

ASU[®] ARIZONA STATE UNIVERSITY



One University
in Many Places



2004 FINANCIAL REPORT

Arizona State University – One University in Many Places

On the front cover –

Left column: Top - Pictured is the Technology Center at East campus. East campus has a polytechnic focus which emphasizes professional and technological programs that address societal needs. **Bottom** - Named in honor of ASU's fifteenth president, Lattie F. Coor Hall was officially dedicated and opened on January 7, 2004. The seven-story building on the Tempe campus features state-of-the-art mediated classrooms, which are an essential support requirement for ASU's instructional mission.

Middle column: Top - The ASU Downtown (Phoenix) facility is the home to the College of Extended Education, which advances ASU's community outreach mission by providing access to quality education beyond the University's traditional campus borders. **Middle** - At Tempe Town Lake the ASU Sailing Club operates eight sailboats with adapted technology which allows disabled participants to operate the boats' controls. In the background is ASU's Sun Devil Stadium. Sun Devil Stadium has hosted ASU's home football games since 1958. It has also hosted four NCAA national championship games and one NFL Super Bowl championship game. **Bottom** - The planet Mars has been a frequent news topic since the January 2004 landings of the NASA rovers *Spirit* and *Opportunity*. The ASU College of Liberal Arts and Sciences had more representatives on the Mars rover teams than any other institution.

Right column. Top - In May 2004, students at the West campus wait for the beginning of their convocation ceremonies. The mission of the West campus encompasses research and teaching, and the development of University-community partnerships. **Middle** - In August 2003, ASU welcomed over 57,000 new and returning students to its campuses. ASU maintains a tradition of academic excellence, and has become an important global center for innovative interdisciplinary teaching and research. **Bottom** - ASU is partnering with the city of Phoenix to build a modern, vibrant university campus in downtown Phoenix, as part of a larger plan to revitalize and redevelop the city's urban core. ASU envisions a campus embedded with the city, embracing the cultural, socioeconomic, and physical setting of the urban downtown of the 21st century.



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* Component units are financially interrelated organizations whose goals are to support Arizona State University.

A LETTER FROM THE PRESIDENT OF ARIZONA STATE UNIVERSITY



ARIZONA STATE UNIVERSITY

We are pleased to present the 2004 Financial Report for Arizona State University. During the past year, we have focused on the implementation of our vision of transforming ASU from a strong regional university into one of the premier comprehensive metropolitan research universities in the nation, an institution that is an unparalleled combination of academic excellence and commitment to its social, economic, cultural, and environmental setting. The New American University we are building is inclusive and engaged, and favors a research enterprise dedicated to societal relevance and socially optimal outcomes of research.

Our efforts to become nationally competitive are guided by an ambitious reorganization of the university launched in April 2004—a ten-year institutional transformation process—that will both create a unique institutional profile and develop a new prototype for the American research university. The reorganization begins with a deliberate and planned clustering of programs on each campus around a related theme and mission, including the development of a 15,000-student campus in downtown Phoenix—the cornerstone of the effort to revitalize the downtown area. ASU will become a federation of unique colleges, schools, academic departments, and interdisciplinary institutes and centers that compete for status, not with other schools within the university, but with peer schools around the country and around the world.

Consistent with the “culture of academic enterprise” that is a signal characteristic of the New American University, ASU is pursuing strategies to increase revenue source diversification, meaning less reliance on state appropriations. Although the dollar amount of state appropriations in future years should undoubtedly increase as a percentage of total funding sources, we anticipate that state appropriations will over the long run continue to decrease. Among measures taken to boost other revenue sources during FY 2004 was an increase in tuition and fees—\$1,010 for undergraduates and \$1,210 for graduate students. Although the increased revenues will advance the entire university, students were the major beneficiaries because the largest portion—about \$14 million—provided increased financial assistance for students, with need-based financial aid increasing 140 percent. In terms of tuition costs, ASU remains one of the lowest priced state universities in the nation, according to the Arizona Board of Regents’ 2003/2004 Tuition and Mandatory Fees Survey of 50 state universities.

ASU has been moving at an accelerated pace to establish itself as one of the leading centers for cutting-edge interdisciplinary research in selected areas, both fundamental and applied. In an effort to realize a world-class research enterprise, the university has pursued a number of strategies. Chief among these is an historic investment in research infrastructure that will add over one million square feet of research space within the next few years in all fields, from the arts and humanities to the sciences and engineering. The foundation for this unprecedented investment is the research infrastructure bill passed by the state legislature in June 2003, which authorized the funding for \$185 million of lease-purchase capital financing of new research facilities. As of June 30, 2004 substantially all these facilities were either under construction or approaching groundbreaking and other important projects were well along in construction or in design, including a combined heat and power facility to support the Biodesign Corridor, and residential student housing.

Other strategies being enacted to stimulate sponsored projects growth include more aggressive hiring of senior research-oriented faculty, and accelerated rates of hiring across all faculty levels to increase the critical mass of faculty in the sciences and engineering; salary incentive plans to reward more research-productive faculty; increased expectations for faculty research activity; and focused investment of funding from the Technology and Research Initiative Fund (TRIF), into strategic initiatives that are expected to lead to growth of new research clusters and to produce competitive proposals for large grant/contract opportunities. In November 2003 Arizona Technology Enterprises, LLC (AzTE) became operational.

OFFICE OF THE PRESIDENT

PO Box 872203, TEMPE, AZ 85287-2203
(480) 965-5606 FAX: (480) 965-0865

AzTE is a single member limited liability company formed by the ASU Foundation to provide the university with technology transfer and intellectual property management services.

ASU's largest-ever federal award—a U.S. Army research grant awarded in February 2004 for the development of flexible displays, totaling \$43.7 million over the next five years, with an option for an additional \$50 million over a subsequent five-year period—epitomizes academic enterprise and the competitive potential of ASU. Since June 2003 ASU has received twenty research awards—federal, state, local, and private—in excess of \$1 million. Since July 2003, more than \$20.5 million in seed funding from several sources has been invested in a portfolio that has engaged a broad spectrum of scholars and researchers in areas as diverse as religion and conflict, health and disability policy, and wireless integrated nanotechnologies. Still other research initiatives have been launched using private funding sources and major gifts.

In accordance with new financial reporting requirements of the Governmental Accounting Standards Board, the 2004 ASU audited financial report includes more information about independent component organizations financially related to the university, including the ASU Foundation, ASU Alumni Association, Sun Angel Foundation, Collegiate Golf Foundation, Price-Elliott Research Park, and the Arizona Capital Facilities Finance Corporation (“related organizations”). Net assets (fund balances) for these related organizations total approximately \$288 million, comprised largely of donor-restricted endowment funds. In the past ASU has disclosed financial information for these entities in the notes to the audited financial statements.

In spite of a restrictive state budget for 2004, this report reveals a break-even year for the university, with a \$1.5 million increase in net assets (fund balances). Total university revenues for 2004 were \$935 million, a 10 percent increase from 2003. Although fluctuations in net assets may be anticipated during the next several years as new research facilities come online, ASU and its related organizations anticipate a continuing long-run trend of annual increases in net assets, especially insofar as the university receives important private gifts. When combined with the \$32 million increase in net assets of the related organizations, the university's \$1.5 million increase in net assets resulted in a total increase of \$33.5 million, primarily for donor-restricted endowments whose earnings contribute support to the university.

As ASU launches an ambitious capital campaign within the foreseeable future and its research enterprise continues to mature, the trend of increasing revenues and net assets for the university and its related organizations is expected to continue. The university's evolving financial position reflects both the growing success of the new culture of academic enterprise and the investment of individuals, foundations, corporations, and government who recognize that a competitive world-class university is essential both to the success of the region and the needs of society.



Michael M. Crow
President, Arizona State University

ARIZONA STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

The following Management's Discussion and Analysis (MD&A) of Arizona State University's financial statements provides an overview of the financial position, and programs and activities of the University for the year ended June 30, 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements and the accompanying notes.

The financial statements presented in this report encompass the University and its discretely presented component units; however, the MD&A focuses only on the University, unless specifically stated otherwise. Information on the component units can be found in this report on an aggregated basis in the component units' statement of financial position and statement of activities, as well as in Note M. Financial information for the component units is presented based upon the Financial Accounting Standards Board's (FASB) reporting model for nongovernment non-profit organizations, and is presented on separate pages from the University's financial statements. The University uses the Governmental Accounting Standards Board's (GASB) reporting model for its financial statements.

While audited financial statements for the prior fiscal year are not presented in this report, condensed data from the prior fiscal year is presented in the MD&A in order to identify certain increases and decreases between years. Restatements of certain prior year information have been made in order to present comparable information, but have not been audited.

The three basic financial statements for the University are the statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows.

ASU - Statement of Net Assets

The statement of net assets presents the financial position of the University at the end of the fiscal year using a format that shows current and noncurrent assets and liabilities, and reports net assets in three separate categories. Assets are what the University owns and are generally measured in current value, except for property and equipment, which are recorded at historical cost less accumulated depreciation. Current assets are generally considered to be convertible to cash within one year. Liabilities are what the University owes to others or what it has collected from others before it has provided the related services. Liabilities are typically recorded at current values. Current liabilities are amounts becoming due and payable during the ensuing fiscal year. The statement of net assets provides a picture of the net assets (assets less liabilities) of the University and their availability for expenditure by the University. The change in net assets for the year is generally one indicator of whether the overall financial condition of the University has improved during the year when considered with non-financial facts such as enrollment levels and the condition of the University's facilities.

The University's assets, liabilities, and net assets at June 30, 2004 and 2003 are summarized below (Dollars in millions).

	<u>2004</u>	<u>2003</u>
ASSETS		
Current assets	\$ 170.0	\$ 181.3
Noncurrent assets (excluding capital assets)	268.4	219.1
Noncurrent capital assets, net	<u>1,114.8</u>	<u>976.7</u>
Total Assets	<u>\$ 1,553.2</u>	<u>\$ 1,377.1</u>
LIABILITIES		
Current liabilities	\$ 88.6	\$ 80.0
Noncurrent liabilities	609.4	443.4
Total Liabilities	<u>\$ 698.0</u>	<u>\$ 523.4</u>
NET ASSETS		
Invested in capital assets, net	\$ 598.1	\$ 627.1
Restricted:		
Nonexpendable	44.2	42.4
Expendable	63.1	53.1
Unrestricted	<u>149.8</u>	<u>131.1</u>
Total Net Assets	<u>\$ 855.2</u>	<u>\$ 853.7</u>

Overall the University's financial position showed a \$1.5 million increase in net assets between fiscal 2003 and 2004. Current assets at June 30, 2004, primarily consisted of cash, short-term investments, accounts receivable, and inventories. Overall there was a 6% decrease in current assets between years, due primarily to a shifting of cash and investments between current and noncurrent classifications, with more cash and investments being noncurrent at June 30, 2004. Current cash and investments for fiscal 2004 totaled \$127.5 million, and noncurrent cash and investments totaled \$253.0 million, for a fiscal 2004 cash and investments total of \$380.5 million. Fiscal 2003 current and noncurrent cash and investments as restated were \$144.5 million and \$205.1 million, respectively, for a total of \$349.6 million.

Capital assets, net of accumulated depreciation increased 14%, or \$138.1 million, over the prior fiscal year. Fiscal 2004 saw significantly increased spending on capital projects, especially additions to buildings, as several major projects were completed or nearing completion at year end. By the end of fiscal 2004, ASU had occupied two new classrooms buildings, one each at the Tempe and West campuses, had finalized tenant improvements needed to convert an office building (the Brickyard) in downtown Tempe to the home of the Ira A. Fulton School of Engineering, and made substantial progress on a new Student Union at the East campus and a major research building on the Tempe campus. During fiscal 2004, ASU also recorded a \$35 million increase in capital assets related to a capital lease agreement for a flexible display research building, with a corresponding entry made to record the future lease payments as a noncurrent liability.

Current liabilities increased \$8.6 million between years. The increase primarily resulted from the \$6.9 million current liability recorded for the voluntary retirement program which was offered in fiscal 2004 to eligible faculty members. Faculty members were required to resign or retire by June 30, 2004 with the subsequent payouts to occur in fiscal 2005, resulting in a liability to the University at June 30, 2004. See Note J for more information regarding this program.

Noncurrent liabilities increased \$166.0 million, or 37%, between years largely due to approximately \$134 million in new system revenue bonds debt obligations issued in fiscal 2004, and \$35 million in a capital lease recorded for the Flexible Display Center (FDC) building at the ASU Research Park. The new debt is being utilized for the Biodesign Institute Building A construction, as well as infrastructure and renovation projects, including the renovation of approximately 33,000 gross square feet of various physical and life sciences labs in order to meet current instructional, research, and building code requirements, and to meet the needs of new faculty.

The \$10.0 million increase in restricted expendable net assets was due to activity in Technology and Research Initiatives Funding (TRIF) accounts, as well as quasi-endowment accounts. Unrestricted net assets show an \$18.7 million increase between years primarily due to increases in capital reserve account balances for use on specific strategic initiatives.

ASU - Capital and Debt Activities

The University is serious about its role of financial stewardship and works hard to manage its resources effectively. Valuable space is maximized to best support ASU's academic programs and research. During fiscal 2004 the University incurred \$161.2 million in net new debt obligations in the forms of system revenue bonds, system revenue refunding bonds, refunding certificates of participations, and a capital lease obligation. The revenue bonds primarily fund construction of Biodesign Institute Building A, laboratory renovations, and infrastructure projects. The refunding certificates of participation resulted in a \$0.9 million reduction in future debt service payments, with an economic gain of \$1.2 million based on the present value savings. In April 2004, the University entered into a 30-year capital lease for the Flexible Display Center (FDC) at the ASU Research Park located in south Tempe. The FDC is a multi-use clean room, laboratory, and office facility.

The FDC capital lease was the direct result of the U.S. Army awarding ASU a \$43.7 million five-year cooperative agreement to establish and lead the Army Flexible Display Center with an option for an additional \$50 million over an added five-year period. The ASU-led Center will be a major collaborative university-government-private industry partnership designed to develop flexible, information displays for military and commercial applications.

