# 2003 Financial Report

UNIVERSITY OF MISSOURI SYSTEM

# Governing Board and Administrative Staff

## UNIVERSITY OF MISSOURI SYSTEM

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## THE UNIVERSITY

The University of Missouri (the "University") was created in 1839 as a public educational institution under the Constitution and laws of the State of Missouri. It is governed by a nine-member Board of Curators. The University System includes campuses located in Columbia, Kansas City, Rolla and St. Louis, the University of Missouri Hospitals and Clinics and related health care facilities, and System administration. The University contains 37 schools, colleges and divisions and is the only public institution in Missouri offering professional and doctoral degrees. The University also administers a statewide extension service, serving every county in the State.

In the fall of 2002, the University enrolled a total of 60,903 students on its four campuses, up 7.8% from fall 2001. Over the five-year period ended 2002, total fall enrollments have increased 12.4%. This increase has primarily been seen at the Columbia and Kansas City campuses, which reflect 14.7% and 30.8% increases, respectively, for the five-year period.

| STUDENT ENROLLMENT | | | | | |
|---|---|---|---|---|---|
| CAMPUS | FALL SEMESTER | | | | |
| | 1998 | 1999 | 2000 | 2001 | 2002 |
| Columbia | 22,780 | 22,930 | 23,309 | 23,667 | 26,124 |
| Kansas City | 10,611 | 11,518 | 12,698 | 12,969 | 13,881 |
| Rolla | 4,918 | 4,715 | 4,626 | 4,883 | 5,240 |
| St. Louis | 15,880 | 15,594 | 15,397 | 14,993 | 15,658 |
| **Total System** | **54,189** | **54,757** | **56,030** | **56,512** | **60,903** |

Consistent with its mission as a major research institution, 25.9% of the students enrolled as of the 2002 fall semester, or 15,771, are enrolled in graduate and professional programs.

## UNIVERSITY ACCOUNTING AND FINANCIAL REPORTING

This report includes five financial statements: the Combined Statements of Net Assets, the Combined Statements of Revenues, Expenses and Changes in Net Assets and the Combined Statements of Cash Flows, for the University of Missouri System and Related Organizations, and the Statements of Net Assets Held for Pension Benefits and the Statements of Changes in Net Assets Held for Pension Benefits, for the University's Retirement Trust. The combined financial statements of the University are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board ("GASB"). A summary of significant accounting policies followed by the University is included in Note 1 to the combined financial statements of this report. A more detailed financial report that includes information on each campus is available upon request from the Office of the Vice President for Finance and Administration.

## COMBINED STATEMENTS OF NET ASSETS

The Combined Statements of Net Assets present the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. The Net Assets present the current financial condition of the University. Assets and liabilities are generally measured using current values, with certain exceptions, such as, capital assets, which are stated at cost, less accumulated depreciation, and long-term debt, which is stated at cost. A summary of the University's assets, liabilities and net assets at June 30, 2003 and 2002, is as follows (in thousands of dollars):

| | Fiscal Year 2003 | Fiscal Year 2002 |
|---|---|---|
| Assets: | | |
| Current assets | $ 510,000 | $ 525,938 |
| Endowed investments | 633,939 | 566,690 |
| Other investments | 484,205 | 476,818 |
| Capital assets | 1,645,122 | 1,534,537 |
| Other noncurrent assets | 85,016 | 80,698 |
| Total assets | $ 3,358,282 | $ 3,184,681 |
| Liabilities: | | |
| Current liabilities | $ 428,455 | $ 420,796 |
| Noncurrent liabilities | 472,089 | 480,097 |
| Total liabilities | 900,544 | 900,893 |
| Net assets: | | |
| Invested in capital assets, net of related debt | 1,177,275 | 1,071,096 |
| Restricted - | | |
| Nonexpendable | 597,771 | 575,191 |
| Expendable | 147,192 | 152,776 |
| Unrestricted | 535,500 | 484,725 |
| Total net assets | 2,457,738 | 2,283,788 |
| Total liabilities and net assets | $ 3,358,282 | $ 3,184,681 |

**Total Assets** have increased by $173.6 million to $3.4 billion, which reflects the University's continued efforts to strengthen its capital position. This increase is primarily attributable to the expansion of **Capital Assets** across all of the campuses. Net capital additions of $189.2 million are offset by $78.6 million in depreciation, resulting in a net change in **Capital Assets** of $110.6 million.

Major additions to **Capital Assets** during the year are shown in the following table.

| MAJOR ADDITIONS TO CAPITAL ASSETS<br>Year Ended June 30, 2003 | | |
|---|---|---|
| **Campus** | **Cost** | **Source of Funding** |
| Columbia: | | |
| Life Sciences Center | $26,610,000 | Federal grant and State appropriations |
| Basketball Arena | 11,596,000 | Gifts |
| Virginia Avenue Housing | 9,568,000 | Bond proceeds |
| Brewer Fieldhouse Renovation | 4,193,000 | Plant fund reserves |
| Hospitals and Clinics: | | |
| Care Transformation Phase I | $ 3,094,000 | Plant fund reserves |
| Procurement Management System | 2,321,000 | Plant fund reserves |
| Kansas City: | | |
| Oak Street Housing | $ 1,129,000 | Gifts and grants |
| Dental School Building | 1,122,000 | State appropriations |
| Rolla: | | |
| Butler Carlton Civil Engineering Building | $ 3,134,000 | State appropriations |
| Havener Center | 1,453,000 | Plant fund reserves and gifts |
| St. Louis: | | |
| Parking Garage | $ 7,992,000 | Bond proceeds |

The University held **Cash and Cash Equivalents** at the end of fiscal year 2003 of $260.5 million, a decrease of $26.8 million from the prior year. This decrease is due to excess cash on hand in fiscal year 2002 in anticipation of additional funding cuts or delays in State funding in the first quarter of fiscal year 2003.

**Long-Term Investment** holdings of $1,118.1 million as of June 30, 2003, increased $74.6 million over the prior year. Long-Term Investments in the University's endowed funds, comprised primarily of a Balanced and Fixed Income Pool, increased $67.2 million in fiscal year 2003 due to receipt of gifts as well as strong bond market performance and improving stock market performance. Performance of the University's various investment pools for the year ended June 30, 2003, is as follows:

| LONG-TERM INVESTMENTS | | | |
|---|---|---|---|
| | **Asset Distribution** | **Total Return** | **Benchmark Index Return** |
| General Pool | $434,028,000 | 5.8% | 5.0% |
| Balanced Pool | 573,446,000 | 4.1% | 3.2% |
| Fixed Income Pool and Other Investments | 61,005,000 | 11.4% | 13.2% |
| Other Investments | 49,666,000 | NA | NA |

*Benchmark index returns are calculated by independent investment consultants based on returns of similar security portfolios.*

In fiscal year 2003, heightened efforts to increase resources through fund raising continued on all four campuses. These increased efforts directly resulted in an increase in total **Pledges Receivable** (current and long-term), up 10.8% over the prior year, to $24.4 million.

**Total Liabilities** decreased $0.3 million from the prior year. The University did not issue additional long-term debt in fiscal year 2003 and, as a result, outstanding debt decreased $10.3 million from principal payments on existing debt. Although there was no new long-term debt issued in fiscal year 2003, the University has planned the issuance of $175 million in System Facilities Revenue Bonds in the fall of 2003 of which $135 million will be used for capital expansion across all campuses and $42 million will be used to refund the Series 1993 System Facilities Bonds.

The following is a summary of the long-term debt by type of debt instrument (in thousands of dollars).

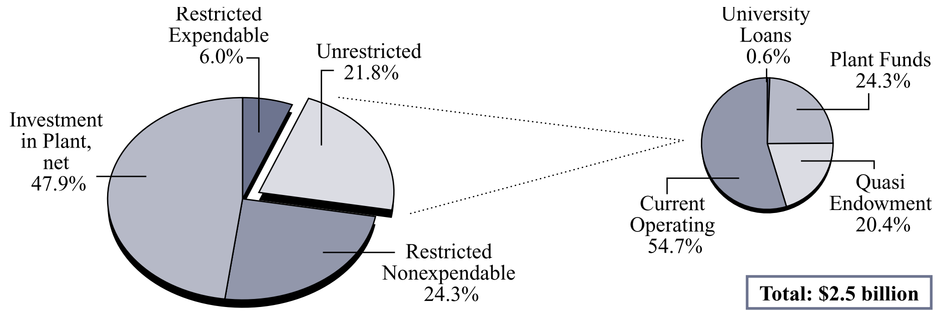
| | Fiscal Year 2003 | Fiscal Year 2002 |
|---|---|---|
| System Facilities Revenue Bonds | $ 297,210 | $ 304,200 |
| Health Facilities Revenue Bonds | 171,750 | 174,815 |
| Notes Payable | 273 | 531 |
| | 469,233 | 479,546 |
| Capital Lease Obligations | 10,864 | 11,170 |
| | $ 480,097 | $ 490,716 |

Other significant changes in liabilities include a $6.2 million increase in **Accrued Liabilities**, which includes accrued salaries, wages and related staff benefits, and self-insurance reserves. This fluctuation relates to increases in self-insurance reserves primarily resulting from outside influences. The insurance markets have been adversely impacted by the September 11, 2001 tragedy and, as a result, insurance markets tightened requirements and the University has responded by increasing reserves. In addition to the external influences, workers compensation reserves were also impacted by increased medical costs and an increase in the number and severity of incidents.

The **Net Assets** of the University have increased in total by $173.9 million, excluding any changes in the University's Retirement Trust. An explanation of these changes, based on the four net asset categories, is as follows:

- **Invested in Capital Assets, Net of Related Debt**, representing capital holdings, net of accumulated depreciation and related debt financing, increased $106.2 million to $1.18 billion. This increase is due to net additions to capital assets and pay down of bonds outstanding.
- **Restricted Nonexpendable Net Assets**, which includes restricted Loan and Endowment balances, increased $22.6 million over fiscal year 2002 to $597.8 million. The increase in this net asset category of $19.9 million is primarily a result of private funding for endowed purposes, resulting in net assets in restricted unexpendable endowments of $524.9 million in fiscal year 2003, compared to $505.0 million in fiscal year 2002. Net assets in restricted loan funds increased $2.7 million to $72.9 million.
- **Restricted Expendable Net Assets** decreased 3.7% from fiscal year 2002 to $147.2 million, which includes the Current Restricted funds of $104.4 million and the Restricted Plant funds of $42.8 million. This category reflects the spend down of restricted capital resources, specifically bond proceeds, dedicated for specific purposes, such as parking and housing structures on the Columbia campus and a new parking facility on the St. Louis campus.
- **Unrestricted Net Assets** increased 10.5% to $535.5 million. This category of net assets includes the Current funds of $293.0 million, Loan funds of $3.3 million, Quasi-Endowment funds of $108.9 million and Plant funds of $130.3 million that have been set aside by management for future capital purposes.

