

# Oakland University

## Notes to Financial Statements

June 30, 2003

### **1. Significant Accounting Policies**

The financial statements have been prepared to incorporate all fund groups utilized internally by Oakland University. These financial statements have been 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 follows the "business-type" activities requirements of GASB Statement No. 34, which provides that the following components be included in the University's annual financial report:

- Management's discussion and analysis.
- Basic financial statements including statements of net assets, statements of revenues, expenses and changes in net assets and statements of cash flows for the University as a whole.
- Notes to the financial statements.

#### *Basis of Accounting*

The accompanying financial statements have been prepared using the accrual basis of accounting whereby all revenues are recorded when earned and all expenses are recorded when they have been incurred.

In accordance with GASB Statement No. 20, the University is required to follow all applicable GASB pronouncements. In addition, the University should apply all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principle Board (APB) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The University has elected not to apply FASB pronouncements issued after November 30, 1989.

Operating revenues of the University consist of tuition and fees, grants and contracts, departmental activities, auxiliary activities and other miscellaneous revenues. Transactions related to capital financing activities, noncapital financing activities, investing activities and state appropriations are components of nonoperating income. When an expense is incurred for which both restricted and unrestricted net assets are available, the University applies the restricted or unrestricted resources at its discretion.

#### *Cash Equivalents*

The University considers all investments with original maturity of 90 days or less when purchased to be cash equivalents.

Oakland University

Notes to Financial Statements  
(Continued)

**1. Significant Accounting Policies (continued)**

*Investments*

Investments are stated at fair value. Total return includes ordinary income as well as realized and unrealized gains and losses.

*Inventories*

Inventories are stated at lower of average cost or market.

*Physical properties*

Physical properties are stated at cost or, when donated, at fair market value at date of gift. A capitalization threshold of \$2,500 is used for equipment. Depreciation is computed using the straight-line method over the estimated useful life of the property. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts. The costs of maintenance and repairs are expensed as incurred.

The following are asset classifications and the respective estimated useful lives:

<u>Classifications</u>	<u>Life</u>
Buildings	40 years
Land improvements and infrastructure	20 years
Library acquisitions	10 years
Equipment	7 years

*Reclassifications*

Certain fiscal year 2002 balances have been reclassified to conform with the current year presentation.

*Revenue Recognition*

Revenues related to the Summer session have been deferred to the subsequent fiscal year in which the session is predominantly conducted.

Operating revenues represent revenue earned from exchange transactions. The University's nonoperating revenues include state appropriations, gifts, investment income, capital appropriations, and grants. Gifts and grants are recognized at the later of the date pledged or when the eligibility requirements of the gifts and grants are met.

Funds are appropriated to the University for operations by the State of Michigan covering the State's fiscal year, October 1 through September 30. The sums appropriated, however, were for the University's fiscal year ending June 30 and are paid in eleven monthly installments from October through August. Therefore, the July and August payments are recorded as part of state appropriations receivable – operations.

Oakland University

Notes to Financial Statements

(Continued)

**1. Significant Accounting Policies (continued)**

*Revenue Recognition (continued)*

Revenues are reported net of discounts and allowances. As a result, certain amounts previously reported as scholarship expenditures are now reported as an allowance against tuition and related revenues.

**2. Cash and Pooled Investments**

Cash balances in the various funds of the University are pooled and may be invested in short-term or intermediate-term income securities or equity securities. The University retains an independent investment manager to handle the University's pooled cash balances.

The Board of Trustees has adopted an investment policy for the University's pooled cash. Specific quality and risk standards are mandated for each investment category by the policy. The policy limits the use of derivative securities and the amount that can be invested in any one security or security type. Equity holdings are limited to 30% or less of the available pooled cash. The University's cash and pooled investments provided a total return of 4.6% and 3.0% for the years ended June 30, 2003 and 2002, respectively.