Major facilities projects completed during this past fiscal year include the Lattie F. Coor Hall, the School of Engineering's Brickyard renovations, and the Classroom and Lab Building at the West campus. Coor Hall is a seven story state-of-the-art instructional and academic center which opened in time for Spring 2004 classes. In December 2003, the Brickyard building in downtown Tempe became home to ASU's Fulton School of Engineering. Moving to the Brickyard allowed for the consolidation of ASU's key research and education efforts in computer information science. Research areas housed in the Brickyard include the Institute for Computer and Information Sciences and Engineering, which centralizes the University's key academic and research programs in computer science.

Major facilities in planning or under construction as of June 30, 2004 included the Biodesign Institute, Buildings A and B; the Interdisciplinary Science and Technology Buildings I, II and III; Instructional/Research Laboratory Renovations Phase I; and Information Technology and Telecommunications Infrastructure Upgrades Phase 1. These projects are scheduled for completion between October 2004 and August 2006. Once completed, they will add over 600,000 square feet of flexible and dedicated research laboratories and related space to the Tempe campus to help ASU compete nationally for research funds and to create and foster an environment to attract and retain the most productive, creative, and innovative research faculty possible.

All of these projects are aligned with the University's strategic priority to recruit the very top level faculty, students, and post-doctoral researchers in order to achieve the envisioned impact for ASU in all areas of its mission - student education, community service, and research discoveries solving world issues.

ASU - Statement of Revenues, Expenses, and Changes in Net Assets

The statement of revenues, expenses, and changes in net assets presents the University's operating, nonoperating, and capital -related financial activity during the fiscal year. This statement differentiates between operating and nonoperating revenues and expenses, and displays the net income or loss from operations for the fiscal year. Operating revenues are generally provided by the University's principal ongoing operations such as student tuition and fees, sponsored research grants and contracts, and sales and services provided by the University's educational departments and self-supporting auxiliary units. State appropriations are considered nonoperating revenues, under the GASB reporting model, as are gifts and other revenues for which the University does not give equal value in exchange for the resources received.

The University's revenues, expenses, and changes in net assets for the years ended June 30, 2004 and 2003, are summarized as follows (Dollars in millions):

	<u>2004</u>	<u>2003</u>
Operating revenues		
Tuition and fees, net	\$ 253.3	\$ 206.2
Federal grants and contracts	136.9	126.3
Auxiliary enterprises, net	94.7	89.3
Other operating revenues	<u>58.6</u>	<u>52.4</u>
Total operating revenues	\$ 543.5	\$ 474.2
Operating expenses	<u>881.3</u>	<u>806.6</u>
Operating loss	\$ (337.8)	\$ (332.4)
Net nonoperating revenues (expenses)		
State appropriations	\$ 312.6	\$ 311.8
Other revenues	62.5	50.6
Other expenses	<u>(45.6)</u>	<u>(32.5)</u>
Loss before other revenues, expenses, gains, or losses	(8.3)	(2.5)
Capital additions and other gains	16.7	9.4
Special item - voluntary retirement program for faculty	<u>(6.9)</u>	<u>-</u>
Increase in net assets	\$ 1.5	\$ 6.9
Net assets, beginning of year	853.7	868.8
Cumulative effect of change in accounting principle		(22.0)
Net assets at end of year	<u>\$ 855.2</u>	<u>\$ 853.7</u>

ARIZONA STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating revenues increased 14% between years with the most material increases occurring in tuition and fees revenues and federal grants and contracts. Tuition and fees, net of scholarship allowances, increased \$47.1 million, or 23%, due to academic year tuition and fees increases of \$1,010 for undergraduate students and \$1,210 for graduate students, as well as a 4% increase in enrollment. The revenues generated from the tuition increase went to substantially increase the University's financial aid commitment, to enhance the student academic experience, and to provide greater faculty support.

The 8%, or \$10.6 million, increase between years in federal grants and contracts was due to a increase in Pell Financial Aid grants of \$4.3 million, and a increase of \$6.3 million in federal research grants. Federal research grants with increased funding in fiscal 2004 included the Flexible Display Center, as well as programs to improve elementary and secondary education by establishing best practices and updating the training of teachers. Increased federal grants were also received for nursing programs to enhance distance learning and to encourage high school students to enter the nursing field. Plant biology projects with increased federal funding included a project to build and test devices to detect bioterrorist agents and to develop immunoprotective countermeasures against pathogenic agents.

Auxiliary enterprises revenues showed a 6%, or \$5.4 million increase primarily due to increases in both bookstore revenues and parking operations revenues. There was a \$5.4 million increase in other operating revenues primarily due to the recording of \$4.4 million in revenues related to the ASU Research Park. Also included in other operating revenues are nongovernmental grants and contracts as well as sales and services of educational departments.

Operating expenses increased by 9%, or \$74.7 million, between years with the increases primarily in the instruction, academic support and scholarships and fellowships (net of scholarship allowances) program areas, and were largely funded by the increase in tuition revenues. Instruction showed a \$27.0 million increase between years, while academic support and scholarships and fellowships showed \$18.9 million and \$7.9 million increases, respectively. Increases in instruction included initiatives to increase available course sections, provide classroom improvements, and fund faculty healthcare benefits. Increased academic support expenses included increased library operating hours, rental of the Brickyard facility for the School of Engineering, as well as technology transfer and intellectual property management fees. Increased scholarship and fellowship expenses were a direct result of the tuition increase. The tuition increase made it possible for ASU to expand its funding of university scholarship programs. The largest increase occurred in an ASU scholarship program that targets undergraduate Arizona resident students from under-represented populations, and students in unique financial circumstances.

The major nonoperating revenue source is state appropriations which showed less than a \$1 million increase between years due to budgetary concerns of the State of Arizona at the time the fiscal 2004 budget was established. This situation was alleviated to some degree in fiscal 2005 where ASU's state appropriations budget has increased to \$335.9 million, including funding for a state mandated pay increase for eligible employees.

Included in nonoperating other revenues are private gifts, technology and research initiative funding (TRIF), and net investment income. Private cash gifts including gifts from the ASU Foundation, increased by 19% between years from \$22.5 million to \$26.7 million. TRIF revenues increased by \$2.9 million, or 16% between years. TRIF is generated from part of an educational sales tax passed by Arizona voters in November 2000 and as such is directly impacted by the health of the Arizona economy. Net investment income showed a \$5.0 million increase between years, with the majority of the increase due to improved investment returns for fiscal 2004. Nonoperating expenses includes interest on debt as well as non-capital equipment expenses for facilities. There was also a significant increase in non-capital expenses for new facilities due to the opening of Coor Hall and the Brickyard renovation project. Fiscal 2004 capital additions and other gains includes \$9.9 million in net gain from the sale of University land which was not in close proximity to any ASU campus, and \$6.8 million in capital gifts and grants.

Net Assets. For fiscal 2004, ASU had a increase in net assets of \$8.4 million before the recording of the liability relating to the \$6.9 million special item for the voluntary retirement program for faculty. After recording this special item, the University had a \$1.5 million increase in net assets.

Another useful presentation of revenues and expenses is by combined sources and uses. Combined sources and uses for the years ended June 30, 2004 and 2003, as restated, follows (Dollars in millions):

SOURCES	2004		2003		Percentage Change
	Dollars	Percentage	Dollars	Percentage	
State appropriations	\$ 312.6	34%	\$ 311.8	37%	-
Tuition and fees, net	253.3	27%	206.2	24%	23%
Grants and contracts	166.3	18%	158.5	19%	5%
Private cash and capital gifts	31.2	4%	28.9	3%	8%
Technology and research initiatives funding	21.6	2%	19.5	2%	11%
Auxiliary enterprises	94.7	10%	89.3	11%	6%
Other sources	55.6	5%	31.8	4%	75%
Total Sources	\$ 935.3	100%	\$ 846.0	100%	10%
USES					
Instruction and academic support	\$ 421.2	45%	\$ 375.3	45%	12%
Research and public service	129.8	14%	122.8	15%	6%
Student services and institutional support	102.0	10%	93.5	11%	9%
Operation and maintenance of plant	45.1	5%	42.0	5%	7%
Scholarships and fellowships, net	45.0	5%	37.1	4%	21%
Auxiliary enterprises	86.4	9%	80.1	9%	8%
Depreciation	51.8	6%	55.9	7%	(8%)
Other uses	52.5	6%	32.4	4%	62%
Total Uses	\$ 933.8	100%	\$ 839.1	100%	11%

Included in other sources is proceeds from the land sale. Included in other uses is the voluntary retirement program for faculty. Depreciation expense decreased between years due to the change in the capitalization threshold.

ASU - Statement of Cash Flows

The statement of cash flows presents information about the changes in the University's cash position using the direct method of reporting sources and uses of cash. The direct method reports all major cash inflows and outflows at gross amounts, differentiating these activities into cash flows arising from operating activities; noncapital financing, including state appropriations; capital and related financing activities, including bond proceeds from debt issued for major capital projects, such as to construct buildings or to upgrade infrastructure; and investing activities.

Cash flows for operating activities will typically be negative for state universities since GASB requires state appropriations, as well as private gifts, to be reported as cash flows from noncapital financing activity. Net cash flows from capital and related financing activities is the difference between capital gifts and grants, bond proceeds, and proceeds from sales of capital assets, less cash used for capital purchases, interest paid on capital debt and leases, and principal paid on capital debt and leases. Cash flows from investing activities show all uses of cash and cash equivalents to purchase investments, and all increases in cash and cash equivalents as a result of selling investments or earning investment income.

The University's primary sources of cash during fiscal 2004 were state appropriations, tuition and fees revenues, federal grant revenues, and bond proceeds. The primary uses of cash were salaries and benefits for faculty, staff, and student employees, payments to suppliers of goods and services to the University, and purchases of capital assets, which includes facility construction and major renovation costs, as well as purchases of capital equipment.

ASU's Component Units (Financially Interrelated Organizations)

In this financial report are the University's component units' financial statements, presented on an aggregated basis and on separate pages from the financial statements of the University. Fiscal 2004 is the first year for the component units to be included in accordance with the requirements of GASB Statement No. 39 - *Determining Whether Certain Organizations Are Component Units*. ASU's component units included in these statements are the ASU Foundation, ASU Alumni Association, Sun Angel Foundation, Sun Angel Endowment, Price-Elliott Research Park Inc. (also known as ASU Research Park), Collegiate Golf Foundation, Arizona Capital Facilities Finance Corporation (ACFFC), and Mesa Student Housing LLC. These component units are non-profit corporations controlled by separate Boards of Directors whose goals are to support Arizona State University. The University does not appoint a voting majority to any of the Boards. Even though these organizations support the University, they are not subsidiaries of the University, nor are they directly controlled by the University. Restatements of certain prior year information have been made in order to present comparable information. For more information on these component units, please refer to Note M. The importance of the component units to the University is that these units hold significant assets and annually receive significant revenues, that benefit the University and/or its students.

An aggregated statement of financial position for the University's component units at June 30, 2004 and 2003 follows (Dollars in millions):

Assets	<u>2004</u>	<u>2003</u>
Cash and investments	\$ 338.2	\$ 300.1
Capital assets, net	99.1	63.4
Receivables, net	58.4	64.5
Other assets	80.7	11.4
Total assets	<u>\$ 576.4</u>	<u>\$ 439.4</u>
Liabilities		
Bonds payable	\$ 191.6	\$ 95.5
Other liabilities	96.6	87.7
Total liabilities	<u>\$ 288.2</u>	<u>\$ 183.2</u>
Net assets		
Permanently restricted	\$ 197.7	\$ 169.8
Temporarily restricted	81.0	78.7
Unrestricted	9.5	7.7
Total net assets	<u>\$ 288.2</u>	<u>\$ 256.2</u>

Included in fiscal 2004 investments on the component units' statement of financial position is \$51.1 million in endowment investments held by the ASU Foundation in trust for the University under terms of an endowment trust agreement. There is a corresponding liability of \$51.1 million recorded, as well as an additional \$5.0 million recorded in other liabilities for funds due the University from the ASU Research Park (\$4.4 million) and the Collegiate Golf Foundation (\$0.6 million). The \$51.1 million in endowment investments held by the ASU Foundation in trust for the University are included in endowment investments on the University's statement of net assets. The University has recorded the \$4.4 million receivable from the ASU Research Park as both a current receivable (\$1.0 million) for the portion anticipated to be received in fiscal 2005, and a noncurrent receivable (\$3.4 million) for the portion anticipated to be received in fiscal 2006, or later. The largest portion of net assets for the component units is permanently restricted endowment funds, primarily at the ASU Foundation, which represent over two-thirds of total net assets. Annual income from permanently restricted endowments is used to support the University, either by the component units or through transfer payments by the component units to the University.

ARIZONA STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

An aggregated statement of activities for the University's component units for the years ended June 30, 2004 and 2003 follows (Dollars in millions):

Revenues	<u>2004</u>	<u>2003</u>
Contributions	\$ 42.9	\$ 70.5
Other revenues	58.1	30.6
Total revenues	<u>\$ 101.0</u>	<u>\$ 101.1</u>
Expenses		
Payments to ASU	\$ 26.8	\$ 29.5
Other expenses	42.2	35.3
Total expenses	<u>\$ 69.0</u>	<u>\$ 64.8</u>
Increase in net assets	<u>\$ 32.0</u>	<u>\$ 36.3</u>
Net assets at beginning of the year	<u>256.2</u>	<u>219.9</u>
Net assets at end of the year	<u>\$ 288.2</u>	<u>\$ 256.2</u>

Included in fiscal 2004 other revenues is \$4.6 million from the University to the Foundation for services provided to the University for development and technology transfer related activities. These expenses are reflected as institutional support and academic support, respectively, on the University's statement of revenues, expenses, and changes in net assets. Included in fiscal 2004 payments to ASU is \$20.7 million in cash donation transfers from the ASU Foundation to ASU academic departments which are recorded as private gifts on the University's statement of revenues, expenses, and changes in net assets.

