FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 AND INDEPENDENT AUDITOR'S REPORT

UNIVERSITY OF IDAHO

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UNIVERSITY OF IDAHO

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2005

The University of Idaho (the "University") is a doctoral-research extensive land-grant institution, with the principal responsibility for research and granting Ph.D. degrees in Idaho. The University serves state, national and international communities by providing academic instruction and conducting research that advances fundamental knowledge. In addition to its main campus in Moscow, the University has instructional centers in Coeur D'Alene, Boise, Twin Falls and Idaho Falls as well as research and extension centers located across the state.

OVERVIEW

The Management's Discussion and Analysis is designed to provide an easily readable analysis of the University's financial condition, results of operations and cash flows based on facts, decisions and conditions known at the date of the auditor's reports. The emphasis of this discussion of the financial performance of the University is for the current year.

The discussion and analysis that follows provides an overview of the University's financial activities for the fiscal year ended June 30, 2005. There are three financial statements presented: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. They are prepared using the accrual basis of accounting, whereby revenues are recognized when services are provided and expenses are recognized when goods or services are received, regardless of when cash is exchanged.

In accordance with GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units, an Amendment of GASB Statement 14*, these statements also present information for the University of Idaho Foundation, Inc. (the "Foundation") which qualifies as a component unit of the University. Separate audited financial statements are prepared for the Foundation and may be obtained by contacting University of Idaho Foundation, P.O. Box 443143, Moscow, ID 83844-3143.

Statement of Net Assets

The statement of net assets outlines the University's financial condition at fiscal year end. This is a point-in-time financial statement and presents end-of-year data concerning assets, liabilities and net assets.

From the data presented, readers are able to determine the assets available to continue the operations of the University. They are also able to determine how much the University owes vendors, investors and lending institutions. Finally, it provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the University.

The statement of net assets is presented in a classified format, which differentiates between current and noncurrent assets and liabilities, and also categorizes net assets into four categories:

- *Invested in Capital Assets, Net of Related Debt*—Net assets representing the University's investment in property, plant and equipment net of depreciation and outstanding debt obligations related to those capital assets.

- *Restricted Nonexpendable*—Net assets subject to donor stipulations requiring the net assets to be maintained permanently by the University. These assets are invested by the Foundation.

- *Restricted Expendable*—Net assets subject to donor stipulations regarding their use. The University may expend these assets for purposes as determined by donors and/or external entities.

- *Unrestricted*—Net assets not subject to donor stipulations which may be expended for any lawful purpose of the University.

Condensed Statements of Net Assets
As of June 30, 2005
(Thousands)

	2005	2004	2003
Assets:			
Current assets	$ 39,966	$ 56,518	$ 48,191
Property, plant and equipment - net	306,409	311,705	297,204
Other noncurrent assets	138,583	107,756	123,940
Total assets	484,958	475,979	469,335
Liabilities:			
Current liabilities	45,116	47,307	44,743
Noncurrent liabilities	127,157	133,148	140,059
Total liabilities	172,273	180,455	184,802
Net assets:			
Invested in capital assets—net of debt	171,201	173,804	173,525
Restricted nonexpendable	78,667	71,171	70,747
Restricted expendable	21,252	20,631	21,610
Unrestricted	41,565	29,918	18,650
Total net assets	$ 312,685	$ 295,524	$ 284,532

Current assets include the University's cash, accounts receivable, grants and loans receivable, inventories and prepaid expenses expected to benefit the University within one year. Accounts, grants and loans receivable result primarily from student accounts and from sponsored projects which are payable on a cost-reimbursement basis. Inventories include books and supplies from auxiliary operations and supplies for resale in other University departments.

Property, plant and equipment, net are values related to construction in progress, library materials, furniture and equipment, buildings and improvements. Equipment acquisitions relate largely to the University's research and instruction programs and include acquisitions of scientific equipment.

