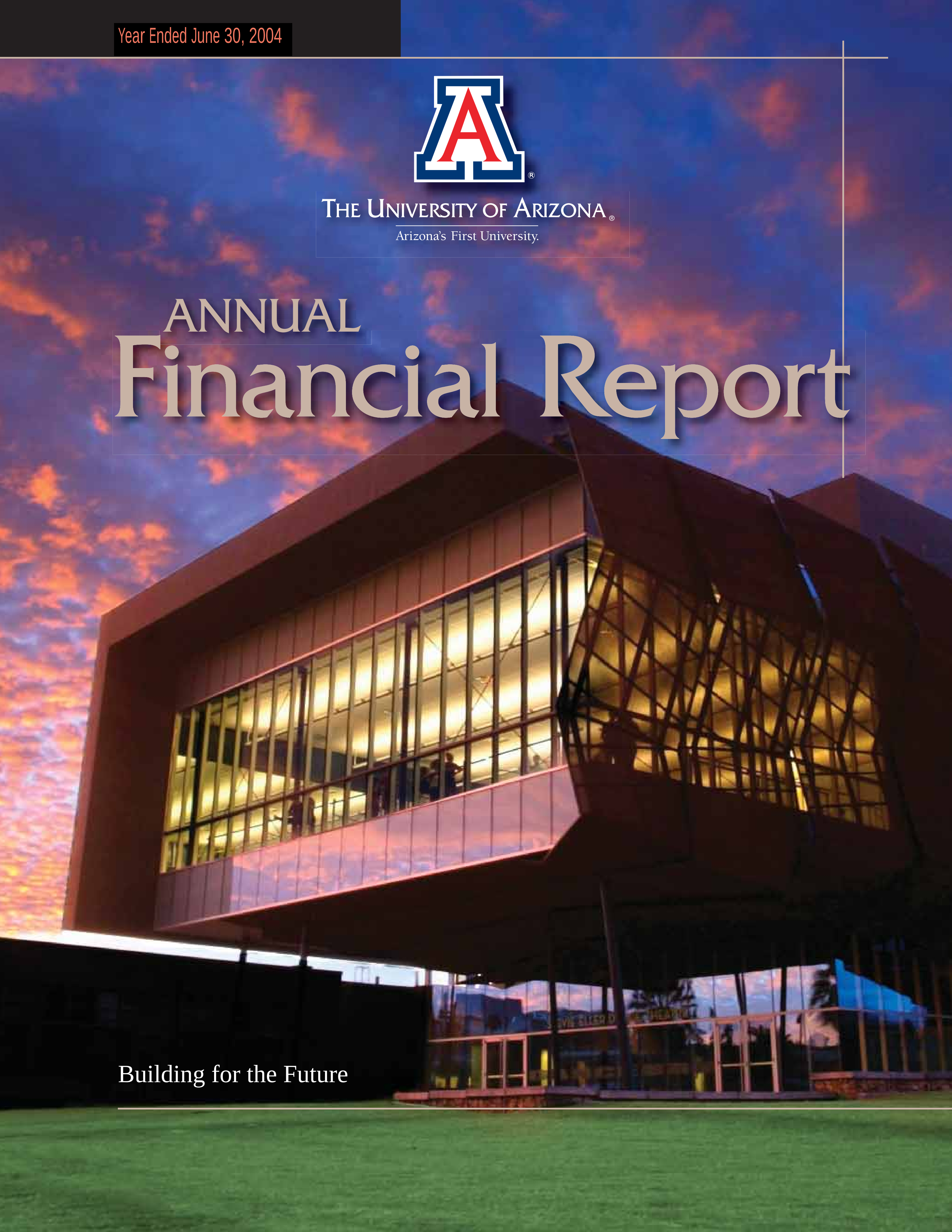
Year Ended June 30, 2004

THE UNIVERSITY OF ARIZONA®
Arizona's First University.

ANNUAL Financial Report



Building for the Future

Building for the Future

Cover Photography and this page are courtesy of David A. Harvey Photography

“Building for the Future” describes the vibrant activity on the University of Arizona campus. The University has embarked on a vigorous capital building program to enhance its mission of excellence in education, research and public service. The many construction projects which are in progress and several recently completed projects add necessary facilities to fulfill this objective.

This photo and the cover photo portray the modernistic architecture of the Stevie Eller Dance Theatre reflecting a spectacular sunset. See page 42 for additional information on exciting new projects currently under construction on the University of Arizona campus.

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A Message *from the* President

Fiscal year 2004 provided both gratifying success and challenges as the University of Arizona worked its way through the transition from a state-financed institution to the new model of public higher education, financed by diverse revenue streams including gifts, tuition, and research contracts and grants as essential elements, in addition to state funds. Fortunately, the successes dominate the financial picture, which grows increasingly strong.

Funding from the State for FY 04 was the same as FY 03, with none of the reductions and rescissions suffered in FY 02 and FY 03.

Tuition rates continued to increase, with tuition revenues net of financial aid rising more slowly due to our serious commitment to preserving affordability for needy families.

The stunning successes of the faculty in winning highly competitive grants and contracts for research created strong positive growth for total University revenues, reinforced by the continuing successes of Campaign Arizona, which crossed the billion dollar threshold in the fall of 2003.

On balance, the University of Arizona is a very prosperous institution, with surging total revenues and a vigorous building program currently emphasizing research laboratories. The prospect of expanding operations of the College of Medicine in Phoenix has been assured, offering extraordinary opportunities for future growth. Although challenges remain, the future continues to be 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 were a period of substantial growth for the University. In the late 1950s, enrollment greatly increased, with the University gaining an average of more than 1,200 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 over 37,000 students through 16 colleges offering 327 degree programs, and is ranked among the leading research universities in the country.

Enrollment Statistics
Academic Year 2003 – 2004

Undergraduate enrollment – Fall 2003	28,482
Graduate enrollment – Fall 2003	8,601
Degrees awarded – Bachelor's	5,352
Degrees awarded – Advanced	2,034
Undergraduate tuition and fees for full-time student – Resident	$3,603
Undergraduate tuition and fees for full-time student – Non-resident	$12,373

The University's 2,223 full time equivalent faculty and 1,328 full time equivalent graduate teaching and research assistants and associates educate a diverse student population. The student population is 53% female, 13.3% Hispanic, 5.3% Asian or Pacific Islander, 2.7% Black, and 1.9% Native American. It includes students from all fifty states, and 135 foreign countries. International students totaled 7.8% of the Fall 2003 enrollment, with the largest numbers of foreign students hailing from India, the People's Republic of China, Korea, Mexico and Japan.

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 educational 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. 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 Service has faculty and staff in all of Arizona's counties, on Indian Reservations, and in over 30 communities and research centers.
- The University of 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 Healthcare), 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. A major step forward this year was the Memorandum of Understanding among University of Arizona, Arizona State University and the Board of Regents on planning for a teaching college and hospital in Phoenix.

- 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 has 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, 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.
- The University's great strengths in Geosciences, Hydrology and Arid Lands Studies are sure to be especially relevant and increasingly important to the State of Arizona since it seems to be in the early stages of what could be a 20-25 year drought.

Opportunities and Challenges

The University has been meeting the needs of the people of the State through numerous 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 2004, the Office of Technology Transfer (OTT) again generated in excess of one million dollars in licensing income. Since 1999, the efforts of the OTT team has increased licensing revenues by an average 27% per year for the six-year period. The University received 95 Invention Disclosures and executed a total of 39 Major Agreements. Fourteen U.S. Patents were issued and 41 full U.S. Patent Applications including divisional, continuation and PCT applications were filed. An additional 50 U.S. Provisional Patent Applications were filed to provide a one-year evaluation period for various technologies.

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 sources for government services, including public education, are State sales and income taxes. Consequently, as the State economy improves (or the State alters the tax base that supports government services), appropriated funds may increase slowly or moderately. Since resident tuition continues to be among the lowest of the public universities in the nation, there are opportunities 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, in only the seventh year of an eight-year campaign, have met their goal and raised over one billion dollars in pledges and contributions. The campaign is continuing.

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
AHSC Biomedical Communications

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 business-type activities and aggregate discretely presented component units of the University of Arizona as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts for the aggregate discretely presented component units is based solely on the reports of the other auditors.

We conducted our audit in accordance with U.S. generally accepted auditing standards. 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 and the reports of the other auditors provide a reasonable basis for our opinions.

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, where applicable, of only those portions of the business-type activities, major fund, and aggregate discretely presented component units of the State of Arizona that are attributable to the University. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of June 30, 2004, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and aggregate discretely presented component units of the University of Arizona as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 1, the University implemented the provisions of the Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, for the year ended June 30, 2004, which requires reporting as component units those organizations that raise and hold economic resources for the direct benefit of the University or its constituents.

The accompanying financial statements have been prepared assuming that the Southern Arizona Capital Facilities Finance Corporation (SACFFC), a discretely presented component unit, will continue as a going concern. As discussed in Note 14, SACFFC has suffered ongoing losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern. SACFFC management's plans with respect to these matters are also described in Note 14. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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

Debbie Davenport
Auditor General

November 5, 2004

2910 NORTH 44TH STREET • SUITE 410 • PHOENIX, ARIZONA 85018 • (602) 553-0333 • FAX (602) 553-0051

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, 2004. University information for the year ended June 30, 2003, is also provided for comparative purposes. A significant change in the presentation of the University's financial statements is incorporated as the University implemented during fiscal year 2004 the reporting requirements of Governmental Accounting Standards Board (GASB) Statement 39 – *Determining Whether Certain Organizations Are Component Units.* Generally, it requires reporting, as a component unit, an organization that raises and holds economic resources for the direct benefit of the University.

This discussion was prepared by management and is focused on the University. It should be read in conjunction with the financial statements and accompanying notes, which follow this section.

Using the Financial Statements

The University's financial statements include 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 reflects the inflows and outflows of cash and cash equivalents during the year. It shows the various cash activities by type, reconciling the beginning cash and cash equivalents amount to the ending cash and cash equivalents amount, which is shown on the Statement of Net Assets described above. In addition, this statement reconciles cash flows from operating activities to operating income/(loss) on the Statement of Revenues, Expenses and Changes in Net Assets described above.

Margaret Hartshorn, AHSC Biomedical Communications

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, 2004, and at June 30, 2003, is as follows:

	2004	2003	% Change
Current assets	$ 204,941	$ 201,975	1%
Noncurrent assets other than capital assets	509,502	326,632	56%
Capital assets	1,013,699	940,362	8%
Total assets	**$ 1,728,142**	**$ 1,468,969**	**18%**
Current liabilities	$ 155,912	$ 157,501	-1%
Noncurrent liabilities other than debt	99,439	97,538	2%
Long-term debt	752,430	508,363	48%
Total liabilities	**$ 1,007,781**	**$ 763,402**	**32%**
Net assets			
Invested in capital assets, net of related debt	$ 422,032	$ 397,160	6%
Restricted - nonexpendable	94,676	86,176	10%
Restricted - expendable	96,758	100,888	-4%
Unrestricted	106,895	121,343	-12%
Total net assets	**$ 720,361**	**$ 705,567**	**2%**

The University's financial position continued to improve in fiscal year 2004. Net assets increased by $14.8 million primarily due to additional investments in capital assets, increased federal grants and contracts activity and increased restricted gift donations.