Combined ASU and Component Units

In reviewing and analyzing the overall financial status of the University, it is important to include the component units due to their significant assets and annual revenues used in support of the University and/or its students. It is also important to know whether the combined net assets of the University and its component units are increasing or decreasing; and to know the composition of the net assets in order to determine the discretion available by the University or its component units in the use of these funds. A high level summary of fiscal 2004 and 2003 financial activity of ASU and its component units on a combined basis follows (Dollars in millions):

	<u>2004</u>			<u>2003</u>		
	ASU	Component Units	Combined	ASU	Component Units	Combined
Net assets at beginning of the year	\$ 853.7	\$ 256.2	\$ 1,109.9	\$ 846.8	\$ 219.9	\$ 1,066.7
Increase in net assets	1.5	32.0	33.5	6.9	36.3	43.2
Net assets at end of year	<u>\$ 855.2</u>	<u>\$ 288.2</u>	<u>\$ 1,143.4</u>	<u>\$ 853.7</u>	<u>\$ 256.2</u>	<u>\$ 1,109.9</u>

At the combined net assets (fund balances) level, there should be no significant eliminations between ASU and its component units. Eliminations would primarily be at the revenues/expenses and assets/liabilities level.

End of the year net assets for the years ended June 30, 2004 and 2003 consisted of the following (Dollars in millions):

	<u>2004</u>			<u>2003</u>		
	ASU	Component Units	Combined	ASU	Component Units	Combined
Invested in capital assets	\$ 598.1		\$ 598.1	\$ 627.0		\$ 627.0
Restricted net assets:						
Nonexpendable/Permanently	44.2	\$ 197.7	241.9	42.4	\$ 169.8	212.2
Expendable/Temporarily	63.1	81.0	144.1	53.1	78.7	131.8
Unrestricted net assets	149.8	9.5	159.3	131.2	7.7	138.9
Net assets at end of year	<u>\$ 855.2</u>	<u>\$ 288.2</u>	<u>\$ 1,143.4</u>	<u>\$ 853.7</u>	<u>\$ 256.2</u>	<u>\$ 1,109.9</u>

Economic Outlook

State appropriations for general operations essentially remained the same in fiscal 2004 as fiscal 2003. A modest increase is occurring for fiscal 2005, with a portion of the fiscal 2005 increase mandated for an employee salary increase. State appropriations for general operations has not kept pace with the growth of the University. Therefore, the University has made ongoing efforts towards diversifying its revenue streams to provide the necessary resources to support excellence in its teaching, research, and public service missions.

Resident undergraduate tuition and fees increased by 39% (\$1,010) and nonresident undergraduate tuition and fees increased by 9% (also \$1,010) for the 2003/2004 academic year. For the 2004/2005 academic year, resident undergraduate tuition increased by 13% and nonresident undergraduate tuition increased by 7% as the University continues efforts to more appropriately value the education provided to its students.

Gifts, grants, and contracts provide vital resources needed to supplement state appropriations and tuition revenues. With the construction and acquisition of research dedicated buildings, the University is striving to provide the essential resources necessary to compete for and ultimately receive governmental as well as private grants and contracts, especially in the biotechnology and bioengineering fields. This course of action proved to be highly successful during fiscal 2004 when ASU was awarded the \$43.7 million flexible display center contract from the U.S. Army, with an option for an additional \$50 million over an added five-year period. Another critical funding source for ASU's continued success is private gifts. Private gifts are significantly important to the University's academic departments for the advancement of quality academic programs, and the University depends on its friends in the community to continue to demonstrate their support and belief in the future of Arizona State University through their generous gifts.

A crucial element to the University's future will be to strengthen its partnerships with other agencies, as shown in its discussions with the City of Phoenix and City of Scottsdale. As mentioned previously, ASU now has a major presence in downtown Tempe with the move of the Ira A. Fulton School of Engineering to the Brickyard during fiscal 2004.

In April 2004, ASU announced plans for the new ASU-Downtown Phoenix Campus. The plans will take place in phases that will require 10 years or longer to complete. ASU plans to ultimately have 15,000 students on the campus to be built in downtown Phoenix. This project is seen as a cornerstone of efforts to revitalize the downtown Phoenix area. Programs expected to move to ASU-Downtown Phoenix include the College of Nursing, the School of Social Work, the Morrison Institute of Public Policy, and the Walter Cronkite School of Journalism and Mass Communication.

ASU is also in the process of establishing the ASU/Scottsdale Center for New Technology and Innovation to be housed in Scottsdale, Arizona. The Center will be a collaboration between the City of Scottsdale, the ASU Foundation, and the University. The ASU Foundation's and University's investment with Scottsdale are expected to create new jobs and generate new businesses in Scottsdale and the region.

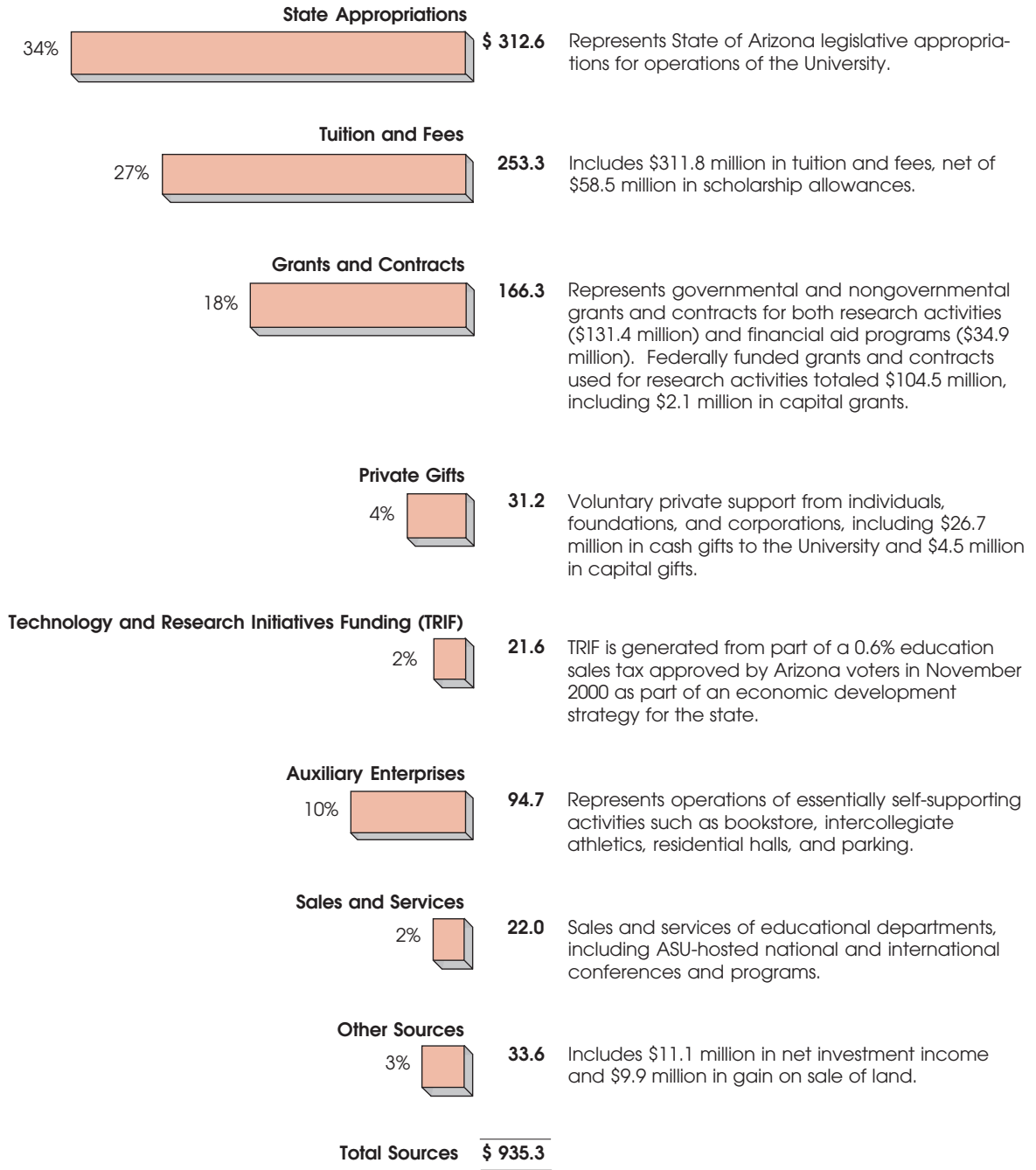


The U.S. Army has awarded Arizona State University a \$43.7 million, five-year cooperative agreement to establish the Army Flexible Display Center (FDC), where flexible, low-power computer displays will be developed that can be continually refreshed with new data and carried in the field. This \$43.7 million agreement has a performance period of five years with an option for an additional \$50 million over an added five-year period. The University leases from ACFFC, a component unit of the University, the building which houses the FDC.

ARIZONA STATE UNIVERSITY COMBINED SOURCES AND USES

Sources

For the year ended June 30, 2004
(Dollars in millions)



Note:

The Combined Sources and Uses statement highlights major financial data. The explanations provided are not intended to be all-inclusive.

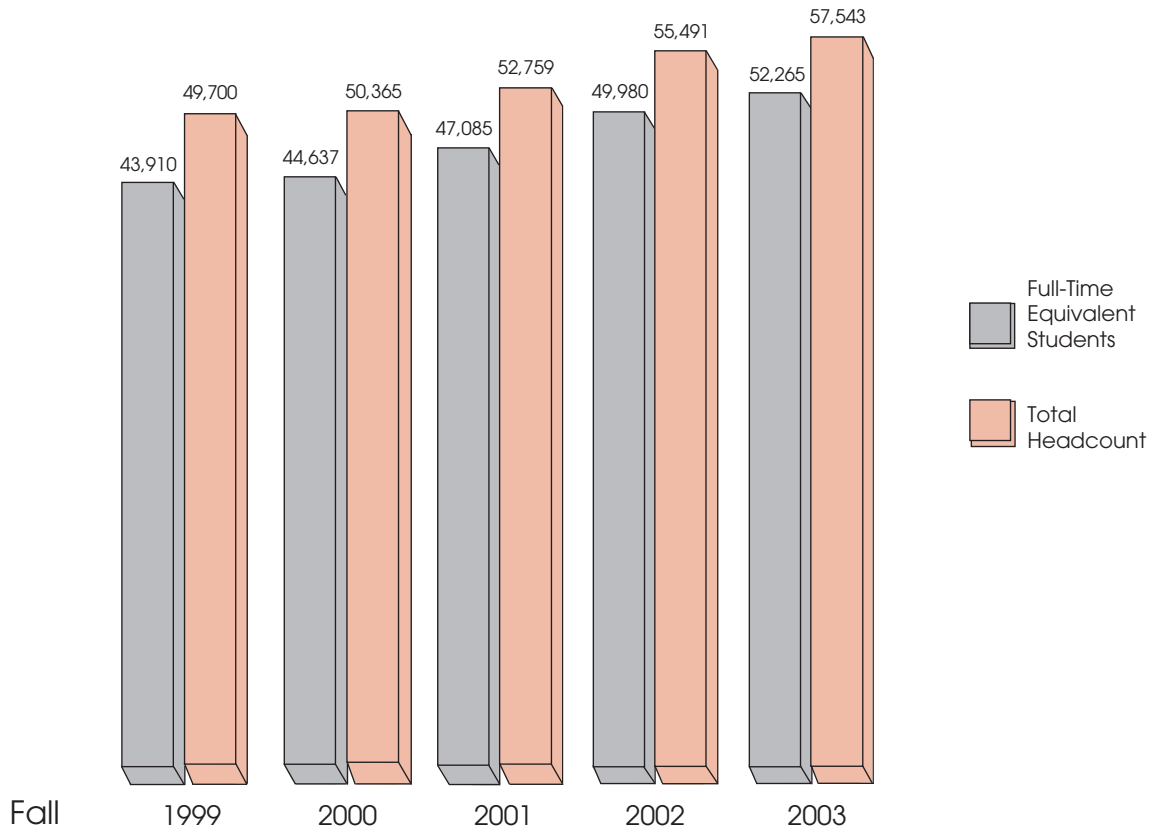
This statement provides an overview of total University financial operations including the ASU Tempe, West, and East campuses, and the ASU Downtown Center. Restricted and unrestricted operating and nonoperating funds are included. Restricted funds have specific purposes stipulated by outside donors and agencies.

Unrestricted funds may be designated by management for specified purposes, including academic and research programs and initiatives, or capital projects. Sources and uses are allocated and controlled by budgets.

Uses

45%	Instruction and Academic Support 	\$ 421.2	Consists of (1) instruction expenses totaling \$310.8 million, which include credit and non-credit courses for academic, occupational, and vocational instruction for regular academic year and summer sessions, and continuing education, and (2) academic support expenses totaling \$110.4 million, which include libraries, academic information technology support, and academic administration.
14%	Research and Public Service 	129.8	Represents (1) research expenses of \$99.6 million for activities specifically organized to produce research outcomes, and (2) public service expenses of \$30.2 million for non-instructional services beneficial to individuals and groups external to the University, such as public broadcasting and community service programs.
10%	Student Services and Institutional Support 	102.0	Consists of (1) student services expenses totaling \$33.8 million, which include admissions, registrar, student activities, counseling, career guidance, student financial aid administration, and student health services, and (2) institutional support expenses of \$68.2 million, which include financial operations, human resources, public safety, community relations, and administrative information technology support.
5%	Operation and Maintenance of Plant 	45.1	Represents expenses for the operation and maintenance of plant, including services related to facilities and grounds, and utility costs. Not included are amounts charged to auxiliary enterprises.
5%	Scholarships and Fellowships 	45.0	Includes restricted grants, including \$30.3 million of federally funded Pell grants, and institutionally awarded merit and need-based scholarships.
9%	Auxiliary Enterprises 	86.4	Consists of departments managed as essentially self-supporting activities that furnish services to students and staff for a fee directly related to, but not necessarily equal to, the cost of the service.
6%	Depreciation 	51.8	Depreciation is computed using the straight-line method over the estimated useful life of each asset.
6%	Other Uses 	52.5	Consists primarily of interest payments on debt service and non-capital expenses on plant project accounts, including \$11.7 million of non-capital equipment for new facilities. Also includes \$6.9 million related to the voluntary retirement program for faculty. See Note J.
Total Uses		\$ 933.8	
Net Increase in Net Assets		1.5	
		<u>\$ 935.3</u>	

ARIZONA STATE UNIVERSITY ENROLLMENT



Degrees Granted in Academic Year 2003-2004

Undergraduate	9,116
Graduate	3,410
	<u>12,526</u>

Fall 2003 Enrollment

Undergraduate	45,430
Graduate	12,113
<hr/>	
In-State	43,163
Out-of-State	14,380

INDEPENDENT AUDITORS' REPORT



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

Members of the Arizona State Legislature

The Arizona Board of Regents

We have audited the accompanying financial statements of the business-type activities and aggregate discretely presented component units of Arizona State University 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 A, 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 Arizona State University 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 A, 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. Also, as described in Note A, the University increased its capitalization threshold for equipment and works of art, which represents a change in the application of an accounting principle.