In order to accurately reflect the current assets, the University has recorded an allowance of $7,071,957 against two notes receivable from the Foundation that are due December 31, 2005. These notes stem from the University Place project in Boise, ID. The Foundation's ability to pay the notes in accordance with the current terms is uncertain. The University intends to pursue the collection of the notes and believes it may be possible that the Foundation will eventually recover a portion of its losses through legal and other actions and will then be able to repay these notes. The University and the Foundation currently are in litigation regarding the University Place project and the University will continue to monitor the recovery efforts of the Foundation and the collectibility of these notes. For further information please refer to the litigation note to the financial statements.

Other noncurrent assets include endowment fund assets, student loans receivable and investments expected to mature over a period greater than one year.

Current liabilities include payroll and related liabilities, amounts payable to suppliers for goods and services received, cash received for which the University has not yet earned the related revenue, and debt principal payments due within one year.

Amounts invested in capital assets, net of related debt, consist of the historical acquisition value of capital assets, reduced by both accumulated depreciation expense charged against assets and debt balances related to capital assets.

Restricted, expendable net assets represent balances that may be expended by the University, but only in accordance with the restrictions imposed upon the University by an external party, such as a donor or legislative mandate. The University's most significant restricted, expendable balance relates to funds held by trustees in accordance with bond covenants, which may only be expended for the renewal and replacement of assets whose revenues are pledged as security for repayment of debt.

Restricted, nonexpendable balances must be held in perpetuity, and include endowment principal.

Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents, or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for specific purposes as described in the notes to the financial statements, and include funds accumulated for contractual payments such as debt service and grant-funded employee termination payouts, funds earmarked for facility renewal and replacement and student organization funds.

YEAR ENDED JUNE 30, 2005 COMPARED TO YEAR ENDED JUNE 30, 2004

Significant Changes in the Statement of Net Assets

- Cash and cash equivalents decreased $3.8 million due to management decisions to invest a portion of the cash balances for a longer term during fiscal year 2005.

- Investments at market increased $13.4 million due to conversions from cash to investments reflecting a management decision to capture additional return by investing for a longer duration.

- Notes receivable decreased by approximately $2 million dollars due to a provision for doubtful accounts taken against a note with the Foundation.

- Repurchase agreements declined by $.7 million. These funds were used to complete the 2001 University of Idaho Housing Project.

- Noncurrent accrued salaries and benefits payable decreased $136 thousand. All the University's 2002 Voluntary Separation Retirement Opportunity Program ("VSROP") expenses have been paid except for a small amount that is due in the current year. The payment for the program during fiscal year 2004 was $1.4 million.

- Notes and bonds payable decreased $5.6 million due to annual debt service payments. During the year the University issued bonds in the amount of $30.7 million. This was a refunding issue which retired debt related to five bonds issues.

Statement of Revenues, Expenses and Changes in Net Assets

The statement of revenues, expenses and changes in net assets presents the revenues received and expenses incurred during the year, classifying activities as either "operating" or "nonoperating." This distinction results in operating deficits for those institutions that depend on State aid and gifts, because the GASB 34 reporting model classifies state appropriations and gifts as nonoperating revenue. The utilization of capital assets is reflected in the financial statements as depreciation expense, which allocates the cost of assets over their expected useful lives.

Condensed Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30
(Thousands)

	2005	2004	2003
Operating revenues	$ 170,790	$ 165,932	$ 157,132
Operating expenses	296,438	286,785	277,483
Operating (loss) income	(125,648)	(120,853)	(120,351)
Net nonoperating revenues (expenses)	138,450	125,844	119,772
Income before other revenues and (expenses)	12,802	4,991	(579)
Other revenues and (expenses)	4,359	6,001	4,974
Increase in net assets	17,161	10,992	4,395
Net assets—beginning of year	295,524	284,532	280,137
Net assets—end of year	$ 312,685	$ 295,524	$ 284,532