Current Assets and Current Liabilities

Current assets consist primarily of cash and cash equivalents, securities lending 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 1.3:1 current ratio (current assets to current liabilities) reflects adequate liquidity and sufficient short-term ability to meet upcoming obligations.

During fiscal year 2004, the University moved aggressively to convert cash and cash equivalents into short-term investments to improve investment returns while continuing previous investment strategies to maximize investment income by converting assets from short-term investments to long-term investments to generate higher rates of return.

Noncurrent Assets Other Than Capital Assets and Long-term Debt

Noncurrent assets other than capital assets consist primarily of restricted investments with bond trustees, long-term investments, investments held for others and endowment investments. The increase in noncurrent assets other than capital assets and long-term debt is primarily due to an increase in restricted investments with bond trustees, as a result of three debt financings that closed during this fiscal year. Proceeds from these financings are being used to fund the construction of additional classroom and research space and infrastructure projects.

David A. Harvey Photography

Student Union Memorial Center

The new Student Union Memorial Center is among the largest Student Unions in the country at 405,000 square feet. Students, faculty, and staff can interact in the numerous state-of-the-art venues, including retail opportunities, bookstore, specialty restaurants, lounges, meeting rooms, games center, a post office, copy center, grand ballroom, computer lab, and much more.

An outdoor walkway known as "The Canyon" is located between the east and west sides of the new building. The east wall of the canyon is curved to replicate the silhouette of the U.S.S. Arizona. Curving balconies overlooking the canyon are an abstract of access walkways on the battleship. 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 and the bell tower represents a mast and sail. One of the original bells salvaged from the Arizona hangs visible for all to see.

Net Assets

The positive increase in restricted nonexpendable net assets is largely attributable to an increase in the agriculture endowment generated by the sale of land and options. Investment in capital assets increased as construction projects were completed and new equipment was purchased to support the University's mission. Unrestricted net assets declined primarily due to land acquisitions, the purchase of the Intercollegiate Athletics Skyboxes from the University of Arizona Foundation, construction spending and debt service payments.

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.

David A. Harvey Photography

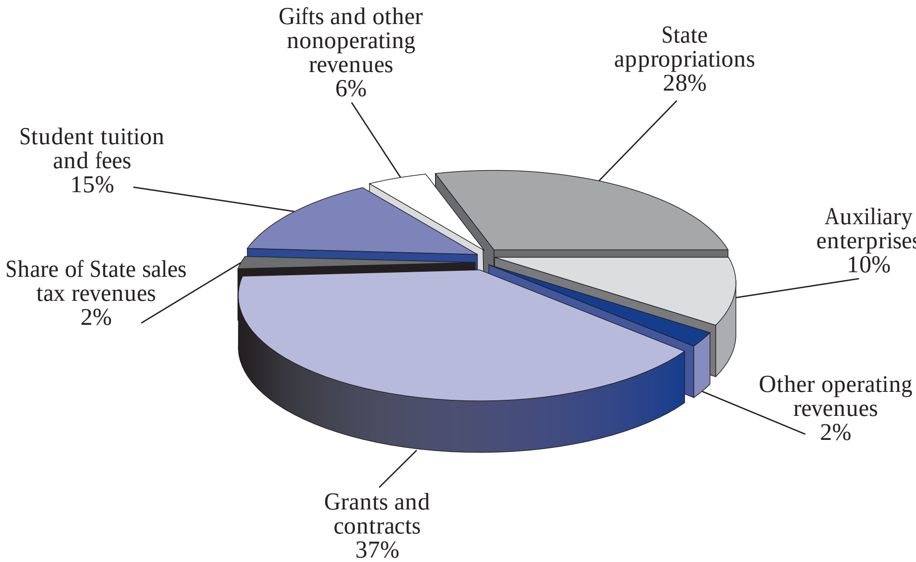
Statement of Revenues, Expenses and Changes in Net Assets

A summarized comparison of the University's operations (in thousands of dollars) for the year ended June 30, 2004, and for the year ended June 30, 2003, is as follows:

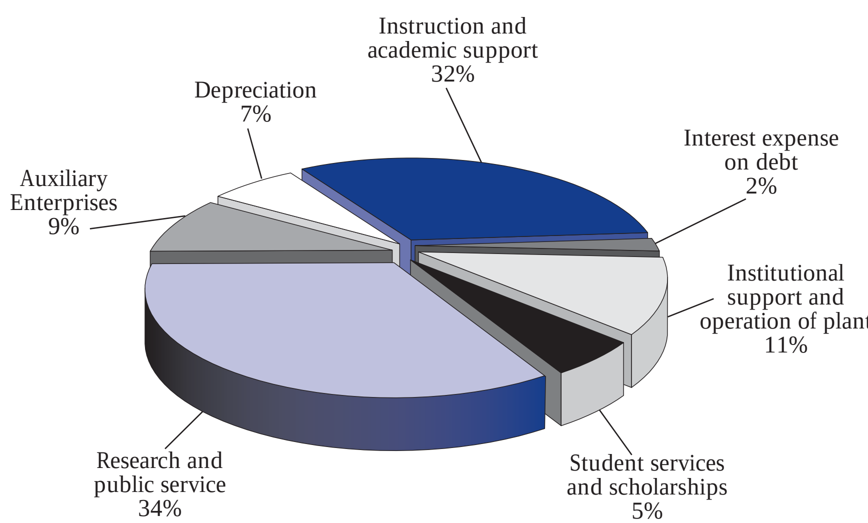
	2004	2003	% Change
Operating revenues			
Student tuition and fees	$ 172,529	$ 149,533	15%
Grants and contracts	419,407	390,167	7%
Auxiliary enterprises	112,087	107,046	5%
Other operating revenues	25,847	23,517	10%
Total operating revenues	**$ 729,870**	**$ 670,263**	**9%**
Operating expenses			
Instruction and academic support	$ 365,647	$ 347,196	5%
Research and public service	381,473	350,025	9%
Student services and scholarships	59,876	53,929	11%
Institutional support and operation of plant	124,836	112,578	11%
Auxiliary enterprises	103,894	95,272	9%
Depreciation	74,205	70,929	5%
Total operating expenses	**1,109,931**	**1,029,929**	**8%**
Operating loss	**$ (380,061)**	**$ (359,666)**	**6%**
Nonoperating revenues (expenses)			
State appropriations	$ 317,250	$ 323,885	-2%
Share of State sales tax revenues	18,924	16,479	15%
Gifts	41,717	40,572	3%
Investment income	20,711	10,868	91%
Interest expense on debt	(23,984)	(19,065)	26%
Other nonoperating revenues, net	7,119	4,792	49%
Net nonoperating revenues	**$ 381,737**	**$ 377,531**	**1%**
Income before capital and endowment additions	**$ 1,676**	**$ 17,865**	**-91%**
Capital and endowment additions	13,118	15,772	-17%
Increase in net assets	**$ 14,794**	**$ 33,637**	**-56%**
Net assets, beginning of year	705,567	671,930	5%
Net assets, end of year	**$ 720,361**	**$ 705,567**	**2%**

The following graphs illustrate operating and nonoperating revenues and expenses for the year ended June 30, 2004.

Operating & Nonoperating Revenues



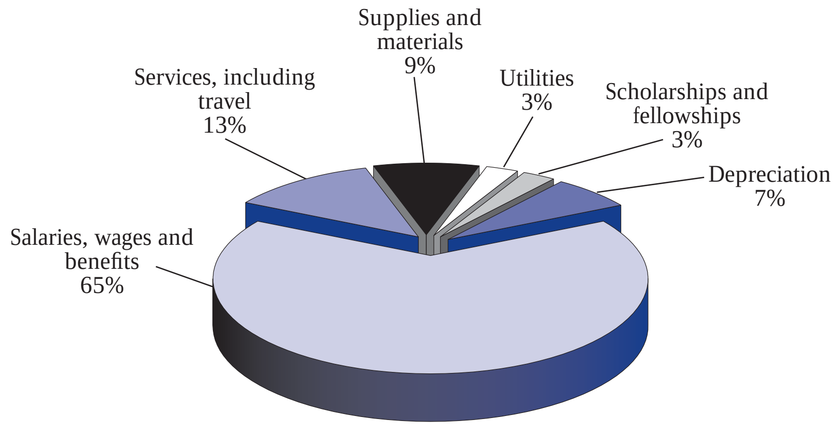
Operating & Nonoperating Expenses



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, 2004, and 2003 follows:

Natural Classification of Operating Expenses:	2004	2003
Salaries, wages and benefits	$ 714,854	$ 662,461
Supplies and materials	102,931	102,339
Services, including travel	145,176	134,705
Utilities	35,079	24,765
Scholarships and fellowships	37,686	34,730
Depreciation	74,205	70,929
Total Operating Expenses	**$1,109,931**	**$ 1,029,929**

Natural Classification of Operating Expenses for the year ended June 30, 2004



Operating revenues and expenses

In fiscal year 2004, the University's operating revenues increased by $59.6 million, or 9%, over fiscal year 2003. Of the $59.6 million increase, 49% was attributable to increases in grants and contracts revenues, 39% was attributable to increases in student tuition and fees and 12% was attributable to increased auxiliary enterprise activities and other operating revenues.

Grants and contracts revenues: Grants and contracts revenues increased 7% in fiscal year 2004. This increase is directly related to increased federal grants and contracts activity. Specifically, continuing grants such as the NASA Goddard near infrared camera (NIRCAM) grant as well as other federal sponsors had increased activity 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.

Student tuition and fees: Tuition and fees rose by nearly $23 million due to increases in enrollment of 734 students (primarily resident undergraduates) and increases in tuition rates. In-state resident undergraduate tuition and fees increased by $1,010, or 39.0%, to $3,603, while out-of-state undergraduate tuition and fees increased by $1,260, or 11.3%, to $12,373.

Operating expenses: Operating expenses increased 8% in fiscal year 2004, primarily due to a significant increase in federally sponsored research activity, which produced a 9% increase in research and public service expenses.

Nonoperating revenues and expenses

State appropriations: The $6.6 million decline in State appropriations is primarily ($4.4 million) related to the reduction in Proposition 204 – Tobacco Settlement funding during fiscal year 2004.

Investment income: The returns generated during fiscal year 2004 increased by $9.8 million over fiscal year 2003. This increase is due primarily to the improved performance of endowments during fiscal year 2004. Endowments are invested in a combination of internally and externally managed equities, fixed income securities and indexed mutual funds. Participating in the rebound in the equity markets, the Growth and Income Pool experienced an excellent return of 15.8% before administrative costs and payouts in fiscal year 2004. Equities in the pool were up over 23.3% during the fiscal year, while bond returns were slightly negative. This performance is the highest since fiscal year 1998 and a marked improvement over the 2.4% return for fiscal year 2003.