The information included in the Management's Discussion and Analysis, Enrollment, and Combined Sources and Uses 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

October 15, 2004

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

ARIZONA STATE UNIVERSITY STATEMENT OF NET ASSETS

June 30, 2004
(Dollars in thousands)

ASSETS

Current Assets:	
Cash and cash equivalent investments	\$ 119,776
Short-term investments	7,758
Accounts receivable, net of allowance of \$2,935	32,623
Student loans receivable	1,211
Inventories	7,510
Deferred expenses	1,089
Total Current Assets	<u>\$ 169,967</u>
Noncurrent Assets:	
Restricted cash and cash equivalent investments	\$ 114,101
Restricted investments with bond trustee	446
Endowment investments	68,152
Other investments	70,290
Accounts receivable	3,394
Student loans receivable, net of allowance of \$1,310	10,767
Deferred expenses	1,309
Capital assets, net of accumulated depreciation	1,114,808
Total Noncurrent Assets	<u>\$ 1,383,267</u>
Total Assets	<u>\$ 1,553,234</u>

LIABILITIES

Current Liabilities:	
Accounts payable and accrued liabilities	\$ 33,246
Voluntary retirement program liability (Note J)	6,880
Compensated absences	1,444
Employee retirement and benefits deposits	3,405
Deferred revenues	24,125
Funds held for others	14,477
Bonds payable	1,396
Lease purchases	3,668
Total Current Liabilities	<u>\$ 88,641</u>
Noncurrent Liabilities:	
Compensated absences	\$ 16,899
Employee retirement and benefits deposits	4,293
Other liabilities	630
Bonds payable	410,008
Lease purchases	142,602
Capital leases	35,000
Total Noncurrent Liabilities	<u>\$ 609,432</u>
Total Liabilities	<u>\$ 698,073</u>

NET ASSETS

Invested in capital assets, net of related debt	\$ 598,105
Restricted for:	
Nonexpendable:	
Scholarships and fellowships	26,475
Academic department uses	6,551
Student loans	11,209
Expendable:	
Scholarships and fellowships	15,897
Academic department uses	35,696
Student loans	1,366
Capital projects	246
Debt service	9,891
Unrestricted (Note H)	<u>149,725</u>
Total Net Assets	<u><u>\$ 855,161</u></u>

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

ARIZONA STATE UNIVERSITY COMPONENT UNITS' STATEMENT OF FINANCIAL POSITION

June 30, 2004
(Dollars in thousands)

ASSETS	
Cash and cash equivalent investments	\$ 6,457
Receivables-	
Pledges receivables	50,616
Other receivables	<u>7,766</u>
Total Receivables	58,382
Investments-	
Investments in securities	272,401
Investments held in trust for ASU	51,070
Other investments	<u>8,331</u>
Total Investments	331,802
Net direct financing leases	35,100
Property and equipment, net of accumulated depreciation	99,084
Other assets	<u>45,618</u>
Total Assets	<u>\$ 576,443</u>
LIABILITIES	
Liability under ASU endowment trust agreement	\$ 51,070
Bonds payable	191,646
Unearned revenue	13,785
Other liabilities	<u>31,724</u>
Total Liabilities	<u>\$ 288,225</u>
NET ASSETS	
Permanently restricted	\$ 197,714
Temporarily restricted	81,016
Unrestricted	<u>9,488</u>
Total Net Assets	<u><u>\$ 288,218</u></u>

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

ARIZONA STATE UNIVERSITY STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Year ended June 30, 2004
(Dollars in thousands)

OPERATING REVENUES	
Student tuition and fees, net of scholarship allowances of \$58,464	\$ 253,302
Federal grants and contracts -	
Research grants and contracts	102,415
Financial aid grants	34,505
State and local grants and contracts	5,478
Nongovernmental grants and contracts	21,553
Sales and services -	
Auxiliary enterprises, net of \$1,492 in scholarship allowances	94,675
Educational departments	21,972
Other revenues	9,626
	\$ 543,526
OPERATING EXPENSES (Note I)	
Educational and general -	
Instruction	\$ 310,827
Research	99,578
Public service	30,187
Academic support	110,348
Student services	33,832
Institutional support	68,256
Operation and maintenance of plant	45,116
Scholarships and fellowships	44,977
Auxiliary enterprises	86,432
Depreciation	51,763
	\$ 881,316
Total Operating Expenses	\$ 881,316
Operating Loss	\$ (337,790)
NONOPERATING REVENUES (EXPENSES)	
State appropriations	\$ 312,594
Technology and research initiatives funding (TRIF)	21,562
Private gifts	26,739
Financial aid trust funds	3,050
Net investment income	11,117
Interest on indebtedness	(19,557)
Other expenses, including \$11.7 million of non-capital equipment for new facilities	(26,063)
	\$ 329,442
Net Nonoperating Revenues	\$ 329,442
Loss Before Other Revenues, Expenses, Gains, or Losses	\$ (8,348)
Capital grants	\$ 2,359
Capital private gifts	4,450
Gain on sale of land	9,906
Additions to permanent endowments	28
Special item - voluntary retirement program for faculty (Note J)	(6,880)
	1,515
Increase in Net Assets	1,515
Net Assets at Beginning of Year, as Restated (Note A)	853,646
Net Assets at End of Year	\$ 855,161

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

ARIZONA STATE UNIVERSITY COMPONENT UNITS' STATEMENT OF ACTIVITIES

Year ended June 30, 2004
(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Totals</u>
REVENUES				
Contributions	\$ 6,453	\$ 21,540	\$ 14,879	\$ 42,872
Rental revenue	10,949			10,949
Sales and services	6,269			6,269
Net investment income	2,747	3,527	13,058	19,332
Net assets released from restrictions	31,436	(31,436)		
Other revenues	12,875	8,692	28	21,595
	<u>70,729</u>	<u>2,323</u>	<u>27,965</u>	<u>101,017</u>
Total Revenues	<u>\$ 70,729</u>	<u>\$ 2,323</u>	<u>\$ 27,965</u>	<u>\$ 101,017</u>
EXPENSES				
Payments to ASU-				
Cash donation transfers	\$ 20,727			\$ 20,727
Cost reimbursements	2,607			2,607
Property donation transfers	678			678
Scholarship funds	2,807			2,807
Program services	11,996			11,996
Personal services, operations, and administrative expenses	16,272			16,272
Fundraising expenses	5,296			5,296
Interest	3,290			3,290
Other expenses	5,303			5,303
	<u>68,976</u>			<u>68,976</u>
Total Expenses	<u>\$ 68,976</u>			<u>\$ 68,976</u>
Increase in Net Assets	1,753	2,323	27,965	32,041
Net Assets at Beginning of Year	7,735	78,693	169,749	256,177
Net Assets at End of Year	<u>\$ 9,488</u>	<u>\$ 81,016</u>	<u>\$ 197,714</u>	<u>\$ 288,218</u>

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

ARIZONA STATE UNIVERSITY STATEMENT OF CASH FLOWS

Year ended June 30, 2004
(Dollars in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	
Student tuition and fees	\$ 242,737
Grants and contracts (federal, state, local, and nongovernmental)	167,661
Sales and services of auxiliary enterprises	91,867
Sales and services of educational activities	22,671
Payments to employees for salaries and benefits	(570,307)
Payments to suppliers for goods and services	(203,403)
Payments for scholarships and fellowships	(50,561)
Student loans issued	(2,748)
Student loans collected	2,761
Other receipts	5,232
Net cash used for operating activities	<u>\$ (294,090)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State appropriations	\$ 312,594
Technology and research initiatives funding (TRIF)	21,444
Private gifts for other than capital purposes	26,397
Financial aid trust funds	3,183
Direct lending program receipts	154,095
Direct lending program disbursements	(153,942)
Funds held for others received	87,684
Funds held for others disbursed	(83,050)
Other payments	(21,107)
Net cash provided by noncapital financing activities	<u>\$ 347,298</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Capital gifts and grants	\$ 3,375
Proceeds from issuance of capital debt	134,000
Purchases of capital assets	(151,368)
Proceeds from sale of land, net	10,448
Principal paid on capital debt and leases	(9,751)
Interest paid on capital debt and leases	(21,485)
Net cash used for capital and related financing activities	<u>\$ (34,781)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales and maturities of investments	\$ 181,761
Purchases of investments	(210,870)
Interest received on investments	12,363
Net cash used for investing activities	<u>\$ (16,746)</u>
Net increase in cash and cash equivalent investments	1,681
Cash and cash equivalent investments at beginning of year, as restated	<u>232,196</u>
Cash and cash equivalent investments at end of year	<u>\$ 233,877</u>
Reconciliation of operating loss to net cash used for operating activities:	
Operating loss	\$ (337,790)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation	51,763
Changes in assets and liabilities:	
Increases in -	
Accounts receivable, net	(9,073)
Student loans receivable, net	(13)
Compensated absences	1,302
Deferred revenues	458
Decreases in -	
Inventories	280
Deferred expenses	892
Accounts payable and accrued liabilities	(1,170)
Employee retirement and benefits deposits	(739)
Net cash used for operating activities	<u>\$ (294,090)</u>
SIGNIFICANT NONCASH TRANSACTIONS	
Assets acquired through capital lease	\$ 35,000
Refinancing of long-term debt	32,360
Losses on disposal of capital assets, net	(5,152)

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

ARIZONA STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

Note A - Organization and Summary of Significant Accounting Policies

The accounting policies of Arizona State University conform to generally accepted accounting principles applicable to public institutions engaged only in business-type activities adopted by the Governmental Accounting Standards Board (GASB).

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

Reporting Entity

Arizona State University is a major research university located in metropolitan Phoenix with a total Fall 2003 enrollment of 57,543 students. The accompanying statements of the University include the activity of the Tempe campus (located in Tempe), West campus (located in northwest Phoenix adjacent to Glendale), East campus (located in Mesa), and the ASU Downtown Center (located in downtown Phoenix and housing the ASU Extended Campus), as well as its discretely presented component units. For financial reporting purposes, the University's portion of the statements includes those funds directly controlled by the University. Control by the University is determined on the basis of financial accountability. The University is classified as a state instrumentality per Internal Revenue Code Section 115. Since fiscal responsibility for the University remains with the State of Arizona, the University is considered a part of the reporting entity for the State's financial reporting purposes.

Also included are the Arizona State University's discretely presented component units, comprised of its major component unit, the ASU Foundation, and several smaller component units consisting of the ASU Alumni Association, Sun Angel Foundation, Sun Angel Endowment, Price-Elliott Research Park, Inc., Collegiate Golf Foundation, Arizona Capital Facilities Finance Corporation (ACFFC), and Mesa Student Housing, LLC.

These component units are non-profit corporations controlled by separate Boards of Directors whose goals are to support Arizona State University. The University does not appoint a voting majority to any of the Boards. Even though these organizations support the University, they are not subsidiaries of the University, nor are they directly controlled by the University. The assets of the component units are the property of the component units and do not belong to the University. The University does not have ownership of the financial and capital resources of the component units and does not have the authority to mortgage, pledge, or encumber the assets of these organizations.

All of the organizations, except for the Collegiate Golf Foundation, are included as discretely presented component units in accordance with GASB Statement Nos. 14 and 39, since they are all legally separate tax-exempt organizations in which:

- The economic resources received or held by the separate organizations are entirely or almost entirely for the direct benefit of the University, its component units, or its constituents;
- The University is entitled to, or has the ability to otherwise access a majority of the economic resources received or held by the separate organizations; and
- 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.

The Collegiate Golf Foundation is included as a discretely presented component unit because it is a legally separate organization that the University believes would be misleading to exclude due to its financial relationship to the University, and for consistency in the reporting of all component units.

Four of these organizations—the ASU Foundation, ASU Alumni Association, Sun Angel Foundation, and Sun Angel Endowment receive funds primarily through donations and dues, and contribute funds to the University for support of various programs.

For the ASU Foundation, the major component unit, the resources of the Foundation are disbursed at the discretion of the Foundation's independent board of trustees, in accordance with donor directions and Foundation policy. The majority of assets held by the Foundation are endowments restricted for donor specified programs and purposes, the principal of which may not be spent. The trustees of the Foundation are entitled to make all decisions regarding the business affairs of the Foundation, including without limitation, distributions made to the University.

A fifth organization, the Price-Elliott Research Park, Inc. (Park), is developing a research park to promote and support research activities, in coordination with the University. In developing the research park, the Park has issued bonds guaranteed by the University.

A sixth financially interrelated organization, the Collegiate Golf Foundation, operates a University-owned golf course.

The seventh and eighth organizations, Arizona Capital Facilities Finance Corporation and Mesa Student Housing, LLC, are providing facilities for either use by students of the University or the University itself.

For financial reporting purposes at the University level, only the component units' statement of financial position and statement of activities are included in the University's financial statements as required by generally accepted accounting principles for public colleges and universities.

