Cash Used For Operating Activities	**$ (293,017)**

Significant Noncash Transactions	
Gifts and conveyances of capital assets	$ 6,455
Assets acquired under capital leases	1,689
Unrealized change in fair value of investments	(13,550)
Refinancing of long-term debt	104,638
Amortization of bond discount and issuance costs	(552)
Amortization of bond premium	231
Gains/losses on disposal of capital assets, net	1,522
Amortization of IBM deferred rent (Note 2)	4,900

See Notes to Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The accompanying financial statements include all funds that are directly controlled by the University. Fiscal responsibility for the University remains with the State of Arizona; therefore, the University is considered part of the State's reporting entity for financial reporting purposes. The financial statements do not include related organizations described in Note 2.

B. Change in Accounting and Reporting Requirements

During the year ended June 30, 2002, the University implemented GASB Statement No. 35, which requires public colleges and universities to use a new reporting model, based upon the reporting guidelines of GASB Statement No. 34, as amended by GASB Statement No. 37. The University also implemented GASB Statement No. 38, which requires new and revised note disclosures.

As a result of implementing GASB Statement No. 35, recording compensated absences for the first time, and making a prior period adjustment related to increasing the cost of a capital asset acquired in a prior fiscal year, the University's aggregate fund balances reported as of June 30, 2001 have been restated as follows:

Aggregated fund balance as of June 30, 2001, as previously reported	$ 1,469,695,000
Prior period adjustment to capital asset	1,103,000
Accumulated depreciation as of June 30, 2001	(759,941,000)
Liability for compensated absences	(23,392,000)
Net assets as of June 30, 2001, as restated	$ 687,465,000

C. Basis of Presentation

The financial statements for the University are presented in accordance with generally accepted accounting principles (GAAP) applicable to public institutions engaged in business-type activities as defined by the Governmental Accounting Standards Board (GASB). The University follows Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, Accounting Principles Board Opinions, and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements.

The financial statements include a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows.

- The Statement of Net Assets provides information about the assets, liabilities, and net assets of the University at June 30. Assets and liabilities are classified as either current or non-current. Current liabilities are obligations that will be paid within one year of the statement date and current assets are those resources available to satisfy current liabilities. Net assets are the residual amounts and are classified according to external donor restrictions and availability of assets to satisfy University obligations. Invested in capital assets, net of related debt, represents capital assets less accumulated depreciation and the amount of related outstanding debt for those assets. Nonexpendable restricted net assets are gifts received for endowment purposes, the corpus of which cannot be expended. Expendable restricted net assets represent grants, contracts, gifts, and other resources that have been externally restricted for specific purposes. Unrestricted net assets include all other net assets, including those that have been designated by management to be used for other than general operating purposes.
- The Statement of Revenues, Expenses, and Changes in Net Assets provides information about the University's financial activities during the year. Revenues and expenses are classified as either operating or non-operating, and all changes in net assets are reported, including capital contributions and additions to endowments. Generally, revenues generated by the University for instruction, research and other activities are considered to be operating revenues. Other revenues, such as State appropriations and gifts, are not considered as generated from

operations and are reported as non-operating revenues.

- The Statement of Cash Flows provides information about the University's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as operating, non-capital financing, capital financing, or investing activities.

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. The University eliminates all internal activity.

D. Significant Accounting Policies

The methods of applying GAAP that materially affect financial presentation are summarized below:

1. **Cash and Investments**
   - Cash equivalents include all highly liquid investments with an original maturity of 90 days or less.
   - Investments are stated at fair value at June 30. Fair value typically is the quoted market price for securities.
   - Investment income includes interest and dividend earnings and realized and unrealized gains and losses received or incurred during the fiscal year from the investment of endowment, operating and trustee funds.

2. **Endowment Spending Rate Policy** – Arizona State law permits the University to expend the entire net appreciation of endowment fund investments. When determining the spending rate for endowment funds, the Investment Committee and University administration consider long and short-term needs, total investment return and price level trends, and general economic conditions. For fiscal year 2002, the expendable rate was established at 5.0% of the market value at June 30, 2001. Donor restricted endowments that are available for expenditure are reported as restricted and expendable on the Statement of Net Assets.

3. **Inventories** – Inventories consist primarily of bookstore items and supplies. They are stated at the lower of cost (determined by the first-in, first-out method) or market.