	2004	2003
Pooled operating funds	$ 2,324,000	$ 4,437,000
Deposits with trustees for capital projects	1,450,000	1,161,000
Endowments	16,937,000	5,270,000
Total investment income	$ 20,711,000	$ 10,868,000

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 has experienced a 32.1% increase in freshman admissions. As a result, the demand for classroom facilities, resident dormitories, and support operations 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 Herring Hall Renovation, Highland Housing Residence Hall, Apache/Santa Cruz Residence Hall Renovations, Sixth Street Parking Garage and Office Building, Highland Commons-Campus Health Services and Disability Resource Center, UA North Master Plan Phase I, Facilities Management AHSC Three Shops Building, Facilities Management Motor Pool Garage, Park Student Union Renovation and Expansion, Shell Space Completion, and McKale Renovation and Expansion. These facilities were completed at a total cost of approximately $75.3 million.

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% as defined by Arizona Revised Statutes §15-1683. The University's legislative debt ratio at the end of fiscal year 2004 was 3.70%.

During fiscal year 2004, the University issued Certificates of Participation Series 2003B, 2004A, 2004B and System Revenue Bonds Series 2004A. The total net proceeds from all these issues was over $250 million and will be used to finance the Biomedical Sciences and Biotechnology Building, the Medical Research Building, the Technology Infrastructure Project, the Chemistry Building Expansion, the Highland Avenue Parking Garage, the Residence Life Building Renewal Phase I Project, and the Drachman Hall Project. These projects will provide over 500,000 square feet of additional classroom and research space, 1,500 additional parking slots to service the northeast campus district, and various infrastructure improvements and upgrades. Detailed debt service information is available in Note 8 of the accompanying notes to the financial statements.

Economic Outlook

As the nation and State of Arizona continue to recover from the economic downturn, the University of Arizona continues to evaluate changes necessary to serve as a center for advanced graduate and professional studies while emphasizing research and providing excellence in undergraduate programs. 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 $21.9 million dollars of new debt in November 2004 to fund the purchase of a student housing facility (see Note 13 in the accompanying notes to the financial statements). Ongoing planned projects include the Chemistry Building expansion, Medical Research Building (MRB), Thomas W. Keating BioResearch Building (KBB) 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 needed long-term financing. The University has moved forward to create buildings that form the core of this new research infrastructure by starting the construction of the MRB and KBB facilities.

With current trends in State appropriations continuing to decline, the University requested and received approval from the Arizona Board of Regents to increase tuition. Due to increased financial need to attract and retain talented faculty and staff, it is the intention of management to continue these requests until the University reaches the top of the bottom one third of the top fifty public institutions in tuition costs.

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.

Favorite Places
Interior view of the new food court in the Student Union Memorial Center.

David A. Harvey Photography

Statement of Net Assets

June 30, 2004 (in thousands of dollars)

Assets

Current assets		
Cash and cash equivalents (Note 3)	$	47,398
Securities lending cash collateral (Note 3)		17,963
Short-term investments (Note 3)		71,407
Receivables:		
Accounts receivable (net of allowances of $285)		14,357
Government grants receivable		43,314
Student loans (net of allowances of $197)		1,862
Inventories		7,506
Deferred expenses		1,134
Total current assets		204,941
Noncurrent assets		
Restricted cash and cash equivalents (Note 3)		17,996
Restricted investments with bond trustees (Note 3)		229,841
Long-term investments (Note 3)		60,976
Investments held for others (Note 3)		24,008
Endowment investments (Note 3)		154,313
Student loans receivable (net of allowances of $1,837)		12,969
Deferred expenses		9,399
Capital assets, not being depreciated (Note 5)		117,909
Capital assets, being depreciated, net (Note 5)		895,790
Total noncurrent assets		1,523,201
Total Assets	**$**	**1,728,142**

Liabilities

Current liabilities		
Accounts payable	$	33,067
Accrued payroll and benefits		22,236
Accrued compensated absences (Note 7)		2,455
Obligations under securities lending (Note 3)		17,963
Deferred revenue and deposits (Note 6)		48,136
Funds held for others		7,422
Current portion of long-term debt (Note 8)		24,633
Total current liabilities		155,912
Noncurrent liabilities		
Deferred revenue and deposits (Note 6)		44,570
Accrued compensated absences (Note 7)		25,185
Funds held for others		29,684
Long-term debt (Note 8)		752,430
Total noncurrent liabilities		851,869
Total Liabilities	**$**	**1,007,781**

Net Assets

Invested in capital assets, net of related debt	$	422,032
Restricted for nonexpendable:		
Endowments		76,652
Student loans		18,024
Restricted for expendable:		
Scholarships and fellowships		28,119
Academic/departmental uses		62,995
Capital projects		2,777
Debt service		2,867
Unrestricted		106,895
Total Net Assets	**$**	**720,361**

See Notes to Financial Statements

Statement of Financial Position - Component Units

June 30, 2004 (in thousands of dollars)

Assets

Cash and cash equivalents	$	23,886
Pledges receivable		60,973
Other receivables		5,806
Investments in marketable securities		269,404
Other investments		4,289
Property and equipment, net		29,576
Other assets		23,396
Total Assets	**$**	**417,330**

Liabilities and Net Assets

Liabilities

Accounts payable and accrued expenses	$	3,431
Annuities payable and other trust liabilities		18,630
Deferred revenue and deposits		5,017
Short-term and long-term debt		30,669
Other liabilities		833
Total Liabilities	**$**	**58,580**

Net Assets

Unrestricted	$	19,264
Temporarily restricted		137,253
Permanently restricted		202,233
Total Net Assets		**358,750**
Total Liabilities and Net Assets	**$**	**417,330**

See Notes to Financial Statements

AHSC Biomedical Communications

Statement of Revenues, Expenses and Changes in Net Assets

Year Ended June 30, 2004 (in thousands of dollars)

Operating Revenues

Student tuition and fees, net of scholarship allowances of $54,555, pledged as security for long-term debt	$ 172,529
Federal grants and contracts	346,282
State grants and contracts	11,919
Local grants and contracts	2,383
Nongovernment grants and contracts	58,823
Sales and services of educational departments, pledged as security for long-term debt	19,311
Auxiliary enterprises, net of scholarship allowances of $2,301, pledged as security for long-term debt	112,087
Other operating revenues, pledged as security for long-term debt	6,536
Total operating revenues	**$ 729,870**

Operating Expenses

Educational and general	
Instruction	$ 298,792
Research	326,369
Public service	55,104
Academic support	66,855
Student services	23,724
Institutional support	65,786
Operation and maintenance of plant	59,050
Scholarships and fellowships	36,152
Auxiliary enterprises	103,894
Depreciation (Note 5)	74,205
Total operating expenses	**$ 1,109,931**
Operating Loss	**$ (380,061)**

Nonoperating Revenues (Expenses)

State appropriations	$317,250
Share of State sales tax revenues	18,924
Gifts	41,717
Investment income	20,711
Interest expense on debt	(23,984)
Other nonoperating revenues, net	7,119
Net nonoperating revenues	**$ 381,737**
Income before Capital and Endowment Additions	**$ 1,676**
Capital grants, gifts and conveyances	$ 11,469
Additions to permanent endowments	1,649
Total capital and endowment additions	**$ 13,118**
Increase in Net Assets	**$ 14,794**

Net Assets

Net Assets - Beginning of year	705,567
Net Assets - End of year	**$720,361**

See Notes to Financial Statements

Statement of Activities - Component Units

Year Ended June 30, 2004 (in thousands of dollars)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues				
Sales and services	$ 512			$ 512
Contributions	1,564	$ 31,316	$ 13,684	46,564
Rental revenues	8,939			8,939
Investment income	1,418	4,887	19,846	26,151
Net assets released from restriction	41,313	(33,390)	(7,923)	
Other income	8,070	4,398	23	12,491
Total revenues	**$ 61,816**	**$ 7,211**	**$ 25,630**	**$ 94,657**
Expenses				
Program services:				
Leasing related expenses	$ 5,876			$ 5,876
Payments to the University	22,186			22,186
Payments on behalf of the University	21,635		21,635	
Supporting services:				
Management and general	5,950			5,950
Fund raising	2,768			2,768
Other expenses	2,269			2,269
Total expenses	**$ 60,684**			**$ 60,684**
Increase in Net Assets	**$ 1,132**	**$ 7,211**	**$ 25,630**	**$ 33,973**
Net Assets - Beginning of year	17,683	130,887	176,207	324,777
Transfers	449	(845)	396	
Net Assets - End of year	**$ 19,264**	**$ 137,253**	**$ 202,233**	**$ 358,750**

See Notes to Financial Statements

Statement of Cash Flows

Year Ended June 30, 2004 (in thousands of dollars)

Cash Flows from Operating Activities

Tuition and fees	$	172,815
Grants and contracts		416,185
Payments for salaries, wages and benefits		(705,957)
Payments to suppliers		(285,523)
Payments for scholarships and fellowships		(37,686)
Loans issued to students		(6,497)
Collections on loans to students		5,748
Auxiliary enterprise receipts		113,380
Sales and services of educational departments		18,603
Other receipts		6,529
Net cash used for operating activities	**$**	**(302,403)**

Cash Flows from Noncapital Financing Activities

State appropriations	$	317,505
Share of State sales tax receipts		18,694
Gifts and grants for other than capital purposes		43,131
Other nonoperating receipts		1,977
Federal Family Education Loans received		107,121
Federal Family Education Loans disbursed		(107,380)
Funds held for others received		59,778
Funds held for others disbursed		(52,042)
Net cash provided by noncapital financing activities	**$**	**388,784**

Cash Flows from Capital Financing Activities

Proceeds from issuance of capital debt, including premiums	$	253,754
Capital grants and gifts received		7,368
Proceeds from sale of capital assets		8,207
Purchase of capital assets		(132,891)
Principal paid on capital debt and leases		(24,121)
Interest paid on capital debt and leases		(22,361)
Net cash provided by capital financing activities	**$**	**89,956**

Cash Flows from Investing Activities

Proceeds from sales and maturities of investments	$	519,680
Interest and dividends on investments		7,306
Purchase of investments		(778,614)
Net cash used for investing activities	**$**	**(251,628)**
Net Decrease In Cash and Cash Equivalents	**$**	**(75,291)**

Cash and Cash Equivalents

Cash and Cash Equivalents - Beginning of year	$	140,685
Cash and Cash Equivalents - End of year	**$**	**65,394**

See Notes to Financial Statements

Statement of Cash Flows (concluded)

Year Ended June 30, 2004 (in thousands of dollars)

Reconciliation of Operating Loss to Net Cash Used for Operating Activities

Operating loss	$ (380,061)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation expense	74,205
Changes in assets and liabilities:	
Increase in:	
Receivables, net	(2,625)
Inventories	(67)
Deferred expenses	(130)
Accrued payroll and benefits and compensated absences	8,897
Deferred revenue and deposits	315
Decrease in:	
Accounts payable	(2,937)
Net Cash Used For Operating Activities	**$ (302,403)**

Significant Noncash Transactions

Gifts and conveyances of capital assets	$ 3,344
Assets acquired through capital leases	13,830
Change in fair value of investments	7,417
Refunding of long-term debt (Note 8)	11,185
Amortization of bond discount and issuance costs	(1,292)
Amortization of bond premium	850
Net loss on disposal of capital assets with an original cost of $21,714, accumulated depreciation of $12,800 and cash proceeds of $8,207	(707)
Amortization of IBM deferred rent	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. In addition, the financial statements include the financial position and activities of the University's discretely presented component units as described in Notes 2 and 14. 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 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 University has chosen the option not to follow FASB statements and interpretations issued after November 30, 1989.