At June 30, 2003 and 2002, the bank balances of cash and certificates of deposit were \$156,919 and \$493,202, respectively. Of the total bank balances, \$100,000 at June 30, 2003 and \$200,000 at June 30, 2002 were covered by federal depository insurance. The remaining cash and certificate of deposit amounts were uninsured and uncollateralized. The University's investment in mutual funds is held by the University's investment manager and is uninsured. The other pooled cash investments are held by the University's investment manager and are substantially all uninsured and unregistered. The individual securities held by the University's investment manager are not in the University's name.

	<u>2003</u>	<u>2002</u>
Cash (overdraft) and certificates of deposit, net	\$ (1,034,696)	\$ (2,826,671)
Demand obligations	21,582,003	14,116,246
U.S. Treasury bonds and notes	4,892,140	2,132,416
U.S. government-backed securities	6,103,845	6,441,391
Corporate bonds and notes	12,041,997	12,674,417
Mutual funds	807,273	1,502,529
Common stock	4,098,762	3,493,749
Other investments	476,239	341,161
	<u>\$48,967,563</u>	<u>\$37,875,238</u>
Cash and cash equivalents	\$20,547,307	\$11,289,575
Other long-term investments in pooled cash	<u>28,420,256</u>	<u>26,585,663</u>
	<u>\$48,967,563</u>	<u>\$37,875,238</u>

Oakland University

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(Continued)

**3. Investments**

The University invests in equity and debt securities and cash equivalents that are considered to be of high quality or "investment grade". Investments made on behalf of a particular fund, or funds, are to be consistent with the fund's philosophy and objectives. The University's pooled investment funds provided a total return of 5.2% and (6.4)% for the years ended June 30, 2003 and 2002, respectively. The University's investments in pooled investment funds are uninsured.

In connection with construction projects, the University has invested bond proceeds in money market funds. The money market funds are not insured.

	<u>2003</u>	<u>2002</u>
Pooled investment funds	\$19,304,280	\$19,781,025
Money market funds	6,304,722	22,607,927
Other investments	133,000	133,000
	<u>\$25,742,002</u>	<u>\$42,521,952</u>
Endowment investments	\$15,558,796	\$16,010,444
Restricted cash and cash equivalents	6,304,722	22,607,927
Other long-term investments, excluding pooled cash portion	3,878,484	3,903,581
	<u>\$25,742,002</u>	<u>\$42,521,952</u>

According to the laws of the State of Michigan, the governing board may appropriate for expenditure for the uses and purposes for which an endowment is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment over the historic dollar value as is prudent under the facts and circumstances prevailing at the time of the action or decision.

**4. Accounts Receivable**

Accounts receivable relate primarily to student tuition and fee billings, pledges from donors, contract and grant awards and auxiliary enterprise sales, such as food service and residence halls. The receivables are shown net of allowances for doubtful accounts of \$1,959,905 in 2003 and \$2,137,927 in 2002.

	<u>2003</u>	<u>2002</u>
Tuition and fees	\$2,707,133	\$3,213,344
Auxiliary enterprises	569,600	594,204
Contracts and grants	2,096,245	2,465,665
Pledges	1,156,621	1,527,585
Other receivables	228,734	223,918
Total accounts receivable	<u>\$6,758,333</u>	<u>\$8,024,716</u>

## Oakland University

### Notes to Financial Statements

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#### 5. Appropriation Receivable

The annual state operating appropriation paid to the University is made in eleven monthly installments from October through August. Consistent with State of Michigan legislation, the University has accrued as of the end of its fiscal year the payments to be received in July and August. As of June 30, 2003 and 2002, the accrual of the July and August state operating appropriation payments created an appropriation receivable of \$9,000,620 and \$9,524,490, respectively. As of June 30, 2003 and 2002, the state capital appropriation receivable was \$1,373,259 and \$4,645,128, respectively.

