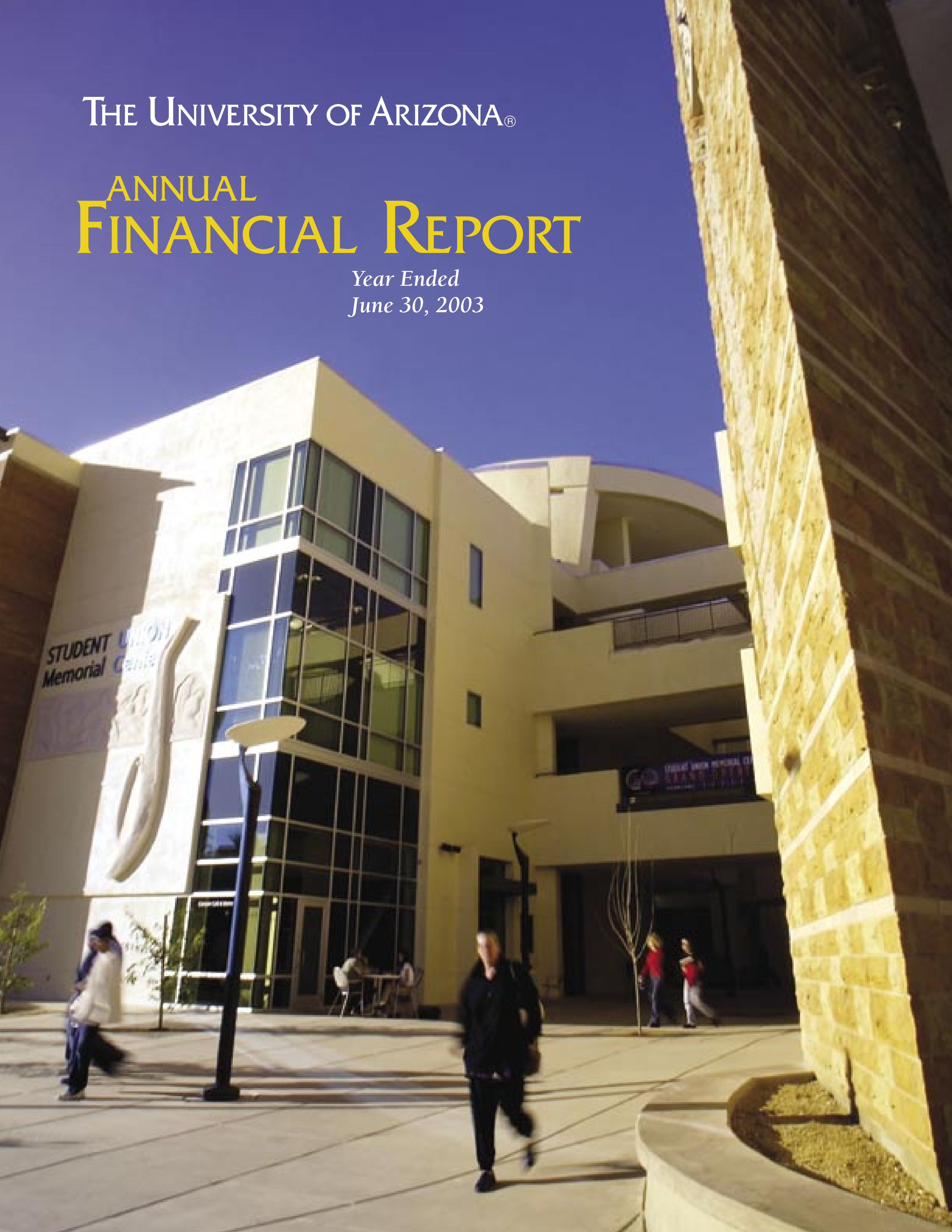
THE UNIVERSITY OF ARIZONA®

ANNUAL FINANCIAL REPORT

Year Ended
June 30, 2003



The magnificent new Student Union Memorial Center opened in February 2003. One of the distinctive features of the Center is the clock tower featuring an original bell salvaged from the U.S.S. Arizona battleship. It was donated to the University by Wilbur L. "Bill" Bowers, class of '27, and hangs for all to see. The tower represents a mast and sail. Other unique features include the outdoor walkway known as "the canyon". The east wall is curved to replicate the silhouette of the ship and curving balconies overlooking the canyon are an abstract of access walkways on the ship. The grand stairway culminates in a canted circular lid. The cylindrical drum is intended to be an allusion to the shape of the Arizona's main gun turret.

Cover photography and this page courtesy of David A. Harvey

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Many of the photos in the annual report portray the unique architecture of the Student Union Memorial Center.

A MESSAGE *from the* PRESIDENT

Fiscal year 2003 was a time of transition for the University of Arizona, with positive implications for the distant future.

The Arizona Board of Regents launched the year with their Changing Directions initiative, providing the University of Arizona with the freedom to pursue a new developmental strategy under the banner of Focused Excellence.

Changes in tuition policies will bring the tuition for residents from 50th among America's 50 senior public universities to 34th in the near future; the first step in this direction was a $1,000/year increase in tuition for resident undergraduates (nearly 40%). At the same time we seek to make the UA more affordable with even more dramatic increases in financial aid.

After suffering two successive reductions in annual allocations from the state general fund, we were able to avoid further cuts for FY04, despite continuing deficits in the state budget.

Perhaps the most dramatic change in our financial fortunes was the decision by the State of Arizona to assume in July, 2007 debt service obligations for new research facilities to be constructed before that time at a cost of $182 million.

These improvements in future revenues from state general fund and tuition sources represent welcome new trends. Fortunately, we have at the same time managed to sustain the positive financial performance of our university in two key areas: private gifts and research contracts.

Our billion dollar goal for Campaign Arizona will be achieved almost two years ahead of the scheduled conclusion on 30 June 2005. By 30 June 2003 more than $960 million had been paid or pledged by our benefactors, who will want to do still more for us after we reach our billion dollar goal in the next few months.

Our exceptional faculty have continued to win major research contracts in the face of increasing national competition. Very significant multi-year awards in the Steward Observatory, the Arizona Cancer Center, and the Lunar and Planetary Laboratory (LPL) assure continued growth in research revenues. The $325 million contract won by LPL in the summer of 2003 for the Mars Lander project shatters all previous University records. The most recent rankings by NSF for research expenditures are for FY01, when UA ranked 23rd among all American universities. It seems likely that our ranking will continue to improve, thanks to our very competitive research faculty.

So optimism is rising after two very hard years. We must find ways to improve the competitiveness of the compensation of our people, because they make it possible for us to continue performing at such a high level. But the tide now seems to be moving our way, and the future is once again promising.

Peter Likins
President

Institutional Profile

The University of Arizona 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 37,000 students through 16 colleges offering 325 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 2002 – 2003

Undergraduate enrollment – Fall 2002	28,278
Graduate enrollment – Fall 2002	8,569
Degrees awarded – Bachelor's	4,981
Degrees awarded – Advanced	1,966
Tuition for full-time student – Resident	$ 2,593
Tuition for full-time student – Non-resident	$11,113

The University's 2,197 full time equivalent instructional faculty and 1,284 graduate teaching assistants and associates educate a diverse student population. The student population is 52% female, 13.2% Hispanic, 5.2% Asian or Pacific Islander, 2.7% Black, and 2% Native American. It includes students from all fifty states, and 135 foreign countries. International students totaled 8% of the Fall 2002 enrollment, with the largest numbers of foreign students hailing from India, the People's Republic of China, Korea, 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 23 universities in the nation (top 14 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.

The University was one of the original Carnegie Research I institutions. 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. For instance, as a result of a 20% increase in National Institutes of Health funding, the largest in recent years, the University's ranking moved from 54th to 44th among institutions that received such funding.