During the year ended June 30, 2004, the University implemented the provisions of the GASB Statement No. 39 — *Determining Whether Certain Organizations Are Component Units*, which requires reporting as a component unit those organizations that raise and hold economic resources for the direct benefit of the University.

The component units are legally separate private nonprofit organizations that report under FASB standards. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the component units' financial information included in the University's financial report. Accordingly, those financial statements have been reported on separate pages following the respective counterpart financial statements of the University.

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.

- 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. Operating revenues and expenses generally result from providing instructional, research, public, and auxiliary services, which are consistent with the University's mission. Accordingly, 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. Operating expenses include the cost of sales and services, administrative expenses, and depreciation of capital assets. Other expenses, such as interest expense on debt, are considered to be nonoperating expenses.

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

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

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 2004, the expendable rate was established at 4% of the three year average market value ending December 31, 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 resale supplies. They are stated at the lower of cost (determined by the first-in, first-out or the weighted average 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)
Infrastructure	100,000	20 - 100
Buildings and improvements	100,000	20 - 50
Equipment	5,000	3 - 25
Library materials	1	10
Land	1	n/a
Construction in progress	5,000	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. COMPONENT UNITS

The financial statements of the University include the operations of the University of Arizona Foundation, Inc., Southern Arizona Capital Facilities Finance Corporation, Campus Research Corporation, Alumni Association and the Law College Association, all discretely presented component units. For financial reporting purposes, only the statement of financial position and statement of activities are included in the University's financial statements as required by U.S. generally accepted accounting principles for public colleges and universities. Discretely presented component units are reported on separate pages following the University's respective counterpart financial statements because those component unit financial statements are prepared in accordance with non-governmental U.S. generally accepted accounting principles (i.e., FASB). Each discretely presented component unit discussed below has a June 30 year-end with the exception of the Law College Association which has a May 31 year-end.

Component units can be defined as legally separate entities for which the University is considered to be financially accountable. GASB Statement No. 14 — *The Financial Reporting Entity* has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the University to impose its will on that organization; or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the University. GASB Statement No. 39 — *Determining Whether Certain Organizations Are Component Units* provides additional criteria for determining whether certain organizations are component units. Organizations that are legally separate, tax-exempt entities and that meet all of the following criteria should also be considered component units, with discrete presentation. These criteria are (1) the economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the University, its component units, or its constituents; (2) the University or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization; and (3) the economic resources received or held by an individual organization that the University, or its component units, is entitled to, or has the ability to otherwise access, are significant to the University.

Discretely Presented Component Units

The University of Arizona Foundation (Foundation) is a legally separate, nonprofit, tax-exempt organization 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. Although the University does not control the timing or amount of receipts from the Foundation, the Foundation's restricted resources are significant to the University and can only be used by, or for the benefit of, the University or its constituents. As the University is also entitled to these resources, the Foundation is considered a component unit of the University and is discretely presented in the University's financial statements. The Foundation's financial statements are not publicly available. For information regarding the Foundation's financial statements, contact the University of Arizona Comptroller at the following address: University of Arizona, Financial Services, P.O. Box 3310, Tucson, Arizona 85722-3310.

Southern Arizona Capital Facilities Finance Corporation (SACFFC) is a legally separate, tax-exempt, 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. As the economic resources held by SACFFC are significant to the University and are entirely or almost entirely for the direct benefit of the University, and as the University is entitled to a majority of the economic resources received or held by SACFFC, it is considered a component unit of the University and is discretely presented in the University's financial statements. Complete copies of the financial statements of the aforementioned component unit can be obtained by contacting the University of Arizona Comptroller at the following address: University of Arizona, Financial Services, P.O. Box 3310, Tucson, Arizona 85722-3310.

The University of Arizona Alumni Association (Alumni Association) is a legally separate, tax-exempt, nonprofit corporation governed by a separate Board of Directors and was established to serve the University and its graduates, former students, and friends by attracting, organizing and encouraging them to advance the University's missions – teaching, research, and public service. There is an Administrative Service Agreement between the Alumni Association and the University whereby the University provides staff, facilities and services to the Alumni Association and the Alumni Association agrees to provide an organizational framework for volunteer service and other activities to benefit and promote the University. As the economic resources held by the Alumni Association are significant to the University and are entirely or almost entirely for the direct benefit of the University, and as the University is entitled to a majority of the economic resources received or held by the Alumni Association, it is considered a component unit of the University and is discretely presented in the University's financial statements. Complete copies of the financial statements of the aforementioned component unit can be obtained by contacting the Alumni Association at the following address: Alumni Association, University of Arizona, P.O. Box 210109, Tucson, Arizona 85721-0109.

The Law College Association of the University of Arizona (Law Association) is a legally separate, tax-exempt, nonprofit corporation governed by a separate Board of Directors and was established to provide support and financial assistance to the College of Law at the University of Arizona. The Law Association funds provide support to the College on many levels, from endowed student scholarships to named faculty professorships. The funds also provide support for various academic programs. As the economic resources held by the Law Association are significant to the University and are entirely or almost entirely for the direct benefit of the University, and as the University is entitled to a majority of the economic resources received or held by the Law Association, it is considered a component unit of the University and is discretely presented in the University's financial statements. Complete copies of the financial statements of the aforementioned component unit can be obtained by contacting the Law Association at the following address: Law College Association, University of Arizona, P.O. Box 210176, Tucson, Arizona 85721-0176.

Campus Research Corporation (CRC) is a legally separate, tax-exempt, nonprofit corporation. The University nominates and appoints five of the nine-member CRC Board of Directors. CRC was established to assist the University in the acquisition, improvement, and operation of the UA Science and Technology Park (Park) and related properties. CRC currently leases from the University the remaining 32% of building space of the Park not leased to the Arizona Research Park Authority. 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 2004, $100,000 was distributed to the University. As the University appoints a majority of the CRC Board of Directors, and as the University approves CRC's budget, the University can thus impose its will on CRC, making CRC a component unit. As CRC provides services to all tenants of the park, not just the University, by acting as the property management company, CRC is presented as a discrete component unit in the University's financial statements. In prior years, CRC met the requirements of GASB Statement No. 14; however, due to its immateriality to the University, it was not incorporated into the University's financial statements as a component unit until fiscal year 2004. In prior years, summarized CRC financial information was presented in the University's footnote disclosures only. Complete copies of the financial statements of the aforementioned component unit can be obtained by contacting the Chief Financial Officer at the following address: University of Arizona Science and Technology Park, 9040 South Rita Road, Suite 1400, Tucson, Arizona 85747.

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 $10,127,000. 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, the University invests those funds separately as directed by the donor, and the individual endowments bear all changes in value. Also included within the separately held category are certain endowments held by external trustees; at June 30, 2004, University endowments totaling $17,367,000 are held and invested by bank trustees according to donor specifications.

Capital project funds totaling $238,889,000 are held in trust by various commercial banks. Of this amount, $235,832,000 is available for future construction costs, and $3,057,000 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 - $17,082,000 and Northern Arizona University - $6,926,000. The University's ASFAT funds are recorded as endowment investments at $12,774,000.

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, and are not subject to custodial credit risk.
4. Money market funds are recorded in the University's name at the trustee.
5. U.S. treasury and agency government obligations of $229,841,000 are held by Bank of New York as counterparty for the benefit of the University. In addition, the remaining U.S. treasury and agency 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. 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.
8. During the fiscal year, the University engaged in securities lending transactions within the endowment funds, as authorized by ABOR. The University entered into an agreement with Bank of New York, 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 Bank of New York 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, 2004, there were no violations of legal or contractual provisions, and there were no borrower or lending agent default losses. Bank of New York 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, 2004, the custodial bank has received only cash collateral. Cash collateral received from the borrower is invested in short term securities which, at June 30, 2004, had a weighted average of less than 30 days to either maturity or to the next coupon reset date, in the case of floating rate securities. In general, the average number of days outstanding for securities lent matched the weighted average maturity of collateral investments. Cash collateral investments, consisting of asset-backed securities, bank notes, corporate floating rate notes, and collateralized repurchase agreements, are held in an account in the name of the University of Arizona. At June 30, 2004, cash collateral investments totaled $17,963,000 while the market value of securities on loan was $17,634,000. Securities lent for cash collateral included corporate stocks and bonds, and U.S. government and agency notes and bonds. The University or the borrower can terminate securities loans on demand. The University cannot sell or pledge any securities received as collateral unless the borrower defaults. The University earns a negotiated fee for participating in securities lending activities.

Cash and investments at June 30, 2004, consist of the following:

	Fair Value
Cash	$ 2,942,000
Investment in State Treasurer's investment pool	309,000
Repurchase agreements	46,523,000
U.S. treasury mutual funds	13,151,000
Money market funds	9,048,000
U.S. treasury and agency government obligations	373,015,000
Common stocks	66,037,000
Exchange traded mutual funds	32,010,000
Preferred stocks	423,000
Equity mutual funds	235,000
Bond mutual funds	32,000
Mortgages and other receivables	1,692,000
Corporate bonds	28,382,000
Endowments held by trustee	17,367,000
Donated land	773,000
Joint venture (Note 4)	14,000,000
Total	**$ 605,939,000**

Investments are stated at fair value determined from quoted market prices, except the joint venture, which is 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, 2004, 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, 2003, assets, liabilities, revenues, and expenses totaled $92 million, $3 million, $8 million, and $2 million, respectively.

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning Balance July 1, 2003	Additions	Retirements	Transfers/ Reclasses	Ending Balance June 30, 2004
Land	$ 51,611,000	$ 2,489,000	$ (2,357,000)		$ 51,743,000
Construction in progress	61,102,000	87,849,000	(79,000)	$ (82,706,000)	66,166,000
Total non-depreciable capital assets	$ 112,713,000	$ 90,338,000	$ (2,436,000)	$ (82,706,000)	$ 117,909,000
Buildings and improvements	$ 991,080,000	$ 25,812,000	$ (3,368,000)	$ 82,413,000	$ 1,095,937,000
Infrastructure	155,582,000	286,000		(42,237,000)	113,631,000
Equipment	298,575,000	29,288,000	(15,130,000)	42,530,000	355,263,000
Library materials	177,235,000	10,732,000	(781,000)		187,186,000
Total depreciable capital assets	$1,622,472,000	$ 66,118,000	$ (19,279,000)	$ 82,706,000	$ 1,752,017,000
Less: accumulated depreciation					
Buildings and improvements	$ 422,844,000	$ 34,926,000	$ (287,000)	$ 189,000	$ 457,672,000
Infrastructure	60,038,000	4,516,000		(28,440,000)	36,114,000
Equipment	177,446,000	25,667,000	(11,733,000)	28,251,000	219,631,000
Library materials	134,495,000	9,096,000	(781,000)		142,810,000
Total accumulated depreciation	$ 794,823,000	$ 74,205,000	$ (12,801,000)		$ 856,227,000
Depreciable capital assets, net	$ 827,649,000	$ (8,087,000)	$ (6,478,000)	$ 82,706,000	$ 895,790,000
Capital assets, net	$ 940,362,000	$ 82,251,000	$ (8,914,000)	$ 0	$ 1,013,699,000

In addition to expenditures through June 30, 2004, it is estimated that $321,175,000 will be required to complete projects under construction or planned for construction. Of that amount, $100,589,000 is contractually encumbered.