4. **Capital Assets, Special Collections and Historical Treasures**
   - Capital assets are stated at cost at the date of acquisition or, if donated, at fair market value at date received.
   - The University maintains special collections and historical treasures for educational and public exhibition. These special collections include Kress, Pfiefer, and Gallagher artwork, Ansel Adams, Richard Avedon, and Edward Westin photography collections, American Indians of the Southwest archeological collection, pottery whole vessel collection, and several medical and law book collections. They are not subject to disposal for financial gain or encumbrance. Accordingly, such collections are not capitalized for financial statement purposes but are inventoried for property control purposes.
   - Interest incurred during the construction phase of projects is capitalized, net of interest earned on the invested proceeds over the same period.
   - Capital assets, other than land and construction-in-progress, are depreciated over their estimated useful lives using the straight-line method. The capitalization thresholds and estimated useful lives for capital assets of the University are as follows:

Asset Category	Capitalization Threshold ($)	Estimated Useful Life (yrs)
Buildings	100,000	10 - 40
Infrastructure	100,000	10 - 100
Equipment	1,000	3 - 25
Library materials	1	10
Land	1	n/a

5. **Compensated Absences** – The University accrues vacation time earned, but not taken, as of fiscal year end. A maximum of 176 hours of vacation may be accrued and paid at termination. The University does not accrue sick time. Upon

retirement, employees with a minimum of 500 hours of accumulated sick time are paid a formulated amount from the Retiree Accumulated Sick Leave (RASL) fund administered by the Arizona State Department of Administration. The University pays a percentage of its payroll to RASL annually and does not have further liability.

6. **Scholarship Allowances** – A scholarship allowance is the difference between the stated charge for tuition and fees and the amount paid by the student or third parties making payments on behalf of the student. Accordingly, some types of student financial aid such as fee waivers, Pell grants, and scholarship awards are considered to be scholarship allowances if used to pay tuition and residence fees. These allowances are netted against tuition and auxiliary revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

The University has both restricted and unrestricted resources available for most programs. Restricted resources are externally restricted for a specific purpose and primarily include sponsored research grants and contracts and gifts. The University's policy regarding whether to first apply restricted or unrestricted resources is made on a case-by-case basis. Restricted resources remain classified as such until spent.

NOTE 2. RELATED ORGANIZATIONS

The financial statements of the University do not include the operations of the University of Arizona Foundation, Inc., University Physicians, Inc., Arizona Research Park Authority, or Campus Research Corporation.

The University of Arizona Foundation, Inc. is a nonprofit corporation controlled by a separate Board of Directors. The principal goals of the Foundation are to support the University through various fund-raising activities, and to contribute funds to the University in support of various programs. According to the audited financial statements of the Foundation for the year ended June 30, 2001, assets, liabilities, revenues, and expenses totaled $299 million, $29 million, $72 million, and $45 million, respectively.

The University Physicians, Inc. (UPI) is a nonprofit corporation established to support the University's College of Medicine in achieving its teaching and research missions through the provision of patient care. UPI is controlled by a Board of Directors comprised of the Dean, three faculty physicians, a representative of the twelve clinical department heads, and three community members. According to the audited financial statements of UPI for the year ended June 30, 2001, assets, liabilities, revenues, and expenses totaled $104 million, $53 million, $145 million, and $135 million, respectively.

Arizona Research Park Authority (ARPA) is a nonprofit corporation created under the auspices of the Arizona Board of Regents (ABOR) and designated by Arizona law as a political subdivision of the State, governed by a separate board of directors, which by law may not include officers or employees of the ABOR. ARPA was established under the State's industrial development authority statute to assist in the acquisition, improvement, and operation of university research parks and related properties. In August 1994, ARPA, with the approval of the ABOR, sold $98 million of nontransferable special revenue bonds to International Business Machines Corporation (IBM) to enable the University to acquire from IBM a 345-acre developed industrial site near Tucson, Arizona, together with 1,000 acres of adjacent unimproved land (collectively, the University of Arizona Science and Technology Park or the "Park"). The bonds are payable solely from lease rentals paid by IBM. If IBM defaults or cancels its lease, the bonds must be surrendered and discharged. Title to the entire Park resides in the University and neither the Park nor any payments by the University secures ARPA's bonds. Since the original transaction, IBM has reduced its leasehold to 70% of the building space for periods up to the remaining term of 22 years. Audited financial statements are not available.