The distribution of the Net Asset balances, including additional details on unrestricted net assets by fund type, as of June 30, 2003, are as follows:

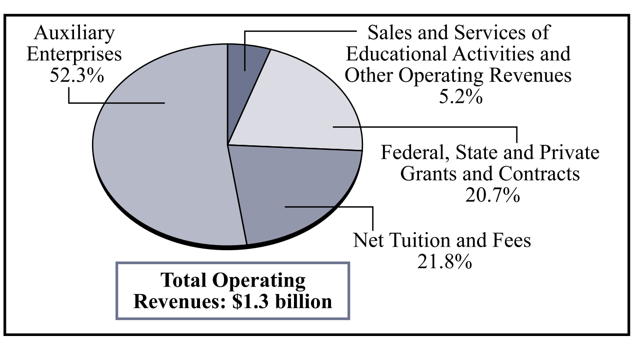


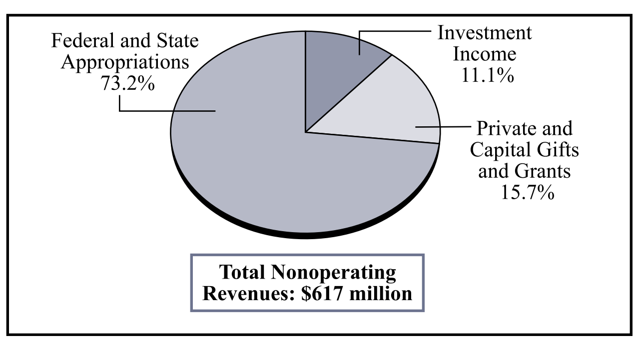

## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Statements of Revenues, Expenses and Changes in Net Assets present the University's results of operations. The statements distinguish revenues and expenses between operating and nonoperating categories, and provide a view of the University's operating margin (in thousands of dollars).

| | Fiscal Year 2003 | Fiscal Year 2002 |
|---|---|---|
| Operating revenues | $ 1,251,846 | $ 1,136,362 |
| Operating expenses | 1,673,590 | 1,632,469 |
| Operating income (loss) | (421,744) | (496,107) |
| Nonoperating revenues (expenses) | 595,694 | 558,740 |
| Increase in net assets | $ 173,950 | $ 62,633 |

Total **Operating Revenues** increased $115.5 million over fiscal year 2002, to $1.3 billion in fiscal year 2003. This fluctuation is due to increases in tuition, grant funding and revenues related to certain auxiliary operations. **Nonoperating Revenues** include funding sources such as State Appropriations, Federal Appropriations and Gift and Investment Income. These sources are categorized under GASB standards as nonoperating because they are not generated as a result of the University's core missions of teaching, research and public service. The following is a graphic illustration of revenues by source, including both operating and nonoperating revenue streams.



**Tuition and Fees**, net of **Scholarship Allowances**, which includes University resources used to reduce fees charged to students for related services, increased 16.9% or $39.5 million over fiscal year 2002. This is attributable to increases in enrollment of 7.8% and an increase of 8.4% in tuition for undergraduate and graduate students, plus a $9 per credit hour surcharge levied in response to extraordinary withholdings in State appropriations experienced at the end of fiscal year 2002.

As a research institution, the University receives a substantial amount of funding through **Federal, State and Private Grants and Contracts**. The University experienced growth in this revenue source of 10.3%, from $235.0 million in fiscal year 2002 to $259.3 million in fiscal year 2003. Federal grant funding increased significantly over the prior year as a result of the continuing efforts to secure grant funding. A decrease in State funding has partially offset the growth in federal funds which is a reflection of a decline in funds available at state agencies.

**Patient Medical Services**, which includes services provided by the University Hospitals and Clinics and related health care units (UHC) and the University Physicians Practice Plan, increased $22.3 million or 5.1% over fiscal year 2002. Of this increase, $4.4 million relates to the operations of the University Physicians, with $18.7 million relating to UHC.

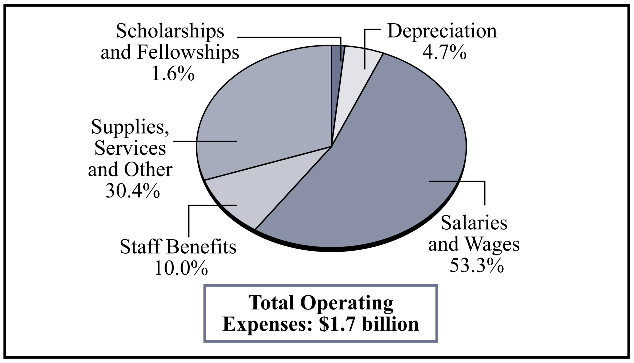
In fiscal year 2002, as a result of budget shortfalls in the State of Missouri, the State withheld over $88.7 million from the University's fiscal year 2002 appropriation for a net receipt of $414.8 million. In fiscal year 2003, the University experienced a 10% cut of $50.5 million to its core appropriation plus withholdings of $28.3 million resulting in net State appropriations received of $423.3 million, which was slightly higher than fiscal year 2002 receipts. In addition, **Capital Appropriations** decreased $17.1 million to $13.6 million in fiscal year 2003 due to a reduction in State resources available for capital purposes.

Gift income is reflected in three categories: **Private Gifts** (generally not restricted for a specific purpose), **Capital Gifts** (restricted for capital expansion) and **Private Gifts for Endowments** (restricted for the establishment of endowments). Total gifts to the University in fiscal year 2003 totaled $80.3 million, compared to $95.5 million in the prior fiscal year, a decrease of $15.2 million. Noncapital private gifts increased 4.9% due to increased focus by the campuses on charitable campaigns, while Capital Gifts decreased 57.3% largely due to a single gift of $25 million received in fiscal year 2002.

**Capital Grants** of $16.6 million in fiscal year 2003 and $8.0 million in fiscal year 2002 represent funding received from Federal and State agencies to be used for the expansion of the University's physical plant. The University has added to its mission to become a leader in life sciences studies. Using Federal and State capital funding, the University is constructing a new Life Sciences Building, a state-of-the-art research facility, on the Columbia campus.

**Investment and Endowment Income** includes interest and dividend income as well as realized and unrealized gains and losses. The market improved in fiscal year 2003, which resulted in increases in market values of investments and the recording of realized and unrealized net gains in the amount of $25.0 million, an improvement of $68.3 million over the realized and unrealized net losses of $43.3 million recorded in fiscal year 2002. Interest and dividend income of $43.8 million declined in the current fiscal year from $57.0 million earned in fiscal year 2002 due to lower yielding securities. Overall, Investment and Endowment Income significantly improved $55.2 million in fiscal year 2003.

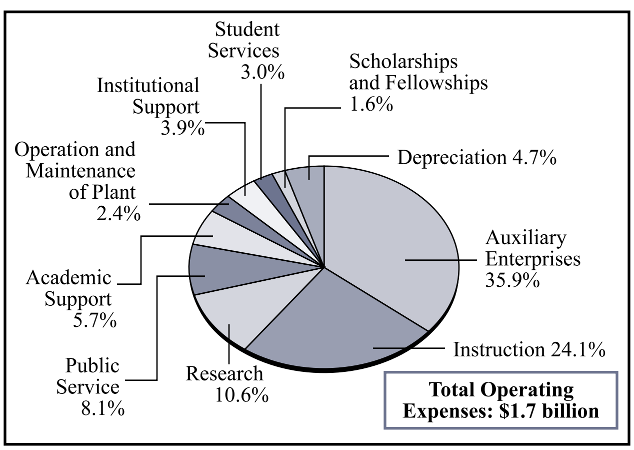
**Total Operating Expenses** reflect a 2.5% or $41.1 million increase over fiscal year 2002. The following is a graphic illustration of total expenses by object of expenditure:




During fiscal year 2003, **Salaries and Wages** and related **Staff Benefits** costs remained relatively flat over the prior fiscal year with an increase of only 0.4%. The increase in salaries was attributable to the addition of operating departments on the Kansas City and Rolla campuses. Staff Benefits showed a slight decline year over year due to a decrease in full-time equivalent employees eligible for benefits, which masked the continuing rise in the cost of employee benefits.

The University's expenses related to **Supplies, Services and Other Operating** costs increased by 5.9% or $28.3 million, to $508.2 million in fiscal year 2003, compared to $479.9 million in fiscal year 2002. Bad debt expense was $8.8 million higher in fiscal year 2003 than in the prior year. The University of Missouri Hospitals and Clinics changed its method of estimating bad debt expense and allowance for doubtful accounts to better reflect the actual write-offs related to contractual allowances versus the patients' inability to pay. The University operates self-insurance plans that provide coverage in a number of areas including employee medical and dental benefits, professional liability, workers' compensation, and general property and liability. Costs associated with these plans increased $11.1 million, net of related University and employee contributions. Other insurance costs for excess coverage above the self-insurance limits increased $4.6 million in fiscal year 2003 over the prior year.

In addition to their natural classification, it is also informative to review operating expenses by function. The following graphic illustration presents total expenses by function.



## STATEMENTS OF CASH FLOWS

The Statements of Cash Flows provide a view of the sources and uses of the University's cash resources. Comparative summary statements of cash flows for the years ended June 30, 2003 and 2002, are as follows (in thousands of dollars):

| | Fiscal Year 2003 | Fiscal Year 2002 |
|---|---|---|
| Net cash used in operating activities | $ (315,183) | $ (426,808) |
| Net cash provided by (used in) investing activities | (28,389) | 76,506 |
| Net cash used in capital and related financing activities | (140,772) | (31,881) |
| Net cash provided by noncapital financing activities | 457,539 | 456,957 |
| Net increase (decrease) in cash and cash equivalents | (26,805) | 74,774 |
| Cash and cash equivalents, beginning of year | 287,339 | 212,565 |
| Cash and cash equivalents, end of year | $ 260,534 | $ 287,339 |

**Net Cash Used in Operating Activities** reflects the continued need for funding from the State of Missouri, as funding received from tuition and fees and related sales and services of auxiliary and educational activities are not sufficient to cover operational needs. Cash used by operating activities decreased $111.6 million from $426.8 million in fiscal year 2002 to $315.2 million in fiscal year 2003. This decrease in the use of cash was impacted by a $46.6 million increase in tuition and fees and a $28.3 million increase in research grants and contracts.

**Net Cash Used in Investing Activities** was $28.4 million in fiscal year 2003 versus cash provided of $76.5 million in fiscal year 2002, a decrease of $104.9 million. Fiscal year 2002 was impacted by the liquidation of approximately $64 million of investments to provide cash funding for operational needs. As financial markets rebounded in fiscal year 2003, the University's Long-Term Investments, particularly within the endowed funds (Balanced Pool), experienced positive total returns.

**Cash Flows from Capital and Related Financing Activities** decreased $108.9 million from net cash used in fiscal year 2002 of $31.9 million to net cash used of $140.8 million in fiscal year 2003. The University issued $125.0 million of System Facilities Revenue Bonds in fiscal year 2002 and no new bonds were issued in fiscal year 2003.

The University's most significant source of cash, **Net Cash Provided by Noncapital Financing Activities**, includes funds provided by State and Federal appropriations and private gifts for endowment purposes. This funding source of $457.5 million for fiscal year 2003 and $456.9 million for fiscal year 2002 directly offsets the use of funds for operating activities.

## UNIVERSITY OF MISSOURI RELATED ORGANIZATIONS

The University operates two not-for-profit subsidiaries, Missouri Care L.C. and the University of Missouri-Columbia Medical Alliance (Medical Alliance). Missouri Care L.C. is a State-licensed health maintenance organization established to provide managed care services in mid-Missouri. During fiscal year 2003, Missouri Care L.C. provided benefits to members through a State Medicaid program. Net assets for the year increased by $550 thousand.

The Medical Alliance was established to facilitate the creation of an integrated healthcare delivery system for mid-Missouri. Capital Region Medical Center ("CRMC") in Jefferson City, Missouri, operates as an affiliate of the Medical Alliance and provides inpatient, outpatient and emergency care services to the surrounding community. The Medical Alliance ended fiscal year 2003 with a $3.8 million increase in net assets.