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 and Public Health. 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. In 2003, the National Cancer Institute designated the University of Arizona

Health Sciences Center's Arizona Cancer Center as a "comprehensive cancer center" and provided five years of increased funding. Other recent grants include $6 million dollars for five years to discover effective new anticancer agents.

- 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 on Mt. Graham, and by recent international prominence gained from University designed and built instruments.
- The internationally-recognized Optical Sciences Center is a leader in science and engineering-related optics. 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. The Meinel Optical Sciences Center's expansion began in summer 2003 and will provide the campus with an improved optics instructional and research environment.
- Research of past cultures in Arizona has resulted in archaeological leadership in the Southwest setting. As an offshoot, this has led 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 worldwide 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 Student Union Memorial Center officially opened in February 2003. This facility, currently the largest of its kind in the country, offers a host of services and amenities to enhance the campus experience. Other than residence halls currently under construction, it completes the major student-related building additions that will be needed to meet the enrollment increases expected over the next few years.

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.

Management regards the University as well positioned to continue its strong financial condition and service to students, patients, the research community, citizens of Arizona and our country. Future successes are largely dependent upon cost containment, the ability to recruit and retain the highest quality students, faculty and staff, and ongoing financial and political support from the State government.

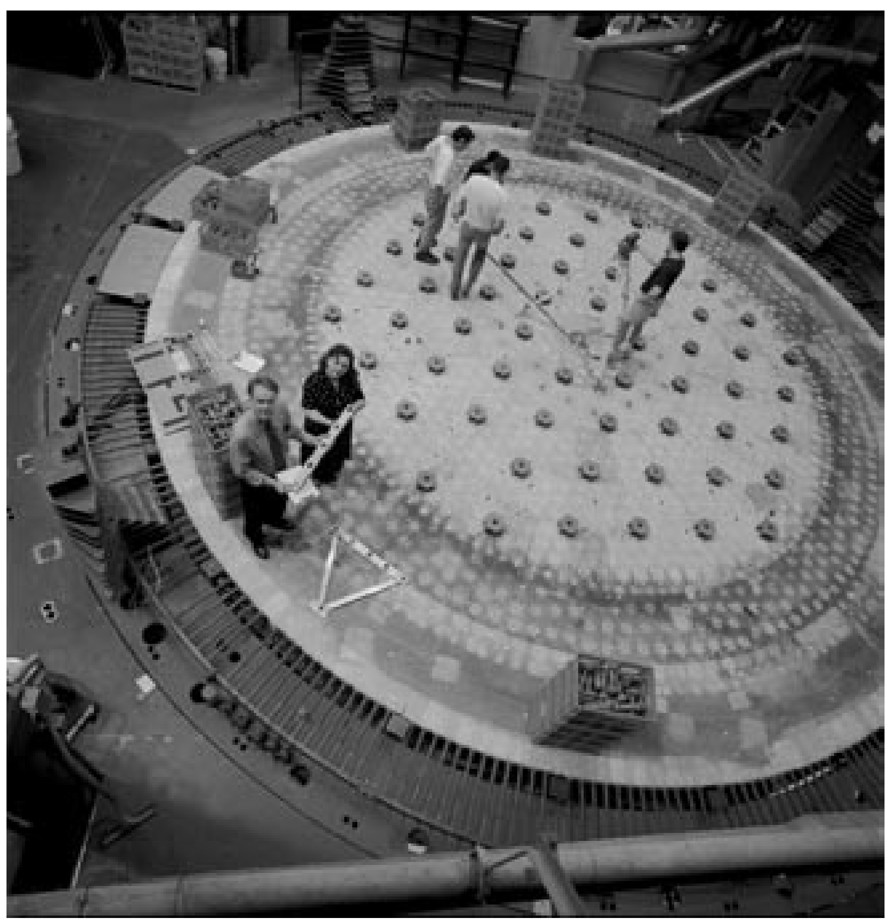
The University is increasing its competitiveness in obtaining sponsored research funds by the expansion of laboratory-oriented facilities and by pursuing organizational and programmatic initiatives (e.g., optics, biotechnology, medicine). This competitiveness was demonstrated when the University received a $325 million dollar award from NASA in support of the Mars Lander project. 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.

During fiscal year 2003, the Office of Technology Transfer (OTT) generated in excess of one million dollars in licensing income, a first since OTT's inception in 1988. The University received 111 Invention Disclosures and a total of 29 Licensing Agreements. Eleven U.S. Patents were issued, 20 U.S. Patents were filed, and 55 Provisional Patent Applications were filed and received.

For instructional purposes the University is dependent upon State appropriations, 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 and income 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 continues to be among the lowest of the public universities in the nation, there may be further opportunity to increase tuition, as long as financial aid resources also increase.

Private gift contributions are an important supplement to the fundamental support from the State of Arizona and are a significant factor in the growth of academic, research, and patient care units. Economic pressures affecting donors may also affect the future level of support afforded the University from corporate and individual giving. Currently, the University, along with the University of Arizona Foundation, is in its sixth year of an eight-year campaign to raise one billion dollars in pledges and contributions.

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.


Margaret Hartshorn

Management's Discussion and Analysis

Introduction

The following discussion and analysis provides an overview of the financial position and activities of the University for the year ended June 30, 2003. Information for the year ended June 30, 2002, is also provided for comparative purposes and has been restated to recognize the change in capitalization threshold for capital equipment from $1,000 to $5,000, classification of compensated absences between current and noncurrent, recognition of deferred amounts on refunding and a few other minor reclassifications. These changes have not been audited and are provided to the reader 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

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 reporting standards, State appropriations, contributions and investment income are considered nonoperating revenues. As a result of these standards, the University typically will appear to operate at a loss. By comparison, the total change in net assets is a better 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.

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, 2003, and at June 30, 2002, is as follows:

	2003	2002 as restated	% Change
Current assets	$ 201,975	$ 295,504	-31.7%
Noncurrent assets other than capital assets	326,632	341,079	-4.2%
Capital assets	940,362	880,703	6.8%
Total assets	**$ 1,468,969**	**$ 1,517,286**	**-3.2%**
Current liabilities	$ 157,501	$ 235,645	-33.2%
Noncurrent liabilities other than debt	97,538	99,494	-2.0%
Long-term debt	508,363	510,217	-0.4%
Total liabilities	**$ 763,402**	**$ 845,356**	**-9.7%**
Net assets			
Invested in capital assets, net of related debt	$ 397,160	$ 370,792	7.1%
Restricted - nonexpendable	86,176	86,666	-0.6%
Restricted - expendable	100,888	87,887	14.8%
Unrestricted	121,343	126,585	-4.1%
Total net assets	**$ 705,567**	**$ 671,930**	**5.0%**

Overall, the University's financial position improved in fiscal year 2003. Net assets increased by $33.6 million primarily due to investments in capital assets, increased federal grants and contracts activity and restricted gift donations.