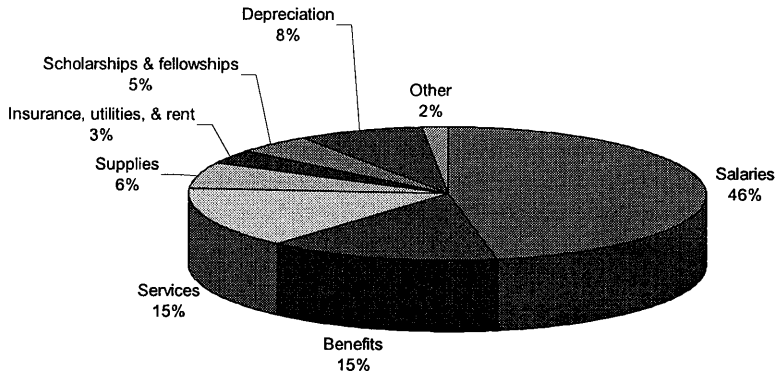
Operating Revenues

Operating revenues are generated through providing services to the various customers and constituencies of the University. Operating revenues include tuition and fees, grant and contract revenues, and sales and service revenue generated by student housing, bookstores and other enterprises. Student enrollment drives a large portion of operating revenues. Trends indicate that in the future a greater proportion of revenues will be obtained from students and other sources to offset a proportional decrease in available state funding.

Operating Expenses

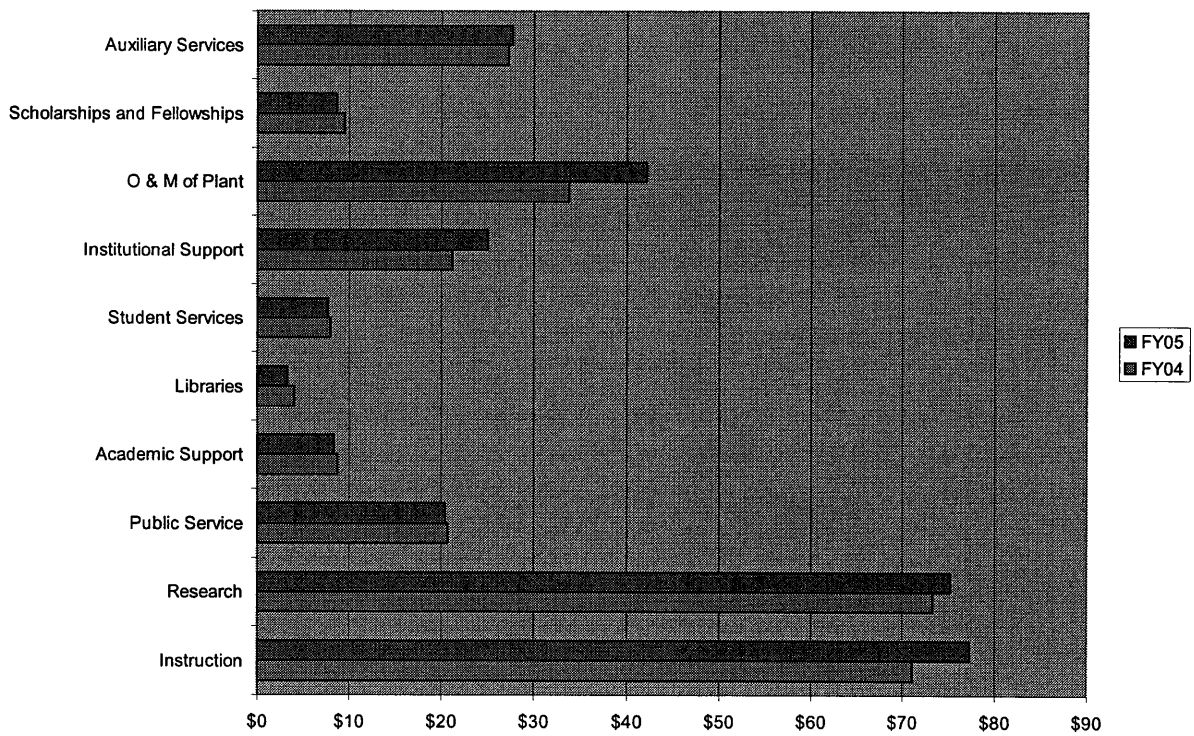
As shown in the following chart, a significant portion of the University's expenses relate to employee compensation and benefits. This relationship is expected to continue, and the proportion may grow as compensation, insurance and other payroll-related costs increase. Due to the volatility of the utilities industry, utilities and plant-related expenses may fluctuate. Additionally, a concerted effort is being made to ensure access to all qualified applicants through endowed scholarships, resulting in increases in financial aid.