NOTE 6. DEFERRED REVENUE & DEPOSITS

Deferred revenue consists primarily of amounts received from grants and contract sponsors which have not yet been earned under the terms of the agreements and the unamortized portion of the International Business Machines Corporation (IBM) lease (see discussion below) related to the acquisition of the University of Arizona Science and Technology Park (Park). Deferred revenue also includes amounts received in advance of an event, such as advance ticket sales for sporting events.

Arizona Research Park Authority (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 sold $98 million of nontransferable special revenue bonds to 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 to ARPA. 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 20 years. The University has recorded the value of the Park as a capital asset and is amortizing the associated deferred revenue over a 20 year period.

Deferred revenue and deposits at June 30, 2004, consist of the following:

Current Deferred Revenue and Deposits	
Unexpended cash advances received for sponsored programs	$ 30,627,000
Auxiliary sales and services	6,613,000
IBM lease related to the acquisition of the Park	4,900,000
Tuition and fees	4,015,000
Other deferred revenues	939,000
Deposits	1,042,000
Total current deferred revenue and deposits	$ 48,136,000
Noncurrent Deferred Revenue and Deposits	
IBM lease related to the acquisition of the Park	$ 44,570,000

NOTE 7. ACCRUED COMPENSATED ABSENCES

The University accrues vacation when earned. At fiscal year-end, the University accrued 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, 2004, is displayed to the right:

Beginning balance	$ 25,496,000
Additions	33,503,000
Reductions	(31,359,000)
Ending balance	$ 27,640,000
Current portion	$ 2,455,000

NOTE 8: LONG-TERM DEBT & LEASE OBLIGATIONS

Long-term debt activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable	$225,610,000	$ 17,780,000	$(10,970,000)	$232,420,000	$11,815,000
Certificates of participation	276,204,000	237,531,000	(15,985,000)	497,750,000	6,370,000
Capitalized lease obligations	29,169,000	23,486,000	(9,787,000)	42,868,000	6,402,000
Subtotal long-term debt	$530,983,000	$278,797,000	$(36,742,000)	$773,038,000	$24,587,000
Premium on sale of debt	8,579,000	4,432,000	(850,000)	12,161,00	925,000
Deferred costs of refundings	(8,175,000)	(765,000)	804,000	(8,136,000)	(879,000)
Total long-term debt	$531,387,000	$282,464,000	$(36,788,000)	$777,063,000	$24,633,000

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 and fees, sales and services, auxiliary enterprises, and other charges.

On May 19, 2004, the University sold System Revenue Bonds Series 2004A (2004A Bonds) for $17,780,000 dated June 1, 2004. The 2004A Bonds include $12,415,000 of serial bonds with interest rates ranging from 3.0% to 5.0% and maturity dates ranging from 2005 to 2024. The 2004A Bonds also include $5,365,000 of term bonds with an interest rate of 5.0% due June 1, 2029. The 2004A Bonds with maturity on or after June 1, 2015, are subject to optional redemption without premium. The 2004A Bonds with maturity on June 1, 2029, are subject to mandatory sinking fund redemption without premium pursuant to the debt documents. The 2004A Bonds were sold at a discount of $18,000. The University realized net proceeds of $17,500,000 after payment of $262,000 for issuance costs, underwriter discounts and bond insurance. The net proceeds are being used to finance $17,500,000 of the $30,000,000 AHSC's Drachman Hall. The other $12,500,000 will come from gift donations.

In fiscal year 2003, the University refunded, in advance of maturity, a portion of outstanding System Revenue Bonds Series 2000A. At June 30, 2004, the outstanding principal balance of the refunded bonds was $5,515,000, which will be paid by investments held in trust with a fair value of $5,852,000. These amounts are not included in the University's financial statements.

The following schedule details outstanding bonds payable at June 30, 2004:

Issue	Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1992A – System Revenue Refunding Bonds	$ 55,490,000	2016	2.9-6.20%	$ 51,450,000
1998 – System Revenue Bonds	54,270,000	2018	3.9-5.25%	41,945,000
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%	76,230,000
2003 – System Revenue Refunding Bonds	30,805,000	2024	3.5-5.00%	30,805,000
2004A – System Revenue Bonds	17,780,000	2029	3.0-5.00%	17,780,000
Total	$ 272,725,000			$ 232,420,000

The following schedule details debt service requirements to maturity for System Revenue Bonds at June 30, 2004:

Year	Principal	Interest
2005	$ 11,815,000	$ 11,973,000
2006	12,355,000	11,422,000
2007	16,710,000	10,857,000
2008	19,370,000	10,024,000
2009	20,370,000	9,049,000
2010-14	82,210,000	30,317,000
2015-19	39,615,000	12,699,000
2020-24	24,610,000	5,207,000
2025-29	5,365,000	831,000
Total	$232,420,000	$102,379,000

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 15, 2003, the University issued Certificates of Participation Series 2003B (2003B Certificates) for $153,960,000 dated October 1, 2003. The 2003B Certificates include $113,695,000 of serial certificates with interest rates ranging from 2% to 5.25% and maturity dates ranging from 2005 to 2027. The serial certificates maturing on or after June 1, 2015, are subject to optional redemption prior to maturity without premium. The 2003B Certificates also include two sets of term certificates consisting of $14,455,000 with an interest rate of 5.0% due June 1, 2028, and $25,810,000 with an interest rate of 5.0% due June 1, 2031. The term certificates maturing on June 1, 2028 and June 1, 2031 are subject to mandatory sinking fund redemption in part on June 1 of the years 2027 through 2030 before maturity without premium. There are also extraordinary redemption dates pursuant to the debt documents. The 2003B Certificates were issued at a premium of $3,158,000. The University realized net proceeds of $154,742,000 after payment of $2,376,000 for issuance costs, underwriters discount and bond insurance. The net proceeds are being used to finance the Thomas W. Keating BioResearch Building, the Medical Research Building, and the Technology Infrastructure Project to support the new facilities.

On May 19, 2004 and June 4, 2004, the University issued Certificates of Participation Series 2004A and B (2004A and B Certificates) for $42,020,000 and $41,400,000 respectively dated June 1, 2004 for both issues. The 2004A Certificates include $35,250,000 of serial certificates with interest rates ranging from 2.5% to 5.25% and maturity dates ranging from 2005 to 2024. The 2004A serial Certificates maturing on or after June 1, 2015, are subject to optional redemption prior to maturity without premium. The 2004A Certificates also include $6,770,000 of term certificates with an interest rate of 5.125% due June 1, 2029. The 2004A term Certificates maturing on June 1, 2029 are subject to mandatory sinking fund redemption in part on June 1 of the years 2025 through 2028 before maturity without premium. There are also extraordinary redemption dates for the 2004A Certificates pursuant to the debt documents. The 2004A Certificates were issued at a premium of $1,274,000. The 2004B Certificates were issued bearing interest at a weekly rate determined by J.P. Morgan Securities Inc., as the remarketing agent, and were issued without a premium or a discount. The 2004B Certificates are also subject to mandatory sinking fund redemption without premium, by lot, on June 1, 2015 through 2031, the final maturity year. The University realized net proceeds for the 2004A Certificates and 2004B Certificates of $83,295,000 after payment of $1,399,000 for issuance costs, underwriters discount and bond insurance. The net proceeds are being used to finance the Chemistry Building Expansion, the Highland Avenue Parking Garage, the Residence Life Building Renewal Phase I, and to refund in advance of maturity the Certificates of Participation Series 1994A with an outstanding principal balance of $11,185,000, at June 30, 2004. The advance refunding generated an economic gain of $297,000 (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 $801,000 in year 1 and $502,000 in year 2; however, annual debt service will increase by an average of $56,000 in year 3 through year 9 and $1.5 million in the last year. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $765,000. This difference, reported in the accompanying financial statements as a deduction from long-term debt, is being charged to operations through the year 2013 using the straight-line method. The refunded Certificates of Participation Series 1994A will be paid by investments held in an irrevocable trust with a fair value of $11,684,000. As a result, 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, 2004, three variable rate Certificates of Participation, Series 1999B, 2000A, and 2004B, totaling $104,200,000. These certificates bear interest at a weekly rate, determined by UBS Financial Services for the 1999B and 2000A Certificates and by J.P. Morgan Securities for the 2004B Certificates, as remarketing agents, with final maturity dates of June 1, 2024, June 1, 2025, and June 1, 2031 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, 2000A, and 2004B 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 variable rate Certificates of Participation are subject to purchase on the demand of the holder at a price equal to principal plus accrued interest on seven days' notice and delivery to the remarketing agents. If the remarketing agents are unable to resell the demand certificates, the University has Standby Purchase Agreements with Bayerische Landesbank to extend credit through the purchase of the un-remarketed certificates. Assuming all of the $104,200,000 COPs are not resold within 90 days, the University would be responsible to make annual installment principal payments of $20,840,000 over a five-year period, plus interest to be calculated as established in the Standby Purchase Agreements. Bayerische Landesbank charges the University an annual commitment fee on the outstanding principal for each of the Standby Purchase Agreements. The fees are 0.17%, 0.18%, and 0.19% respectively for the Series 1999B, 2000A, and 2004B Certificates of Participation. The Standby Purchase Agreements are valid through November 30, 2015.

In fiscal year 2003, the University refunded, in advance of maturity, the Certificates of Participation Series 1994B and a portion of outstanding Certificates of Participation Series 2001B. At June 30, 2004, the outstanding principal balances for the Certificates of Participation Series 1994B was $12,100,000 and $7,020,000 for the Certificates of Participation Series 2001B, which will be paid by investments held in trust with a fair value of $12,568,000 and $7,231,000 respectively. These amounts are not included in the University's financial statements.