#### 6. Capital Assets

The following table presents the changes in the various capital asset categories for fiscal years 2003:

<u>Asset Classification</u>	<u>Balance July 1, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2003</u>
Land	\$ 4,324,914	–	–	\$ 4,324,914
Land improvements and infrastructure	21,001,173	\$ 5,325,066	–	26,326,239
Buildings	200,783,279	56,903,970	–	257,687,249
Equipment	40,288,323	3,420,518	\$ 1,911,051	41,797,790
Library acquisitions	20,760,903	1,005,113	17,625	21,748,391
Construction in progress (net)	52,569,222	(45,515,677)	–	7,053,545
Total	<u>339,727,814</u>	<u>21,138,990</u>	<u>1,928,676</u>	<u>358,938,128</u>
Accumulated depreciation:				
Land improvements and infrastructure	(6,211,642)	(1,047,961)	–	(7,259,603)
Buildings	(60,753,532)	(5,443,852)	–	(66,197,384)
Equipment	(28,827,757)	(3,657,308)	(1,878,932)	(30,606,133)
Library acquisitions	(14,949,166)	(1,099,247)	(17,625)	(16,030,788)
Total	<u>(110,742,097)</u>	<u>(11,248,368)</u>	<u>(1,896,557)</u>	<u>(120,093,908)</u>
Total capital assets, net	<u>\$ 228,985,717</u>	<u>\$ 9,890,622</u>	<u>\$ 32,119</u>	<u>\$ 238,844,220</u>

#### 7. State Building Authority

During the fiscal year ended June 30, 2003, the University entered into a lease agreement with the State Building Authority (SBA) and the State of Michigan for the School of Education and Human Services Building. During prior fiscal years, the University entered into similar lease agreements for the Science and Engineering Building and the business and information technology building (Elliott Hall). The buildings were financed with SBA revenue bonds and state appropriations.

The SBA bond issues are secured by a pledge of rentals to be received from the State of Michigan pursuant to the lease agreements between the SBA, the State of Michigan, and the University. During the lease terms, the SBA will hold title to the facilities; the State of Michigan will make all annual lease payments to the SBA; and the University will pay all operating and maintenance costs of the facilities.

Oakland University

Notes to Financial Statements

(Continued)

**7. State Building Authority (continued)**

At the expiration of the leases, the SBA has agreed to sell each facility to the University for the sum of one dollar. The cost and accumulated depreciation for these facilities is included in the accompanying statement of net assets.

**8. Long-Term Liabilities**

*Bonds Payable*

In June 1995, the University issued general revenue bonds in the amount of \$37,000,000 to provide funds for a student recreation and athletics center. The bonds bear interest rates from 4.9% to 6.0% and mature at various dates through 2026. In September 1997, the University issued general revenue bonds in the amount of \$11,650,000 to provide funds for various campus improvement projects. The bonds bear interest rates from 4.4% to 5.1% and mature at various dates through 2011.

In August 2001, the University issued general revenue bonds in the amount of \$48,000,000 to provide for various campus improvement projects. The bonds are variable rate demand obligations and mature March 1, 2031. In connection with the bond issue, the University entered into an interest rate swap agreement with Lehman Brothers Special Financing Inc. in an initial notional amount of \$34,370,000 effective July 1, 2001. The agreement swaps the University's variable rate for a synthetic fixed rate of 4.62%. The notional amount declines over time and terminates March 1, 2031. Under the swap agreement the University pays a synthetic fixed rate of 4.62%. No amounts were paid or received when the swap was initiated. The University has not calculated the fair value of the swap agreement. The University is currently making payments under the swap agreement.

The following table summarizes debt service requirements for the outstanding bonds:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 1,645,000	\$ 4,061,131	\$ 5,706,131
2005	1,795,000	3,983,331	5,778,331
2006	1,835,000	3,893,581	5,728,581
2007	1,885,000	3,797,481	5,682,481
2008	2,005,000	3,704,018	5,709,018
2009-2013	11,095,000	16,856,333	27,951,333
2014-2018	13,490,000	14,017,725	27,507,725
2019-2023	17,415,000	10,579,045	27,994,045
2024-2028	22,550,000	6,042,821	28,592,821
2029-2031	16,435,000	1,112,293	17,547,293
	<u>\$90,150,000</u>	<u>\$68,047,759</u>	<u>\$158,197,759</u>

Interest includes payments and receipts under the swap agreement at the synthetic fixed rate of 4.62%. The variable rate paid on the bonds was 1.08% at June 30, 2003.