Current Assets and Current Liabilities

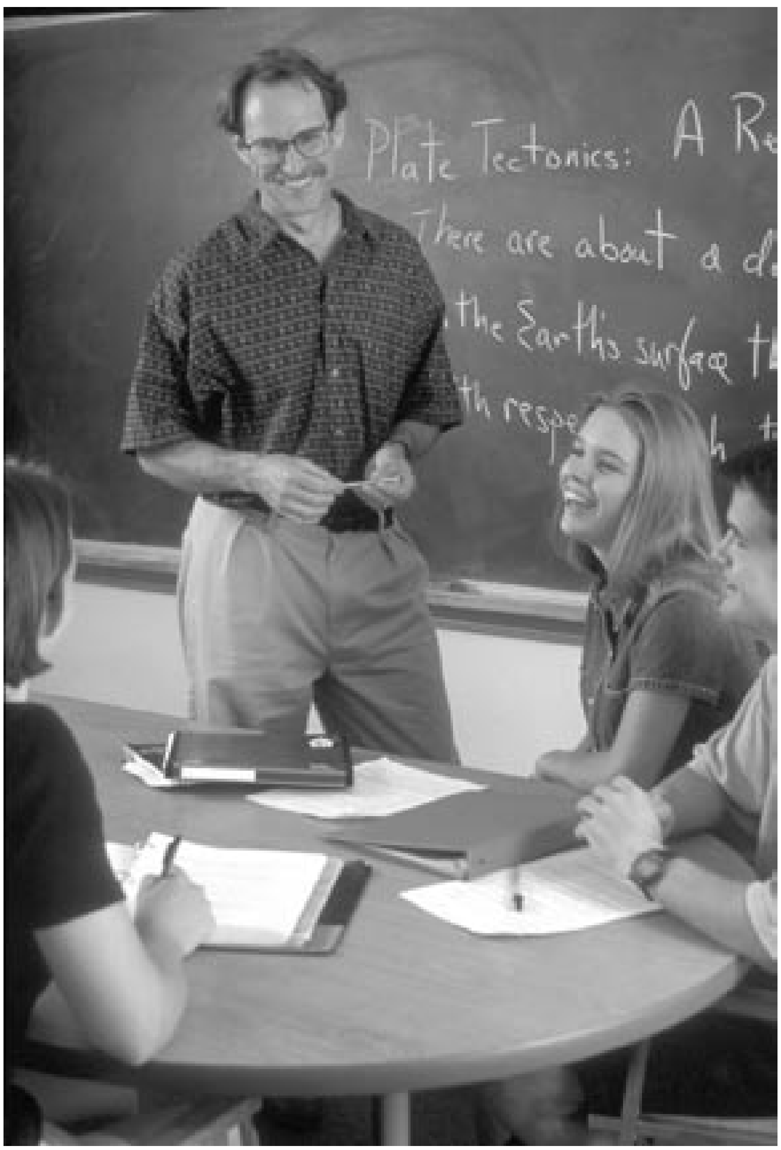
Current assets consist primarily of cash and cash equivalents, securities lending cash collateral, short-term investments and various receivables (primarily accounts receivable and government grants). Current liabilities consist primarily of trade accounts payable and accrued liabilities, securities lending obligations, deferred revenues, and the current portion of long-term debt payable. The University's 1.28 current ratio (current assets to current liabilities) reflects adequate liquidity and sufficient short-term ability to meet upcoming obligations.

During fiscal year 2003, the University discontinued participation in securities lending activities with operating funds, resulting in a significant reduction in current assets and current liabilities. The $67.4 million dollar variance comprises 72% of the total variance in current assets and 86% of the variance in current liabilities. Also, the University changed investment strategies to maximize investment income and moved assets from short-term investments to long-term investments thereby resulting in a further reduction in current assets.

Net Assets

The positive increase in restricted expendable net assets primarily comes from State funds received related to Proposition 204 - Tobacco Settlement Fund and Proposition 301 - Technology and Research Initiative Fund, as well as increased restricted gift activity.

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.



John Florence

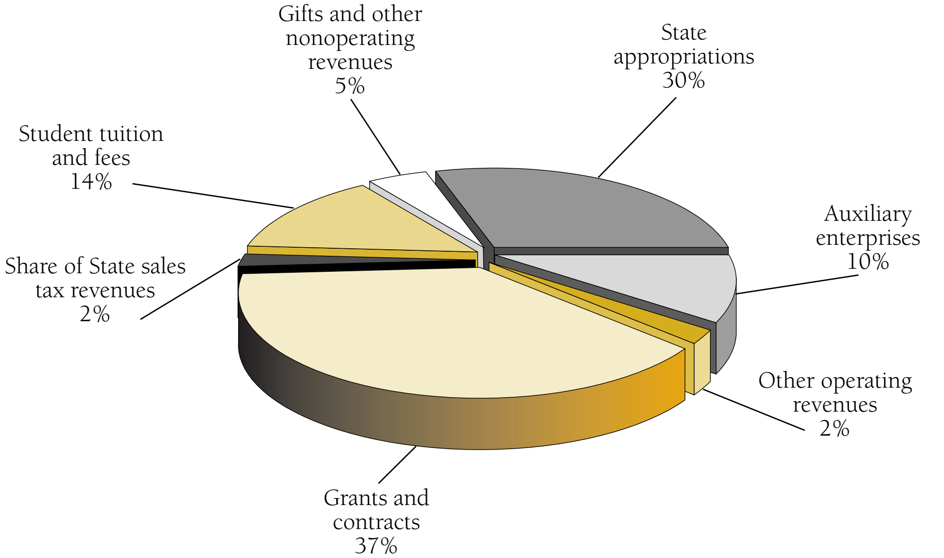
Statement of Revenues, Expenses and Changes in Net Assets

A summarized comparison of the University's operations (in thousands of dollars) for the year ended June 30, 2003, and for the year ended June 30, 2002, is as follows:

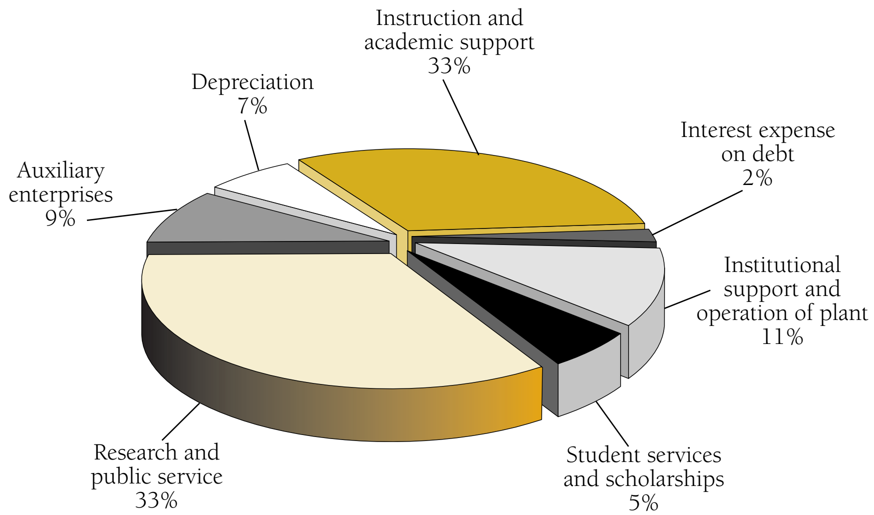
	2003	2002 as restated	% Change
Operating revenues			
Student tuition and fees	$ 149,533	$ 140,096	6.7%
Grants and contracts	390,167	330,083	18.2%
Auxiliary enterprises	107,046	95,655	11.9%
Other operating revenues	23,517	20,151	16.7%
Total operating revenues	**$ 670,263**	**$ 585,985**	**14.4%**
Operating expenses			
Instruction and academic support	$ 347,196	$ 339,906	2.1%
Research and public service	350,025	294,565	18.8%
Student services and scholarships	53,929	53,213	1.3%
Institutional support and operation of plant	112,578	116,216	-3.1%
Auxiliary enterprises	95,272	87,495	8.9%
Depreciation	70,929	66,286	7.0%
Total operating expenses	**1,029,929**	**957,681**	**7.5%**
Operating loss	**$ (359,666)**	**$ (371,696)**	**-3.2%**
Nonoperating revenues (expenses)			
State appropriations	$ 323,885	$ 329,320	-1.7%
Share of State sales tax revenues	16,479	15,799	4.3%
Gifts	40,572	35,407	14.6%
Investment income	10,868	3,677	195.6%
Interest expense on debt	(19,065)	(21,185)	-10.0%
Other nonoperating revenues, net	4,792	7,953	-39.7%
Net nonoperating revenues	**$ 377,531**	**$ 370,971**	**1.8%**
Capital and endowment additions	15,772	19,012	-17.0%
Increase in net assets	**$ 33,637**	**$ 18,287**	**83.9%**
Net assets, beginning of year, as restated	**671,930**	**653,643**	**2.8%**
Net assets, end of year	**$ 705,567**	**$ 671,930**	**5.0%**

The following graphs illustrate operating and nonoperating revenues and expenses for the year ended June 30, 2003.