The following schedule details outstanding Certificates of Participation at June 30, 2004:

Issue		Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1999A	Fixed Student Union Certificates	$ 21,607,000	2024	5.00-5.30%	$ 22,275,000
1999B	Student Union Certificates	36,500,000	2024	Variable	36,500,000
1999	Parking Garage, Res. Life Certificates	18,635,000	2024	4.20-5.75%	18,105,000
2000A	McKale, UA Police Dept., Mt. Graham	28,300,000	2025	Variable	26,300,000
2001A	Park Std. Union, Learning Svcs., 6th Street Garage, TEP Bldg.	31,695,000	2025	3.40-5.50%	31,115,000
2001B	Gittings Bldg., Highland Infra., Life Sci.	21,425,000	2022	3.00-5.125%	13,385,000
2002A	Student Housing, Health Bldg., UA North	76,965,000	2022	3.75-5.50%	72,230,000
2002B	Meinel Bldg., Refund COPS 1994B	29,845,000	2023	3.00-5.125%	29,845,000
2003A	Refund COPS 1997 & Portion of COPS 2001B	10,615,000	2022	3.50-5.00%	10,615,000
2003B	Medical Research Bldg., T. W. Keating BioResearch Bldg., Technology Infrastructure	153,960,000	2031	2.00-5.25%	153,960,000
2004A	Chemistry Bldg. Expansion, Res. Life Phase I, Highland Pkg. Garage, Refund COPS 1994A	42,020,000	2029	2.50-5.25%	42,020,000
2004B	Chemistry Bldg. Expansion	41,400,000	2031	Variable	41,400,000
	Total	$ 512,967,000			$ 497,750,000

The following schedule details debt service requirements to maturity for Certificates of Participation payable at June 30, 2004:

Year	Principal	Interest
2005	$ 6,370,000	$ 20,201,000
2006	7,455,000	19,963,000
2007	8,470,000	19,721,000
2008	12,890,000	19,433,000
2009	13,450,000	18,962,000
2010-14	95,608,000	85,534,000
2015-19	128,076,000	61,358,000
2020-24	138,526,000	31,950,000
2025-29	62,825,000	12,197,000
2030-31	24,080,000	1,435,000
Total	$ 497,750,000	$ 290,754,000

Yisrael Espinoza, UA Photo Services

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, a transfer of ownership by the end of the lease term, or comply with other accounting criteria. Major capital leases entered into this fiscal year include the Louise Foucar Marshall Building, which was entered into with Park/University Redevelopment LLC for $12,983,000, with an average interest rate of 5.29% and a final payment date of June 1, 2032. In addition the Facilities Management Building Meters Project was entered into with G.E. Capital Public Finance Inc. for $3,889,000, with an interest rate of 3.35%, and a final payment date of July 15, 2008. The proceeds for the Project 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, 2004:

Cost of assets	$ 390,699,000
Less: accumulated depreciation	(45,519,000)
Carrying value	$ 345,180,000

The following schedule details debt service requirements to maturity for capital leases payable at June 30, 2004:

Year	
2005	$ 7,284,000
2006	7,100,000
2007	6,464,000
2008	4,649,000
2009	3,820,000
2010-14	12,612,000
2015-19	4,398,000
2020-24	4,409,000
2025-29	4,419,000
2030-32	2,659,000
Total minimum lease payments	$ 57,814,000
Less: interest	(14,946,000)
Present value of net minimum lease payments	$ 42,868,000

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 2004, rent expenses totaled $18,165,000.

The following schedule details future operating lease payments to maturity:

Year	Operating Lease Payments
2005	$ 2,343,000
2006	2,036,000
2007	1,591,000
2008	1,295,000
2009	282,000
Total	$ 7,547,000

NOTE 9. RISK MANAGEMENT

The University is exposed to various risks of loss related to: torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The University participates in a self-insurance program administered by the State of Arizona Department of Administration, Risk Management Section. 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 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, 2004, active ASRS members and the University were each required to contribute 5.7 percent (5.2 percent retirement and .5 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, 2004, 2003, and 2002, was $13,330,000, $5,010,000, and $4,866,000, 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, 2004, 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.

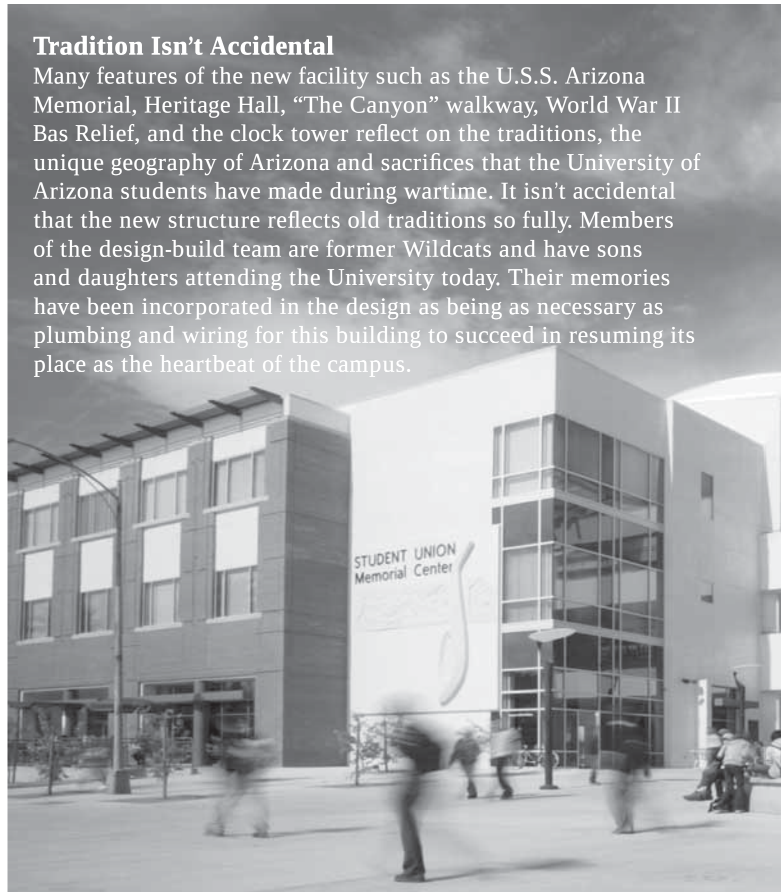
Funding Policy. The Arizona State Legislature establishes the contribution rates for active plan members and the University. For the year ended June 30, 2004, plan members and the University were each required by statute to contribute an amount equal to 7 percent of a member's compensation, except for a 8.10 percent University contribution for the ASRS defined contribution plan. Contributions to these plans for the year ended June 30, 2004, were as follows:

Plan	University Contributions	Member Contributions	Total Contributions
TIAA/CREF	$ 11,836,000	$ 11,836,000	$ 23,672,000
VALIC	736,000	736,000	1,472,000
Fidelity	2,760,000	2,760,000	5,520,000
AETNA	330,000	330,000	660,000
Vanguard	894,000	894,000	1,788,000
ASRS	126,000	109,000	235,000

NOTE 11. OPERATING EXPENSES BY NATURAL CLASSIFICATION

Operating expenses by natural classification for the year ended June 30, 2004, consist of the following:

Category	
Salaries and wages	$ 571,320,000
Benefits	143,534,000
Supplies and materials	102,931,000
Services, including travel	145,176,000
Utilities	35,079,000
Scholarships and fellowships	37,686,000
Depreciation	74,205,000
Total operating expenses	$ 1,109,931,000



Tradition Isn't Accidental

Many features of the new facility such as the U.S.S. Arizona Memorial, Heritage Hall, "The Canyon" walkway, World War II Bas Relief, and the clock tower reflect on the traditions, the unique geography of Arizona and sacrifices that the University of Arizona students have made during wartime. It isn't accidental that the new structure reflects old traditions so fully. Members of the design-build team are former Wildcats and have sons and daughters attending the University today. Their memories have been incorporated in the design as being as necessary as plumbing and wiring for this building to succeed in resuming its place as the heartbeat of the campus.

NOTE 12. CONTINGENT LIABILITIES

In August 2003, four University of Arizona students filed a lawsuit against the Arizona Board of Regents and the State of Arizona in Pima County (Arizona) Superior Court. The complaint alleged that the tuition increase approved by the Board for the 2003-04 academic year violates the State's constitution. The plaintiffs requested that the suit be certified as a class action on behalf of all students at the three universities governed by the Board. The complaint also asserted that the State has not provided funding to the three universities governed by the Board at the level required by the State Constitution. The complaint sought (i) a declaratory judgment that the actions of each of the defendants violate the State Constitution, (ii) preliminary and permanent injunctive relief to prevent the Board from imposing the tuition increase and to compel repayment of any amounts already collected, and (iii) preliminary and injunctive relief ordering the State to set in place a plan to provide increased funding for maintenance, operation and improvement of the State's universities. In March 2004, the Superior Court granted the Board's and the State's motion to dismiss the case. In the related minute entry, the court held that in the exercise of its legislative and administrative function, which includes setting tuition levels for the State's three universities, the Board is absolutely immune from suit and that the conduct of the business of the State Legislature is absolutely immune from suit. The plaintiffs have filed a notice of appeal with the Arizona Court of Appeals. The plaintiffs have filed their opening brief and the Board and the State have filed their answering brief in the appeal. As of October 12, 2004, the plaintiffs have not filed their reply brief and no hearings have been scheduled by the Court of Appeals. The Board intends to vigorously defend the appeal. Management believes that the claim can be adequately and successfully defended, but is not able to predict at this time what the ultimate outcome of the case will be or how the case may affect the financial condition of the University. An adverse judgment in the litigation described above would be covered by the statutory self-insurance program under the Risk Management Section of the State of Arizona Department of Administration.

In February 2004, two cases were filed arising from the same set of circumstances that lists a variety of causes of action based upon alleged violations of cultural and religious privacy and violations of human subjects research protocols. The complaints allege that, from 1990 through 1994, Arizona State University (ASU) researchers collected blood samples from individual members of the Havasupai Tribe for research purposes. The ASU Human Subjects Institutional Review Board approved the research to study the causes of various medical and behavioral disorders. In 1999, the principal investigator on the project moved to the University of Arizona (University). At that time, she transported the blood

David A. Harvey Photography

samples from the project and the related documentation to the University. In February 2003, the dissertation of an ASU student raised concerns that Havasupai blood samples had been used for purposes beyond the consent granted by participants. The plaintiffs in one case consist of 52 individual members of the Havasupai Tribe while the other case consists of the Havasupai Tribe. The complaints seek compensatory and punitive damages of $75,000,000. Management believes that the claim can be adequately and successfully defended, but is not able to predict at this time what the ultimate outcome of the case will be or how the case may affect the financial condition of the University. An adverse judgment in the litigation described above would be covered by the statutory self-insurance program under the Risk Management Section of the State of Arizona Department of Administration.

In September 2004, an action was filed by Kaman Aerospace Corporation alleging counts of breach of contract, negligent misrepresentation, unjust enrichment and quantum merit. This action arises out of a contract between the University and Kaman Aerospace in connection with the construction of a scientific apparatus known as the LOTIS 5.6M Collimator to be used for testing large optical systems in a vacuum environment. The plaintiff entered into a contract to design and fabricate the structural, electrical, mechanical and software control systems for the project. The plaintiff alleges that the University has breached the contract and failed to pay for changes in the scope of work pursuant to the terms of the contract. The complaint seeks compensation for the additional costs incurred by the plaintiff of $5,950,110 plus reasonable attorney fees and costs. Management believes that the claim can be adequately and successfully defended, but is not able to predict at this time what the ultimate outcome of the case will be or how the case may affect the financial condition of the University. An adverse judgment in the litigation described above would not be covered by the statutory self-insurance program under the Risk Management Section of the State of Arizona Department of Administration.