## UNIVERSITY OF MISSOURI RETIREMENT TRUST

The University operates the University of Missouri Retirement, Disability and Death Benefit Plan (the "Plan"), which is a single employer, defined benefit plan. The assets of the Plan are held in trust and are restricted for use only to pay for benefits and expenses of the Plan. Therefore, these net assets and changes in net assets are reflected separately from the operations of the University. Comparative summary financial statements for the Plan, for the years ended June 30, 2003 and 2002, are as follows (in thousands of dollars):

| **Net Assets Held for Pension Benefits** | Fiscal Year 2003 | Fiscal Year 2002 |
|---|---|---|
| Assets: | | |
| Cash and cash equivalents | $ 160,474 | $ 216,079 |
| Investments and related receivables | 2,014,536 | 1,983,712 |
| Total assets | 2,175,010 | 2,199,791 |
| Liabilities: | | |
| Payables and accrued liabilities | 244,749 | 209,790 |
| Collateral for securities lending | 121,358 | 154,765 |
| Total liabilities | 366,107 | 364,555 |
| Net Assets Held for Pension Benefits | $ 1,808,903 | $ 1,835,236 |

| **Changes in Net Assets Held for Pension Benefits** | Fiscal Year 2003 | Fiscal Year 2002 |
|---|---|---|
| Net revenues and other additions: | | |
| Net investment income (loss) | $ 75,579 | $ (131,386) |
| University contribution | 17,962 | 25,319 |
| Total net revenues and other additions | 93,541 | (106,067) |
| Expenses and other deductions: | | |
| Administrative expenses | 9,590 | 9,294 |
| Payments to retirees and beneficiaries | 110,284 | 83,059 |
| Total expenses and other deductions | 119,874 | 92,353 |
| Decrease in net assets held for pension benefits | (26,333) | (198,420) |
| Net assets held for pension benefits, beginning of year | 1,835,236 | 2,033,656 |
| Net assets held for pension benefits, end of year | $ 1,808,903 | $ 1,835,236 |

**Net Assets Held for Pension Benefits** have decreased $26.3 million, from $1.835 billion in fiscal year 2002 to $1.809 billion in fiscal year 2003. This decrease is a result of the payment of benefits to retirees in excess of the University's contribution partially offset by net investment income of $75.6 million. For the year ended June 30, 2003, the Plan experienced improved performance in total investment return of 4.1% compared to negative investment return of (6.5)% for the year ended June 30, 2002. The 4.1% investment return for fiscal year 2003 compares positively to the benchmark index of 3.2% while the negative investment return of (6.5)% for fiscal year 2002 is slightly worse than the negative benchmark index of (6.3)%.

The allocation of the Retirement Trust Investments for fiscal year 2003 is shown in the following table.

| RETIREMENT TRUST INVESTMENTS | | | |
|---|---|---|---|
| | Asset Allocation | Total Return | Benchmark Index Return |
| Domestic Equities | 44.5% | 0.8% | 0.8% |
| International Equities | 19.1% | (2.6)% | (6.1)% |
| Emerging Markets Equities | 6.0% | 8.9% | 8.2% |
| Alternative Investments | 2.4% | - | - |
| Real Estate | 8.3% | 6.9% | 7.1% |
| Global Fixed Income | 19.7% | 13.0% | 11.7% |
| **Total (Composite)** | 100.0% | 4.1% | 3.2% |

*Benchmark index returns are calculated by independent investment consultants based on returns of similar security portfolios.*

In late fiscal year 2002, the Board of Curators approved a Voluntary Early Retirement Incentive Program (VERIP-2002) for employees who met the VERIP-2002 eligibility criteria, applied for retirement between June 1, 2002 and September 30, 2002, and retired no later than January 1, 2003. There were 724 employees who took part in VERIP-2002, which resulted in a $47.3 million increase in the actuarial liability and a $1.8 million increase in future annual liabilities. **Payments to Retirees** increased in fiscal year 2003, however, the University expects payments to retirees to stabilize in fiscal year 2004.

Although the Plan has seen decreases in Net Assets Held for Pension Benefits of $26.3 million in fiscal year 2003 and $198.4 million in fiscal year 2002, the most recent actuarial estimates as of October 2002 show that the Plan is overfunded by $12.2 million.

**FISCAL YEAR 2003-2004 OUTLOOK**

In fiscal year 2003, the University of Missouri continued to feel the impact of the State of Missouri's budgetary problems. The University ended fiscal year 2002 with $73.6 million in unanticipated withholdings and started fiscal year 2003 with a ten percent, or $50.5 million, cut to its core State appropriation. On the heels of these two reductions in State support, the University was subject to additional extraordinary withholdings of 3.4% or $14.8 million during the course of the year. Fortunately, record student enrollments generated unbudgeted revenues that helped to offset this unanticipated change in State support.

The outlook for fiscal year 2004 reflects the State's dismal budgetary situation. Faced with declining revenues and large increases in "mandatory" expenses, the State has turned to higher education again for disproportionate reductions in support. In June, the State legislature approved, and the Governor signed, recurring State appropriations of $433.5 million for the University of Missouri for fiscal year 2004. This included a 5.5%, or $22.4 million, cut to the core appropriations for the University's operations. The University's hospitals and several other small special purpose programs, administered by the University and supported by State appropriations, were exempted from the core cut and received flat appropriations relative to fiscal year 2003. Immediately after approving the appropriation, the Governor announced a 2.5% or $9.7 million extraordinary withholding on the core appropriation.

The University's declining State support is coupled with large increases in the cost of the University's insurance and employee benefit programs and the need to provide a salary increase pool to retain and recruit top faculty and staff. The costs of property and liability insurance coverage as well as workers compensation insurance continue to rise. Employee medical coverage is marked by increases in prescription drugs, and the downturn in the equity markets has dramatically increased the actuarially determined contribution to the University's defined benefit retirement plan. Although the contribution as a percent of salary and wages of 3.95% is low compared to other higher education institutions, this represents a 52% increase over the fiscal year 2003 contribution of 2.6%.

To compensate for the $32.1 million reduction in State support and the increases in operating expenses cited above, the University has reduced the workforce through a voluntary early retirement program effective January 2003, implemented a number of operational efficiencies, initiated a program viability audit process, and increased tuition for in-state undergraduates by 19.8%. In spite of the large increase in tuition, preliminary information indicates that fall 2003 enrollments on all four campuses have increased over the prior year continuing a trend of historically high numbers of students and higher than anticipated revenues.

While the fiscal challenges are many, the University of Missouri is taking proactive steps to both increase revenues and decrease expenses. In addition, through expense controls on the campuses during fiscal year 2003, planned increases in net assets at year-end in anticipation of the cut in State support will help the University balance its fiscal year 2004 budget. This will allow the University to continue to identify new funding sources to replace the reduction in State support and to fully implement cost reduction strategies. Unless there is a dramatic downturn in the economy, the State's budget office does not anticipate additional withholdings during the fiscal year 2004, and so the University is positioned to end the year within its fiscal year 2004 budget projections.

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Deloitte & Touche

## INDEPENDENT AUDITORS' REPORT

Board of Curators
University of Missouri System

We have audited the accompanying combined financial statements of the University of Missouri (the "University") and its aggregate discretely presented component units and its fiduciary fund type ("Retirement Trust") as of and for the years ended June 30, 2003 and 2002, as shown on pages 14 through 36. These combined financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the University and of its aggregate discretely presented component units and its fiduciary fund type as of June 30, 2003 and 2002, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 12 are not a required part of the combined financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the University's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 8, 2003, on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte + Touche LLP

October 8, 2003

Deloitte
Touche
Tohmatsu

(in thousands of dollars)

| | University | | Related Organizations | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| **Assets** | | | | |
| **Current Assets:** | | | | |
| Cash and Cash Equivalents | $ 260,534 | $ 287,339 | $ 8,940 | $ 8,668 |
| Accounts Receivable, Net | 148,553 | 168,579 | 19,849 | 19,945 |
| Current Pledges Receivable, Net | 11,338 | 8,002 | | |
| Investment Settlements Receivable | 35,517 | 21,694 | | |
| Current Notes Receivable, Net | 9,246 | 8,362 | | |
| Inventories | 24,430 | 23,880 | 2,323 | 2,044 |
| Prepaid Expenses and Other Current Assets | 20,382 | 8,082 | 936 | 601 |
| **Total Current Assets** | **510,000** | **525,938** | **32,048** | **31,258** |
| **Noncurrent Assets:** | | | | |
| Restricted Cash and Cash Equivalents | 13,351 | 12,853 | 3,639 | 4,108 |
| Pledges Receivable, Net | 13,109 | 14,055 | | |
| Notes Receivable, Net | 43,571 | 43,665 | | |
| Deferred Charges and Other Assets | 14,985 | 10,125 | 511 | 543 |
| Long-Term Investments | 1,118,144 | 1,043,508 | 25,092 | 25,619 |
| Capital Assets, Net | 1,645,122 | 1,534,537 | 55,173 | 54,505 |
| **Total Noncurrent Assets** | **2,848,282** | **2,658,743** | **84,415** | **84,775** |
| **Total Assets** | **$ 3,358,282** | **$ 3,184,681** | **$ 116,463** | **$ 116,033** |
| **Liabilities** | | | | |
| **Current Liabilities:** | | | | |
| Accounts Payable | $ 65,442 | $ 59,096 | $ 9,793 | $ 13,666 |
| Accrued Liabilities | 138,482 | 132,290 | 6,861 | 6,363 |
| Deferred Revenue | 45,432 | 42,787 | | |
| Funds Held for Others | 49,538 | 49,412 | | |
| Investment Settlements Payable | 74,308 | 69,618 | | |
| Collateral for Securities on Loan | 44,148 | 56,974 | | |
| Capital Lease Obligations, Current | 332 | 306 | | |
| Bonds and Notes Payable, Current | 10,773 | 10,313 | 562 | 537 |
| **Total Current Liabilities** | **428,455** | **420,796** | **17,216** | **20,566** |
| **Noncurrent Liabilities:** | | | | |
| Capital Lease Obligations | 10,532 | 10,864 | | |
| Bonds and Notes Payable | 458,460 | 469,233 | 23,036 | 23,570 |
| Noncurrent Deferred Revenue | 3,097 | | | |
| **Total Noncurrent Liabilities** | **472,089** | **480,097** | **23,036** | **23,570** |
| **Total Liabilities** | **900,544** | **900,893** | **40,252** | **44,136** |
| **Net Assets** | | | | |
| Invested in Capital Assets, Net of Related Debt | 1,177,275 | 1,071,096 | 54,508 | 54,729 |
| Restricted: | | | | |
| Nonexpendable | 597,771 | 575,191 | | |
| Expendable | 147,192 | 152,776 | 3,639 | 4,108 |
| Unrestricted | 535,500 | 484,725 | 18,064 | 13,060 |
| **Total Net Assets** | **2,457,738** | **2,283,788** | **76,211** | **71,897** |
| **Total Liabilities and Net Assets** | **$ 3,358,282** | **$ 3,184,681** | **$ 116,463** | **$ 116,033** |

*See notes to the combined financial statements.*

*(in thousands of dollars)*

| | University | | Related Organizations | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| **Operating Revenues:** | | | | |
| Tuition and Fees | $ 377,810 | $ 330,964 | $ - | $ - |
| Less: Scholarship Allowances | 104,391 | 97,013 | | |
| Net Tuition and Fees | 273,419 | 233,951 | | |
| Federal Grants and Contracts | 170,879 | 131,853 | | |
| State and Local Grants and Contracts | 36,102 | 51,695 | | |
| Private Grants and Contracts | 52,287 | 51,404 | | |
| Sales and Services of Educational Activities | 16,561 | 14,955 | | |
| Auxiliary Enterprises: | | | | |
| Patient Medical Services | 461,588 | 439,287 | 144,320 | 132,737 |
| Housing and Dining Services | 49,798 | 46,376 | | |
| Bookstores | 37,839 | 35,544 | | |
| Other Auxiliary Enterprises | 104,828 | 92,227 | | |
| Notes Receivable Interest Income, Net of Fees | 943 | 903 | | |
| Other Operating Revenues | 47,602 | 38,167 | | |
| **Total Operating Revenues** | **1,251,846** | **1,136,362** | **144,320** | **132,737** |
| **Operating Expenses:** | | | | |
| Salaries and Wages | 892,415 | 887,971 | 41,793 | 39,489 |
| Staff Benefits | 168,225 | 168,672 | 10,273 | 8,842 |
| Supplies, Services and Other Operating Expenses | 508,183 | 479,921 | 80,441 | 73,658 |
| Scholarships and Fellowships | 26,209 | 25,768 | | |
| Depreciation | 78,558 | 70,137 | 7,040 | 6,759 |
| **Total Operating Expenses** | **1,673,590** | **1,632,469** | **139,547** | **128,748** |
| **Operating Income (Loss) before State Appropriations and Nonoperating Revenues (Expenses) and Transfers** | **(421,744)** | **(496,107)** | **4,773** | **3,989** |
| State Appropriations | 423,330 | 414,794 | | |
| **Operating Income (Loss) after State Appropriations, before Nonoperating Revenues (Expenses) and Transfers** | **1,586** | **(81,313)** | **4,773** | **3,989** |
| **Nonoperating Revenues (Expenses):** | | | | |
| Federal Appropriations | 14,860 | 15,386 | | |
| Investment and Endowment Income | 68,880 | 13,729 | 274 | 1,132 |
| Private Gifts | 46,467 | 40,505 | 206 | 108 |
| Interest Expense | (20,468) | (18,112) | (1,220) | (1,228) |
| Other Nonoperating Revenues (Expenses) | (1,171) | (1,193) | | |
| **Net Nonoperating Revenues (Expenses) before Capital and Endowment Additions and Transfers** | **108,568** | **50,315** | **(740)** | **12** |
| Capital State Appropriations | 13,584 | 30,682 | | |
| Capital Gifts and Grants | 30,239 | 39,857 | | |
| Private Gifts for Endowment Purposes | 20,254 | 23,092 | | |
| **Net Other Nonoperating Revenues (Expenses) before Transfers** | **172,645** | **143,946** | **(740)** | **12** |
| Nonmandatory Transfers to Related Organizations | (281) | | 281 | |
| **Net Nonoperating Revenues (Expenses) and Transfers** | **172,364** | **143,946** | **(459)** | **12** |
| **Increase in Net Assets** | **173,950** | **62,633** | **4,314** | **4,001** |
| **Net Assets, Beginning of Year** | **2,283,788** | **2,221,155** | **71,897** | **67,896** |
| **Net Assets, End of Year** | **$ 2,457,738** | **$ 2,283,788** | **$ 76,211** | **$ 71,897** |