Operating & Nonoperating Revenues



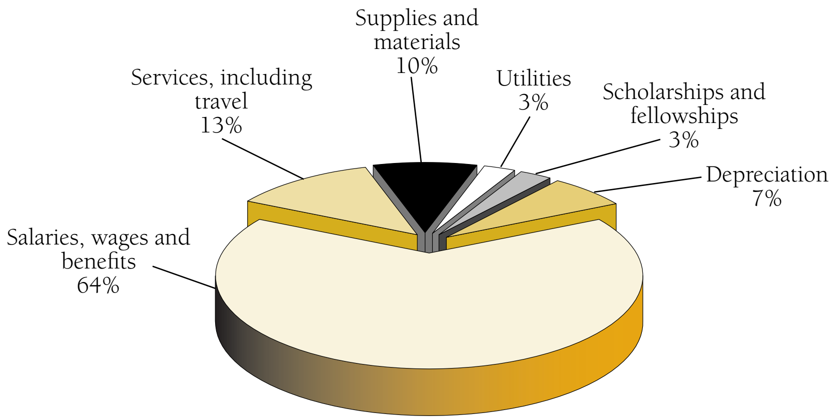
Operating & Nonoperating Expenses



In addition to programmatic (functional) classification of operating expenses, a summary of the University's expenses by natural classification (in thousands of dollars) for the years ending June 30, 2003, and 2002 follows:

Natural Classification of Operating Expenses	**2003**	**2002** *as restated*
Salaries, wages and benefits	$ 662,461	$ 630,330
Supplies and materials	102,339	93,388
Services, including travel	134,705	108,770
Utilities	24,765	26,615
Scholarships and fellowships	34,730	32,292
Depreciation	70,929	66,286
Total Operating Expenses	**$ 1,029,929**	**$ 957,681**

Natural Classification of Operating Expenses for the year ended June 30, 2003



Operating revenues and expenses

In fiscal year 2003, the University's operating revenues increased by $84.3 million, or 14.4%, over fiscal year 2002. Of the $84.3 million increase, 71% was attributable to increases in grants and contracts revenues and 11% due to increases in student tuition and fees.

Student tuition and fees: Tuition and fees rose by over $9 million in fiscal year 2003 due to increases in enrollment of 625 students and tuition. In-state tuition and fees increased by $103, or 4.1%, to $2,593, while out-of-state tuition and fees increased by $757, or 7.3%, to $11,113.

Grants and contracts revenues: Grants and contracts revenues increased 18.2% in fiscal year 2003. This increase is directly related to increased federal grants and contracts activity. Specifically, continuing grants such as the NASA - High Resolution Imaging grant as well as other federal sponsors increased significantly over the prior year. 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.

Operating expenses: Operating expenses increased 7.5% in fiscal year 2003, primarily due to a significant increase in federally sponsored research activity, which produced an 18.8% increase in research and public service expenses.

Nonoperating revenues and expenses

Investment income: Investment returns generated during fiscal year 2003 increased by $7.2 million over fiscal year 2002. This increase is due primarily to the improved performance of endowments during the year. Endowments are invested in a combination of equity and fixed income securities. During the year, the Standard and Poor's 500 gained 0.2% and the Lehman Aggregate Bond Index gained 10.4%. Endowment Growth and Income Pool returned 2.43%. Sources of investment income were as follows:

	2003	***2002***
Pooled operating funds	$ 4,437,000	$ 7,206,000
Deposits with trustees for capital projects	1,161,000	3,628,000
Endowments	5,270,000	(7,157,000)
Total investment income	$ 10,868,000	$ 3,677,000

Statement of Cash Flows

A summarized comparison of the University's cash flows (in thousands of dollars) for the year ended June 30, 2003, and June 30, 2002, is as follows:

	2003	***2002 as restated***	***% Change***
Net cash provided (used) by (for):			
Operating activities	$ (299,409)	$ (304,747)	-1.8%
Noncapital financing activities	388,861	375,313	3.6%
Capital financing activities	(145,621)	(74,187)	96.3%
Investing activities	13,276	96,488	-86.2%
Net increase (decrease) in cash and cash equivalents	$ (42,893)	$ 92,867	-146.2%
Cash and cash equivalents - beginning of year	183,578	90,711	102.4%
Cash and cash equivalents - end of year	$ 140,685	$ 183,578	-23.4%

In fiscal year 2003 University cash decreased $42.9 million. This was primarily due to the liquidation of funds held in trust by various commercial banks to fund construction projects.

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 $299 million in fiscal year 2003. State appropriations, gifts and capital grants provided nearly $379 million for operational activities and equipment purchases. Capital financing activities netted a cash outflow of $145.6 million.

Investing activities netted a cash inflow of $13.3 million, in sharp contrast to the $96.5 million inflow of cash in fiscal year 2002. This variance was primarily the result of cash flow requirements for upcoming and ongoing construction projects. The University liquidated a net $52 million from funds held in trust in fiscal year 2002 and then disbursed those funds in fiscal year 2003.

Capital and Debt Analysis

The University's capital improvement projects are essential to support the University's mission of providing excellent education and research programs. Over the last 10 years, the University experienced a 39.5% 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, managing building renewal and replacement projects, and expanding parking and student housing capacities.

Facilities construction projects completed recently include the Central Animal Facility Shell Space, Life Science South Shell Space, Agriculture Research Complex, Student Union Memorial Center, Bookstore, Stevie Eller Dance Theatre, Villa Del Puente Dormitories, Sixth Street Parking and Transportation Administration Office Building, El Portal Dormitory Offices, and UA South Academic Technology Building. These facilities, completed at a total cost of approximately $124 million, added over 1.3 million square feet of critically needed space. In addition to these facilities projects, several infrastructure projects were completed. These projects include Highland District Infrastructure Phase I, Gas Turbines and Boilers, and Lighting Efficiency Retrofit. The combined cost of these three projects was $20 million.

Major projects currently under construction are the Meinel Optical Sciences Center Expansion, Park Student Union Expansion, Herring Hall Renovation, UA North Campus Building, Highland District Dormitories, Sixth Street Parking Garage, Highland Health and Wellness Center, Apache-Santa Cruz Dormitory Renovation, and McKale Renovations and Expansion Project.

During fiscal year 2003, the University issued Certificates of Participation Series 2002B for which a portion of the proceeds were used to finance the Meinel Optical Sciences Center expansion project. The expansion adds 47,000 gross square feet to provide new assembly and meeting space, faculty offices, and new instructional and research laboratory space. The project is estimated to cost $17.2 million and to be completed in July 2004.

The University generally finances capital improvements and acquisitions through the issuance of System Revenue Bonds (SRBs) and Certificates of Participation (COPs). Prior to the issuance of debt, a funding plan must be submitted for review and approval to the State Joint Committee on Capital Review and the Arizona Board of Regents. The University must adhere to a debt ratio limit of 8% (total SRBs and COPs debt service to total operating expenses and debt service) as defined by Arizona Revised Statutes §15-1683. The University's legislative debt ratio at the end of fiscal year 2003 was 3.79%. Detailed debt service information is available in Note 8 of the accompanying notes to the financial statements.