Financial statements of these component unit organizations are audited by independent auditors. All of the above units have a fiscal year end of June 30, 2004. Because the University's component units use a nongovernmental generally accepted accounting principles (GAAP) reporting model, the University has chosen to present their aggregated financial information on pages separate from the financial statements of the University. To obtain individual audited financial statements for any of the aforementioned component units, please contact: Arizona State University Financial Services, P.O. Box 875812, Tempe, AZ 85287-5812; or (480) 965-3601.

ASU's Basis of Presentation and Accounting

The accompanying financial statements of the University include a statement of net assets; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows, each of which provide a comprehensive, entity-wide perspective of the University. A statement of net assets provides information about the assets, liabilities, and net assets of the University at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to external donor restrictions,

ARIZONA STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

or availability of assets to satisfy the University's obligations. A 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 additions and additions to endowments. A 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 and related financing, or investing activities.

The University's portion of the financial statements have been prepared in accordance with generally accepted accounting principles as prescribed 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 such pronouncements conflict with GASB pronouncements. The University has elected not to apply the FASB Statements and Interpretations issued after November 30, 1989 to its financial statements.

For financial reporting purposes under GASB, the University is considered a public institution engaged only in business-type activities. Accordingly, the University's financial statements have been presented under the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus emphasizes the long-term effects of operations on overall net resources, i.e., total assets and total liabilities. The statement of revenues, expenses, and changes in net assets prepared using the economic resources measurement focus includes only transactions and events that increase or decrease net assets during the year. Under the accrual basis, revenues are recognized when earned and expenses are recorded when an obligation has been incurred, or benefit has been received. All significant intra-university transactions have been eliminated.

Change in Accounting Principle

In fiscal 2004, the University increased its capitalization threshold for equipment and works of art and historical treasures to \$5,000, which resulted in the restatement of net assets reflected below. The change in capitalization threshold was adopted to enhance the University's asset management process and capital asset data integrity. The University's net assets reported as of June 30, 2003, have been restated as follows:

Net assets June 30, 2003, as previously reported	\$ 875,741
Cumulative effect of change in capitalization thresholds	(22,095)
Net assets July 1, 2003, as restated	<u>\$ 853,646</u>
	<u> </u>

Summary of Significant Accounting Policies

Cash and cash equivalent investments. In accordance with GASB Statement No. 9, all highly liquid investments with an original maturity of three months or less, are considered to be cash and cash equivalent investments. University funds invested through the State of Arizona's Local Government Investment Pool are considered cash and cash equivalent investments, since such investments are available for withdrawal by the University at any time, even though some of the investments of the Pool are invested for over three months.

Investments. Short-term, endowment, and other investments are stated at fair value at June 30, 2004. Fair value typically is the quoted market price for investments. Investment income includes realized and unrealized gains and losses on investments.

Accounts receivable. Accounts receivable includes \$9 million related to student tuition and fee payments due from students and agencies making payments on behalf of students, and \$8 million for auxiliary enterprises provided to students, faculty, and staff, with over half the balance related to the Bookstore. Also included is \$4 million due from the State of Arizona, including \$3.4 million in technology and research initiatives funding. Also outstanding at June 30, 2004 was \$2 million from Federal grant sponsors and \$2 million from nongovernmental grant sponsors, primarily for the reimbursement of allowable expenses made pursuant to the University's grants and contracts. The University has also recorded a \$4.4 million receivable from the Price-Elliott Research Park, a component unit of the University.

Student loans receivable. Loans receivable from students bear interest primarily at 5% and are generally repayable in installments to the University over a ten-year period commencing nine months from date of separation from the University. Student loans receivable are recorded net of an allowance for estimated uncollectible amounts and related collection costs.

Inventories. Auxiliary enterprises use various methods to value their inventory. The ASU Bookstore comprises approximately 77% of the total inventory reported on the statement of net assets and its inventory is valued at cost using the retail method.

Capital assets. Capital assets are recorded at cost at the date of acquisition, or fair market value at the date of donation in the case of gifts. The University's capitalization policy includes all equipment and works of art and historical treasures with a unit cost of \$5,000 or more. New construction, as well as, renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of structures and have a project cost of at least \$100,000 are capitalized. Non-capital equipment and facility costs, routine repairs, and maintenance are charged to operating expenses in the year in which the expense was incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 40 years for buildings and infrastructure, 10 years for library books, and 5 to 12 years for equipment. The University does not depreciate works of art and historical treasures that are considered inexhaustible and are held for exhibition, education, research, and public service.

Compensated absences. Compensated absences are employee vacation leave balances, which have been earned, but not used. Vacation leave benefits are accrued as a liability on the statement of net assets and reported as an expense in the statement of revenues, expenses, and changes in net assets as employees earn the benefits.

Deferred revenues. Deferred revenues consist primarily of student tuition and fees and residential housing payments related to the ensuing year. Also included are amounts received from grant and contract sponsors which have not yet been earned.

Lease purchases. The University records as a lease purchase, direct financing arrangements where the University is directly acquiring property by the leasing of the property from lenders or the seller of the property, with title to the property transferring from the lenders or sellers to the University upon completion of the lease payments, consisting of principal and interest.

Capital leases. In accordance with FASB Statement No. 13: *Accounting for Leases*, the University records as a capital lease, property arrangements with a separate entity where the University is leasing a building constructed or acquired and owned by the separate entity, but located on University owned land. Upon eventual termination of the ground lease, the University through the ground lease termination, receives effective title to the building. The net present value of the building lease payments are recorded as a building acquisition with a corresponding liability of capital leases.

Net assets. The University's net assets are classified based on the following three categories:

- ◆ Invested in capital assets, net of related debt: includes capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.
- ◆ Restricted:
 - Nonexpendable – gifts that have been received for endowment purposes, the corpus of which cannot be expended, and the balance in the Perkins Loan program.
 - Expendable – grants, contracts, gifts, and other resources that have been externally restricted for specific purposes.
- ◆ Unrestricted: all other net assets, including those designated by management for specific purposes. Substantially all unrestricted net assets are committed and/or designated for educational and research programs and initiatives, or capital projects.

When an expense is incurred that can be paid from either restricted or unrestricted net assets, the University's policy is to allow the department incurring the expense to determine the appropriate funding source. Factors used by departments to determine which resources to use include relative priorities of the department in accordance with the University's strategic initiatives, externally imposed matching requirements of certain restricted funds, and any pertinent lapsing provisions of the available restricted or unrestricted funding resources. Major capital purchases are many times split funded from multiple restricted and unrestricted funding sources.

Revenues. Revenues and expenses are classified as operating or nonoperating. Operating expenses are those incurred in conducting the primary programs and services of the University. Generally, revenues generated by the University, such as student tuition and fees, sales and services of auxiliary enterprises, and most Federal, state, local, and private research grants and contracts are considered operating. Other significant revenues relied upon for operations, including state appropriations, private gifts, and investment activity, are considered nonoperating revenues, as defined by GASB Statement No. 35.

Scholarship allowances. Student tuition and fee revenues and other student related revenues are reported net of scholarship allowances in the statement of revenues, expenses, and changes in net assets. Scholarship allowances are the difference between the stated charge for services provided by the University, and the amount that is paid by the students (and/or third parties making payments on a student's behalf). To the extent that revenues from programs such as Pell Grants and University funded scholarships are used to satisfy tuition and fees, and other student charges, the University has recorded a scholarship allowance.

Not included in scholarship allowances is \$4.7 million in faculty and staff tuition waivers that are recorded as either instruction or institutional support program expenses on the statement of revenues, expenses, and changes in net assets – and as personal services and benefits expenses, in Note I.

Technology and research initiatives funding (TRIF). As passed by Arizona voters in November 2000, TRIF is generated from a part of a 0.6% education sales tax. Collection of the tax began on June 1, 2001. As the governing board of the three state universities, the Arizona Board of Regents (the Board) administers the portion of the collected education sales tax which funds the universities' TRIF initiatives. The Board receives funding requests from each university and determines the amount and duration of awards. The Board is required to submit an annual report to the governor and other Arizona state officials which uses a detailed set of performance measures to determine the overall effectiveness of each TRIF funded initiative.

Note B - Cash and Investments

Under Arizona State law and Arizona Board of Regents' policies, the University may invest its operating funds only in the State of Arizona Local Government Investment Pool, collateralized time certificates of deposit or repurchase agreements, U.S. Treasury securities, or Federal agency securities. Gift and endowment funds may be invested under the direction of an investment committee in such a manner as to obtain the most favorable rate of return and income stability commensurate with safety of principal. Bond trustee funds are invested by the bond trustee in accordance with the financing indenture. The beginning cash and cash equivalents balance at July 1, 2003 required restatement on the Statement of Cash Flows due to the reclassification of investments with bond trustee to cash equivalents based on a new assessment of those investments. Components of cash and investments at June 30, 2004 consisted of the following (Dollars in thousands):

	<u>Fair Value</u>
<u>Cash and Cash Equivalent Investments</u>	
Operating funds:	
State of Arizona Local Government Investment Pool, net of outstanding checks	\$ 119,776
Noncurrent:	
Restricted funds with bond trustee	114,101
<u>Current Short-term Investments</u>	
Operating funds:	
U.S. Treasury and Other Federal Agency Securities	7,758
<u>Noncurrent Investments</u>	
Endowment funds:	
Arizona State University Foundation, as endowment investment manager and trustee for the University	51,070
Arizona Universities' Financial Aid Trust	17,082
Operating funds:	
U.S. Treasury and Other Federal Agency Securities	70,290
Bond trustee funds:	
Guaranteed Investment Contract	446
Total Cash and Investments	<u>\$ 380,523</u>

ARIZONA STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Bond trustee funds. The bond trustee funds are managed by Bank of New York, U.S. Bank, and J.P. Morgan Chase, and generally consist of U.S. Government securities (Treasury securities or other Federal agency securities), cash, certificates of deposit, and Federal money market accounts. Each bank's trust department purchases U.S. Government securities for the University. U.S. Government securities are held by either the Federal Reserve Bank or the Depository Trust Company (DTC) in custodial accounts for Bank of New York, U.S. Bank, and J.P. Morgan Chase in computerized book-entry systems in which changes of financial institutions' interests are recorded. In turn, change in the University's ownership interests are recorded in Bank of New York's, U.S. Bank's, and J.P. Morgan Chase's records.

Generally, funds not directly invested in U.S. Government securities are invested in pooled Federal money market accounts in which securities are purchased and held by the trustee. Occasionally, small cash balances are maintained, or certificates of deposit are purchased by the bank's trust department. For cash and certificates of deposit, book-entry pledges of Federal government securities are obtained as collateral and held by the trust department on a pooled basis.

Endowment funds. The University has entered into a contract for management of its pooled endowment funds by the ASU Foundation with the objective of attracting a higher level of asset management and more diversification of the portfolio than available by the University. The University still retains its fiduciary responsibility and oversight over the endowment funds managed by the ASU Foundation. The ASU Foundation is a nonprofit corporation that exists to support ASU. The endowment funds are invested in a diversified portfolio that is actively managed by outside managers retained by the ASU Foundation. The University's endowment spending policy is the same as the ASU Foundation's policy described in Note M. The financial aid trust fund is funded from student fees and by the Arizona State Legislature. The fund is managed in a pool by the University of Arizona along with the financial aid trust funds for the other two state universities.

Pooled cash and short-term investments. Pooled cash and short-term investments at June 30, 2004, were principally with the State of Arizona Local Government Investment Pool. The State Board of Investment provides oversight for the State Treasurer's pools, and the Local Government Investment Pool Advisory Committee provides consultation and advice to the Treasurer. The fair value of a participant's position in the pool approximates the value of that participant's pool shares. The University's investment in the pool represents shares in that pool's portfolio. The shares are not identified with specific investments and are not subject to custodial credit risk. The University also has investments in U.S. Treasury securities and Federal agency securities. U.S. Treasury and Federal agency securities are held in the custodial account of Bank of New York with the Federal Reserve Bank or DTC and in the University's name in the bank's records. These securities are either purchased from a broker/dealer or a financial institution.

The University's bank and collected (portion of bank balance available for investment) balances at the bank at June 30, 2004, were \$4.1 million and \$0.6 million, respectively, and the carrying value of deposits on the University's accounting system was a deficit \$6.8 million. The carrying value of deposits balance has been netted against the State of Arizona Local Government Investment Pool in the preceding table. The cash deficit balance on the accounting system occurs because cash is not transferred from investments to the bank account until outstanding checks are expected to be presented to the bank for payment. The University's deposits are fully collateralized with governmental securities (U.S. or investment grade municipals) held by either the bank's agent or the bank's agent's custodial account with either the Federal Reserve or the DTC in the University's name.

Note C - Capital Assets

Capital asset activity for the year ended June 30, 2004 consisted of the following (Dollars in thousands):

	Beginning Balances (as restated)	Additions/ Increases	Retirements/ Decreases	Ending Balances
Capital Assets:				
Land	\$ 72,333	\$ 1,462	\$ (974)	\$ 72,821
Infrastructure	84,225	7,936		92,161
Buildings	917,750	152,084	(1,329)	1,068,505
Construction in Progress	69,231	2,816		72,047
Equipment	206,741	18,050	(19,321)	205,470
Works of Art and Historical Treasures	30,591	778	(315)	31,054
Library Books	161,632	11,946	(500)	173,078
Total	<u>\$ 1,542,503</u>	<u>\$ 195,072</u>	<u>\$ (22,439)</u>	<u>\$ 1,715,136</u>
Less Accumulated Depreciation:				
Infrastructure	\$ 23,876	\$ 2,134		\$ 26,010
Buildings	294,511	24,257	\$ (479)	318,289
Equipment	130,607	16,568	(16,310)	130,865
Library Books	116,860	8,804	(500)	125,164
Total	<u>\$ 565,854</u>	<u>\$ 51,763</u>	<u>\$ (17,289)</u>	<u>\$ 600,328</u>
Capital Assets, Net	<u>\$ 976,649</u>	<u>\$ 143,309</u>	<u>\$ (5,150)</u>	<u>\$ 1,114,808</u>

The capital assets net beginning balances have been adjusted by \$22.0 million to reflect a change in the capitalization threshold for equipment and works of art and historical treasures to \$5,000, effective for fiscal 2004. Also, effective for fiscal 2004 the capitalization threshold for facility project costs increased to \$100,000. Construction in progress additions represent expenses for new projects net of capital assets placed in service. It is estimated \$187.9 million in additional expenses will be required to complete projects under construction at June 30, 2004.