Campus Research Corporation (CRC) is a nonprofit corporation governed by a separate Board of Directors and was established to assist the University in the acquisition, improvement, and operation of the UA Science and Technology Park and related properties. CRC currently leases from the University the remaining 30% of building space of the Park not leased to ARPA (see preceding paragraph). CRC is responsible for assisting in the development of the presently undeveloped portions of the Park and for subleasing unoccupied space, newly developed space, and space now occupied by IBM or its subtenants once the current subleases expire. The University is responsible for payment of the operational expenses associated with the space occupied by University departments, offices, and programs. All income received by CRC from its activities, after payment of expenses and financial reserves, will be distributed to the University. During fiscal year 2002 $300,000 was distributed to the University.

CRC's June 30, 2002, audited financial statements disclosed:

- $12,805,000 total assets, including $5,277,000 in net property and equipment and $5,195,000 in net intangible assets, the major components of which relate to leasehold interest and deferred leasing costs
- $4,778,000 total liabilities, including $2,951,000 of long-term debt in the form of two collateralized notes payable to Wells Fargo, Arizona
- $6,422,000 total revenues, primarily consisting of rental income from the Park and related properties
- $4,660,000 total expenses, including $2,115,000 project operating costs and $683,000 amortization of intangible assets
- During fiscal year 2002 cash and cash equivalents decreased by $152,000.

CRC's audited financial statements may be obtained by writing to Office of Economic Development, PO Box 210066, Tucson, Arizona 85721-0066.

NOTE 3. CASH, INVESTMENTS & SECURITIES LENDING

Under Board of Regents' policies, the University may invest its pooled operating funds in collateralized certificates of deposit and repurchase agreements with commercial banks, United States Treasury securities and other Federal agency securities or in the government investment pool administered by the State Treasurer's Office. Deposits are made only at depository banks approved by the Board.

At year-end, the University's total bank balance is $1,888,000. Of this balance, $100,000 is covered by federal depository insurance. The remaining balance is collateralized by U.S. Government obligations held by an agent of the bank in the name of the State of Arizona.

Endowment funds are invested under the direction of an investment committee responsible for defining, developing, and implementing investment objectives, policies, and restrictions. Funds are primarily invested in the Consolidated Endowment Growth/Income Pool. The investment objective of the pool is to maximize long-term total return from income and capital appreciation at an acceptable level of risk and volatility. If donors restrict investments, those funds are invested separately, and the individual endowments bear all changes in value. At June 30, 2002, University endowments totaling $16,544,000 are held and invested by bank trustees according to donor specifications.

Restricted cash and investments are held in trust for capital projects by various commercial banks. $2,655,000 is held for debt requirements and $104,274,000 is available for future construction costs. Trust funds are invested by the trustee in accordance with the Board's authorizing resolutions.

The University currently invests all funds for the Arizona Student Financial Aid Trust (ASFAT), which was established by the Arizona Board of Regents and is funded by the Arizona State Legislature and student fees. Funds invested for other universities are recorded as investments held for others and include the following at fair value: Arizona State University - $11,392,000; Northern Arizona University - $5,159,000; ASU West - $992,000; ASU East - $97,000. The University's ASFAT funds are recorded as endowment investments at $9,591,000.

Securities collateralized and custodial credit risk are as follows:

1. The University's investment in the State Treasurer's investment pools represents a proportionate interest in those pools' portfolios; however, the University's portion is not identified with specific investments and is not subject to custodial credit risk.
2. Repurchase agreements are collateralized by U.S. Government obligations held by the University's custodial bank in the University's name.
3. U.S. treasury funds are open-end mutual funds recorded in the University's name at various financial institutions. Equity and bond open-end mutual funds are held in the University's name.
4. Money market funds are recorded in the University's name at the trustee.

5. U.S. treasury and agency government obligations:

   a. $95,720,000 is held by the University's custodial bank in the name of the University. These securities were purchased by the University either from a broker/dealer or a financial institution.

   b. $14,746,000 is held by trustees. These securities are recorded in the University's name at the trustee. The trustee acts as both custodian and purchasing agent for these investment transactions.

6. Certificates of deposit are covered by FDIC insurance.

7. Common stocks, preferred stocks, and corporate bonds are held by the University's custodial bank in the name of the University. These securities were purchased by the University either from a broker/dealer or a financial institution.