*See notes to the combined financial statements.*

*(in thousands of dollars)*

| | University | | Related Organizations | |
|---|---|---|---|---|
| | **2003** | **2002** | **2003** | **2002** |
| **Cash Flows from Operating Activities:** | | | | |
| Tuition and Fees | $ 276,560 | $ 229,989 | $ - | $ - |
| Federal, State and Private Grants and Contracts | 257,949 | 229,642 | | |
| Sales and Services of Educational Activities and Other Auxiliaries | 128,363 | 94,019 | | |
| Patient Care Revenues | 473,015 | 447,599 | 144,416 | 131,158 |
| Student Housing Fees | 50,842 | 45,898 | | |
| Bookstore Collections | 39,633 | 34,305 | | |
| Payments to Suppliers | (500,389) | (478,282) | (84,928) | (70,698) |
| Payments to Employees | (894,477) | (876,540) | (41,295) | (38,623) |
| Payments for Benefits | (168,225) | (168,672) | (10,273) | (8,842) |
| Payments for Scholarships and Fellowships | (26,209) | (25,768) | | |
| Student Loans Issued | (13,047) | (9,052) | | |
| Student Loans Collected | 13,357 | 11,542 | | |
| Student Loan Interest and Fees | (157) | 345 | | |
| Other Receipts, Net | 47,602 | 38,167 | | |
| **Net Cash Provided by (Used in) Operating Activities** | **(315,183)** | **(426,808)** | **7,920** | **12,995** |
| **Cash Flows from Investing Activities:** | | | | |
| Interest and Dividends on Investments | 52,051 | 34,734 | 742 | 925 |
| Sales and Maturities of Investments, Net of Purchases | (80,159) | 41,772 | 527 | (3,534) |
| Other Investing Activities | (281) | | 281 | |
| **Net Cash Provided by (Used In) Investing Activities** | **(28,389)** | **76,506** | **1,550** | **(2,609)** |
| **Cash Flows from Capital and Related Financing Activities:** | | | | |
| Capital State Appropriations | 13,014 | 30,979 | | |
| Private Gifts | 38,665 | 34,962 | 206 | 108 |
| Capital Gifts and Grants | 23,539 | 39,857 | | |
| Proceeds from Sales of Capital Assets | 2,120 | 1,272 | | |
| Purchase of Capital Assets | (187,223) | (191,020) | (7,708) | (6,678) |
| Proceeds from Issuance of Capital Debt, Net | | 125,052 | | |
| Principal Payments on Capital Debt | (10,313) | (9,248) | (509) | (186) |
| Proceeds from Capital Project Notes | 84,455 | 90,665 | | |
| Payments on Capital Project Notes | (85,000) | (90,000) | | |
| Payments on Capital Lease | (306) | (282) | | |
| Escrow Deposit on Defeasance | | (45,824) | | |
| Interest Payments on Capital Debt | (19,723) | (18,294) | (1,187) | (1,051) |
| **Net Cash Used in Capital and Related Financing Activities** | **(140,772)** | **(31,881)** | **(9,198)** | **(7,807)** |
| **Cash Flows from Noncapital Financing Activities:** | | | | |
| State Educational Appropriations | 423,470 | 415,584 | | |
| Federal Appropriations | 14,860 | 15,386 | | |
| Endowment and Similar Funds Gifts | 20,254 | 23,092 | | |
| Other Payments | (1,171) | (1,193) | | |
| Deposits of Affiliates | 126 | 4,088 | | |
| **Net Cash Provided by Noncapital Financing Activities** | **457,539** | **456,957** | | |
| **Net Increase (Decrease) in Cash and Cash Equivalents** | **(26,805)** | **74,774** | **272** | **2,579** |
| **Cash and Cash Equivalents, Beginning of Year** | **287,339** | **212,565** | **8,668** | **6,089** |
| **Cash and Cash Equivalents, End of Year** | **$ 260,534** | **$ 287,339** | **$ 8,940** | **$ 8,668** |

*(Continued)*

*(in thousands of dollars)*

| | University | | Related Organizations | |
|---|---|---|---|---|
| | **2003** | **2002** | **2003** | **2002** |
| **Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities:** | | | | |
| Operating Income (Loss) | $ (421,744) | $ (496,107) | $ 4,773 | $ 3,989 |
| Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities: | | | | |
| Depreciation Expense | 78,558 | 70,137 | 7,040 | 6,759 |
| Changes in Assets and Liabilities - | | | | |
| Accounts Receivable, Net | 21,113 | (21,948) | 96 | (1,579) |
| Inventory, Prepaid Expenses and Other Assets | (8,672) | (688) | (614) | (533) |
| Notes Receivable | (790) | 1,932 | | |
| Accounts Payable | 8,046 | 2,659 | (3,873) | 3,493 |
| Accrued Liabilities | 6,358 | 11,099 | 498 | 866 |
| Deferred Revenue | 1,948 | 6,108 | | |
| **Net Cash Provided by (Used in) Operating Activities** | **$ (315,183)** | **$ (426,808)** | **$ 7,920** | **$ 12,995** |
| **Supplemental Disclosure of Noncash Activities:** | | | | |
| University of Missouri Hospitals and Clinics Obtained an Interest in the Institute for Outpatient Surgery LLC in Exchange for Equipment | $ 1,400 | $ - | $ - | $ - |
| Building and Improvements Subleased to the Institute for Outpatient Surgery LLC | $ 3,142 | $ - | $ - | $ - |
| Gifts of Capital Assets | $ 12,112 | $ - | $ - | $ - |

*See notes to the combined financial statements.*

## Statements of Net Assets Held for Pension Benefits

AS OF JUNE 30, 2003 AND 2002

| | (in thousands of dollars) 2003 | 2002 |
|---|---|---|
| **Assets** | | |
| Cash and Cash Equivalents | $ 160,474 | $ 216,079 |
| Investment Settlements Receivable | 113,815 | 79,504 |
| Investments: | | |
| Government Obligations | 330,907 | 331,743 |
| Corporate Bonds and Notes | 146,322 | 186,342 |
| Preferred and Common Stocks | 1,113,903 | 1,215,096 |
| Other | 309,589 | 171,027 |
| **Total Assets** | **2,175,010** | **2,199,791** |
| **Liabilities** | | |
| Accounts Payable and Accrued Liabilities | 1,745 | 1,748 |
| Collateral for Securities Lending | 121,358 | 154,765 |
| Investment Settlements Payables | 243,004 | 208,042 |
| **Total Liabilities** | **366,107** | **364,555** |
| **Net Assets Held for Pension Benefits** | **$ 1,808,903** | **$ 1,835,236** |

## Statements of Changes in Net Assets Held for Pension Benefits

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

| | (in thousands of dollars) 2003 | 2002 |
|---|---|---|
| **Net Revenues and Other Additions** | | |
| Investment Income (Loss): | | |
| Interest and Dividend Income | $ 57,686 | $ 53,324 |
| Net Appreciation (Depreciation) in Fair Value of Investments | 17,893 | (184,710) |
| Net Investment Income (Loss) | 75,579 | (131,386) |
| University Contribution | 17,962 | 25,319 |
| **Total Net Revenues and Other Additions** | **93,541** | **(106,067)** |
| **Expenses and Other Deductions** | | |
| Administrative Expenses | 9,590 | 9,294 |
| Payments to Retirees and Beneficiaries | 110,284 | 83,059 |
| **Total Expenses and Other Deductions** | **119,874** | **92,353** |
| **Decrease in Net Assets Held for Pension Benefits** | **(26,333)** | **(198,420)** |
| **Net Assets Held for Pension Benefits, Beginning of Year** | **1,835,236** | **2,033,656** |
| **Net Assets Held for Pension Benefits, End of Year** | **$ 1,808,903** | **$ 1,835,236** |

*See notes to the combined financial statements.*

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Financial Reporting Entity and Component Unit Disclosures** —The University of Missouri System (the “University”), a Federal land grant institution and an agency of the State of Missouri (the “State”), conducts education, research and public service and related activities principally at its four campuses in Columbia, Kansas City, Rolla and St. Louis, which include the University of Missouri Hospitals and Clinics and related heath care facilities. The University also administers a statewide cooperative extension service with centers located in each county in the State. The governing body of the University is the Board of Curators of the University of Missouri.

As required by accounting principles generally accepted in the United States of America, these financial statements present the combined financial position and combined financial activities of the University (“the primary unit”) and its component units. The component units are included in the University’s financial reporting entity because of the significance of their financial relationship with the University. The notes to the combined financial statements relate only to the primary unit and do not include component units amounts, as these amounts are immaterial to the financial statements as a whole.

The Related Organizations column in the Combined Statements of Net Assets and the Combined Statements of Revenues, Expenses and Changes in Net Assets includes the financial data of the University’s component units. The University of Missouri – Columbia Medical Alliance and Missouri Care L.C., a health maintenance organization, are reported in a separate column to emphasize that they are not-for-profit subsidiaries legally separate from the University.

The University operates the University of Missouri Retirement, Disability and Death Benefit Plan (the “Plan”), which is a single employer, defined benefit plan. The assets of the Plan are held in trust and are restricted for use only to pay for benefits and expenses of the Plan. Separate statements, including Statements of Net Assets Held for Pension Benefits and Statements of Changes in Net Assets Held for Pension Benefits, are included for the Plan. The notes to the combined financial statements include information on the Plan.

**Accrual Accounting and Basis for Reporting** –The combined financial statements of the University are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (“GASB”). The University applies all applicable GASB pronouncements and Financial Accounting Standards Board (“FASB”) Statements and Interpretations issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

The University has adopted GASB Statement No. 35, *Basic Financial Statement—and Management’s Discussion and Analysis—for Public Colleges and Universities*, as amended by GASB Statements No. 37 and No. 38. GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities. Accordingly, the University’s resources are classified for accounting and reporting purposes into the following four net asset categories:

- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted:**

  **Nonexpendable** – Net assets subject to externally imposed stipulations that they be maintained permanently by the University. Such assets include the University’s permanent endowment funds. In fiscal years 2003 and 2002, the University received $20,254,000 and $23,092,000, respectively, in nonexpendable gifts. The University’s policy permits any realized and unrealized appreciation on the endowments to remain with the endowment after the 5% spending distribution discussed in Note 2.

  **Expendable** – Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.
- **Unrestricted:** Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Curators or may otherwise be limited by contractual agreements with outside parties.