Operating Expenses



As illustrated in the following graph, instruction and research activities together constitute nearly half the University's expenses. The cost of investing in the operation and maintenance of plant is the third largest expense category of the University. The costs of providing auxiliary services is the fourth largest cost category and includes Dining and Residence Hall operations, Commons & Student Union operations, Associated Students of University of Idaho, Kibbie Dome, Bookstore, Student Health Services and Athletics.

Expenses by Program (in millions)



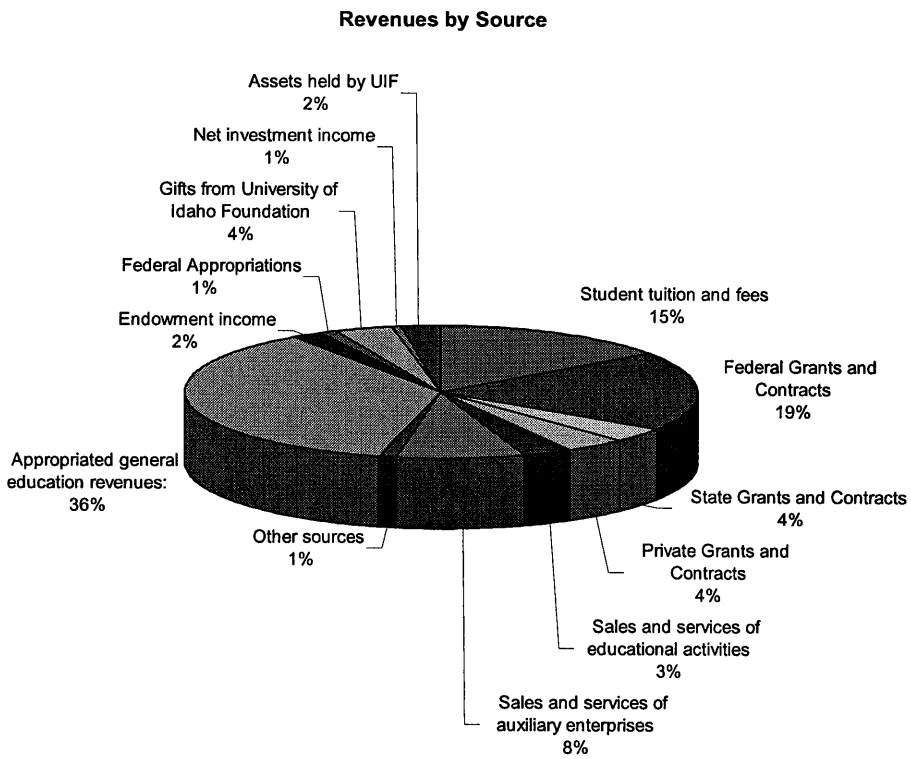
Nonoperating Revenues

Similar to most public higher education institutions, the University receives significant nonoperating revenues, including state appropriations, which offset the losses generated by operating activities. The operating loss for the year ended June 30, 2005 of $125.6 million was offset by $138.5 million in net nonoperating revenues, principally composed of $114.3 million of state appropriations, $6.7 million of land grant endowment income, $11.1 million of gifts, and $2.2 million of net investment income. Net nonoperating revenues were offset by $5.7 million in interest expense and $2.0 million in provision for doubtful accounts.

Other Revenues and Expenses

Other revenues include contributions to the University for capital assets from the Foundation and the state's permanent building fund.

The following graph illustrates operating revenues, nonoperating revenues and other revenues by source for fiscal year 2005:



Significant Changes in the Statement of Revenues, Expenses and Changes in Net Assets

Operating revenues increased by $4.4 million primarily due to the following:

- Student tuition and fee revenue increased $3.4 million due mainly to an overall increase of 8.5% to the fee structure.
- Revenue from auxiliary sales increased by $2.4 million due to the new Living and Learning Center dormitory coming on-line and an increase in summer conference activity.