8. At June 30, 2002, the University held three investment contracts: a Guaranteed Investment Contract (GIC) for $1,503,000 with an insurance company from proceeds of the 1994A Certificates of Participation; a Bank Investment Contract (BIC) for $1,187,000 with a bank from proceeds of the 1994B Certificates of Participation; and a tri-party repurchase agreement (TPR) for $8,611,000 with a securities firm from proceeds of the 1999A and 2000A Certificates of Participation. The GIC and BIC are not collateralized, however, if the bond ratings of the insurance company or bank fall below prescribed levels, collateralization of the investment with U.S. Government obligations is required, or the University may terminate the contract. The TPR is collateralized by a U.S. Government obligation held by the tri-party custodian in both the University's and the securities firm's name.

9. Endowment funds held by trustees include deposits, mutual funds, common stocks, corporate bonds, U.S. Government obligations, obligations of agencies sponsored by the Federal Government, and mortgage-backed notes receivable. These deposits and securities are held by the trustees as irrevocable trusts in the names of the individual donors for the benefit of the University according to the donors' stipulations.

10. During the fiscal year, the University engaged in securities lending transactions. The University entered into an agreement with Wells Fargo, the University's custodial bank, to carry out these transactions. The custodial bank enters into agreements with brokers to loan securities and have the same securities returned at a later date. It is the policy of the University to receive as collateral at least 102% of the market value of the loaned securities and accrued interest, and maintain collateral at no less than 100% for the duration of the loan. At year-end, the University has no credit risk to borrowers because the University was holding more collateral than the amount of loaned securities outstanding. The University records the collateral received as an asset, which is offset by an obligation recorded under securities lending. During the fiscal year ended June 30, 2002, there were no violations of legal or contractual provisions, and there were no borrower or lending agent default losses. Wells Fargo does not indemnify the University to the extent of borrower defaults. Collateral can be received in the form of U.S. Government securities, letters of credit, or cash. As of June 30, 2002, the custodial bank has received only cash and letter of credit collateral. Cash collateral received from the borrowers is invested in a short-term cash collateral investment pool, which, on average, has a weighted maturity of 55 days. The relationship between the maturities of the cash collateral investment pool and the University's loans is affected by the maturities of the securities loans made by other entities that use the custodial bank's pool, which the University cannot determine. This pool consists of investments in domestic and foreign bank obligations, commercial paper and participations, mortgage backed and pass-through securities, corporate notes, bond debentures, and tri-party repurchase agreements. At June 30, 2002, cash collateral investments totaled $101,730,000 with a corresponding market value of securities on loan of $100,117,000. Securities lent for cash collateral included corporate stocks, corporate bonds, government notes, and government bonds. The University or the borrower can terminate all securities loans on demand. The University cannot sell or pledge securities received as collateral unless the borrower defaults. The University earns a negotiated fee for participating in loan activities.

Cash and investments at June 30, 2002, consist of the following:

	TOTAL COST	TOTAL FAIR VALUE
Cash overdraft	$ (32,931,000)	$ (32,931,000)
Investment in State Treasurer's investment pool	1,409,000	1,409,000
Repurchase agreements	82,113,000	82,113,000
U.S. treasury mutual funds	137,094,000	137,094,000
Money market funds	4,575,000	4,575,000
U.S. treasury and agency government obligations	109,637,000	110,466,000
Certificates of deposit	95,000	95,000
Common stocks	65,530,000	64,192,000
Preferred stocks	4,565,000	4,439,000
Equity mutual funds	339,000	219,000
Bond mutual funds	4,889,000	5,092,000
Mortgages and other receivables	1,190,000	1,190,000
Corporate bonds	34,012,000	34,333,000
Investment contracts (GIC, BIC and TPR)	11,301,000	11,301,000
Endowments held by trustee	14,735,000	16,544,000
Donated land	1,585,000	1,585,000
Joint venture (Note 4)	14,000,000	14,000,000
Totals	**$ 454,138,000**	**$ 455,716,000**

The cash overdraft results from an aggressive short-term investment policy in which the University invests its funds until outstanding checks are cashed. Investments are stated at fair value determined from quoted market prices, except nonparticipating interest bearing contracts, and joint venture, which are stated at cost. Donated land is stated at fair market value at the time of donation.