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Notes to Financial Statements

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**8. Long-Term Liabilities (continued)**

The University is exposed to credit risk, which is the risk that the counterparty will not fulfill its obligations. However, as of June 30, 2003 the counterparty to the swap agreement was rated A by Standards & Pools, A+ by Fitch and A2 by Moody's. The swap exposes the University to basis risk, which is the risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instruments are based on different indexes. As these rates change, the overall synthetic rate on the bonds may change. The swap agreement includes collateral requirements intended to mitigate the credit risk.

The swap agreement uses the International Swaps and Derivatives Association, Inc. Master Agreement, which includes standard termination events such as failure to pay and bankruptcy. In addition, the Master Agreement includes additional termination events. If the swap is terminated, the variable rate bonds will no longer carry a synthetic interest rate and the University may be required to pay an amount equal to the swap's fair value, if it is negative.

The University capitalized construction period interest of \$480,390 and \$1,097,418 in the fiscal years ended June 30, 2003 and 2002, respectively, as part of the assets constructed.

*Note Payable*

In March 2003 the University issued a general revenue note payable in the amount of \$4,819,949 to fund the repayment of its capital lease dated March 18, 1997 and to fund an e-mail system upgrade project. The note has a fixed interest rate of 2.75% per annum, requires monthly payments of \$98,506, and is scheduled to be paid off in July 2007.

Required annual note payments for the fiscal years ending June 30 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$1,068,292	\$113,781	\$1,182,073
2005	1,098,757	83,316	1,182,073
2006	1,129,787	52,286	1,182,073
2007	1,161,693	20,380	1,182,073
2008	98,052	224	98,276
	<u>\$4,556,581</u>	<u>\$269,987</u>	<u>\$4,826,568</u>

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Notes to Financial Statements  
(Continued)

**8. Long-Term Liabilities (continued)**

*Long-Term Liabilities*

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

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Lease, note and bonds payable:					
Capital lease obligations	\$ 4,674,049	–	\$4,674,049	–	–
Note payable	–	\$4,819,950	263,369	\$ 4,556,581	\$1,068,292
Bonds payable:					
General revenue bonds, series 1995	34,425,000	–	720,000	33,705,000	755,000
General revenue bonds, series 1997	9,300,000	–	855,000	8,445,000	890,000
General revenue bonds, series 2001	48,000,000	–	–	48,000,000	–
Total lease, note and bonds payable	96,399,049	4,819,950	6,512,418	94,706,581	2,713,292
Other liabilities:					
Compensated absences	2,246,296	67,341	–	2,313,637	2,313,637
Federal portion of Perkins loan program	1,951,588	106,644	81,939	1,976,293	–
Total other liabilities	4,197,884	173,985	81,939	4,289,930	2,313,637
Total long-term liabilities	<u>\$100,596,933</u>	<u>\$4,993,935</u>	<u>\$6,594,357</u>	<u>\$98,996,511</u>	<u>\$5,026,929</u>

**9. Expenditures by Natural Classification**

The table below lists total operating expenditures analyzed by natural classification:

	<u>2003</u>	<u>2002</u>
Employee compensation	\$109,433,413	\$102,777,383
Supplies and other services	35,966,997	34,696,711
Student aid	4,172,043	3,363,362
Depreciation	11,248,368	10,465,941
Total	<u>\$160,820,821</u>	<u>\$151,303,397</u>



## Oakland University

### Notes to Financial Statements

(Continued)

#### **10. Cash Flow Statement**

The table below details the reconciliation of the net operating loss to net cash used by operating activities:

	<u>2003</u>	<u>2002</u>
Operating loss	\$(53,550,720)	\$(52,795,208)
Adjustments to reconcile net operating loss to net cash used by operating activities:		
Depreciation expense	11,248,368	10,465,941
Changes in assets and liabilities:		
Accounts receivable, net	895,419	31,958
Inventories	276,152	(229,022)
Deposits and prepaid expenses	463,114	(681,942)
Student loans receivable, net	90,132	113,747
Accounts payable and accrued expenses	(446,258)	125,858
Accrued payroll	618,441	(1,873,495)
Compensated absences	67,341	153,409
Deferred revenue and student fees	(230,648)	(409,505)
Deposits	(417,479)	(602,151)
Federal portion of student loan program	24,705	(18,913)
Net cash used by operating activities	<u>\$(40,961,433)</u>	<u>\$(45,719,323)</u>

#### **11. Employee Benefits**

The University has contributory, defined-contribution retirement plans for all qualified employees. The plans consist of employee-owned retirement contracts funded on a current basis and are primarily administered by Teachers Insurance and Annuity Association – College Retirement Equities Fund (“TIAA-CREF”). Contributions by the University for the years ended June 30, 2003 and 2002 were \$8,760,282 and \$8,236,550, respectively.

The University also maintains a noncontributory, defined-benefit retirement plan which is not open to new participants. The plan is administered by TIAA-CREF. At January 1, 2003, the date of the most recent actuarial valuation, the present value of benefits accrued under the plan were fully funded.

The University provides termination benefits resulting from unused sick days upon retirement for certain employee groups. These benefits are funded and paid by the University.

In addition to the above retirement plans, the University provides certain health care benefits for retired employees. In general, retirees with 15 years of service and at least 62 years of age are eligible for benefits in accordance with either union agreements or University policy. The benefits are provided by paying and expensing insurance premiums which are based on claims paid during the year. The expenses recognized for the years ended June 30, 2003 and 2002 were \$881,753 and \$838,300, respectively. The University is not required to and does not record a post-employment health care benefit obligation under current GASB guidance.

## Oakland University

### Notes to Financial Statements

(Continued)

#### **11. Employee Benefits (continued)**

The University is self-insured for worker's compensation and unemployment compensation. Liabilities for claims incurred but not reported under these self-insurance programs have been established.

#### **12. Liability and Property Insurance**

The University is one of eleven Michigan universities participating in the Michigan Universities Self-Insurance Corporation (M.U.S.I.C.), which provides insurance coverage for errors and omissions liability, commercial general liability, property loss, automobile liability, and automobile physical damage coverage. M.U.S.I.C. provides coverage for claims in excess of agreed-upon deductibles.

Loss coverages, except for the automobile physical damage program which has no M.U.S.I.C. layer, are structured on a three-layer basis with each member retaining a portion of its losses, M.U.S.I.C. covering the second layer and commercial carriers covering the third. Commercial general liability and property coverage is provided on an occurrence basis; errors and omissions coverage is provided on a claims made basis.

#### **13. Contingencies and Commitments**

In the normal course of its activities, the University is a party in various legal actions. Although some actions have been brought for large amounts, the University has not experienced any significant losses or costs. The University and its legal counsel are of the opinion that the outcome of asserted and unasserted claims outstanding will not have a material effect on the financial statements.

The University is the guarantor on certain faculty residence mortgages. As of June 30, 2003, the amount subject to guarantee by the University was \$2,024,512.

The estimated costs to complete construction projects in progress are \$9,662,626 as of June 30, 2003. These projects will be funded from State and State Building Authority appropriations, private gifts, bond sale proceeds, and other University funds.

As of June 30, 2003, future minimum payments required under operating leases for various equipment totaled \$723,808 to be paid over the next four fiscal years. The future minimum payments as of June 30, 2002, totaled \$1,140,902.

#### **14. Oakland University Foundation**

Oakland University Foundation is an independent corporation formed for the purpose of receiving funds for the sole benefit of the University. At June 30, 2003 and 2002, the net assets of the Foundation were \$7,203,109 and \$7,694,415, respectively. The Foundation transferred \$1,015,919 to the University during fiscal 2002-2003 and \$942,758 during fiscal year 2001-2002.

The Foundation's cash and pooled investments held by the University are included in the University's statement of net assets. This amount was cash due the University of \$179,895 at June 30, 2003 and cash due the Foundation of \$248,034 at June 30, 2002.