The accompanying combined financial statements have been prepared on an accrual basis. The University reports as a Business Type Activity, as defined by GASB Statement No. 35. Business Type Activities are those that are financed in whole or in part by funds received from external parties for goods or services.

The University's policy for defining operating activities as reported on the Combined Statements of Revenues, Expenses and Changes in Net Assets are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Nearly all the University's expenses are from exchange transactions. Certain significant revenue streams relied upon for operations are recorded as nonoperating revenues, as defined by GASB Statement No. 35, including Federal and State appropriations, gifts and investment income.

**Cash, Cash Equivalents and Investments** – Cash and cash equivalents consist of the University's bank deposits and investments with original maturities of three months or less. Investment assets are carried at fair value based primarily on market quotations. Purchases and sales of investments are accounted for on the trade date basis. Investment settlements receivable and investment settlements payable represent investment transactions occurring on or before June 30, which settle after such date. Investment income is recorded on the accrual basis. Net unrealized gains (losses) are included in investment and endowment income in the Combined Statements of Revenues, Expenses and Changes in Net Assets. Derivative instruments such as forward foreign currency contracts are recorded at fair value. The University enters into forward foreign currency contracts to reduce the risk related to fluctuations in currency exchange rates in their international investments. These contracts are marked to market and the changes in their market value are recorded in investment and endowment income on the Combined Statements of Revenues, Expenses and Changes in Net Assets.

**Pledges Receivable** – The University receives unconditional promises to give (pledges) through private donations from corporations, alumni and various other supporters of the University. Revenue is recognized when a pledge is received and all eligibility requirements, including time requirements, are met. These pledges have been recorded as pledges receivable on the Combined Statements of Net Assets and as private gift revenue on the Combined Statements of Revenues, Expenses and Changes in Net Assets, at the present value of the estimated future cash flows. An allowance has been made for uncollectible pledges based upon management's expectations regarding the collection of the pledges and the University's historical collection experience.

**Inventories** – These assets are stated at the lower of cost or market. Cost is determined on an average cost basis, with the exception of the University Hospitals and Clinics inventories, where cost is determined using the first-in, first-out method.

**Capital Assets** – These assets are carried, if purchased, at cost or, if donated, at fair value at date of gift. Depreciation of plant physical properties is provided on a straight-line basis over the estimated useful lives (three to forty years) of the respective assets. The University has capitalized works of art and continues to add to these collections. As these collections generally consist of historical artifacts and artworks, they are considered inexhaustible and have not been subject to depreciation. The net interest expense incurred during the construction of debt-financed facilities is included in the capitalization of the related facilities.

**Deferred Revenue** – These balances consist of summer session student fees and amounts received from grant and contract sponsors which have not yet been earned. Revenues and related expenditures in connection with the summer session in progress at June 30 are deferred until the following fiscal year. Grant and contract revenues are recognized only to the extent expended.

**Interest Rate Swap Agreements** – The University enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenditures resulting from those agreements, no amounts are recorded in the financial statements.

**Scholarship Allowance** – Tuition and fees and related housing, dining and bookstore revenues are presented net of scholarships and fellowships applied to student accounts, while scholarships, fellowships and other payments made directly to students are presented as scholarship and fellowship expenses.

**Patient Medical Services** – Patient medical services revenues are reported net of contractual allowances. Patient medical services are primarily provided through University of Missouri Hospitals and Clinics, Ellis Fischel Cancer Research Center, Columbia Regional Hospital, Missouri Rehabilitation Center and University Physicians.

**Use of Estimates** – The preparation of combined financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**New Accounting Pronouncement** – In May 2002, the GASB issued GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. The Statement amends Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. Generally, it requires reporting, as discretely presented component units, organizations that raise and hold economic resources for the direct benefit of a governmental unit. This Statement is effective for the University beginning July 1, 2003. The University is currently evaluating the effect that the Statement will have on the basic combined financial statements.

**Reclassifications** – Certain prior year amounts have been reclassified to conform to current year presentation.

## 2. SALE OF ASSETS

On July 1, 2002, the University Hospitals and Clinics sold medical equipment to the Institute for Outpatient Surgery LLC ("IOS") in exchange for $1,860,000 in cash, release of certain employee benefit liabilities and a 36% initial interest in IOS with a fair value of approximately $1,400,000. As a result of the transaction, University Hospitals and Clinics recognized a total gain of approximately $2,232,000 of which $702,000 was deferred. The investment in IOS is accounted for under the equity method of accounting. As of June 30, 2003, the University Hospitals and Clinics' percentage ownership in IOS was approximately 30%.

## 3. CASH, CASH EQUIVALENTS AND INVESTMENTS

Cash, cash equivalents and investments for the University are managed in three major categories:

**Pooled General Investments** – The general investment pools, managed by the University, averaged a total return of 5.82% and 7.15%, including unrealized gains and losses, for the years ended June 30, 2003 and 2002, respectively.

**Pooled Endowment Investments** – Endowment and similar funds are pooled for investment purposes when appropriate and permissible. The investment objective is to achieve long-term total returns sufficient to preserve principal, after adjusting for inflation, and to meet the endowment spending targets. The endowment pools, managed by outside managers, are the balanced pool and the fixed income pool and earned a total return of 4.1% and 11.4%, respectively, including unrealized gains and losses, for the year ended June 30, 2003, and (5.3)% and 9.0%, respectively, for the year ended June 30, 2002.

The Board of Curators has adopted a total return philosophy in determining the spendable return for the endowments and similar funds. The spending formula distributes annually 5% of a trailing 12-quarter average of the endowment's total market value, with the understanding that this spending rate over the long term will not exceed total real return (net of inflations) from investments. To achieve uniformity in amounts to spend from one year to the next, the actual amount available to spend in any given year will not be less than 96% or more than 106% of the prior year's expenditure.

**Retirement Investments** – Retirement investments emphasize diversification across asset classes and growth of principal. There were no investments, other than U.S. Government obligations, in any one organization in excess of 5% of total retirement fund assets. The retirement investments earned a total return of 4.1%, including unrealized gains and losses, for the year ended June 30, 2003, and (6.5)% for the year ended June 30, 2002.

**Total Cash, Cash Equivalents and Investments** – The University's cash and cash equivalents include bank deposits and repurchase agreements, with carrying values of $6,014,000 and $3,696,000 for the years ended June 30, 2003 and 2002, respectively. The entire bank balance of deposits is covered by FDIC insurance or U.S. Treasury securities that are pledged as collateral and segregated by the Federal Reserve Bank in a pledge account. The collateral is administered by the University's depository institutions and pledged in the University's name. The remaining balance in cash and cash equivalents represents investments maturing in three months or less.

Investments, including cash equivalents but excluding real estate and farm properties, have been categorized to give an indication of the level of credit risk assumed by the University at June 30, 2003. Category 1 includes investments that are insured or registered or for which the securities are held by the Entity or an agent in its name. Category 2 includes uninsured and unregistered investments for which the securities are held by the financial institution's trust department or agent in the Entity's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the financial institution, or by its trust department or agent but not in the Entity's name. Mutual funds and money market investments are not required to be categorized.

The balances as of June 30, 2003 and 2002, (in thousands of dollars) are summarized as follows:

**University**

| | 2003 | | | | 2002 | | | |
|---|---|---|---|---|---|---|---|---|
| | Category | | | Carrying Amount | Category | | | Carrying Amount |
| | 1 | 2 | 3 | | 1 | 2 | 3 | |
| Cash and Cash Equivalents | $ 35,640 | $ - | $ 180,746 | $ 216,386 | $ 56,118 | $ - | $ 162,085 | $ 218,203 |
| US Government obligations | 483,786 | | | 483,786 | 453,936 | | | 453,936 |
| Corporate Bonds and Notes | 203,147 | | | 203,147 | 214,651 | | | 214,651 |
| Corporate Stock | 346,104 | | | 346,104 | 364,399 | | | 364,399 |
| Total | $ 1,068,677 | $ - | $ 180,746 | 1,249,423 | $ 1,089,104 | $ - | $ 162,085 | 1,251,189 |
| Mutual Funds | | | | 2,617 | | | | |
| Real Estate | | | | 57,945 | | | | 29,009 |
| Other | | | | 37,896 | | | | 6,528 |
| Securities Lending Collateral | | | | 44,148 | | | | 56,974 |
| Total Investments | | | | $ 1,392,029 | | | | $ 1,343,700 |

**Retirement**

| | 2003 | | | | 2002 | | | |
|---|---|---|---|---|---|---|---|---|
| | Category | | | Carrying Amount | Category | | | Carrying Amount |
| | 1 | 2 | 3 | | 1 | 2 | 3 | |
| Cash and Cash Equivalents | $ 39,116 | $ - | $ - | $ 39,116 | $ 61,314 | $ - | $ - | $ 61,314 |
| US Government obligations | 330,907 | | | 330,907 | 331,743 | | | 331,743 |
| Corporate Bonds and Notes | 146,322 | | | 146,322 | 186,342 | | | 186,342 |
| Corporate Stock | 1,113,903 | | | 1,113,903 | 1,215,096 | | | 1,215,096 |
| Total | $ 1,630,248 | $ - | $ - | $ 1,630,248 | $ 1,794,495 | $ - | $ - | $ 1,794,495 |
| Real Estate | | | | 195,436 | | | | 53,998 |
| Other | | | | 114,153 | | | | 117,029 |
| Securities Lending Collateral | | | | 121,358 | | | | 154,765 |
| Total Investments | | | | $ 2,061,195 | | | | $ 2,120,287 |

**Securities Lending Transactions** – The University participates in a securities lending program to augment income. The program is administered by the University's custodial agent bank, which lends equity, government and corporate securities for a predetermined period of time, to an independent broker/dealer (borrower) in exchange for collateral. Collateral may be cash, U.S. Government securities, defined letters of credit or other collateral approved by the University. Loans of domestic securities are initially collateralized at 102% of the fair value of securities lent. Loans of international securities are initially collateralized at 105% of the fair value of securities lent. The University has minimized its exposure to credit risk from borrower default by having the custodial agent bank determine daily that required collateral meets a minimum of 100% of the market value of securities on loan for domestic securities lent and 105% for international securities lent.

The University continues to receive interest and dividends during the loan period, as well as a fee from the borrower. In addition, the maturities of the investments made with the cash collateral generally match the maturities of the securities lent. At June 30, 2003, the University has no credit risk exposure since the collateral held exceeds the value of the securities lent. The University is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

The provisions of GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions* provide that cash and securities received as collateral as a result of a securities lending transaction, which the University can pledge or sell without a borrower default, should be recorded as assets on the Combined Statements of Net Assets with a related liability for the return of the collateral.

In addition, at June 30, 2003 and 2002, letters of credit and security collateral, not meeting the criteria for inclusion in the Combined Statements of Net Assets, totaled $12,685,000 and $1,192,000, respectively, for the Retirement Trust and $5,617,000 and $4,064,000, respectively, for the University. At June 30, 2003, the aggregate fair value of the securities lent was $128,487,000 for the Retirement Trust and $47,978,000 for the University. The aggregate fair value of the collateral received was $134,043,000 for the Retirement Trust and $49,765,000 for the University.

**Foreign Currency Transactions** – The University and the Retirement Trust invest a significant portion of their portfolios in international investments (14.7% and 30.7% in fiscal year 2003). To reduce the risk related to fluctuations in currency exchange rates, the University has entered into forward foreign currency contracts throughout the year. As of June 30, 2003 and 2002, 3.5% or $48,959,000 and 3.7% or $49,952,000, respectively, of the University's total portfolio is invested in forward foreign currency contracts. As of June 30, 2003 and 2002, 8.1% or $166,013,000 and 7.6% or $160,864,000 of the Retirement Trust's total portfolio is invested in forward foreign currency contracts. These contracts are marked to market and the changes in their market value are recorded in investment and endowment income on the Combined Statements of Revenues, Expenses and Changes in Net Assets.

## 4. FUNDS HELD IN TRUST BY OTHERS

At June 30, 2003 and 2002, Funds Held in Trust by Others (principally endowment funds) aggregated $77,386,000 and $80,665,000, respectively, at fair value. Since only the income earned is available to the University, these funds are not included in the accompanying Combined Statements of Net Assets. Distributions received by the University for the years ended June 30, 2003 and 2002, aggregated $1,829,000 and $2,847,000, respectively.