NOTE 4. JOINT VENTURE

The University is a participant in the Large Binocular Telescope Corporation (LBT). LBT was formally organized as a not-for-profit corporation in August 1992 pursuant to a Memorandum of Understanding, as amended, executed on February 24, 1989, between the University and Arcetri Astrophysical Observatory in Florence, Italy (Arcetri). The purpose of the joint venture is to design, develop, construct, own, operate, and maintain a binocular telescope currently being constructed in Arizona. The current members of LBT are the University, Arcetri, Research Corporation, Ohio State University, and LBT Beteiligungsgesellschaft (LBTB).

The University has committed resources equivalent to 25% of LBT's construction costs and annual operating costs. As of June 30, 2002, the University has made cash contributions of $14,000,000 toward the project's construction costs. The University's financial interest represents future viewing/observation rights. Upon completion of construction, these rights will be divided among the participants in proportion to their contributions. According to the audited financial statements of LBT for the year ended December 31, 2001, assets, liabilities, revenues, and expenses totaled $78 million, $2 million, $9 million, and $1 million, respectively.

NOTE 5. CAPITAL ASSETS

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

	Beginning Balance July 1, 2001 as restated	Additions	Retirements	Transfers/ Reclasses	Ending Balance June 30, 2002
Land	$ 50,919,000	$ 780,000	$ (520,000)	$ (1,144,000)	$ 50,035,000
Construction in progress	98,036,000	99,587,000	(61,000)	(117,885,000)	79,677,000
Total non-depreciable capital assets	$ 148,955,000	$100,367,000	$ (581,000)	$(119,029,000)	$ 129,712,000
Buildings	$ 839,553,000	$ 1,327,000	$(11,129,000)	$ 73,174,000	$ 902,925,000
Infrastructure	84,209,000	1,240,000		47,722,000	133,171,000
Equipment	362,917,000	52,704,000	(13,210,000)	(1,867,000)	400,544,000
Library materials	158,033,000	9,699,000	(841,000)		166,891,000
Total depreciable capital assets	$1,444,712,000	$ 64,970,000	$(25,180,000)	$ 119,029,000	$ 1,603,531,000
Less: accumulated depreciation					
Buildings	$ 375,882,000	$ 30,013,000	$ (7,813,000)	$ (5,573,000)	$ 392,509,000
Infrastructure	37,638,000	7,265,000		6,598,000	51,501,000
Equipment	227,710,000	31,745,000	(10,584,000)	(1,025,000)	247,846,000
Library materials	118,711,000	8,270,000	(841,000)		126,140,000
Total accumulated depreciation	$ 759,941,000	$ 77,293,000	$(19,238,000)		$ 817,996,000
Depreciable capital assets, net	$ 684,771,000	$ (12,323,000)	$ (5,942,000)	$ 119,029,000	$ 785,535,000
Capital assets, net	$ 833,726,000	$ 88,044,000	$ (6,523,000)		$ 915,247,000

In addition to expenditures through June 30, 2002, it is estimated that $112,495,000 will be required to complete projects under construction or planned for construction. Of that amount $71,085,000 is contractually encumbered.

NOTE 6. DEFERRED REVENUE

Deferred revenue consists primarily of amounts received from grants and contract sponsors which have not yet been earned under the terms of the agreements. Deferred revenues also include amounts received in advance of an event, such as advance ticket sales for sporting events.

Deferred revenue and deposits at June 30, 2002, consist of the following:

Current Deferred Revenue and Deposits	
Unexpended cash advances received for sponsored programs	$ 35,600,000
Auxillary sales and services	6,262,000
IBM lease related to the acquisition of the Park (Note 2)	4,900,000
Tuition and fees	3,798,000
Other deferred revenues	830,000
Deposits	1,517,000
Total current deferred revenue and deposits	$ 52,907,000
Noncurrent Deferred Revenue and Deposits	
IBM lease related to the acquistion of the Park (Note 2)	$ 54,371,000

NOTE 7: LONG-TERM DEBT & LEASE OBLIGATIONS

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

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable	$ 246,901,000	$ 93,080,000	$ (102,696,000)	$ 237,285,000	$ 14,690,000
Certificates of participation	185,279,000	98,526,000	(20,135,000)	263,670,000	4,550,000
Capitalized lease obligations	29,259,000	11,756,000	(6,357,000)	34,658,000	8,977,000
Total long-term debt	$ 461,439,000	$ 203,362,000	$ (129,188,000)	$ 535,613,000	$ 28,217,000

Bonds – The University's bonded debt consists of various issues of system revenue bonds that are generally callable with interest payable semi-annually. Bond proceeds are used to pay for acquiring or constructing capital facilities and infrastructure. Bond proceeds are also used for refunding obligations from previously issued bonds. Payment of principal and interest on bonds are secured by a pledge of tuition, fees, rentals, and other charges.