Note D - Bonds Payable

Bonds payable at June 30, 2004, consisted of the following (Dollars in thousands):

	Average Interest Rate	Final Maturity	Balance 7/1/2003	Additions	Reductions	Balance 6/30/2004	Current Portion
Housing Revenue Bonds	3.70%	2004	\$ 638		\$ (582)	\$ 56	\$ 56
1989 System Revenue Bonds	7.09%	2004	2,590		(2,590)		
1991 System Revenue Bonds	7.13%	2005	2,965		(1,430)	1,535	
1993 System Revenue Refunding Bonds	4.93%	2008	18,005		(1,765)	16,240	
2000 System Revenue Bonds	5.86%	2025	14,150		(335)	13,815	
2002 System Revenue Bonds	4.84%	2027	85,000		(655)	84,345	1,340
2002 System Revenue Refunding Bonds	4.16%	2019	139,505		(3,225)	136,280	
2003 System Revenue Refunding Bonds	4.35%	2017	7,130			7,130	
2003 A/B Variable Rate Demand System Revenue Bonds	1.04%	2035		\$ 103,000		103,000	
2004 System Revenue and Refunding Bonds	4.93%	2035		39,250		39,250	
Subtotal: Par Amount of Bonds			\$ 269,983	\$ 142,250	\$ (10,582)	\$ 401,651	\$ 1,396
Premium on Sale of Bonds			10,556	1,560	(1,248)	10,868	
Deferred Amount on Refundings			(2,393)	(337)	1,615	(1,115)	
			<u>\$ 278,146</u>	<u>\$ 143,473</u>	<u>\$ (10,215)</u>	<u>\$ 411,404</u>	<u>\$ 1,396</u>

In October 2003, the University issued two series of Variable Rate Demand System Revenue Bonds, Series 2003A and 2003B, totaling \$103 million. Both series of bonds bear interest at a weekly rate determined by the respective remarketing agent. Both series of bonds have a final maturity date of July 1, 2034. The bonds are subject to conversion, at the option of the Arizona Board of Regents on behalf of the University, to a different or alternate adjustable rate mode, or a fixed rate pursuant to the debt documents. If not converted, the Series 2003A and Series 2003B bonds will bear interest at a weekly rate not to exceed 12% per annum based upon prevailing market conditions, as determined by the respective remarketing agents. The bonds were issued primarily to fund the construction of Biodesign Institute A building, infrastructure improvements, and other Tempe campus projects. The interest rates in effect at June 30, 2004 was 1.04% for the Series 2003A and 1.05% for the Series 2003B bonds. The remaining bonds of the University are fixed rate bonds.

The variable rate bonds 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 bonds, the University has a Standby Purchase Agreement with Bank of America, N.A. to extend credit through the purchase of the unremarketed bonds. Assuming all of the \$51.5 million Series 2003A bonds and \$51.5 million Series 2003B bonds are not resold within 90 days, the University would be responsible to make annual installment principal payments of \$20.6 million over a five-year period, plus interest to be calculated as established in the Standby Purchase Agreement. The University has agreed to pay Bank of America, N.A. an annual commitment fee of 0.18% on the outstanding principal for the Standby Purchase Agreement. The Standby Purchase Agreement is valid through October 15, 2008.

In June 2004, the University issued \$39.3 million of system revenue (\$29.5 million) and refunding (\$9.8 million) bonds primarily for the financing of renovations and information technology/telecommunications upgrade projects at the Tempe campus.

The University's fixed rate bonded debt consists of various issues of system revenue bonds that are generally callable at a prescribed date with interest payable semi-annually. In prior years, certain system revenue bonds of the University were defeased through advance refundings by depositing sufficient U.S. Government securities to pay all future debt service in an irrevocable trust. Accordingly, the liabilities for these defeased bonds are not included in the University's financial statements. The principal amount of such bonds outstanding at June 30, 2004 was \$13.9 million.

The housing revenue bonds are payable from housing revenues as defined in the bond indentures. The 1993, 2002, 2003 and 2004 system revenue refunding bonds, and the outstanding 1989, 1991, 2000, 2002, 2003 and 2004 system revenue bonds are payable from tuition and fees, certain auxiliary enterprises revenues, and certain other revenues as defined in the bond indentures.

Securities and cash restricted for bond debt service funds and maintenance and replacement reserves held by the trustees at June 30, 2004, totaled \$17.8 million. The following schedule reflects future debt service payment commitments to investors, including interest, using the interest rate in effect at June 30, 2004 for variable rate issues (Dollar in Thousands):

	System Revenue Bonds		Housing Bonds	
	Principal	Interest	Principal	Interest
2005	\$ 1,340	\$ 16,260	\$ 56	\$ 1
2006	15,285	15,411		
2007	14,430	14,687		
2008	16,920	13,892		
2009	17,765	13,068		
2010-14	104,290	51,190		
2015-19	91,785	26,745		
2020-24	50,465	14,232		
2025-29	49,510	5,281		
2030-34	32,335	1,387		
2035	7,470			
	<u>\$ 401,595</u>	<u>\$ 172,153</u>	<u>\$ 56</u>	<u>\$ 1</u>

The University has pledged portions of its gross revenues towards the payment of debt related to various system revenue bonds outstanding at June 30, 2004. These pledged revenues include student tuition and fees, auxiliary enterprises revenue, investment income, and indirect cost recovery revenue. Pledged revenues do not include state appropriations, gifts, endowment income, or other restricted revenues.

The University presently plans to issue approximately \$60 million of system revenue bonds during fiscal 2005.

ARIZONA STATE UNIVERSITY

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Note E - Lease Purchases

Certificates of participation (COPS) and other lease purchase financing arrangements at June 30, 2004, consisted of the following (Dollars in thousands):

Certificates of Participation:	Average Interest Rate	Final Maturity	Balance 7/1/2003	Additions	Reductions	Balance 6/30/2004	Current Portion
1991 Towers Project (through ASU Foundation)	6.89%	2010	\$ 2,645		\$ (260)	\$ 2,385	\$ 275
1993 West Campus Refunding	5.18%	2005	30,135		(26,065)	4,070	
1999A Downtown Center	5.75%	2024	5,365		(135)	5,230	145
1999B Downtown Center	8.00%	2024	4,995		(95)	4,900	100
2002 Certificates of Participation	4.75%	2026	103,800		(3,915)	99,885	2,180
2004 West Campus Refunding	2.36%	2009		\$ 22,495		22,495	
Other Lease Purchases	3.52%-11.00%	2018	3,823	2,274	(1,059)	5,038	968
Subtotal: Par Amount of COPS/ Other Lease Purchases			\$ 150,763	\$ 24,769	\$ (31,529)	\$ 144,003	\$ 3,668
Premium on Sale of COPS			2,551	1,044	(196)	3,399	
Deferred Amount on Refundings				(1,176)	44	(1,132)	
			<u>\$ 153,314</u>	<u>\$ 24,637</u>	<u>\$ (31,681)</u>	<u>\$ 146,270</u>	<u>\$ 3,668</u>

In April 2004, the University issued \$22.5 million of refunding certificates of participation Series 2004, with an average rate of 2.4%, to refund a portion of the outstanding 1993 West campus refunding certificates of participation of \$22.4 million with an average interest rate of 5.18%. The net proceeds of \$23.3 million, after the net addition of \$0.8 million for premium, underwriting fees, and other issuance costs, were used to purchase U.S. Government securities which were deposited into a depository trust fund in order to retire the 2004 and 2006 through 2009 maturities of the 1993 refunding certificates of participation. The refunded debt is considered defeased and related liabilities are not included in the University's financial statements. The issuance of the refunding certificates of participation at a lower interest rate than the rate of the refunded debt resulted in a \$0.9 million reduction in future debt service payments (\$4.5 million savings in fiscal 2004 offset by an increase in debt service of \$3.6 million in future years), with an economic gain of \$1.2 million based upon the present value savings.

Debt service for the 1993 refunding certificates of participation with maturities of 2004 and 2006 through 2009 will be paid from the depository trust fund established with proceeds from the 2004 refunding certificates of participation. The principal amount held in the depository trust fund at June 30, 2004 was \$22.4 million.

Securities and cash restricted for certificates of participation debt service funds held by trustees at June 30, 2004, totaled \$6.2 million. Payment commitments to investors, including interest, for lease purchases consisted of the following (Dollars in thousands):

	Certificates of Participation		Other Lease Purchases	
	Principal	Interest	Principal	Interest
2005	\$ 2,700	\$ 6,744	\$ 968	\$ 212
2006	6,870	6,243	900	174
2007	8,265	5,942	729	138
2008	9,260	5,629	402	109
2009	9,575	5,298	353	93
2010-14	29,055	22,045	1,382	231
2015-19	29,490	14,974	304	38
2020-24	30,620	6,265		
2025-29	13,130	649		
	<u>\$ 138,965</u>	<u>\$ 73,789</u>	<u>\$ 5,038</u>	<u>\$ 995</u>

Subsequent to June 30, 2004, the University issued \$80 million of certificates of participation lease purchase obligations, to be funded from the research infrastructure state legislation.

The University plans to issue approximately \$119 million of additional research infrastructure certificates of participation during fiscal 2005.

Note F - Capital Leases

Capital lease commitments to lessors at June 30, 2004, consisted of the following, based on the net present value of the lease payments (Dollars in thousands):

	Average Interest Rate	Final Maturity	Balance 7/1/2003	Additions	Reductions	Balance 6/30/2004	Current Portion
Flexible Display Center	Various	2034	-	\$ 35,000	-	\$ 35,000	-

During fiscal 2004, the University entered into a lease agreement with Nanotechnology Research, LLC (NR), a Arizona limited liability company, of which the sole member is ACFFC, an Arizona non-profit corporation and component unit of the University. The Flexible Display Center (FDC) is a flexible display multi-use cleanroom facility located at the ASU Price-Elliott Research Park. The lease term began on April 7, 2004, with lease payments of approximately \$2 million annually for 30 years. The University recorded a capital lease of \$35.0 million in fiscal 2004.

The lease agreement is based on the variable interest rate on the lease revenue bonds issued by NR. Cash outflows for lease payments are not scheduled to begin until fiscal 2007 due to the anticipated availability of capitalized interest to fund lease payments in fiscal 2005 and 2006. Lease payment commitments, including interest reimbursement to the lessor at the rates in effect at June 30, 2004, for this capital lease consisted of the following (Dollars in thousands):

	Capital Lease Payments
2005	-
2006	-
2007	\$ 133
2008	399
2009	1,156
2010-14	6,151
2015-19	6,873
2020-24	7,758
2025-29	8,849
2030-34	8,559
Total minimum lease payment	<u>\$ 39,878</u>
Less amount representing interest	<u>(4,878)</u>
Present value of net minimum lease payments	<u>\$ 35,000</u>

During the year ended June 30, 2004, the University entered into a lease with ASUF, LLC, an Arizona Limited Liability Company of the ASU Foundation. The University will lease a portion of the project, approximately 90,000 square feet of office space and the related parking structure. The lease payments will begin during fiscal 2005, after construction is completed and will be approximately \$2.4 million per year for approximately thirty years. Upon occupancy of the ASU Foundation building, anticipated during fiscal 2005, the portion occupied by the University, totaling \$29.4 million will be recorded by the University as a capital lease.

Note G - Compensated Absences

The University has recorded a liability for accruals of vacation leave earned, but not taken at fiscal year end. Changes in accrued compensated absences for the year ended June 30, 2004 follows (Dollars in thousands):

Balance 7/1/2003	Additions	Reductions	Balance 6/30/2004	Current Portion
\$ 17,041	\$ 18,569	\$ (17,267)	\$ 18,343	\$ 1,444

Note H - Unrestricted Net Assets

As discussed in the Summary of Significant Accounting Policies, the University is following standards for external reporting purposes, which require net assets to be classified for accounting and reporting purposes into one of three net asset categories according to externally imposed restrictions. Unrestricted net assets, as defined by GASB Statement No. 35, are not subject to externally imposed stipulations; however, they are subject to internal restrictions. For example, unrestricted net assets may be designated for specific purposes by actions of management or may otherwise be limited by contractual purchase obligation agreements with outside parties. As of June 30, 2004, substantially all of the University's unrestricted net assets were from University generated revenues and were internally designated for academic and research programs and initiatives, and capital projects.

Note I - Operating Expenses by Classification

Operating expenses by functional and natural classification for the year ended June 30, 2004, are summarized as follows (Dollars in thousands):

	Year ended June 30, 2004				
	Personal Services & Benefits	Supplies & Services	Scholarships & Fellowships	Depreciation	Total
Instruction	\$ 278,476	\$ 31,141	\$ 1,210		\$ 310,827
Research	71,107	26,943	1,528		99,578
Public service	18,677	10,497	1,013		30,187
Academic support	76,397	33,811	140		110,348
Student services	27,309	6,452	71		33,832
Institutional support	50,580	17,676			68,256
Operation & maintenance of plant	20,382	24,734			45,116
Scholarships & fellowships	710	527	43,740		44,977
Auxiliary enterprises	31,949	51,624	2,859		86,432
Depreciation				\$ 51,763	51,763
Total Operating Expenses	<u>\$ 575,587</u>	<u>\$ 203,405</u>	<u>\$ 50,561</u>	<u>\$ 51,763</u>	<u>\$ 881,316</u>

Note J - Voluntary Retirement Program for Faculty

The voluntary separation and retirement incentive program (VSRIP) for faculty and academic professionals provides ASU greater flexibility to expand or alter its academic areas of emphasis and to strengthen and expand its research activities in a comprehensive and efficient manner. The program also enables ASU to recruit new faculty and academic professionals with expertise matching these new academic and research areas. The program was open to tenured faculty and academic professionals who met certain requirements for participation including completion of 10 or more net years of service to ASU and attainment of age 55. The plan was, purely on a voluntary basis, a one-time opportunity for eligible faculty and academic professionals with continuing status to relinquish their employment rights at ASU in return for economic incentives. The University accepted enrollment in the program between August 15, 2003 and December 1, 2003. Enrollment in the VSRIP indicated the participant had agreed to retire or resign no later than June 30, 2004, in return for a payout amount equal to his or her fiscal 2004 academic year base salary, to be paid in fiscal 2005.