## 5. ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2003 and 2002, are summarized as follows (in thousands of dollars):

| | 2003 | 2002 |
|---|---|---|
| Grants and contracts | $ 46,300 | $ 44,981 |
| State appropriations | 2,249 | 1,819 |
| Student fees and other academic charges | 48,625 | 58,476 |
| University Hospitals and Clinics patient services, net of contractual allowances | 53,974 | 58,646 |
| University Physicians patient services, net of contractual allowances | 13,454 | 15,849 |
| Subtotal | 164,602 | 179,771 |
| Less provision for loss on accounts receivable: | | |
| University Hospitals and Clinics patient services allowances | (10,685) | (4,890) |
| University Physicians patient services allowances | (999) | (2,436) |
| Other | (4,365) | (3,866) |
| Subtotal | (16,049) | (11,192) |
| | $ 148,553 | $ 168,579 |

## 6. NOTES RECEIVABLE

Notes receivable consist of resources available for financial loans to students. These resources are provided through Federal loan programs and University loan programs generally funded by external sources. Notes receivable at June 30, 2003 and 2002, are summarized as follows (in thousands of dollars):

| | 2003 | 2002 |
|---|---|---|
| Federal health profession loans | $ 13,912 | $ 14,486 |
| Carl D. Perkins National loans | 27,571 | 27,775 |
| University loan programs | 13,796 | 13,613 |
| Subtotal | 55,279 | 55,874 |
| Less provision for loss on notes receivable | (2,462) | (3,847) |
| | $ 52,817 | $ 52,027 |

## 7. CAPITAL ASSETS

Capital assets activity for the years ended June 30, 2003 and 2002, is summarized as follows (in thousands of dollars):

| | 2003 Beginning Balance | Additions | Retirements | 2003 Ending Balance |
|---|---|---|---|---|
| Land | $ 46,407 | $ 7,905 | $ 323 | $ 53,989 |
| Infrastructure | 157,581 | 12,348 | 575 | 169,354 |
| Buildings and improvements | 1,416,639 | 145,251 | 6,569 | 1,555,321 |
| Construction in progress | 167,212 | (20,367) | | 146,845 |
| Equipment | 391,588 | 39,160 | 13,702 | 417,046 |
| Artwork and historical artifacts | 9,408 | 6,943 | 53 | 16,298 |
| Library books | 174,250 | 8,095 | | 182,345 |
| | 2,363,085 | 199,335 | 21,222 | 2,541,198 |
| Less accumulated depreciation | 828,548 | 78,558 | 11,030 | 896,076 |
| | $ 1,534,537 | $ 120,777 | $ 10,192 | $ 1,645,122 |

| | 2002 Beginning Balance | Additions | Retirements | 2002 Ending Balance |
|---|---|---|---|---|
| Land | $ 45,663 | $ 744 | $ - | $ 46,407 |
| Infrastructure | 149,223 | 8,503 | 145 | 157,581 |
| Buildings and improvements | 1,318,527 | 100,288 | 2,176 | 1,416,639 |
| Construction in progress | 145,512 | 21,700 | | 167,212 |
| Equipment | 348,866 | 50,870 | 8,148 | 391,588 |
| Artwork and historical artifacts | 9,286 | 122 | | 9,408 |
| Library books | 165,204 | 9,046 | | 174,250 |
| | 2,182,281 | 191,273 | 10,469 | 2,363,085 |
| Less accumulated depreciation | 766,818 | 70,137 | 8,407 | 828,548 |
| | $ 1,415,463 | $ 121,136 | $ 2,062 | $ 1,534,537 |

The estimated cost to complete construction in progress at June 30, 2003, is $469,674,000 of which $68,549,000 is available from unrestricted net assets. The remaining costs are expected to be funded from $55,706,000 of State appropriations, $60,175,000 of gifts, $10,853,000 of grants, $196,335,000 of bond proceeds, $31,125,000 of State funded bonds and $46,931,000 of other University funds.

Capital assets include a building facility under a capital lease of $8,332,000 and $11,975,000 and related accumulated depreciation of $1,562,000 and $1,647,000 at June 30, 2003 and 2002, respectively.

## 8. ACCRUED LIABILITIES

Accrued liabilities at June 30, 2003 and 2002, are summarized as follows (in thousands of dollars):

| | 2003 | 2002 |
|---|---|---|
| Accrued salaries, wages and related benefits | $ 37,102 | $ 38,707 |
| Accrued vacation | 40,032 | 40,543 |
| Accrued self insurance claims | 58,275 | 49,855 |
| Interest payable | 3,073 | 3,185 |
| | $ 138,482 | $ 132,290 |

## 9. BONDS AND NOTES PAYABLE

As of June 30, 2003 and 2002, $469,233,000 and $479,546,000, respectively, of bonds and notes were outstanding. These outstanding bonds are comprised of $297,210,000 and $304,200,000 in System Facilities Revenue Bonds and $171,750,000 and $174,815,000 in Health Facilities Revenue Bonds at June 30, 2003 and 2002, respectively. The bonds are payable, both as to principal and interest, from net income or designated revenues from the related financed activities. These bonds bear interest at fixed and variable rates ranging from .98% to 5.75% per annum and mature at various dates through November 2033. Interest on the variable rate System Facilities Revenue Bonds is paid at the Bond Market Association™ daily bond rate. Due to operating results at the University of Missouri Hospitals and Clinics and related health care facilities, $13,351,000 and $12,853,000 in funds are held in escrow at June 30, 2003 and 2002, respectively, in accordance with Bond covenants. These funds are reflected as restricted cash and cash equivalents in the Combined Statements of Net Assets.

The remaining note payable of $273,000 and $531,000 at June 30, 2003 and 2002, respectively, is collateralized by a purchase money deed of trust covering physical properties with a net book value of $2,200,000 as of June 30, 2003. Interest is payable annually at a rate of 5.75%; the final principal and interest payment of $288,000 will be made in January 2004.

Bonds and Notes Payable activity by series of issuance for the year ended June 30, 2003, was as follows (in thousands of dollars):

| | 2003 Beginning Balance | Payments | 2003 Ending Balance |
|---|---|---|---|
| System Facilities Revenue Bonds: | | | |
| Series 1993 | $ 38,810 | $ 1,000 | $ 37,810 |
| Series 1997 | 6,020 | 885 | 5,135 |
| Series 1998 | 58,475 | 2,110 | 56,365 |
| Series 2000 | 76,695 | 2,370 | 74,325 |
| Series 2001 | 84,200 | 625 | 83,575 |
| Series 2002 | 40,000 | | 40,000 |
| Health Facilities Revenue Bonds: | | | |
| Series 1996A | 111,620 | 1,265 | 110,355 |
| Series 1998A | 63,195 | 1,800 | 61,395 |
| Note Payable | 531 | 258 | 273 |
| | 479,546 | $ 10,313 | 469,233 |
| Less Current Portion | 10,313 | | 10,773 |
| | $ 469,233 | | $ 458,460 |

Bonds and Notes Payable activity by series of issuance for the year ended June 30, 2002, was as follows (in thousands of dollars):

| | 2002 Beginning Balance | Issuance | Payments | Defeasance | 2002 Ending Balance |
|---|---|---|---|---|---|
| System Facilities Revenue Bonds: | | | | | |
| Series 1993 | $ 39,755 | $ - | $ 945 | $ - | $ 38,810 |
| Series 1997 | 49,905 | | 840 | 43,045 | 6,020 |
| Series 1998 | 60,505 | | 2,030 | | 58,475 |
| Series 2000 | 78,950 | | 2,255 | | 76,695 |
| Series 2001 | | 84,200 | | | 84,200 |
| Series 2002 | | 40,000 | | | 40,000 |
| Health Facilities Revenue Bonds: | | | | | |
| Series 1996A | 112,840 | | 1,220 | | 111,620 |
| Series 1998A | 64,910 | | 1,715 | | 63,195 |
| Note Payable | 774 | | 243 | | 531 |
| | 407,639 | $ 124,200 | $ 9,248 | $ 43,045 | 479,546 |
| Less Current Portion | 9,248 | | | | 10,313 |
| | $ 398,391 | | | | $ 469,233 |

As of June 30, 2003, the total of principal and interest (in thousands of dollars) due on bonds and notes during the next five years and in subsequent five-year periods is as follows:

| Fiscal Year | Principal | Interest |
|---|---|---|
| 2004 | $ 10,773 | $ 21,574 |
| 2005 | 11,020 | 21,054 |
| 2006 | 11,570 | 20,511 |
| 2007 | 12,195 | 19,938 |
| 2008 | 12,775 | 19,335 |
| 2009-2013 | 66,855 | 86,798 |
| 2014-2018 | 76,345 | 69,860 |
| 2019-2023 | 89,720 | 49,465 |
| 2024-2028 | 103,625 | 25,617 |
| 2029-2033 | 74,355 | 7,139 |
| | $ 469,233 | $ 341,291 |

On August 8, 2001, the University issued $84,200,000 of System Facilities Revenue Bonds, consisting of $39,225,000 in Series 2001A bonds at a variable interest rate and $44,975,000 of Series 2001B bonds at a rate of 5.12%. Proceeds from the issuance of the Series 2001A bonds were used to finance construction of new parking facilities on the Columbia and St. Louis campuses, various other projects and the cost of issuance. Proceeds from the issuance of the Series 2001B bonds were used to advance refund and defease a portion of the University of Missouri System Facilities Revenue Bonds, Series 1997 in the amount of $43,045,000 and to finance certain costs of issuance.

A $2,320,000 loss in connection with the insubstance defeasance of the Series 1997 Bonds was deferred in 2002 and included as deferred charges to be amortized over the remaining life of the original series 1997 Bonds. The defeasance decreased aggregate debt service payments by $1,838,000 resulting in an economic gain (difference between the present values of the old and new debt service payments) to the University of $1,408,000.

On May 29, 2002, the University issued $40,000,000 of variable rate demand System Facilities Revenue Bonds, Series 2002A. Proceeds from the issuance of the bonds were used to current refund a portion of the University's outstanding Capital Projects Notes, Series FY2001-2002 and to finance certain costs of issuance. The refunding did not result in a gain or loss for the University. The bonds are payable, in full, on November 1, 2032.

On July 16, 2002, the University entered into a thirty-year interest rate swap agreement on $40,000,000, notional amount, of its variable rate System Facilities Revenue Bonds. Based on the swap agreement, the University owes interest calculated at a fixed rate of 3.95% to the counterparty to the swap. In return, the counterparty owes the University interest based on a variable rate set weekly. The $40,000,000 in bond principal is not exchanged; it is only the basis on which the interest payments are calculated.

The University continues to pay interest to the bondholders at the variable rate provided by the bonds. However, during the term of the swap agreement, the University effectively pays a fixed rate on the debt. The University will revert to variable rates if the counterparty to the swap defaults or if the swap is terminated. A termination of the swap agreement may also result in the University's making or receiving a termination payment.

As of June 30, 2003, the swap had a fair value of $(5,142,000), which represents the cost to the University to terminate the swap. The fair value was developed using the zero coupon method and proprietary models, and was prepared by the counterparty, J.P. Morgan Chase Bank, a major U.S. financial institution. The zero coupon method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each net settlement of the swap.

As of June 30, 2003, the University was not exposed to credit risk on the termination payment because the swap had a negative fair value and the University would have owed the payment. However, should interest rates change and the fair value of the swap become positive, the University would be exposed to credit risk. The swap counterparty was rated AA- by Fitch Ratings and Standard & Poor's and Aa3 by Moody's Investors Service as of June 30, 2003. In the event a ratings downgrade occurs, the counterparty may be required to provide collateral if the University's overall exposure exceeds predetermined levels. Permitted collateral investments include U.S. Treasuries, U.S. government agencies, cash, and commercial paper rated A1/P1 by Standard & Poor's and Moody's, respectively. Collateral may be held by the University or by a third party custodian.