Economic Outlook

As is the case for most of the country, the State of Arizona continued to experience weak economic conditions in fiscal year 2003. As a result of the distressed economy, the State legislature reduced State appropriations in fiscal year 2003. 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.

Part of the strategic plan includes positioning the University for future expansion of externally sponsored research through capital improvements and additional facilities. The University plans to issue $152.5 million dollars of debt in November 2003 to fund new capital projects. Planned projects include the Medical Research Building, Institute of Biomedical & Biotechnology Science Building and Infrastructure Projects - Phase VI. At a time when other state legislatures were cutting appropriations and support to higher education, the Arizona State Legislature passed House Bill 2529 in support of expanded research infrastructure needs for each of the three State universities. This bill recognized the need for facilities to spur research activity and makes an investment in the future of the University of Arizona by providing the needed long-term financing. Sponsored research at the University continues to grow. In August 2003, NASA awarded the University of Arizona $325 million in support of the Mars Lander project. This award is the largest single grant in University of Arizona history and demonstrates the competitiveness of our faculty in obtaining external funding.

With current trends in State appropriations continuing to decline, the University is continuing to examine opportunities to increase tuition revenues to offset decreased State support. Meeting the one billion dollar goal of Campaign Arizona almost two years in advance of the target date helps to solidify the future financial foundation of the University and demonstrates the strong support of our benefactors. Due to increased financial needs to attract and retain talented faculty and staff, the University will request approval from the Arizona Board of Regents for a tuition increase within the next fiscal year.

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 to the State of Arizona and the nation.

Independent Auditors' Report

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, 2003, 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 the changes in financial position, and 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 of the State of Arizona as of June 30, 2003, and the changes in its financial position and its cash flows 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, 2003, and the changes in financial position and 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 increased its capitalization threshold for equipment, which represents a change in the application of an accounting principle.

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 19, 2003

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Statement of Net Assets

June 30, 2003 *(in thousands of dollars)*

Assets

Current assets	
Cash and cash equivalents (Note 3)	$ 86,347
Securities lending cash collateral (Note 3)	34,251
Short-term investments (Note 3)	16,137
Receivables:	
Accounts receivable, net of allowances of $330	12,575
Government grants receivable	42,401
Student loans, net of allowances of $191	1,920
Inventories	7,459
Deferred expenses	885
Total current assets	201,975
Noncurrent assets	
Restricted cash and cash equivalents (Note 3)	54,338
Restricted investments with bond trustees (Note 3)	1,502
Long-term investments (Note 3)	93,071
Investments held for others (Note 3)	19,362
Endowment investments (Note 3)	139,503
Student loans receivable, net of allowances of $1,869	12,398
Deferred expenses	6,458
Capital assets, not being depreciated (Note 5)	112,713
Capital assets, being depreciated, net (Note 5)	827,649
Total noncurrent assets	1,266,994
Total Assets	**$ 1,468,969**

Liabilities

Current liabilities	
Accounts payable	$ 29,886
Accrued payroll and benefits	15,483
Accrued compensated absences (Note 7)	2,055
Obligations under securities lending (Note 3)	34,251
Deferred revenues and deposits (Note 6)	48,425
Funds held for others	4,377
Current portion of long-term debt (Note 8)	23,024
Total current liabilities	157,501
Noncurrent liabilities	
Deferred revenues and deposits (Note 6)	49,470
Accrued compensated absences (Note 7)	23,441
Funds held for others	24,627
Long-term debt (Note 8)	508,363
Total noncurrent liabilities	605,901
Total Liabilities	**$ 763,402**

Net Assets

Invested in capital assets, net of related debt	$ 397,160
Restricted for nonexpendable:	
Endowments	68,569
Student loans	17,607
Restricted for expendable:	
Scholarships and fellowships	25,648
Academic/departmental uses	61,677
Capital projects	2,638
Debt service	10,925
Unrestricted	121,343
Total Net Assets	**$ 705,567**

See Notes to Financial Statements

Statement of Revenues, Expenses & Changes in Net Assets

Year Ended June 30, 2003 *(in thousands of dollars)*

Operating Revenues

Student tuition and fees, net of scholarship allowances of $39,296, pledged as security for long-term debt	$	149,533
Federal grants and contracts		315,215
State grants and contracts		13,218
Local grants and contracts		2,457
Nongovernment grants and contracts		59,277
Sales and services of educational departments, pledged as security for long-term debt		19,576
Auxiliary enterprises, net of scholarship allowances of $1,747, pledged as security for long-term debt		107,046
Other operating revenues, pledged as security for long-term debt		3,941
Total operating revenues	**$**	**670,263**

Operating Expenses

Educational and general		
Instruction	$	285,946
Research		308,192
Public service		41,833
Academic support		61,250
Student services		20,851
Institutional support		61,955
Operation and maintenance of plant		50,623
Scholarships and fellowships		33,078
Auxiliary enterprises		95,272
Depreciation (Note 5)		70,929
Total operating expenses	**$**	**1,029,929**
Operating Loss	**$**	**(359,666)**

Nonoperating Revenues (Expenses)

State appropriations	$	323,885
Share of State sales tax revenues		16,479
Gifts		40,572
Investment income		10,868
Interest expense on debt		(19,065)
Other nonoperating revenues, net		4,792
Net nonoperating revenues	$	377,531
Income before Capital and Endowment Additions	**$**	**17,865**
Capital grants, gifts and conveyances	$	14,670
Additions to permanent endowments		1,102
Total capital and endowment additions	$	15,772
Increase in Net Assets	**$**	**33,637**

Net Assets

Net Assets - Beginning of year, as restated (Note 1)		671,930
Net Assets - End of year	**$**	**705,567**

See Notes to Financial Statements

Statement of Cash Flows

Year Ended June 30, 2003 *(in thousands of dollars)*

Cash Flows from Operating Activities

Tuition and fees	$	149,101
Grants and contracts		381,802
Payments for salaries, wages and benefits		(658,646)
Payments to suppliers		(265,770)
Payments for scholarships and fellowships		(34,730)
Loans issued to students		(5,256)
Collections on loans to students		5,203
Auxiliary enterprise revenues		104,908
Sales and services of educational departments		20,034
Other receipts		3,945
Net cash used for operating activities	**$**	**(299,409)**

Cash Flows from Noncapital Financing Activities

State appropriations	$	323,829
Share of State sales tax revenues		15,058
Gifts and grants for other than capital purposes		44,120
Other nonoperating revenues		820
Federal Family Education Loans received		96,968
Federal Family Education Loans disbursed		(96,350)
Funds held for others received		59,145
Funds held for others disbursed		(54,729)
Net cash provided by noncapital financing activities	**$**	**388,861**

Cash Flows from Capital Financing Activities

Proceeds from capital debt, including premiums	$	19,439
Capital grants and gifts received		10,692
Proceeds from sale of capital assets		3,169
Purchase of capital assets		(131,352)
Principal paid on capital debt and leases		(27,412)
Interest paid on capital debt and leases		(20,157)
Net cash used for capital financing activities	**$**	**(145,621)**

Cash Flows from Investing Activities

Proceeds from sales and maturities of investments	$	401,495
Interest and dividends on investments		8,264
Purchase of investments		(396,483)
Net cash provided by investing activities	**$**	**13,276**
Net Decrease In Cash and Cash Equivalents	**$**	**(42,893)**