On February 6, 2002, the University sold System Revenue Refunding Bonds (SRB) Series 2002 for $93,080,000 dated March 1, 2002, with interest rates ranging from 3% to 5.25% and maturity dates ranging from 2003 to 2011. The Series 2002 bonds are not subject to redemption prior to their stated maturity. The Series 2002 bonds were sold at a premium of $4,692,000. The University realized net proceeds of $97,135,000 after payment of $637,000 for issuance costs, underwriter discounts and bond insurance. The net proceeds were used to pay off higher interest rate System Revenue Bonds Series 1992, with an outstanding principal balance of $92,750,000. The Series 1992 bonds were called June 1, 2002. The current refunding decreased the University's total debt service requirements by $7,971,000, and the University received an economic gain of $7,930,000 (difference between the present values of the old debt and new debt service payments). The refunded debt is defeased and is not included in the University's financial statements.

In fiscal year 1998, the University refunded, in advance of maturity, a portion of outstanding system revenue bonds Series 1994. At June 30, 2002, the outstanding principal balance of the refunded bonds was $15,740,000, which will be paid by investments held in trust with a carrying value of $17,287,000. These amounts are not included in the University's financial statements.

The following schedule details outstanding bonds payable at June 30, 2002:

Issue			Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1992A	–	System Revenue Refunding Bonds	$ 55,490,000	2016	2.9-6.2%	$ 51,955,000
1993	–	System Revenue Refunding Bonds	42,085,000	2017	2.7-5.0%	17,755,000
1994	–	System Revenue Bonds	28,500,000	2006	4.8-6.35%	5,510,000
1998	–	System Revenue Bonds	54,270,000	2018	3.9-5.25%	48,185,000
2000A	–	System Revenue Bonds	21,300,000	2024	5.0-5.8%	20,800,000
2002	–	System Revenue Bonds	93,080,000	2011	3.0-5.25%	93,080,000
		Total	$ 294,725,000			$ 237,285,000

The following schedule details debt service requirements to maturity for System Revenue Bonds at June 30, 2002:

Year	Principal	Interest
2003	$ 14,690,000	$ 13,125,000
2004	16,310,000	11,511,000
2005	17,005,000	10,831,000
2006	17,820,000	10,015,000
2007	18,690,000	9,166,000
2008-12	95,860,000	30,544,000
2013-17	45,295,000	9,764,000
2018-22	8,515,000	2,152,000
2023-24	3,100,000	272,000
Total	$237,285,000	$ 97,380,000

Certificates of Participation - The University utilizes certificates of participation (COPs) that are generally callable, and various capital leases to acquire buildings, equipment and land.

On December 12, 2001, the University issued Certificates of Participation, Series 2001B for $21,425,000. The 2001B Certificates have an optional redemption date of June 1, 2012. There are also extraordinary redemption dates pursuant to the debt documents. The 2001B Certificates include $13,915,000 of serial certificates with interest rates ranging from 3.0% to 5.0% and maturity dates ranging from 2003 to 2017. The 2001B Certificates also include $7,510,000 of term certificates due June 1, 2022, with an interest rate of 5.125%. The 2001B Certificates were issued at a discount of $99,000. The proceeds are being used to construct the Highland District Residence Life Infrastructure, reconfigure the Arizona Health Sciences Center Animal Facility, and expand the Gittings Dance Hall.