Operating expenses increased $9.2 million primarily due to the following:

- Depreciation expense increased $5.0 million due mainly to a change in estimated useful lives used in the calculation. Equipment estimated useful lives changed from an average of 10 years to 7 years to more closely align with the useful lives used by the State of Idaho.

- Salaries and benefits expense increased $4 million. During previous fiscal years, the VSROP program created vacancies throughout the University. During fiscal year 2005, some of those positions were filled as well as some key leadership positions. A mid-year salary increase of 2% on average was instituted. In addition, employee and retiree health insurance benefit costs increased by approximately 10 percent.

- During the fiscal year ended June 30, 205, UI revised its estimate of useful lives of equipment. The revisions were made to more accurately measure the useful lives of each asset type. Previously, all equipment had a useful life of 10 years. Equipment useful lives now range from 5 to 30 years with an average of 7 years. The change had the effect of increasing equipment depreciation expense and decreasing the net assets by approximately $5.5 million.

- Insurance, Utilities, and Rent increased $1.7 million in part due to the rent related to the occupation of the Water Center Building and an increase in utilities.

- Scholarship and fellowship expenses decreased $1.1 million.

Nonoperating revenues increased $16.6 million primarily due to the following:

- State appropriated funds increased $4.5 million, a 4% increase. This increase is for all six appropriations received by the University and includes adjustments for inflation, enrollment increases as well as contractual adjustments for WWAMI and WOI medical and veterinary education programs.

- Land Grant Endowment revenue decreased by $1.2 million

- Gift revenue increased $4.1 million.

- The value of the Endowment assets held in trust by the Foundation increased by $7.1 million.

- An increase in the provision for doubtful accounts decreased nonoperating revenues by $2 million.

Other revenues decreased by $1.6 million primarily due to an decrease in capital gifts from the Foundation of $.6 million and a decrease in capital appropriations of $1.3 million due to the completion of the Teaching and Learning Center project.

Statement of Cash Flows

The statement of cash flows presents detailed information about the cash activities of the University during the year ended June 30, 2005. The statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by the operating activities of the University. The second section reflects cash flows from noncapital financing activities. This section reflects the cash received and spent for nonoperating, noninvesting and noncapital financing purposes. The third section, cash flows from capital and related financing activities, deals with the cash used for the acquisition and construction of capital and related items. The fourth section reflects the cash flows from investing activities and shows the purchases, proceeds and interest received. The fifth section reflects the net change in cash position.

ECONOMIC OUTLOOK

In fiscal year 2005, the University implemented $4.75 million of permanent base budget reductions and reallocations to re-balance the university's overall fiscal year 2006 fiscal year budget. The actions taken were initiated by the University's President and based in part upon deliberations of the Vision and Resources Task Force convened by the President. In addition to balancing the budget, nearly all colleges and operating units have increased their reserves as a safeguard against the uncertainties of additional program or enrollment changes.

The newly opened Teaching and Learning Center houses over half of the Moscow campus classrooms and has invigorated the central core of campus. This high tech classroom facility is structurally joined with the University Commons building and provides first rate classroom experiences in support of the University's academic mission.

University leadership continues to emphasize accountability and stewardship of University human and financial resources, with a primary focus on maintaining relevance and excellence in programs offered. University leadership is in the process of filling several key management positions and will continue to strive for the proper balance between revenue increases and spending reductions to ensure that quality programs remain viable, while access to the University is not unduly limited by the cost of attendance.

The University plans to grow and diversify its revenue bases through increases in externally funded grants and contracts, strong philanthropic support, increased student support and other initiatives. In order to deal with unforeseen events, the University plans to maintain modest financial reserves.

The State of Idaho ended fiscal year 2005 with an approximate $211 million surplus and general fund revenues continue to flow in ahead of expectations. Growth in the State's economy may provide the governor and legislature with additional resources to address the many compelling needs of higher education in Idaho.