Cash and Cash Equivalents

Cash and Cash Equivalents - Beginning of year	$	183,578
Cash and Cash Equivalents - End of year	**$**	**140,685**

See Notes to Financial Statements

Statement of Cash Flows (Continued)

Year Ended June 30, 2003 *(in thousands of dollars)*

Reconciliation of Operating Loss to Net Cash Used for Operating Activities

Operating loss	$	(359,666)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation expense		70,929
Changes in assets and liabilities:		
Receivables, net		(5,967)
Inventories		(676)
Deferred expenses		182
Accounts payable		(3,411)
Accrued payroll and benefits and compensated absences		3,815
Deferred revenues and deposits		(4,615)
Net Cash Used For Operating Activities	**$**	**(299,409)**

Significant Noncash Transactions

Gifts and conveyances of capital assets	$	3,978
Assets acquired through capital leases		597
Change in fair value of investments		5,069
Refunding of long-term debt (Note 8)		53,655
Amortization of bond discounts and issuance costs		(960)
Amortization of bond premiums		679
Net loss on disposal of capital assets with an original cost of $21,328, accumulated depreciation of $16,992, and cash proceeds of $3,169		(1,167)
Amortization of IBM deferred rent (Note 2)		4,900

See Notes to Financial Statements

Notes to Financial Statements

NOTE 1. BASIS OF PRESENTATION & SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements include all activities 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.

The financial statements are presented in accordance with U.S. generally accepted accounting principles (GAAP) applicable to governmental colleges and universities engaged in business-type activities as adopted 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 noncurrent. 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, and revolving student loan funds. 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.

David A. Harvey Photography

- The Statement of Revenues, Expenses and Changes in Net Assets provides information about the University's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and additions to endowments. Generally, revenues generated by the University for instruction, 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 nonoperating revenues.
- The Statement of Cash Flows provides information about the University's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as operating, noncapital financing, capital financing, or investing activities.

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

Change in Accounting Principle

In fiscal year 2003, the University increased its capitalization threshold for equipment from $1,000 to $5,000. The change in capitalization threshold was adopted to enhance the University's asset management process and capital asset data integrity. The University's net assets reported as of June 30, 2002, have been restated as follows:

Net assets, beginning of year, as previously reported	$ 706,474,000
Cumulative effect of change in capitalization threshold	(34,544,000)
Net assets, beginning of year, as restated	$ 671,930,000

Significant Accounting Policies

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

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 changes in fair value of investments during the fiscal year from the investment of endowment, operating and trustee funds.

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 2003, the expendable rate was established at 4.5% of the three year average market value ending June 30, 2002. Donor restricted endowments that are available for expenditure are reported as restricted and expendable on the Statement of Net Assets.

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.

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 purposes 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	1 - 50
Infrastructure	100,000	5 - 100
Equipment	5,000	3 - 25
Library materials	1	10
Land	1	n/a
Construction in progress	1	n/a

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.

Restricted and Unrestricted Resources – 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., Southern Arizona Capital Facilities Finance Corporation, 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, 2002, assets, liabilities, revenues, and expenses totaled $298 million, $28 million, $43 million, and $43 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, 2002, assets, liabilities, revenues, and expenses totaled $117 million, $57 million, $163 million, and $154 million, respectively.

Southern Arizona Capital Facilities Finance Corporation (SACFFC) is a nonprofit Corporation formed in June 2002 and governed by a separate Board of Directors. SACFFC acquires, constructs, and operates student housing for the benefit of the University of Arizona. On July 3, 2002, SACFFC issued tax-exempt Certificates of Participation in the amount of $20,875,000 for 30 years to construct a student housing facility on University property, under a ground lease agreement with the Arizona Board of Regents. The term of the agreement is 40 years or until the debt is retired. The University is not legally responsible for repayment of the tax-exempt debt, and there is no pledge or guarantee by the University for repayment of the debt. The student housing facility is expected to open in September 2003, operated by a private company under a Management Agreement with SACFFC. Audited financial statements are not available.

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 68% of the building space for periods up to the remaining term of 21 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 32% 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 2003 $350,000 was distributed to the University. In February 2003, Arizona Center for Innovation, LLC (AzCI), a wholly owned subsidiary of CRC, was organized for the purpose of promoting the development of high technology companies in southern Arizona. AzCI's financial statements have been consolidated with CRC's and all significant intercompany transactions have been eliminated.

CRC's consolidated June 30, 2003, audited financial statements disclosed:

- $20,199,000 total assets, including $10,307,000 in net property and equipment and $4,776,000 in net intangible assets, the major components of which relate to leasehold interest and deferred leasing costs

- $13,182,000 total liabilities, including $10,493,000 of long-term debt in the form of two collateralized notes payable to Wells Fargo, Arizona
- $6,283,000 total revenues, primarily consisting of rental income from the Park and related properties
- $7,293,000 total expenses, including $2,431,000 project operating costs, $729,000 amortization of intangible assets, and a $1,744,000 loss on interest rate swap agreements
- During fiscal year 2003, cash and cash equivalents increased by $450,000.

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 $2,151,000. 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 and 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, 2003, University endowments totaling $16,431,000 are held and invested by bank trustees according to donor specifications.

Capital project funds totaling $54,561,000 are held in trust by various commercial banks. Of this amount, $1,502,000 is held for debt requirements, $47,965,000 is available for future construction costs, and $5,094,000 is from bond proceed earnings for unrestricted purposes. 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 - $12,471,000; Northern Arizona University - $5,630,000; ASU West - $1,119,000; ASU East - $142,000. The University's ASFAT funds are recorded as endowment investments at $10,407,000.

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, who is also the counterparty, 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 mutual funds are recorded in the University's name at various financial institutions.
5. U.S. treasury and agency government obligations 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 and deposited with the custodial bank.
6. Common stocks, exchange traded mutual funds, 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 and deposited with the custodial bank.
7. The Guaranteed Investment Contract (GIC) is with an insurance company from proceeds of the 1994A Certificates of Participation. The GIC is not collateralized; however, if the bond ratings of the insurance company fall below prescribed levels, collateralization of the investment with U.S. Government obligations is required, or the University may terminate the contract.
8. 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 endowments are held by the trustees as irrevocable trusts in the names of the individual donors for the benefit of the University and are invested by the trustee according to the donors' stipulations.

9. During the fiscal year, the University engaged in securities lending transactions within the endowment funds, as authorized by ABOR policies. 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 Wells Fargo 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, 2003, there were no violations of legal or contractual provisions, and there were no borrower or lending agent default losses. Wells Fargo does indemnify the University against losses due to borrower defaults. Collateral can be received in the form of U.S. Government securities, letters of credit, or cash. As of June 30, 2003, the custodial bank has received only cash 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 14 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, 2003, cash collateral investments totaled $34,251,000 with a corresponding market value of securities on loan of $33,158,000. 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, 2003, consist of the following:

	Fair Value
Cash overdraft	$ (6,941,000)
Investment in State Treasurer's investment pool	325,000
Repurchase agreements	72,552,000
U.S. treasury mutual funds	23,348,000
Money market mutual funds	53,059,000
U.S. treasury and agency government obligations	123,556,000
Common stocks	51,229,000
Exchange traded mutual funds	30,735,000
Preferred stocks	894,000
Equity mutual funds	210,000
Bond mutual funds	2,494,000
Mortgages and other receivables	834,000
Corporate bonds	24,629,000
Guaranteed investment contract (GIC)	1,502,000
Endowments held by trustee	16,431,000
Donated land	1,403,000
Joint venture (Note 4)	14,000,000
Total	**$ 410,260,000**

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 time of donation.