The swap exposes the University to basis risk should the weekly BMA rate paid by the counterparty fall below the daily interest rate due on the bonds. This basis risk can be the result of a downgrade of the University's rating, daily rates becoming higher than weekly rates, or the pricing of the University's bonds by the remarketing agent at rates higher than the BMA index.

At June 30, 2003 and 2002, defeased and in-substance defeased bonds aggregating $55,157,000 and $71,494,000, respectively, are outstanding.

## 10. SHORT-TERM BORROWINGS

During the year ended June 30, 2003, the University sold $85,000,000 of capital project notes at an effective interest rate of 1.6%. The maximum amount of notes outstanding during the year was $85,000,000, and all were repaid in full by June 30, 2003.

During the year ended June 30, 2002, the University sold $90,000,000 of capital project notes at an effective interest rate of 2.61%. The maximum amount of notes outstanding during the year was $90,000,000, and all were repaid in full by June 30, 2002.

## 11. LEASE OBLIGATIONS

The University leases various facilities and equipment through operating and capital leases. Facilities under capitalized leases are recorded at the present value of future minimum lease payments. The future minimum payments on all significant leases with initial or remaining terms of one year or more at June 30, 2003, are as follows (in thousands of dollars):

| Fiscal Year | Capital | Operating |
|---|---|---|
| 2004 | $ 1,215 | $ 2,587 |
| 2005 | 1,215 | 1,585 |
| 2006 | 1,215 | 845 |
| 2007 | 1,215 | 280 |
| 2008 | 1,215 | 208 |
| 2009-2013 | 6,075 | 859 |
| 2014-2018 | 6,075 | 487 |
| 2019-2023 | 1,518 | |
| Total future minimum payments | 19,743 | $ 6,851 |
| Less: amount representing interest | 8,879 | |
| Present value of future minimum lease payments | $ 10,864 | |

Total rental expenditures for operating leases for the years ended June 30, 2003 and 2002, were $12,375,000 and $13,805,000, respectively.

*Description of Sublease Arrangement with IOS* – Concurrent with the sale of assets to IOS, the University Hospitals and Clinics entered into an agreement with IOS whereby IOS subleased certain building space from the Hospitals and Clinics for a period of approximately 17 years at current market rates. The Hospitals and Clinics recorded the transaction as a direct financing lease and recorded a minimum lease payment to be received of $6,375,000, unearned rental income of $3,233,000 and a write-off of $3,142,000 of building and improvements related to the sublease. The future minimum lease payments to be received under this sublease are as follows (in thousands of dollars):

| | |
|---|---|
| Total minimum lease payments to be received: | |
| Current | $ 370 |
| Noncurrent | 5,636 |
| Total | 6,006 |
| Less: unearned rental income | (2,963) |
| Present value of future minimum lease payments | $ 3,043 |

During 2003, the University Hospitals and Clinics received $270,000 of rental income from IOS. At June 30, 2003, minimum lease payments for each of the five succeeding fiscal years are as follows: $82,000 in 2004, $90,000 in 2005, $99,000 in 2006, $109,000 in 2007, $120,000 in 2008 and $2,543,000 thereafter.

## 12. RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; injuries to employees; natural disasters; and various medically related benefit programs for employees. The University funds these losses through a combination of self-insured retentions and commercially purchased insurance. The amount of self-insurance funds and commercial insurance maintained are based upon analysis of historical information and actuarial estimates. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

The liability for self-insurance claims at June 30, 2003 and 2002 of $58,275,000 and $49,855,000, respectively, represents the present value of amounts estimated to have been incurred by those dates, using discount rates ranging from 3.75% to 4.65% for fiscal year 2003 and 4.65% to 5.00% for fiscal year 2002, based on expected future investment yield assumptions. Changes in this liability (in thousands of dollars) during fiscal years 2003 and 2002 were as follows:

| Fiscal Year | Beginning of Year | New Claims and Changes in Estimates | Claim Payments | End of Year |
|---|---|---|---|---|
| 2003 | $ 49,855 | $ 122,277 | $ 113,857 | $ 58,275 |
| 2002 | 50,187 | 94,019 | 94,351 | 49,855 |

## 13. CONTINGENCIES

In December 2002 the Circuit Court of St. Louis County, Missouri rendered a decision finding that the University had violated a statute enacted in 1872 which provided that youth over the age of 16 and resident of the State of Missouri could attend the University without payment of tuition for undergraduate education. The court did not consider what would be an appropriate remedy or if in fact there should be any finding of damages. The University appealed the Court's decision to the Eastern District Court of Appeals in St. Louis, which transferred the appeal to the Supreme Court of Missouri. The Supreme Court dismissed the appeal as being premature and remanded the case to the Circuit Court of St. Louis County for a trial and determination of what remedy, if any, is appropriate. The statute was amended in 2001 to authorize the charging of tuition. The University believes that an adverse decision could reach several hundred million dollars.

## 14. RETIREMENT, DISABILITY AND DEATH BENEFIT PLAN

**Plan Description** – The University of Missouri Retirement, Disability and Death Benefit Plan (the "Plan") is a single employer, defined benefit plan for all qualified employees. As authorized by State statute, the University's Board of Curators administers the Plan and establishes its terms. Separate financial statements and supplemental schedules are not prepared for the Plan.

Total University payrolls were $892,415,000 and $887,971,000 for the years ended June 30, 2003 and 2002, respectively, of which $701,617,000 and $709,228,000 were covered by the Plan for the respective periods. At June 30, 2003 and 2002, membership in the Plan consisted of:

| | 2003 | 2002 |
|---|---|---|
| Active members: | | |
| Vested | 8,355 | 8,480 |
| Nonvested | 7,435 | 8,153 |
| Pensioners | 6,547 | 5,824 |
| Former employees with deferred pensions | 2,038 | 2,051 |
| Total | 24,375 | 24,508 |

**Benefit Provisions** – All full-time employees are eligible for benefits after five years of credited service. The annual lifetime annuity payable to a vested employee who retires at age 65 or later is calculated as 2.2% times the number of years of service times the compensation base. Compensation base is defined as the individual's average compensation for the five consecutive highest salary years. Academic members who render summer teaching and research service receive an additional credit for such service. Pension adjustments may be approved at certain times, which increase the benefits paid existing pensioners.

Full benefits are available to members who retire at age 65 or after. Vested employees may retire prior to age 65, provided they are at least age 55 with at least ten years of credited service, or age 60 with five years of credited service. Benefits are reduced for those who retire early, unless they retire at age 62 or later with at least 25 years of credited service. At retirement, up to 30% of the value of the retirement annuity can be taken in a lump sum; also the single life annuity can be exchanged for an actuarially equivalent annuity option (elected from an array of annuities with joint and survivor, period certain, and guaranteed annual increase features).

Vested employees who terminate prior to eligibility for retirement may elect to have 100% of the actuarial equivalent of their benefit transferred to an Individual Retirement Annuity or into another employer's qualified plan that accepts such rollovers. If the actuarial equivalent is less than $20,000, it may be taken in the form of a lump sum payment.

The value of the accrued benefit to a vested employee at termination or at retirement is subject to a minimum value as provided by the Plan's cash balance feature. This feature computes an accrual equal to 5% of the employee's eligible compensation invested at 7.5% per annum.

The Plan includes a provision allowing vested employees, who become disabled, to continue to accrue service credit until they retire, and a provision which prescribes a pre-retirement death benefit for vested employees.

In fiscal year 2002, the Board of Curators approved a Voluntary Early Retirement Incentive Program (VERIP-2002) for employees who met the VERIP-2002 eligibility criteria, applied for retirement between June 1, 2002 and September 30, 2002, and retired no later than January 1, 2003. Participants in VERIP-2002 received the greater retirement benefit derived from adding three years of additional service credit or from eliminating the reduction factor for retirements prior to age 65. During fiscal year 2003, 724 employees took part in VERIP-2002. This resulted in a $47,326,000 increase in the actuarial liability and a $1,778,000 increase in future annual liabilities.

**Contributions** – The University's contributions to the Plan are equal to the actuarially determined contribution requirement, as a percent of payroll, which averaged 2.6% and 3.6% for the years ended June 30, 2003 and 2002, respectively. The Plan is funded 100% by University contributions and does not require employee contributions. The contribution rate is updated annually, at the beginning of the University's fiscal year on July 1, to reflect the actuarially determined funding requirement from the most recent valuation, as of the preceding October 1, and the adoption of any Plan amendments during the interim.

**SCHEDULE OF EMPLOYER CONTRIBUTIONS**

*(in thousands of dollars)*

| Fiscal Year | Annual Required Contribution: As % of Payroll | Annual Required Contribution: In Dollars | Percentage Contributed | Net Pension Obligation |
|---|---|---|---|---|
| 1998 | 5.9% | $ 33,303 | 100% | $ 0 |
| 1999 | 6.0% | 36,044 | 100% | 0 |
| 2000 | 5.8% | 37,036 | 100% | 0 |
| 2001 | 4.4% | 29,272 | 100% | 0 |
| 2002 | 3.6% | 25,319 | 100% | 0 |
| 2003 | 2.6% | 17,962 | 100% | 0 |

The annual required contribution for the year ended June 30, 2003, was determined as part of the October 1, 2001, actuarial valuation, using the entry age normal actuarial cost method, and adjusted for the Plan amendments effective September 1, 2002.

The annual required contribution for the year ended June 30, 2002, was determined as part of the October 1, 2000, actuarial valuation, using the entry age normal actuarial cost method, and adjusted for the Plan amendments effective September 1, 2001.

Significant assumptions used in the valuations for the years ended June 30, 2003 and 2002 were:

| | 2003 | 2002 |
|---|---|---|
| • Assumed annual rate of return on investments | 8.0% | 8.0% |
| • Projected annual average salary increases for academic and administrative employees | 5.2% | 5.2% |
| • Projected annual average salary increases for clerical and service employees | 4.5% | 4.5% |
| • Future retiree ad hoc increases or cost of living adjustments. | 0.0% | 0.0% |

The actuarial value of assets is based on the cost of the Plan's underlying assets. Although a net pension obligation did not exist as of June 30, 2003, any future liabilities incurred would be amortized over 20 years using the level dollar method on an open basis.

The schedule of funding progress is as follows:

**SCHEDULE OF FUNDING PROGRESS**
*(in thousands of dollars)*

| Date | Actuarial Value of Assets | Accrued Liability | Funding Excess/ (Unfunded Liability) | Funded Ratio | Covered Payroll | Funding Excess/ (Unfunded Liability) as a % of Covered Payroll |
|---|---|---|---|---|---|---|
| 10/1/97 | $ 1,359,159 | $ 1,266,397 | $ 92,762 | 107.3% | $ 543,357 | 17.1% |
| 10/1/98 | 1,487,269 | 1,425,583 | 61,686 | 104.3% | 578,035 | 10.7% |
| 10/1/99 | 1,740,756 | 1,531,205 | 209,551 | 113.7% | 623,318 | 33.6% |
| 10/1/00 | 1,906,678 | 1,686,684 | 219,994 | 113.0% | 646,198 | 34.0% |
| 10/1/01 | 2,119,047* | 1,813,018 | 306,029 | 116.9% | 696,163 | 44.0% |
| 10/1/02 | 1,949,794 | 1,937,617 | 12,177 | 100.6% | 654,575 | 1.9% |

** The actuarial value of assets methodology changed effective October 1, 2001, from the book value method to the expected return asset valuation method.*

## 15. OTHER POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 14, the University provides postretirement medical, dental and life insurance benefits to employees who retire from the University after attaining age 55 and before reaching age 60 with ten or more years of service, or, who retire after attaining age 60 with five or more years of service. As of June 30, 2003 and 2002, 5,694 and 4,965 retirees met those eligibility requirements.

For employees retiring prior to September 1, 1990, the University contributes toward premiums at the same rate as for active employees; 2/3 of the premium for medical benefits and 1/2 of the dental plan premium. For employees who retired under the terms of the Retirement and Death Benefit Plan on September 1, 1990 or thereafter, the University contributes toward premiums on the basis of the employee's length of service and age at retirement.