On April 4, 2002, the University issued Certificates of Participation, Series 2002A in the amount of $76,965,000 with interest rates ranging from 3.75% to 5.5% and maturity dates ranging from 2003 to 2022. The certificates have an optional redemption date of June 1, 2012. The Certificates of Participation, Series 2002A were sold at a premium of $1,439,000. The University realized net proceeds of $77,318,000 after payment of $1,086,000 for issuance costs, underwriters discount and bond insurance. The net proceeds from the sale of these certificates are being used to finance the construction of a new Highland District Student Residential Hall, a new Campus Health Facility, and the University North Building located in northwest Tucson. In addition, a portion of the proceeds were used to advance-refund two certificates of participation Series 1991 and 1992 with a total outstanding principal balance of $16,735,000, and a call date of July 15, 2002. The refunding reduced the University's total debt service requirements for the two certificates of participation by $319,000, and provided a net present value cash flow benefit of $1,169,000. The refunded Certificates of Participation Series 1991 and 1992 will be paid by investments held in an irrevocable trust with a combined carrying value of $17,509,000. The refunded debt is considered defeased and is not included in the University's financial statements.

The University has outstanding at June 30, 2002, two Variable Rate Certificates of Participation, Series 1999B and 2000A totaling $64,200,000. Both certificates bear interest at a weekly rate determined by Paine Webber, as remarketing agent, with final maturity dates of June 1, 2024, and June 1, 2025, respectively. These certificates are subject to conversion, at the option of the Arizona Board of Regents, to an adjustable rate, an annual rate, or a term rate pursuant to the debt documents. If not converted, the 1999B and 2000A certificates will bear interest at a weekly rate not to exceed 12 percent per annum determined under prevailing market conditions by the remarketing agent.

The following schedule details outstanding Certificates of Participation at June 30, 2002:

Issue		Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1994A	Residence Life Certificates	$ 16,725,000	2014	4.1-5.8%	$ 12,775,000
1994B	Maingate Admin. Certificates	16,170,000	2024	4.25-6.0%	14,470,000
1997	Alumni Foundation Bldg. Certificates	2,965,000	2008	3.8-4.5%	1,920,000
1999A	Fixed Student Union Certificates	21,607,000	2024	5.0-5.3%	21,980,000
1999B	Student Union Certificates	36,500,000	2024	Variable	36,500,000
1999	Parking Garage, Res. Life Certificates	18,635,000	2024	4.2-5.75%	18,380,000
2000A	McKale, UA Police Dept., Mt. Graham	28,300,000	2025	Variable	27,700,000
2001A	Park Std. Union, Learning Svcs., Garage	31,695,000	2025	3.4-5.5%	31,555,000
2001B	Gittings Bldg., Highland Infra., Life Sci.	21,425,000	2022	3.0-5.125%	21,425,000
2002A	Student Housing, Health Bldg., UA North	76,965,000	2022	3.75-5.5%	76,965,000
	Total	$ 270,987,000			$ 263,670,000

The following schedule details debt service requirements to maturity for Certificates of Participation payable at June 30, 2002:

Year	Principal	Interest
2003	$ 4,550,000	$ 11,912,000
2004	6,195,000	10,603,000
2005	7,220,000	10,366,000
2006	7,615,000	10,055,000
2007	7,920,000	9,753,000
2008-12	46,765,000	43,644,000
2013-17	67,039,000	35,190,000
2018-22	85,231,000	15,261,000
2023-25	31,135,000	1,795,000
Total	$263,670,000	$148,579,000

Capital Leases - During the fiscal year the University entered into various long term leases to acquire equipment and enhance fixtures and infrastructure. These leases are classified as capital leases since they provide a bargain purchase option or a transfer of ownership by the end of the lease term. A major capital lease entered into this fiscal year was for the Lighting Energy Conservation improvement project. This capital lease was entered into with G.E. Capital Public Finance Inc. for $7,002,000, with an interest rate of 4.23%, and a final payment date of November 1, 2007. The proceeds were placed in trust to finance the improvement project to reduce electricity costs for the University.

Following is a summary of capital assets financed by certificates of participation and capital leases at June 30, 2002:

Cost of assets	$ 237,205,000
Less: accumulated depreciation	(30,656,000)
Net book value	$ 206,549,000

The following schedule details debt service requirements to maturity for capital leases payable at June 30, 2002:

Year	
2003	$ 10,169,000
2004	9,640,000
2005	6,954,000
2006	6,082,000
2007	4,639,000
2008-12	941,000
Total minimum lease payments	38,425,000
Less: interest	(3,767,000)
Present value of minimum lease payments	$ 34,658,000

Operating Leases - The University has entered into certain operating leases, generally with options for annual renewal, and other rental agreements for real property and equipment. For fiscal year 2002, rent expenses totaled $16,542,000.