NOTE 4. JOINT VENTURE

The University is a participant in the Large Binocular Telescope Corporation (LBT). LBT was formally incorporated as a nonprofit 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, 2003, 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, 2002, assets, liabilities, revenues, and expenses totaled $84 million, $1 million, $10 million, and $3 million, respectively.

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003, was as follows:

	Beginning Balance July 1, 2002, as restated	Additions	Retirements	Transfers/ Reclasses	Ending Balance June 30, 2003
Land	$ 50,035,000	$ 1,912,000	$ (222,000)	$ (114,000)	$ 51,611,000
Construction in progress	79,676,000	89,506,000	(40,000)	(108,040,000)	61,102,000
Total non-depreciable capital assets	$ 129,711,000	$ 91,418,000	$ (262,000)	$ (108,154,000)	$ 112,713,000
Buildings	$ 902,927,000	$ 2,761,000	$ (2,551,000)	$ 87,943,000	$ 991,080,000
Infrastructure	133,171,000	2,156,000		20,255,000	155,582,000
Equipment	288,889,000	27,937,000	(18,207,000)	(44,000)	298,575,000
Library materials	166,891,000	10,653,000	(309,000)		177,235,000
Total depreciable capital assets	$1,491,878,000	$ 43,507,000	$ (21,067,000)	$ 108,154,000	$1,622,472,000
Less: accumulated depreciation					
Buildings	$ 392,509,000	$ 31,576,000	$ (1,255,000)	$ 14,000	$ 422,844,000
Infrastructure	51,502,000	8,515,000		21,000	60,038,000
Equipment	170,735,000	22,175,000	(15,429,000)	(35,000)	177,446,000
Library materials	126,140,000	8,664,000	(309,000)		134,495,000
Total accumulated depreciation	$ 740,886,000	$ 70,930,000	$ (16,993,000)		$ 794,823,000
Depreciable capital assets, net	$ 750,992,000	$ (27,423,000)	$ (4,074,000)	$ 108,154,000	$ 827,649,000
Capital assets, net	$ 880,703,000	$ 63,995,000	$ (4,336,000)		$ 940,362,000

In addition to expenditures through June 30, 2003, it is estimated that $319,963,000 will be required to complete projects under construction or planned for construction. Of that amount, $41,286,000 is contractually encumbered.

NOTE 6. DEFERRED REVENUES & DEPOSITS

Deferred revenues consist 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 revenues and deposits at June 30, 2003, consist of the following:

Current Deferred Revenues and Deposits	
Unexpended cash advances received for sponsored programs	$ 32,574,000
Auxiliary sales and services	4,816,000
IBM lease related to the acquisition of the Park (Note 2)	4,900,000
Tuition and fees	3,322,000
Other deferred revenues	1,163,000
Deposits	1,650,000
Total current deferred revenues and deposits	$ 48,425,000
Noncurrent Deferred Revenues and Deposits	
IBM lease related to the acquisition of the Park (Note 2)	$ 49,470,000

NOTE 7. ACCRUED COMPENSATED ABSENCES

The University accrues vacation leave when earned. At fiscal year end the University accrues up to the maximum 22 days allowed by University policy for which an employee can be paid upon termination of employment. 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. Accrued compensated vacation for the year ended June 30, 2003, was as follows:

Beginning balance	$ 24,874,000
Additions	30,705,000
Reductions	(30,083,000)
Ending balance	$ 25,496,000
Current portion	$ 2,055,000


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NOTE 8. LONG-TERM DEBT & LEASE OBLIGATIONS

Long-term debt activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable	$ 237,285,000	$ 30,805,000	$ (42,480,000)	$ 225,610,000	$ 10,970,000
Certificates of participation	263,670,000	40,604,000	(28,070,000)	276,204,000	4,800,000
Capitalized lease obligations	34,658,000	5,065,000	(10,554,000)	29,169,000	7,291,000
Subtotal long-term debt	$ 535,613,000	$ 76,474,000	$ (81,104,000)	$ 530,983,000	$ 23,061,000
Premium on sale of bonds	6,729,000	2,529,000	(679,000)	8,579,000	760,000
Deferred costs of refundings	(3,685,000)	(5,002,000)	512,000	(8,175,000)	(797,000)
Total long-term debt	$ 538,657,000	$ 74,001,000	$ (81,271,000)	$ 531,387,000	$ 23,024,000

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 is secured by a pledge of tuition, fees, rentals, and other charges.

On April 28, 2003, the University sold System Revenue Refunding Bonds Series 2003 (2003 Bonds) for $30,805,000 dated May 1, 2003. The 2003 Bonds include $25,110,000 of serial bonds with interest rates ranging from 3.5% to 5.0% and maturity dates ranging from 2013 to 2022. The 2003 Bonds also include $5,695,000 of term bonds with an interest rate of 4.5% due June 1, 2024. The 2003 Bonds with maturity on or after June 1, 2014, are subject to optional redemption without premium. The 2003 Bonds with maturity on June 1, 2024, are subject to mandatory sinking fund redemption without premium pursuant to the debt documents. The 2003 Bonds were sold at a premium of $1,373,000. The University realized net proceeds of $31,783,000 after payment of $395,000 for issuance costs, underwriter discounts and bond insurance. The net proceeds were used to advance-refund System Revenue Bonds Series 1993 and Series 1994 with a total outstanding principal balance of $23,265,000. The net proceeds were also used to advance-refund a portion, $6,590,000, of the System Revenue Bonds Series 2000A with an outstanding principal balance of $20,800,000. The advance refunding reduced the University's debt service by an average of $4,021,000 per year in the first 5 years. However, the total debt service on the refinancing debt is greater than the total debt service on the refunded debt by $16,792,000. Thus the net present value of the differences between the old debt and the new debt is an additional cost of $1,164,000 to the University. The refunded System Revenue Bonds will be paid by investments held in an irrevocable trust with a combined carrying value of $32,436,000. The refunded debt is considered 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, 2003, 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 $17,035,000. These amounts are not included in the University's financial statements.

The following schedule details outstanding bonds payable at June 30, 2003:

Issue		Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1992A	– System Revenue Refunding Bonds	$ 55,490,000	2016	2.9-6.2%	$ 51,710,000
1998	– System Revenue Bonds	54,270,000	2018	3.9-5.25%	43,580,000
2000A	– System Revenue Bonds	21,300,000	2024	5.0-5.75%	14,210,000
2002	– System Revenue Refunding Bonds	93,080,000	2011	3.0-5.25%	85,305,000
2003	– System Revenue Refunding Bonds	30,805,000	2024	3.5-5.0%	30,805,000
	Total	$ 254,945,000			$ 225,610,000

The following schedule details debt service requirements to maturity for System Revenue Bonds at June 30, 2003:

Year	Principal	Interest
2004	$ 10,970,000	$ 11,695,000
2005	11,395,000	11,153,000
2006	11,925,000	10,615,000
2007	16,265,000	10,063,000
2008	18,910,000	9,244,000
2009-13	85,300,000	31,291,000
2014-18	46,960,000	12,362,000
2019-23	19,380,000	4,222,000
2024	4,505,000	223,000
Total	$225,610,000	$100,868,000

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

On October 31, 2002, the University issued Certificates of Participation Series 2002B (2002B Certificates) for $29,845,000 dated November 1, 2002. The 2002B Certificates include $16,665,000 of serial certificates with interest rates ranging from 3% to 5.125% and maturity dates ranging from 2005 to 2021. The serial certificates maturing on or after June 1, 2013, are subject to optional redemption prior to maturity without premium. The 2002B Certificates also include several term certificates consisting of $3,725,000 with an interest rate of 5.125% due June 1, 2016; $4,130,000 with an interest rate of 5.125% due June 1, 2018; and $5,325,000 with an interest rate of 4.75% due June 1, 2023. The term certificates maturing on June 1, 2016, June 1, 2018, and June 1, 2023, are subject to mandatory sinking fund redemption in part one year before maturity. There are also extraordinary redemption dates pursuant to the debt documents. The 2002B Certificates were issued at a premium of $1,154,000. The University realized net proceeds of $30,444,000 after payment of $555,000 for issuance costs, underwriters discount and insurance. The net proceeds are being used to finance $16,200,000 of the $17,200,000 Meinel Optical Science Building project, and to refund in advance of maturity the Certificates of Participation Series 1994B with an outstanding principal balance of $14,130,000. The advance-refunding generated a net present value benefit of $652,000 (difference between the present values of old debt and new debt service payments) for the University. The advance-refunding reduced the University's debt service by an average of $416,000 per year in the first 3 years. The total debt service of the refinancing debt is $53,000 less than the total debt service of the refunded debt. The refunded Certificates of Participation Series 1994B will be paid by investments held in an irrevocable trust with a carrying value of $15,426,000. As a result, the refunded debt is considered to be defeased and is not included in the University's financial statements.