The University makes available two group term life insurance options. Option A coverage is equal to the retiree's salary at the date of retirement and graded adjustments in coverage made at the attainment of specific age levels. This coverage is paid in full by the University. Option B coverage is equal to two times the retiree's salary at the date of retirement with graded adjustments in coverage made at the attainment of specific age levels. The University pays approximately 91% of the cost of Option B coverage. Group term life insurance will end on January 1 following the retiree's 70th birthday.

Postemployment medical, dental and life insurance benefits are also provided to those long-term disability claimants who were vested in the University's retirement plan at the date their disability began, provided the onset date of their disability was on or after September 1, 1990. As of June 30, 2003 and 2002, 204 and 218 long-term disability claimants met those eligibility requirements.

The University makes available two long-term disability options to its employees. Option A coverage is equal to 60% of the employee's salary on the date the disability began, with full integration with benefits from other sources. Option B coverage is equal to 66 2/3% of the employee's salary, integrated with other benefits so that benefits from all sources will not exceed 85% of the employee's salary. Both options have a 149-day waiting period and provide benefits to age 65. The University pays for the full cost of Option A coverage; employees enrolled in Option B pay for the additional cost of Option B over Option A.

The terms and conditions governing the postemployment benefits to which employees are entitled are in the sole authority and discretion of the University's Board of Curators.

Postemployment benefit costs, other than long-term disability, are funded on a current basis and amounted to $13,021,000 and $11,798,000 for the years ended June 30, 2003 and 2002, respectively. Long-term disability costs are recognized during the period in which the employee becomes eligible to receive disability benefits and amounted to $3,161,000 and $4,366,000 for the years ended June 30, 2003 and 2002, respectively.

## 16. SEGMENT INFORMATION

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds are outstanding. A segment has a specific identifiable revenue stream pledged in support of revenue bonds and has related expenses, gains and losses, assets, and liabilities that are required by an external party to be accounted for separately. The University has two segments that meet the reporting requirements of GASB Statement No. 35.

The outstanding debt of the University consists of System Facility Revenue Bonds and Health Facilities Revenue Bonds. The System Facility Revenue Bonds are issued in accordance with a Resolution adopted by the Board of Curators in October 1993. The Resolution provides that the bonds are payable from the gross income and revenues derived from the related facilities including student fees, housing, dining, bookstore and parking revenues and various other University revenues.

The Health Facilities Revenue Bonds are limited obligation bonds secured by revenues of the Health System. The Health System consists of the University of Missouri Hospitals and Clinics, which includes the University of Missouri Hospital, Ellis Fischel Cancer Center, Rusk Rehabilitation Center and the Children's Hospital; the University Physicians Medical Practice Plan, which includes faculty of the University of Missouri – Columbia School of Medicine; and the Missouri Rehabilitation Center.

Summary financial information for the System Facility and the Health Facilities Revenue Bonds as of June 30, 2003 and 2002, is as follows (in thousands of dollars):

| | System Facility Revenue Bonds | | Health Facilities Revenue Bonds | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| **Condensed Statements of Net Assets** | | | | |
| Assets: | | | | |
| Current assets | $ 81,568 | $ 118,390 | $ 95,891 | $ 101,287 |
| Noncurrent assets | 336,263 | 321,884 | 364,430 | 345,120 |
| **Total assets** | $ 417,831 | $ 440,274 | $ 460,321 | $ 446,407 |
| Liabilities: | | | | |
| Current liabilities | $ 25,277 | $ 24,377 | $ 56,400 | $ 50,451 |
| Noncurrent liabilities | 289,910 | 297,210 | 235,041 | 235,317 |
| Total liabilities | 315,187 | 321,587 | 291,441 | 285,768 |
| Net assets: | | | | |
| Invested in capital assets, net of related debt | 41,966 | 35,384 | 49,391 | 45,879 |
| Restricted - | | | | |
| Nonexpendable | | | 596 | 578 |
| Expendable | 632 | 17,426 | 14,648 | 14,488 |
| Unrestricted | 60,046 | 65,877 | 104,245 | 99,694 |
| Total net assets | 102,644 | 118,687 | 168,880 | 160,639 |
| **Total liabilities and net assets** | $ 417,831 | $ 440,274 | $ 460,321 | $ 446,407 |
| **Condensed Statements of Revenues, Expenses and Changes in Net Assets** | | | | |
| Operating revenues | $ 110,547 | $ 103,134 | $ 457,911 | $ 435,793 |
| Operating expenses: | | | | |
| Depreciation | 10,939 | 5,770 | 24,464 | 25,690 |
| All other operating expenses | 93,998 | 77,753 | 437,161 | 421,685 |
| Total operating expenses | 104,937 | 83,523 | 461,625 | 447,375 |
| Operating income (less) | 5,610 | 19,611 | (3,714) | (11,582) |
| Nonoperating revenues (expenses) | (6,755) | (2,229) | 21,291 | 16,232 |
| Excess (deficit) of revenues over expenses | (1,145) | 17,382 | 17,577 | 4,650 |
| Transfer from other University units | (14,898) | 21,776 | (9,336) | (10,276) |
| Increase (decrease) in net assets | (16,043) | 39,158 | 8,241 | (5,626) |
| Net assets, beginning of year | 118,687 | 79,529 | 160,639 | 166,265 |
| **Net assets, end of year** | $ 102,644 | $ 118,687 | $ 168,880 | $ 160,639 |
| **Condensed Statements of Cash Flows** | | | | |
| Net cash flows provided by operating activities | $ 19,138 | $ 24,819 | $ 36,957 | $ 18,722 |
| Net cash flows provided by (used in) investing activities | 3,791 | 4,849 | (15,679) | 22,991 |
| Net cash flows used in capital and related financing activities | (57,836) | (1,729) | (36,198) | (39,525) |
| Net cash flows provided by non-capital financing activities | | 2 | 12,444 | 10,164 |
| Net increase (decrease) in cash and cash equivalents | (34,907) | 27,941 | (2,476) | 12,352 |
| Cash and cash equivalents, beginning of year | 107,033 | 79,092 | 17,042 | 4,690 |
| **Cash and cash equivalents, end of year** | $ 72,126 | $ 107,033 | $ 14,566 | $ 17,042 |

## 17. OPERATING EXPENSES BY FUNCTION

The operating expenses of the University are presented based on natural expenditure classifications. The University's operating expenses by functional classification are as follows:

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

| Functional Classification | Salaries and Wages | Staff Benefits | Supplies, Services and Other Operating Expenses | Scholarships and Fellowships | Depreciation | Total |
|---|---|---|---|---|---|---|
| Instruction | $ 280,408 | $ 47,564 | $ 75,740 | $ - | $ - | $ 403,712 |
| Research | 98,020 | 15,592 | 63,623 | | | 177,235 |
| Public Service | 67,933 | 13,795 | 53,686 | | | 135,414 |
| Academic Support | 58,507 | 13,375 | 23,901 | | | 95,783 |
| Student Services | 31,818 | 5,324 | 12,565 | | | 49,707 |
| Institutional Support | 68,013 | 14,899 | (16,989) | | | 65,923 |
| Operation and Maintenance of Plant | 29,712 | 6,148 | 3,895 | | | 39,755 |
| Auxiliary Enterprises | 258,004 | 51,528 | 291,762 | | | 601,294 |
| Scholarships and Fellowships | | | | 26,209 | | 26,209 |
| Depreciation | | | | | 78,558 | 78,558 |
| **Total Operating Expenses** | $ 892,415 | $ 168,225 | $ 508,183 | $ 26,209 | $ 78,558 | $1,673,590 |

**Year Ended June 30, 2002**
(in thousands of dollars)

| Functional Classification | Salaries and Wages | Staff Benefits | Supplies, Services and Other Operating Expenses | Scholarships and Fellowships | Depreciation | Total |
|---|---|---|---|---|---|---|
| Instruction | $ 268,031 | $ 45,871 | $ 55,420 | $ - | $ - | $ 369,322 |
| Research | 95,180 | 15,255 | 60,091 | | | 170,526 |
| Public Service | 70,559 | 15,217 | 58,752 | | | 144,528 |
| Academic Support | 62,841 | 12,397 | 29,574 | | | 104,812 |
| Student Services | 31,170 | 5,797 | 13,950 | | | 50,917 |
| Institutional Support | 70,154 | 15,420 | (17,893) | | | 67,681 |
| Operation and Maintenance of Plant | 33,023 | 7,909 | (11,964) | | | 28,968 |
| Auxiliary Enterprises | 257,013 | 50,806 | 291,991 | | | 599,810 |
| Scholarships and Fellowships | | | | 25,768 | | 25,768 |
| Depreciation | | | | | 70,137 | 70,137 |
| **Total Operating Expenses** | $ 887,971 | $ 168,672 | $ 479,921 | $ 25,768 | $ 70,137 | $1,632,469 |

## 18. RELATED ORGANIZATIONS

The Related Organizations column in the combined financial statements includes the financial data of the University of Missouri – Columbia Medical Alliance and Missouri Care L.C.

The University of Missouri – Columbia Medical Alliance (the "Medical Alliance"), a not-for-profit corporation, provides an integrated health care delivery system for mid-Missouri by establishing affiliations with various medical facilities. Capital Region Medical Center in Jefferson City, Missouri, operates as an affiliate of the Medical Alliance and provides inpatient, outpatient and emergency care services to the surrounding community.

Missouri Care L.C. is a not-for-profit health maintenance organization which provides services to patients in central Missouri under a certification from the Missouri Department of Social Services. Missouri Care L.C. has contracted with the University of Missouri Healthcare System as a major provider of health care services to the organization's members.

The amounts shown in the Combined Statements of Revenues, Expenses and Changes in Net Assets – Related Organizations column that relate to the Medical Alliance, including Capital Region Medical Center, and Missouri Care L.C., as of June 30, 2003 and 2002, are shown below (in thousands of dollars):

| | 2003 | | | 2002 | | |
|---|---|---|---|---|---|---|
| | Medical Alliance | Missouri Care L.C. | Total | Medical Alliance | Missouri Care L.C. | Total |
| **Total Operating Revenues** | $ 106,880 | $ 37,440 | $ 144,320 | $ 98,992 | $ 33,745 | $ 132,737 |
| **Operating Expenses:** | | | | | | |
| Salaries and wages | 41,793 | | 41,793 | 39,489 | | 39,489 |
| Staff benefits | 10,273 | | 10,273 | 8,842 | | 8,842 |
| Supplies, services and other operating expenses | 43,551 | 36,890 | 80,441 | 40,035 | 33,623 | 73,658 |
| Depreciation | 7,040 | | 7,040 | 6,613 | 146 | 6,759 |
| **Total Operating Expenses** | 102,657 | 36,890 | 139,547 | 94,979 | 33,769 | 128,748 |
| **Operating Income (Loss) Before Nonoperating Revenues (Expenses) and Transfers** | 4,223 | 550 | 4,773 | 4,013 | (24) | 3,989 |
| **Nonoperating Revenues (Expenses) and Transfers:** | | | | | | |
| Investment income | 274 | | 274 | 946 | 186 | 1,132 |
| Private gifts | 206 | | 206 | 108 | | 108 |
| Interest expense | (1,220) | | (1,220) | (1,228) | | (1,228) |
| **Net Other Nonoperating Revenues (Expenses) Before Transfers** | (740) | | (740) | (174) | 186 | 12 |
| **Transfers to Related Organizations** | 281 | | 281 | (263) | 263 | |
| **Increase in Net Assets** | 3,764 | 550 | 4,314 | 3,576 | 425 | 4,001 |
| **Net Assets, Beginning of Year** | 67,704 | 4,193 | 71,897 | 64,128 | 3,768 | 67,896 |
| **Net Assets, End of Year** | $ 71,468 | $ 4,743 | $ 76,211 | $ 67,704 | $ 4,193 | $ 71,897 |

Financial statements for the Capital Region Medical Center, an affiliate of the Medical Alliance, and Missouri Care L.C. are available upon request.

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