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Enrollment in the program signified the participants' agreement to relinquish their rights to tenure or continuing status, and to release the University from certain types of legal liability. The payout will be made in two equal installments, one each on July 15, 2004 and January 15, 2005. All payments are subject to income related taxes and appropriate withholding when paid. Receipt of payment does not make the participant eligible for employment-related benefits such as accrual of vacation leave, sick leave, retirement contributions or additional credit for length of service. Participants in the VSRIP do not have any rights to re-employment or future employment with the University. Subsequent to June 30, 2004 the first installment was paid to VSRIP participants.

As of June 30, 2004 the University has recorded a liability of \$6.9 million on the statement of net assets to reflect the amounts due the 79 VSRIP participants and related employee benefits. A corresponding entry has been made on the statement of revenues, expenses, and changes in net assets as a special item. The \$6.9 million liability consists of approximately \$6.5 million in salary and \$0.4 million in primarily social security related benefits costs. The VSRIP is not expected to become an on-going feature of ASU's employment benefits. Funding for the VSRIP is in the University's fiscal 2005 budget.

Note K - Retirement Plans

The University participates in one cost-sharing multiple-employer defined benefit pension plan and five defined contribution pension plans. The following disclosures are required by Governmental Accounting Standards Board (GASB) Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. In addition to the below mentioned plans, there are two other retirement plans totaling \$0.4 million in total University and employee contributions for the year ended June 30, 2004.

Defined Benefit Plan

Plan Description. The Arizona State Retirement System (ASRS) administers a cost-sharing multiple-employer defined benefit pension plan that covers eligible employees of the University. Benefits are established by state statute and provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of Arizona Revised Statutes (A.R.S.) Title 38, Chapter 5, Article 2. The ASRS issues a publicly available annual financial report that includes its financial statements and required supplementary information. That report may be obtained by writing to the ASRS, 3300 North Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910 or 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 by statute to contribute at the actuarially determined rate of 5.70% (5.20% retirement and 0.50% long-term disability) of the employees' annual covered payroll. The Arizona State Legislature establishes and may amend active plan members' and the University's contribution rates. Both the University and the covered employees made the required contributions for the years ended June 30, 2004, 2003, and 2002 as follows (Dollars in thousands):

	Contributions Rates (Each)	University Contributions	Employee Contributions	Total Contributions
2004	5.70%	\$ 10,769	\$ 10,769	\$ 21,538
2003	2.49%	4,408	4,408	8,816
2002	2.49%	4,191	4,191	8,382

Defined Contribution Plans

Plan Description. In accordance with A.R.S. § 15-1628, University faculty, academic professionals, service professionals and administrative staff have the option to participate in defined contribution pension plans. These plans are administered by independent insurance and annuity companies approved by the Arizona Board of Regents. For the year ended June 30, 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 were approved by the Arizona Board of Regents. Benefits under these plans depend solely on the contributed amounts and the returns earned on the investment of those contributions. Contributions made by employees vest immediately and University contributions vest no later than after five years of full-time employment. Employee and University contributions and associated returns earned on investments may be withdrawn starting upon termination of employment, death, or retirement. The distribution of employee contributions and associated investment earnings are made in accordance with the employee's contract with the applicable insurance and annuity company. University contributions and associated investment earnings must be distributed to the employee in the form of an annuity paid over the employee's life.

Funding Policy. The Arizona State Legislature establishes and may amend active plan members' and the University's contribution rates. For the year ended June 30, 2004, plan members and the University were each required by statute to contribute an amount equal to 7.00% of an employee's compensation. Contributions to these plans for year ended June 30, 2004, were as follows (Dollars in thousands):

	Contributions Rates (Each)	University Contributions	Employee Contributions	Total Contributions
TIAA/CREF	7%	\$ 9,806	\$ 9,806	\$ 19,612
VALIC	7%	1,626	1,626	3,252
Fidelity	7%	1,526	1,526	3,052
Aetna	7%	275	275	550
Vanguard	7%	604	604	1,208

Note L - Other Matters

Risk Management. Pursuant to A.R.S. § 41-621, the University participates in a self-insurance program administered by the State of Arizona, Department of Administration, Risk Management Section. The State's Risk Management Program covers the University, subject to certain deductibles, for risks of loss related to such situations as theft, damage and destruction of property, buildings, and equipment; errors and omissions; injuries to employees; natural disasters; and liability for acts or omissions of any nature while acting in authorized governmental or proprietary capacities and in the course and scope of employment or authorization, except as prescribed in A.R.S. § 41-621. Loss risks not covered by the Risk Management Section and where the University has no insurance coverage are losses arising from contractual breaches and losses that arise out of and are directly attributable to an act or omission determined by a court to be a felony. From time to time, various claims and lawsuits associated with the normal conduct of University business are pending or may arise against the University.

Except for the possible effect of the tuition lawsuit as described below, if it should ever be adjudicated in favor of the plaintiffs, and depending upon the amount of any such adjudication, in the opinion of University management, any losses from the resolution of any other pending claims or litigation not covered by the Risk Management Section should not have a material effect on the University financial statements. Also, in accordance with the disclosure requirements of GASB Statement No. 10, we note that judgments and claims not covered by the Risk Management Section during the three years ended June 30, 2004, have not been material to the University's financial statements.

Legal Matters. In the 2003 ASU Annual Financial Report it was mentioned that in November 2000, the Arizona Cardinals NFL football team (the "Cardinals") requested an administrative review of its rights pursuant to its license to use the University's Sun Devil Stadium, claiming that the Cardinals had the right to approve any new signage at Sun Devil Stadium and that the University, by installing a new matrix videoboard and permanent advertising panels without the Cardinals' express approval, had violated the Cardinals' license. This complaint by the Arizona Cardinals has been settled and dismissed with prejudice by stipulation with an amended stadium license agreement being entered into with the Arizona Cardinals. There was no cash settlement component to the agreement.

In March 2004, 52 individual members of the Havasupai Tribe, alleged damages arising from research conducted on Havasupai blood samples that were collected in the early 1990s. The plaintiffs allege that appropriate informed consent procedures were not followed and that unauthorized research was performed on the samples. One of the faculty members involved in the research moved from Arizona State University (ASU) to the University of Arizona in the mid 1990s. Plaintiffs have made claims for breach of fiduciary duty, fraud, intentional infliction of emotional distress, conversion, violation of civil rights, and negligence. The complaint names the Arizona Board of Regents (ABOR), Arizona State University, and faculty from ASU and the University of Arizona. The plaintiffs seek \$10 million in compensatory damages and \$15 million in punitive damages. In addition, in June 2004, the Havasupai Tribe filed an action against ABOR, ASU, the University of Arizona and others, arising from the same set of allegations. The plaintiff seeks compensatory damages of \$25 million and punitive damages of \$25 million. The State of Arizona Attorney General's Office is providing legal representation in both of these matters. The University cannot predict the outcome of these matters at this time, but intends to vigorously defend itself in these matters. It is anticipated that judgments, if any, against the University will be covered by State Risk Management insurance.

In August 2003, four University of Arizona students filed a lawsuit against the Arizona Board of Regents (ABOR) and the State of Arizona in Pima County (Arizona) Superior Court. The complaint alleged that the tuition increase approved by the ABOR 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 ABOR. The complaint also asserted that the State has not provided funding to the three universities governed by the ABOR 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 ABOR 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 ABOR's and the State's motion to dismiss the case. In the related minutes 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 ABOR 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 ABOR intends to vigorously defend the appeal. However, neither the ABOR nor the University is able to predict at the present time whether the lawsuit will proceed or what the ultimate outcome of the matter will be, or whether, or to what extent, it might impact the ABOR's ability to impose and collect tuition increases, or would otherwise affect the financial condition of the University.

Federal Grants. Federal grants provided to the University are subject to review and audit by Federal agencies. In the opinion of the University, any adjustments or repayments which may be required would not be material to the overall financial condition of the University.

Brickyard. In July 2004, the ASUF Brickyard, LLC, an Arizona Limited Liability Company of the ASU Foundation, a component unit of the University, purchased the Brickyard office building and parking facility in downtown Tempe for \$34.5 million, and is master leasing the entire facility to the University pursuant to a 15 year lease. This lease has no purchase options for the University. Approximately 65% of the facility is being used by the University for classrooms, offices, and research areas, with the remaining portion being rented by the University to various firms for retail and restaurant operations. The annual rent to be paid by the University to the ASU Foundation is approximately \$2.8 million.

Power Plant. At June 30, 2004, the University was in the process of entering into a privatized/third party agreement with Arizona Capital Facilities Finance Corporation (ACFFC), a component unit of the University, for the construction and operation by a third party energy management firm of a co-generation power plant on the University's Tempe campus with the power plant providing to the University a portion of the University's anticipated future energy needs. The anticipated tax exempt financing by ACFFC is approximately \$51 million. The contract being entered into with ACFFC will be for 25 years, along with a related ground lease, and calls for minimum annual energy purchase obligations on the part of the University of approximately \$7 million to cover the ACFFC's fixed management services and capital costs. Additional billing amounts will be based on a pass through to the University of the service provider's variable costs, primarily natural gas.

This new power plant is anticipated to be more efficient and produce energy at a lower cost than the presently existing power plant which will also continue to operate. After full completion of the new power plant, it is anticipated that over the long run, the new privatized/third party power plant will operate close to full capacity with possibly less utilization of the existing less efficient power plant. Even though the University has a minimum annual purchase obligation of approximately \$7 million for the new power plant, this is less than the University's present Tempe campus utility purchases of approximately \$18 million annually, which is not presently under a minimum annual energy purchase commitment.

ARIZONA STATE UNIVERSITY NOTES TO FINANCIAL STATEMENTS

McAllister Academic Village. At June 30, 2004, the University was planning to enter into a ground lease with ACFFC for the construction and operation of the McAllister Academic Village (MAV) residential facility. Total anticipated tax exempt financing by the ACFFC for this project is approximately \$125 million. The project, to be constructed in two phases, will include approximately 2,000 beds for freshman residential students for initial occupancy starting in August 2006 for phase one and August 2007 for phase two.

The ACFFC will have overall responsibility for the residential portion, comprising about 90% of the facility, including budgetary approval, with the University leasing the non-residential portion of the facility. The ACFFC will contract out management of the residential portion, with the contract for the residential life program and room assignments, including rent collections being with the University's Residential Life Department, and with custodial and facility maintenance being with a non-university contractor.

In order for ACFFC to obtain the lowest cost and most efficient financing arrangement possible for the residential portion of the facility, the University is contemplating a contingent commitment to make up any debt service funding deficiencies to the bondholders of the MAV debt, if such a situation should ever exist.

It is contemplated that the non-residential portion of the facility will be a capital lease of the University based on the net present value of the lease payments to be made by the University.

Note M – Component Units (Financially Interrelated Organizations)

Arizona State University's discretely presented component units are comprised of its major component unit, the ASU Foundation, and several smaller component units consisting of the ASU Alumni Association, Sun Angel Foundation, Sun Angel Endowment, Price-Elliott Research Park, Inc., Collegiate Golf Foundation, Arizona Capital Facilities Finance Corporation, and Mesa Student Housing, LLC.

Summary of Significant Accounting Policies

Basis of presentation. The component unit financial statements have been prepared on the accrual basis of accounting, in accordance with the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, organizations are required to report information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Income taxes. All of ASU's component units, except the Collegiate Golf Foundation and Arizona Capital Facilities Finance Corporation (ACFFC), qualify as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (IRC) and, therefore, there is no provision for income taxes. In addition, they qualify for the charitable contribution deduction and have been classified as organizations that are not private foundations. Any income determined to be unrelated business taxable income (UBTI) would be taxable. ACFFC is classified as a Section 501(c)(4) organization, a tax-exempt organization but not qualified for the charitable contribution deduction, and the Collegiate Golf Foundation is not a tax-exempt organization.

Use of estimates. The preparation of the component units' financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contributions. Contributions are recorded in accordance with SFAS No. 116, *Accounting for Contributions Received and Contributions Made*. Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends, or the purpose of the restriction is accomplished), temporarily or permanently restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions. Restricted support, where restrictions are met in the same period as the donation is made, is shown as an addition to unrestricted support.

Pledges Receivable

The ASU Foundation's pledges receivable (unconditional promises to give) are recorded at their net realizable value using a discount rate of 10.9% for pledges initially committed to by donors before July 1, 2002. A discount rate of 6% is used for pledges initially committed to by donors after July 1, 2002. An allowance for uncollectible pledges is estimated based on the ASU Foundation's collection history and is recorded as a charge to contribution support and a credit to pledges receivable.

ASU Foundation's pledges receivable consist of the following balances (Dollars in thousands):

	ASU Foundation
Gross pledges receivable	\$ 70,864
Present value discount	(15,074)
Allowance for uncollectible pledges	<u>(5,174)</u>
Net pledges receivable	<u>\$ 50,616</u>

ASU Foundation's promises to give are receivable as follows (Dollars in thousands):

	ASU Foundation
Receivable in one year	\$ 15,449
Receivable in two to five years	37,266
Receivable after five years	<u>18,149</u>
Total gross pledges to be received	<u>\$ 70,864</u>

Investments in Securities

The ASU Foundation reports investments in accordance with SFAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Under SFAS No. 124, the ASU Foundation is required to report investments in equity securities that have readily determinable fair values, and all investments in debt securities, at fair value. Equities, fixed income, and mutual funds, are stated at fair market value, based on quoted market prices. Investment securities, in general, are exposed to various risks, such as interest rate credit and overall market volatility.