On May 6, 2003, the University issued Refunding Certificates of Participation Series 2003A (2003A Certificates) in the amount of $10,615,000 dated May 1, 2003. The 2003A Certificates include $6,575,000 of serial certificates with interest rates ranging from 3.5% to 5.0% and maturity dates ranging from 2013 to 2022. The 2003A Certificates include $4,040,000 of term certificates due June 1, 2018, with an interest rate of 4.0%. The certificates maturing on or after June 4, 2014, have an optional redemption prior to maturity without premium. The certificates maturing on June 1, 2018, are subject to mandatory sinking fund redemption without premium. All 2003A Certificates are subject to extraordinary redemption pursuant to the debt documents. The 2003A Certificates were issued at a premium of $2,000. The University realized net proceeds of $10,384,000 after payment of $233,000 for issuance costs, underwriters discount and insurance. The net proceeds from the sale of these certificates are being used to advance-refund the Certificates of Participation Series 1997 with an outstanding principal balance of $1,630,000 and $8,040,000 of the Certificates of Participation Series 2001B with an outstanding balance of $21,425,000. The advance-refunding reduced the University's debt service by an average of $781,000 per year in the first 10 years. However, the total debt service on the refinancing debt is greater than the total debt service on the refunded debt by $5,514,000. Thus the net present value of the difference between the old debt and the new debt service payments is an additional cost of $675,000 to the University. The refunded Certificates of Participation Series 1997 and 2001B will be paid by investments held in an irrevocable trust with a combined carrying value of $11,642,000. The refunded debt is considered to be defeased and is not included in the University's financial statements.

The University has outstanding at June 30, 2003, two Variable Rate Certificates of Participation Series 1999B and 2000A, totaling $63,500,000. 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, 2003:

Issue		Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1994A	Residence Life Certificates	$ 16,725,000	2014	4.1-5.8%	$ 12,000,000
1999A	Fixed Student Union Certificates	21,607,000	2024	5.0-5.3%	22,123,000
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%	18,245,000
2000A	McKale, UA Police Dept., & Mt. Graham	28,300,000	2025	Variable	27,000,000
2001A	Park Std. Union, Learning Svcs., Garage	31,695,000	2025	3.4-5.5%	31,340,000
2001B	Gittings Bldg., Highland Infra., Life Sci.	21,425,000	2022	3.0-5.125%	13,386,000
2002A	Student Housing, Health Bldg., UA North	76,965,000	2022	3.75-5.5%	75,150,000
2002B	Meinel Bldg. & Refund COPS 1994B	29,845,000	2023	3.0-5.125%	29,845,000
2003A	Refund COPS 1997 & Portion of Series 2001B	10,615,000	2022	3.5-5.0%	10,615,000
	Total	$ 292,312,000			$ 276,204,000

The following schedule details debt service requirements to maturity for Certificates of Participation payable at June 30, 2003, using the interest rate in effect at June 30 for variable rate issues:

Year	Principal	Interest
2004	$ 4,800,000	$ 11,153,000
2005	6,250,000	10,934,000
2006	6,620,000	10,671,000
2007	6,870,000	10,421,000
2008	6,905,000	10,154,000
2009-13	52,120,000	46,233,000
2014-18	80,518,000	32,802,000
2019-23	94,956,000	12,962,000
2024-25	17,165,000	695,000
Total	$276,204,000	$146,025,000

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 the Facility Management modular buildings and equipment acquisition. This capital lease was entered into with G.E. Capital Public Finance Inc. for $3,200,000, with an interest rate of 3.45%, and a final payment date of July 15, 2007. The proceeds were placed in trust to finance the project until completion.

Following is a summary of capital assets financed by certificates of participation and capital leases at June 30, 2003:

Cost of assets	$ 315,791,000
Less: accumulated depreciation	(38,430,000)
Carrying value	$ 277,361,000

The following schedule details debt service requirements to maturity for capital leases payable at June 30, 2003:

Year	Debt Service Payments
2004	$ 8,296,000
2005	6,183,000
2006	5,138,000
2007	3,664,000
2008	2,401,000
2009-13	7,715,000
Total minimum lease payments	33,397,000
Less: interest	(4,228,000)
Present value of minimum lease payments	$ 29,169,000

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 2003, rent expenses totaled $18,619,000.

The following schedule details future operating lease payments to maturity:

Year	Operating Lease Payments
2004	$ 2,591,000
2005	1,068,000
2006	724,000
2007	285,000
Total	$ 4,668,000

NOTE 9. 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, 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.

NOTE 10. 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 Arizona Revised Statutes (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, 2003, 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, 2003, 2002, and 2001, was $5,010,000, $4,866,000, and $5,084,000, 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, 2003, 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

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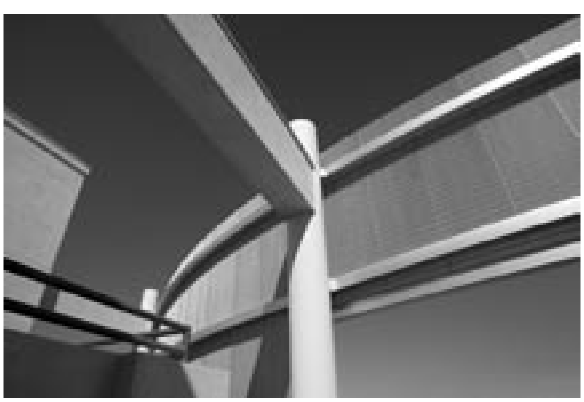
and Annuity Company (AETNA), and The Vanguard Group (Vanguard) were approved by the Arizona Board of Regents. In addition, employees hired before July 1, 1972, have the option to participate in the defined contribution plan administered by the ASRS. Benefits under these plans depend solely on the contributed 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, 2003, 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, 2003, were as follows:

Plan	University Contributions	Member Contributions	Total Contributions
TIAA/CREF	$ 11,577,000	$ 11,577,000	$23,154,000
VALIC	731,000	731,000	1,462,000
Fidelity	2,418,000	2,418,000	4,836,000
AETNA	498,000	498,000	996,000
Vanguard	644,000	644,000	1,288,000
ASRS	132,000	131,000	263,000



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NOTE 11. OPERATING EXPENSES BY NATURAL CLASSIFICATION

Operating expenses by natural classification for the year ended June 30, 2003, consist of the following:

Category	
Salaries and wages	$ 550,979,000
Benefits	111,482,000
Supplies and materials	102,339,000
Services, including travel	134,705,000
Utilities	24,765,000
Scholarships and fellowships	34,730,000
Depreciation	70,929,000
Total operating expenses	$ 1,029,929,000

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