NOTE 13. SUBSEQUENT EVENT

On October 27, 2004, the University issued System Revenue Bonds Series 2004B in the amount of $50,265,000 dated November 1, 2004, to purchase a student housing complex from Southern Arizona Capital Facilities Corporation (SACFFC), and to refund in advance of maturity a portion of the University's System Revenue Bonds Series 1998 and System Revenue Bonds Series 2000A. The System Revenue Bonds Series 2004B bear interest rates ranging from 3% to 5% and mature in 2034. The complex consists of 150 units with 325 beds located on campus within the University planning boundary. SACFFC is an Arizona non-profit corporation formed to finance capital facilities construction such as the student housing complex as described in Note 2.

NOTE 14. DISCRETELY PRESENTED COMPONENT UNIT DISCLOSURES

A. Summary of Significant Accounting Policies
University of Arizona Foundation

Basis of Accounting

For financial reporting purposes, three net asset categories are utilized to reflect resources according to the existence or lack thereof of externally (donor) imposed restrictions. A description of the three net asset categories follows:

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

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

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

Cash and Cash Equivalents
Cash and cash equivalents includes monies held in certificates of deposit, overnight money market accounts, and money market funds. Cash equivalents are stated at cost, which approximates fair value.

Investments in Securities
Investments in securities are stated at fair value in the statement of financial position. Investments in domestic and international equity securities and mutual funds, U.S. government and agency obligations and mutual funds, corporate bonds, REIT funds, and international fixed income mutual funds are valued based on quoted market prices. Investments in real estate and timber partnerships are recorded at fair value as determined by the General Partner based on the appraised value of the Partnerships' assets. Absolute return limited partnership interests are recorded at fair value based on quoted market prices (where the underlying investment is a mutual fund) or as determined by the fund manager. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses in the statement of activities.

Annuities Payable and Other Trust Liabilities
Annuities payable and other trust liabilities are stated at the actuarially computed present value of future payments to the annuitants. The excess of the fair values of assets received (classified according to their nature in the statement of financial position) pursuant to annuity agreements over the actuarially computed annuities payable (using market rates in effect on the contribution date) is recorded as contributions in the year received. The fair values of such assets held in trust at June 30, 2004 total $36,509,301, of which $1,160,499 were unrestricted, $19,962,158 were temporarily restricted and $15,386,644 were permanently restricted.

Net Assets Released From Restriction
Expenses are not incurred in the temporarily restricted or permanently restricted net asset categories. As the restrictions on these net assets are met, the assets are reclassified to unrestricted net assets. The total assets reclassified are reported as net assets released from restriction in the accompanying statement of activities.

Campus Research Corporation

Property, Equipment and Depreciation
Property and equipment are stated at cost and depreciation is provided for using the straight-line method over the estimated useful lives of the assets. Expenditures for major improvements to property are capitalized and expenditures for repairs and maintenance are expensed as incurred. The Organization has recorded in the financial statements a building and related debt for which the ABOR/UA holds the title to the building, under the requirements of a lease.

Southern Arizona Capital Facilities Finance Corporation

Property, Equipment and Depreciation
Property and equipment are stated at cost and are depreciated over the estimated useful lives of the assets. Construction period bond interest payments have been capitalized as a building cost, net of interest income earned on bond proceeds. Building costs are depreciated on a straight-line basis over a period of forty years.

Photo Next Page
Johan Lahtinen, Assistant Director and Maria Arvizu, Senior Management Analyst in Space Management are performing an inventory on the 8.4 meter diameter primary mirror for the Large Binocular Telescope at the Optical Sciences Department Mirror Laboratory.

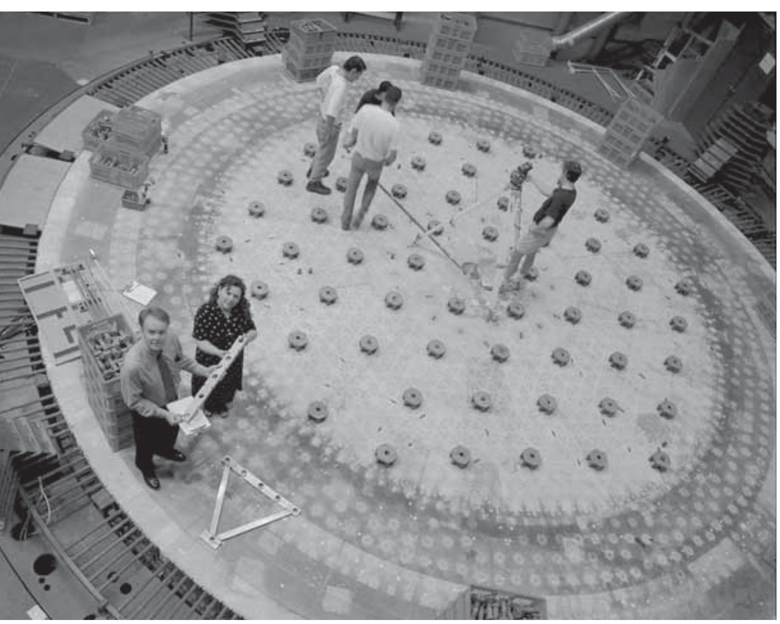
B. Investments

University of Arizona Foundation

Investments are comprised of the following amounts at June 30, 2004:

	Fair Value	Cost
U.S. government/agency obligations and mutual funds	$ 63,878,391	$ 64,388,233
Domestic/international equity securities and mutual funds	130,256,947	115,757,796
Corporate bonds	26,199,454	26,360,421
REIT fund, real estate and timber partnerships	7,197,521	6,318,064
Absolute return limited partnerships	27,182,965	26,700,000
International fixed income mutual funds	8,278,900	8,280,558
Total	$262,994,178	$247,805,072

The Foundation participates in a securities lending program established by Wells Fargo Bank, the custodian of the majority of the Foundation's investment assets (the "Program"). Under the Program, the custodian makes the Foundation's securities available for loan to selected brokerage firms and other borrowing organizations. Each loan is required to be collateralized in an amount equal to at least 102 percent of the market value of the loaned security and accrued interest thereon. Each loaned security is marked to market daily, and the custodian is required to ensure that collateralization remains at an amount of at least 102 percent on a daily basis. At June 30, 2004, $33,818,539, $34,305,421 and $2,158,706 in U.S. government and agency obligations, equity securities and corporate bonds, respectively, were in use under the Program.



Margaret Hartshorn, AHSC Biomedical Communications

C. Pledges Receivable

University of Arizona Foundation

Unconditional promises are included in the financial statements as pledges receivable and revenue of the appropriate net asset category. Unconditional promises are recorded at their net realizable value using yields on U.S. Treasury obligations of equivalent maturity dates at the end of the fiscal year in which they were received. Unconditional promises at June 30, 2004, totaled $30,931,915.

Law College Association

At May 31, 2004, the Association had unconditional promises to give pledged for future support. Net of present value discounts and allowances for doubtful pledges, these unconditional promises totaled $30,040,718. Note that 99% of the Association's gross pledges receivable come from an individual donor.

D. Property and Equipment

Campus Research Corporation

Property and equipment consisted of the following as of June 30, 2004:

Building and infrastructure improvements	$ 11,092,688
Furniture, equipment and other property	599,726
Total	$ 11,692,414
Less accumulated depreciation	(1,022,459)
Property and equipment, net	$ 10,669,955

Southern Arizona Capital Facilities Finance Corporation

Property and equipment consisted of the following as of June 30, 2004:

Buildings	$17,674,876
Furnishings	164,275
Total	$17,839,151
Less accumulated depreciation	(371,775)
Property and equipment, net	$17,467,376

E. Long-Term Debt

Campus Research Corporation

Bonds payable, Series A, are payable in monthly installments of interest only at the floating taxable bond rate (remarketed weekly) through July 2003, have scheduled payments of principal plus interest beginning July 2003, with a lump sum payment of $6,491,300 due in June 2013, and are collateralized by leasehold interests in real property and an assignment of rents.

Bonds payable, Series B, are payable in scheduled monthly installments of principal plus interest at the floating taxable bond rate (remarketed weekly) through December 2005, and are collateralized by a leasehold interest in real property and an assignment of rents.

Bonds Payable, Series A	$8,088,000
Bonds Payable, Series B	1,419,800
Total	$9,507,800

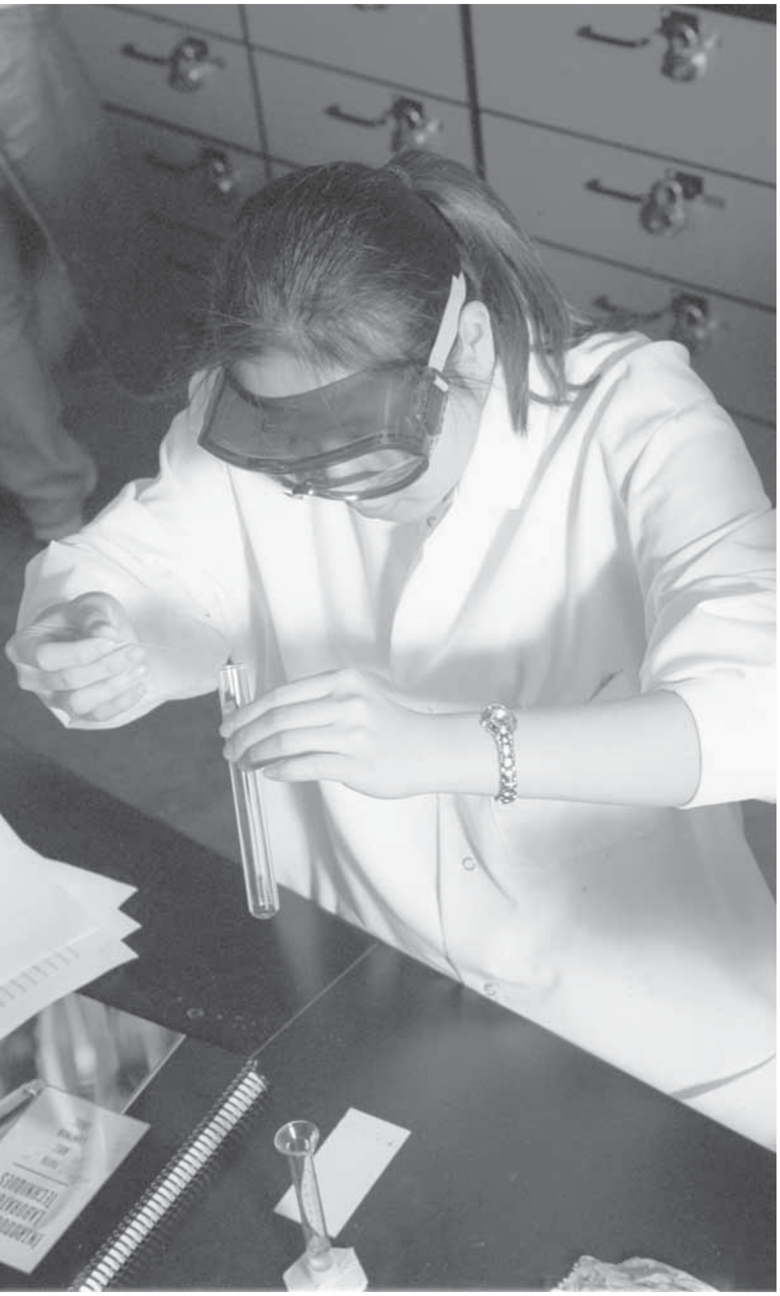
Wells Fargo Bank Arizona issued an $11,400,000 letter of credit to enhance the sale of the bonds and the Organization entered into a reimbursement agreement with the bank, which provides real property as collateral to the bank. The letter of credit is renewed annually in July at the outstanding bond amount plus 45 days of interest.