The ASU Foundation investment policy is approved by the Foundation's Board of Directors. The approved investment policy defines the amount made available for award from the permanently restricted endowment pool. At June 30, 2004, ASU Foundation made approximately \$4.4 million available for award according to the following approved rate:

- " If the current market value of an endowment is greater than its historic gift value, the approved rate is 4.0%.
- " If the current market value of an endowment is less than its historic gift value, the approved rate is:
 - 2%, if an endowment agreement is signed by the donor and ASU Foundation.
 - 0%, if an endowment agreement is not signed by the donor and ASU Foundation.

ASU Foundation has ownership of certain cash and cash equivalents that are not in the possession of ASU Foundation but are held, along with other marketable securities, by outside investment managers. Although these cash and cash equivalents are readily available to ASU Foundation, it is the intent of ASU Foundation to hold these cash and cash equivalents for investment purposes and, accordingly, these cash and cash equivalents are classified as investment assets in the accompanying combined financial statements.

ASU Endowment Trust Agreement

In March 2003, the ASU Foundation and the University entered into a trust agreement, appointing the ASU Foundation the trustee of selected University endowments. In accordance with the trust agreement, the ASU Foundation receives a management fee for providing these services. Unrealized and realized gains and losses, and interest and dividends, if any, are added to or subtracted from the recorded value of the invested trust assets managed by the ASU Foundation. The invested trust assets are separate from ASU Foundation investments, and a corresponding liability is also presented for the fair value of the invested trust assets managed for the University.

Assets Managed for Related Organization

Prior to June 2004, the ASU Foundation managed the investments of the ASU Alumni Association (the Association). Unrealized and realized investment gains and losses, and interest and dividends, if any, were added to the cost of the invested Association assets managed by the ASU Foundation. The assets were included in the ASU Foundation's investments, and a corresponding liability was presented for the fair value of the assets managed for the Association. In June 2004, the ASU Foundation and the Association agreed to terminate this relationship and to return the assets to the Association.

Foundation for Arizona Universities

In December 2003, the Foundation for Arizona Universities (FAU) was formed to support the ASU Foundation, the University of Arizona Foundation, and the Northern Arizona University Foundation. At June 30, 2004, the ASU Foundation has recorded the fair value of its portion of the assets gifted (primarily real property) held by FAU on its behalf.

Investment Summary

Investments consist of (Dollars in thousands):

	ASU Foundation Investments	ASU Foundation Investments Held in Trust	Other Component Units	Total
Money market funds and cash equivalents	\$ 14,908	\$ 3,000	\$ 29,993	\$ 47,901
Equities:				
Domestic	69,418	17,588	7,701	94,707
International	35,005	10,517		45,522
Total equities	104,423	28,105	7,701	140,229
Fixed Income	66,636	9,475	7,860	83,971
Mutual funds:				
Absolute return fund	9,183	2,893		12,076
Long/short fund of funds	8,998	2,834		11,832
Inflation hedge	7,867	2,541		10,408
Emerging markets	7,152	2,192		9,344
Total mutual funds	33,200	10,460		43,660
Other securities	90	30	7,590	7,710
Donated land and buildings held for investment	6,046			6,046
Other investments	1,334		951	2,285
Total investments	\$ 226,637	\$ 51,070	\$ 54,095	\$ 331,802

ARIZONA STATE UNIVERSITY NOTES TO FINANCIAL STATEMENTS

Direct Financing Lease Agreement – ACFFC

For the ACFFC, there were, as of June 30, 2004, five projects that it owns. Four of the projects consist of three privatized, on-campus housing operations, and one on-campus privatized energy management arrangement, for which independent management companies are responsible for providing services to students served by the University or the University itself. In conjunction with these privatized arrangements, the independent management companies, with the approval and assistance of the University, have obtained tax-exempt financing in order to maximize the overall financial benefits to the University and its students. The fifth project is a flexible display multi-use clean room facility, located at the Price-Elliott Research Park. This facility was acquired by ACFFC, due primarily to the seller not desiring to sell the facility directly to the University. This facility is leased to the University, with up to one-half of the facility being available for sub-lease by the University to industry partners. This lease has been recorded by the University as a capital lease.

For the ACFFC facilities, the University is not legally responsible for repayment of the debt, and there is no pledge or guarantee by the University for repayment of the debt. Upon final principal repayment by ACFFC of the outstanding debt for each project, and termination of the respective ground lease, title to the facilities effectively transfers to the University.

Pursuant to a Sublease Agreement, Nanotechnology Research, LLC, a wholly-owned subsidiary of ACFFC, leases its interest in the Research Park to the University, which will pay rent at times and in amounts sufficient to pay all principal and interest (after utilization of amounts held in the Capitalized Interest Accounts) on the Series 2004 Bonds, as well as all fees and expenses related to the Series 2004 Bonds. The Sublease Agreement is a net lease, and Nanotechnology is entitled to receive the rents and all other sums payable pursuant to the Sublease Agreement free from all taxes, charges, fees, and expenses, all of which will be paid by the University.

The Sublease Agreement commenced April 7, 2004, and continued until June 30, 2004, with successive automatic annual renewals for the period July 1 through June 30 of each year without action on the part of Nanotechnology or the University, through the period ending March 31, 2034. The Sublease Agreement is subject to early termination by Nanotechnology or the University upon the payment in full of the Series 2004 Bonds.

Upon termination or expiration of the Sublease Agreement, Nanotechnology's interest in the premises, including all buildings and improvements on the leased premises, transfers to the University without further consideration. Therefore, the lease is classified as a direct financing capital lease.

Lease payments are based on a variable interest rate currently determined on a weekly basis. The average interest rate approximates 1.22% at June 30, 2004. Lease payments commence once the Capitalized Interest Accounts are fully utilized, which at present interest rates is expected to be in 2007. ACFFC's net investment in this direct financing lease is \$35.0 million.

Property and Equipment

Property and equipment consists of (Dollars in thousands):

	ASU Foundation	ACFFC	Other Component Units	Total
Cost or donated value				
Construction in progress	\$ 15,695	\$ 25,929		\$ 41,624
Buildings and improvements		14,018	\$ 15,794	29,812
Furniture, fixtures, and equipment	309	20,576	2,627	23,512
Land leasehold improvements			13,336	13,336
Other property and equipment		308	2,680	2,988
Total cost or donated value	\$ 16,004	\$ 60,831	\$ 34,437	\$ 111,272
Accumulated depreciation	(126)	(2,399)	(9,663)	(12,188)
Net property and equipment	\$ 15,878	\$ 58,432	\$ 24,774	\$ 99,084

The ASU Foundation Board of Directors approved the construction of a new headquarters office building and related facilities (the Project). The Project is located on the northeast corner of College Avenue and University Drive in Tempe, Arizona, on land donated from the ASU Foundation to the University. The construction is underway and commenced under a guaranteed contract completion date of December 2004.

During the year ended June 30, 2004, the University entered into a lease with ASUF, LLC, an Arizona Limited Liability Company of the ASU Foundation. The University will lease a portion of the headquarters office building project, approximately 90,000 square feet of office space and the related parking structure. The lease payments will begin during fiscal 2005, after construction is completed, and will be approximately \$2.4 million per year for approximately thirty years. Upon occupancy of the ASU Foundation Building, anticipated during fiscal 2005, the portion occupied by the University, totaling \$29.4 million, will be recorded by the University as a capital lease, and by the ASU Foundation as a net direct financing lease.

Bonds Payable

Bonds payable are as follows (Dollars in thousands):

	Final Maturity	ASU Foundation	ACFFC	Other Component Units	Total
Series 2004A Variable Rate Demand Lease Revenue Bonds	2034		\$ 20,175		\$ 20,175
Series 2004B Variable Rate Demand Lease Revenue Bonds	2034		14,825		14,825
Series 2003 Lease Revenue Term Bonds	2023	\$ 20,400			20,400
Series 2003 Lease Revenue Term Bonds	2028	10,575			10,575
Series 2003 Lease Revenue Term Bonds	2034	16,625			16,625
Series 2003 Serial and Term Bonds	2035		13,395		13,395
Series 2002 Bonds	2018		31,990		31,990
Series 2002 Bonds	2034		15,000		15,000
Series 2001A Term Bonds	2032			\$ 20,105	20,105
Series 2001B Term Bonds	2006			730	730
Series 2000 Serial and Term Bonds	2032		10,905		10,905
Series 1995 Development Refunding Bonds	2021			17,950	17,950
Unamortized bond premium (discount)			1,336	(2,365)	(1,029)
		<u>\$ 47,600</u>	<u>\$ 107,626</u>	<u>\$ 36,420</u>	<u>\$ 191,646</u>

Maturities of bonds payable are as follows (Dollars in Thousands):

Final Maturity	ASU Foundation	ACFFC	Other Component Units	Total
2005		\$ 1,055	\$ 390	\$ 1,445
2006		1,420	870	2,290
2007	\$ 580	1,960	1,630	4,170
2008	595	2,175	1,225	3,995
2009	615	3,085	1,285	4,985
Thereafter	<u>45,810</u>	<u>97,931</u>	<u>31,020</u>	<u>174,761</u>
	<u>\$ 47,600</u>	<u>\$ 107,626</u>	<u>\$ 36,420</u>	<u>\$ 191,646</u>

As of June 30, 2004, the Price-Elliott Research Park had \$18.0 million of revenue bonds outstanding at an average interest rate of 5.0%. The debt service on the bonds is secured by a subordinated lien on Tempe campus revenues. Park revenues are not pledged in order to provide development flexibility to the Park.

Annual debt service on the Park bonds will be \$1.2 million in fiscal year 2005 and varies from a low of \$1.2 million in fiscal 2005 to a high of \$1.7 million in fiscal 2006. The University is obligated to pay the annual debt service, if not paid by the Park, under a debt service assurance agreement.

Beginning in fiscal 1990, the University provided operating cash advances to the Park repayable with interest to the University (1) upon the Park's total gross receipts for a fiscal year exceeding its total disbursements for that fiscal year and (2) before any Park surpluses are transferred to the ASU Foundation, for the benefit of ASU. The last year for cash transfers to the Park was fiscal 1998. Since the Park's repayment to the University was dependent upon successful future operations and the entering into of additional land leases, the transfers to the Park were recorded by the University as current year expenses when made and not as an asset on the University's Statement of Net Assets. This accounting treatment was followed on the University's financial report even though the Park recorded the operating cash advances as a payable to the University. Total cash advances repayable to the University at June 30, 2004, including accrued interest, totaled \$4.4 million. During fiscal year 2004, the Park repaid \$1.1 million to the University, with this amount being recorded as other revenues. On the basis of the Park having made repayments to the University for the last six years, with repayment of the remaining \$4.4 million not being in doubt, along with the Park's financial statements now being included in the University's annual financial report, the remaining \$4.4 million was recorded on the University's financial statements at June 30, 2004, as a receivable and other revenues of the University.

ARIZONA STATE UNIVERSITY NOTES TO FINANCIAL STATEMENTS

Financial Statement Information

The following represents summary financial information for ASU's one major component unit (ASU Foundation) and all other component units combined (Dollars in thousands):

Statement of Financial Position June 30, 2004

	<u>ASU Foundation</u>	<u>Other Component Units</u>	<u>Total</u>
Assets			
Investments	\$ 277,707	\$ 54,095	\$ 331,802
Property and equipment, net	15,878	83,206	99,084
Other assets	<u>96,520</u>	<u>49,037</u>	<u>145,557</u>
Total assets	<u>\$ 390,105</u>	<u>\$ 186,338</u>	<u>\$ 576,443</u>
Liabilities			
Bonds payable	\$ 47,600	\$ 144,046	\$ 191,646
Other liabilities	59,494	37,085	96,579
Total liabilities	<u>\$ 107,094</u>	<u>\$ 181,131</u>	<u>\$ 288,225</u>
Net Assets			
Permanently restricted\$ 195,947	\$ 1,767	\$ 197,714	
Temporarily restricted	80,364	652	81,016
Unrestricted	6,700	2,788	9,488
Total net assets	<u>\$ 283,011</u>	<u>\$ 5,207</u>	<u>\$ 288,218</u>

Statement of Activities Year ended June 30, 2004

	<u>ASU Foundation</u>	<u>Other Component Units</u>	<u>Total</u>
Revenues			
Contributions	\$ 36,526	\$ 6,346	\$ 42,872
Rental revenue		10,949	10,949
Other revenues	34,714	12,482	47,196
Total revenues	<u>\$ 71,240</u>	<u>\$ 29,777</u>	<u>\$ 101,017</u>
Expenses			
Program services-			
Payments to ASU	\$ 20,888	\$ 5,931	\$ 26,819
Other program services	11,996		11,996
Personal services, operations, and administrative expenses	3,250	13,022	16,272
Other expenses	4,910	8,979	13,889
Total expenses	<u>\$ 41,044</u>	<u>\$ 27,932</u>	<u>\$ 68,976</u>
Increase in net assets	<u>\$ 30,196</u>	<u>\$ 1,845</u>	<u>\$ 32,041</u>
Net assets at beginning of year	<u>252,815</u>	<u>3,362</u>	<u>256,177</u>
Net assets at end of year	<u>\$ 283,011</u>	<u>\$ 5,207</u>	<u>\$ 288,218</u>

Subsequent Events

Subsequent to June 30, 2004, \$22.4 million of Variable Rate Revenue Bonds, Tax Exempt Series A 2004, and \$12.1 million Variable Rate Revenue Bonds, Taxable Series B, were sold by the Industrial Development Authority of the City of Tempe, Arizona. The net proceeds of these bonds, upon closing, were lent to ASUF Brickyard, LLC, a wholly-owned subsidiary of the ASU Foundation, to acquire, improve, and equip a retail and office building located at Mill Avenue and Seventh Street in Tempe, Arizona.

Also subsequent to June 30, 2004, the ASUF Scottsdale, LLC, a wholly-owned subsidiary of the ASU Foundation, signed a 99-year lease with the City of Scottsdale to develop the ASU/Scottsdale Center for New Technology and Innovation. Development plans include approximately 1.2 million square feet of space, with approximately 90% devoted to research and related office space, and 10% devoted to retail businesses.

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