The following schedule details future operating lease payments to maturity:

Year	
2003	$ 2,159,000
2004	1,769,000
2005	498,000
2006	295,000
Total	$ 4,721,000

NOTE 8. SELF-INSURANCE PROGRAM

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. Arizona Revised Statutes §41-621 *et seq* provides that losses eligible for coverage and 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 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. Accordingly, 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.

NOTE 9. RETIREMENT PLANS

The University participates in one cost-sharing multiple-employer defined benefit pension plan and six defined contribution pension plans.

A. Defined Benefit Plan

Plan Description. The Arizona State Retirement System (ASRS) administers a cost-sharing multiple-employer defined benefit pension plan that covers employees of the University. Benefits are established by State statute and provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of ARS Title 38, Chapter 5, Article 2. The ASRS issues a publicly available 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, PO Box 33910, Phoenix, Arizona 85067-3910, or by calling (602) 240-2000 or (800) 621-3778.

Funding Policy. For the year ended June 30, 2002, active ASRS members and the University were each required to contribute 2.49 percent (2 percent retirement and .49 percent long term disability) of the members' annual covered payroll. The University's portion of contributions to the ASRS for the years ended June 30, 2002, 2001, and 2000, was $4,866,000, $5,084,000, and $5,027,000, respectively, which equaled the required contributions for the year. The Arizona State Legislature establishes and may amend active plan members' and the University's contribution rates.

B. Defined Contribution Plans

Plan Description. In accordance with ARS §15-1628, University faculty, academic professionals, and administrative officers have the option to participate in defined contribution pension plans. For the year ended June 30, 2002, plans offered by the Teachers Insurance Annuity Association/College Retirement Equities Fund (TIAA/CREF), Variable Annuity Life Insurance Company (VALIC), Fidelity Investments Tax-Exempt Services Company (Fidelity), Aetna Life Insurance and Annuity Company (Aetna), and The Vanguard Group (Vanguard) were approved by the Arizona Board of Regents. In addition, employees hired before July 1, 1972, have the option to participate in the defined contribution plan administered by the ASRS. 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; University contributions vest after five years of full-time employment. Member and University contributions and associated returns earned on investments may be withdrawn upon termination of employment, death, or retirement. 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.

Funding Policy. The Arizona State Legislature establishes the contribution rates for active plan members and the University. For the year ended June 30, 2002, plan members and the University were each required by statute to contribute an amount equal to 7 percent of a member's compensation, except for a 7.06 percent University contribution for the ASRS plan. Contributions to these plans for the year ended June 30, 2002, were as follows:

Plan	University Contributions	Member Contributions	Total Contributions
TIAA/CREF	$ 11,293,000	$ 11,293,000	$22,586,000
VALIC	785,000	785,000	1,570,000
Fidelity	1,946,000	1,946,000	3,892,000
Aetna	646,000	646,000	1,292,000
Vanguard	384,000	384,000	768,000
ASRS	161,000	159,000	320,000

NOTE 10. OPERATING EXPENSES BY NATURAL CLASSIFICATION

Operating expenses by natural classification for the year ended June 30, 2002 consist of the following:

Category	
Personal services and benefits	$ 630,330,000
Supplies and services	217,043,000
Scholarships and fellowships	32,292,000
Depreciation	77,294,000
Total operating expenses	$ 956,959,000

NOTE 11. PLEDGED REVENUES

The University has various system revenue bonds outstanding at fiscal year end for which it has pledged portions of its gross revenues toward payment of this outstanding debt. Gross revenues generally mean tuition, fees, rentals, and revenues from certain auxiliary enterprises. Gross revenues do not include any monies derived from appropriations by the State Legislature, gifts, nor monies derived from endowment income or other restricted revenue sources.

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
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 University of Arizona as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the University's financial statements are intended to present the financial position and changes in financial position, including cash flows, of only that portion of the business-type activities of the State of Arizona that is attributable to the transactions of the University. They do not purport to, and do not, present fairly the financial position and changes in financial position, including cash flows, of the State in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Arizona as of June 30, 2002, and the changes in financial position, including cash flows, of the University for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 1, the University adopted the provisions of GASB Statement No. 35, *Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities*, for the year ended June 30, 2002, to implement a new financial reporting model.

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

Debbie Davenport
Auditor General

September 27, 2002

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