The Series A and Series B bonds payable bear interest at a market rate of interest as stated previously. However, the Organization entered into two separate interest rate swap contracts with Wells Fargo that effectively convert the interest rate on the Series A and Series B notes to 6.3% and 4.77%. Under the swap contracts, the Organization pays interest at the fixed rate and receives interest at LIBOR (proxy rate), which was 1.6% at June 30, 2004. The notional amount under the swaps decreases as principal payments are made on the bonds so that the notional amount equals the principal outstanding under the bonds. The swaps are designed to hedge the risk of changes in interest payments on the note.

The swaps were issued at market terms so that they had no fair value at inception. As required by generally accepted accounting principles, the carrying amount of the swaps has been adjusted to fair value at June 30, 2004 which, because of changes forecasted in levels of LIBOR, resulted in reporting a liability for the fair value of the future net payments forecasted under the swaps. The change in fair value is recorded as a component of the change in net assets for 2004 and the liability is classified as noncurrent since management does not intend to settle the swaps during fiscal year 2005.

Southern Arizona Capital Facilities Finance Corporation

The Corporation has issued $20,875,000 of tax-exempt bonds, known as the “Southern Arizona Capital Facilities Finance Corporation Student Housing Revenue Bonds (La Aldea Project at the University of Arizona) Series 2002.” The bonds have various maturity dates through September 1, 2033 at interest rates that vary from 3% to 5.1%. The bonds are secured by a deed of trust on the La Aldea buildings. Interest and principal payments are due semi-annually each March 1st and September 1st. All of the project’s revenues are pledged to the bond trustee, out of which all operating and capital improvement expenditures are made. The bond trustee is required to remit $130 per bed annually to a replacement fund, increased by 3% each year. Excess revenues, after all required expenditures are made, are payable to the University of Arizona under a ground lease for the 2.2 acre project site. The University charged $1,000 as a base rent for the ground



Robert Walker, UA Photo Services

lease over its term. The bonds are subject to redemption after August 31, 2012, at par, with the approval of the University. If an event of default occurs under the ground lease, the bonds are required to be redeemed within 90 days. The Corporation must maintain net revenues of at least 100% of the scheduled principal and interest payments each year and at least 120% for each two-year fiscal period. Since this has not been the case, the bonds are in technical default. However, the bond trustee has not declared the bonds to be in default at this time. See G. Subsequent Event below regarding planned redemption of the bonds.

Scheduled future maturities of the bonds payable are as follows:

Year ended June 30, 2005	$	260,000
2006		310,000
2007		330,000
2008		345,000
2009		365,000
Thereafter		19,145,000
Total	$	20,755,000
Less current portion		(260,000)
Long term portion	$	20,495,000

F. Scholarship Suites

University of Arizona Foundation

The Foundation constructed scholarship suites at the University's football stadium in 1990 at a total cost of $7,698,000. The scholarship suites, which were being depreciated over 20 years, consisted of skyboxes, luxury seats, a press box, a presidential suite, and other facilities.

On June 25, 2004, the University purchased the scholarship suites from the Foundation by placing $3,232,261 into an irrevocable defeasance escrow maintained by an independent trustee for the benefit of the holders of the Scholarship suite refunding bonds. This amount, when combined with existing debt service reserve funds of $668,599, will be sufficient to redeem the $3,675,000 in outstanding Scholarship suite refunding bonds as they mature from August 1, 2004 through August 1, 2009. Accordingly, the Foundation has been released from all obligations relating to the Scholarship suite refunding bonds. The Foundation recognized a gain on the sale of the scholarship suites of $512,403.

G. Subsequent Event

Southern Arizona Capital Facilities Finance Corporation

As a result of significant operating losses on the La Aldea project, the related bonds are in technical default and the management agreement is subject to termination. In September 2004, the University of Arizona sought approval from the Arizona Board of Regents to issue $21.9 million of bonds to purchase the project from the Corporation and assume management responsibilities. The Corporation would use the net proceeds to redeem the bonds and pay outstanding construction costs.

H. Condensed Financial Statements of Major Component Units

Major Component Units Statement of Financial Position June 30, 2004 (in thousands of dollars)	**University of Arizona Foundation**	**Non-Major Component Units**	**Total**
Assets			
Cash, cash equivalents and investments	$ 279,326	$ 13,964	$ 293,290
Pledges receivable	30,932	30,041	60,973
Property and equipment, net	1,332	28,244	29,576
Other assets	21,513	11,978	33,491
Total Assets	**$ 333,103**	**$ 84,227**	**$ 417,330**
Liabilities and Net Assets			
Liabilities			
Annuities payable and other trust liabilities	$ 18,630		$ 18,630
Short-term and long-term debt	160	$ 30,509	30,669
Other liabilities	1,749	7,532	9,281
Total Liabilities	**$ 20,539**	**$ 38,041**	**$ 58,580**
Net Assets			
Unrestricted	$ 7,873	$ 11,391	$ 19,264
Temporarily restricted	104,558	32,695	137,253
Permanently restricted	200,133	2,100	202,233
Total Net Assets	**$ 312,564**	**$ 46,186**	**$ 358,750**
Total Liabilities and Net Assets	**$ 333,103**	**$ 84,227**	**$ 417,330**

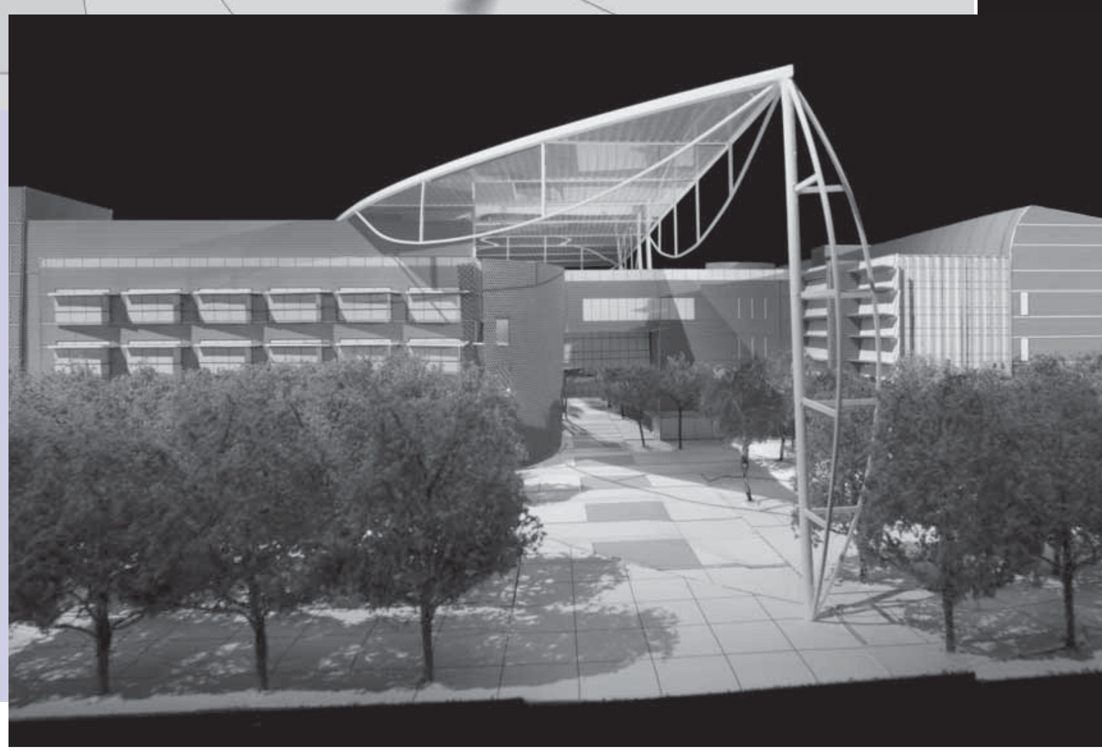
Major Component Units Statement of Activities Year Ended June 30, 2004 (in thousands of dollars)	University of Arizona Foundation	Non-Major Component Units	Total
Revenues			
Contributions	$ 42,679	$ 3,885	$ 46,564
Rental revenues	952	7,987	8,939
Investment income	25,277	874	26,151
Other income	8,833	4,170	13,003
Total revenues	**$ 77,741**	**$ 16,916**	**$ 94,657**
Expenses			
Program services:			
Leasing related expenses		$ 5,876	$ 5,876
Payments to the University	$ 22,086	100	22,186
Payments on behalf of the University	16,979	4,656	21,635
Supporting services:			
Management and general	3,965	1,985	5,950
Fund raising	2,579	189	2,768
Other expenses	865	1,404	2,269
Total expenses	**$ 46,474**	**$ 14,210**	**$ 60,684**
Increase in Net Assets	**$ 31,267**	**$ 2,706**	**$ 33,973**
Net Assets - Beginning of year	281,297	43,480	324,777
Net Assets - End of year	**$ 312,564**	**$ 46,186**	**$ 358,750**

Margaret Hartshorn, AHSC Biomedical Communications

Building for the Future

Richard and Bauer Architecture

The Meinel Optical Sciences Building Expansion (top), Roy P. Drachman Hall (middle) and Thomas W. Keating BioResearch Building (bottom) are currently under construction. These projects are scheduled for completion in 2005. These facilities will add approximately 206,000 square feet of additonal office and research space. Perhaps "Building for the Future" can stimulate the creative thinking necessary to carry us through the twenty-first century.



Zimmer Gunsul Frasca Partnership

The University of Arizona is an equal opportunity, affirmative action institution. The University prohibits discrimination in its programs and activities on the basis of race, color, religion, sex, national origin, age, disability, veteran status, or sexual orientation and is committed to maintaining an environment free from sexual harassment and retaliation.

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Mark A. McGurk
Comptroller
Financial Services Office

Floyd J. Roman
Assistant Comptroller
Financial Services Office

Michael A. Treiber
Assistant Comptroller
Financial Services Office

Duc Ma
Director, Capital Finance
Financial Services Office

Design

Steve W. Tkachyk
UAHSC Biomedical Communications

Back Cover

Chemistry Building Expansion (top). A new facility south of the existing Chemistry Building. Once completed this project will provide additional research labs and faculty offices for the Department of Chemistry. Rendering courtesy of Zimmer Gunsul Frasca Partnership.

The University of Arizona Science Center preliminary image (bottom). This image was prepared by Ralph Appelbaum Associates, Inc. An architect is currently preparing concept designs. The University of Arizona Science Center will be an integral component in the revitalization of the downtown Tucson Rio Nuevo Project.

Contributions to this publication by the Financial Services Office staff are greatly appreciated:
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