

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Financial Statements

June 30, 2005 and 2004

(With Independent Auditors' Report Thereon)

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

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KPMG LLP
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Independent Auditors' Report

The Board of Trustees
California State University, San Marcos:

We have audited the accompanying financial statements of the business-type activities of the California State University, San Marcos (the University) and its aggregate discretely presented component units as of and for the years ended June 30, 2005 and 2004, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based upon our audits. We did not audit the financial statements of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the aggregate discretely presented component units, are based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 and the reports of other auditors provide a reasonable basis for our opinions.

As discussed in note 2, the financial statements present only the statements of net assets, statements of revenues, expenses, and changes in net assets, and statements of cash flows of the University and do not purport to, and do not, present fairly the financial position of the California State University System, as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the University and of its aggregate discretely presented component units as of June 30, 2005 and 2004, and the respective changes in financial position and, where applicable, cash flows thereof, for the years then ended in conformity with U.S. generally accepted accounting principles.

Management's Discussion and Analysis on pages 3 through 13 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

October 7, 2005

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Management's Discussion and Analysis

June 30, 2005 and 2004

This section of California State University, San Marcos annual financial report presents our discussion and analysis of the financial performance of the University for fiscal years ended June 30, 2005 and 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements and notes.

Introduction to the Financial Statements

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB) Statements No. 34, *Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and No. 35, *Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*. For reporting purposes, the University is considered a special-purpose government engaged in business-type activities, which best represents the activities of the University.

The financial statements include the statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows. These statements are supported by the notes to the financial statements and this section. All sections must be considered together to obtain a complete understanding of the financial picture of the University.

Statement of Net Assets – The statement of net assets includes all assets and liabilities. Assets and liabilities are reported at their book value, on an accrual basis, as of the statement date. It also identifies major categories of restrictions on the net assets of the University.

Statement of Revenues, Expenses, and Changes in Net Assets – The statement of revenues, expenses, and changes in net assets presents the revenues earned and expenses incurred during the year on an accrual basis.

Statement of Cash Flows – The statement of cash flows presents the inflows and outflows of cash for the year and is summarized by operating, noncapital financing, capital and related financing, and investing activities. The statement is prepared using the direct method of cash flows and, therefore, presents gross rather than net amounts for the year's activities.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Management's Discussion and Analysis

June 30, 2005 and 2004

Analytical Overview

Summary

The following discussion highlights management's understanding of the key financial aspects of the University's financial activities as of and for the years ended June 30, 2005 and 2004. Included is a comparative analysis of current year and prior year activities and balances; a discussion of restrictions of University net assets; a discussion of capital assets and long-term debt; and factors impacting future reporting periods.

The University's condensed summary of net assets as of June 30, 2005, 2004, and 2003 is as follows:

Condensed Summary of Net Assets

	June 30		
	2005	2004	2003
Assets:			
Current assets	\$ 28,238,591	28,489,769	25,271,767
Capital assets	162,968,819	149,570,121	148,010,794
Other noncurrent assets	49,554,216	30,657,688	17,947,479
Total assets	240,761,626	208,717,578	191,230,040
Liabilities:			
Current liabilities	14,158,858	15,636,856	16,106,667
Noncurrent liabilities	34,462,004	9,398,470	9,967,534
Total liabilities	48,620,862	25,035,326	26,074,201
Net assets:			
Invested in capital assets, net of related debt	156,463,965	141,373,505	138,311,093
Restricted, expendable	20,570,018	29,886,422	12,787,904
Unrestricted	15,106,781	12,422,325	14,056,842
Total net assets	\$ 192,140,764	183,682,252	165,155,839

As of June 30, 2005

Assets

The \$32 million increase in total assets is primarily due to a \$25.2 million lease receivable added in the current year. The lease agreement is the result of a transaction whereby the University refinanced certain San Marcos University Corporation bonds used to build campus housing that was placed into service in August 2003. The San Marcos University Corporation debt was refinanced through the issuance of System-wide revenue bonds Series 2005A that are recorded as a long-term liability with the University. In return for the University refinancing the San Marcos University Corporation debt, the University entered into a 30-year lease agreement whereby the San Marcos University Corporation agreed to lease the campus housing facilities.

The \$13.4 million increase in capital assets is due to ongoing capital projects, primarily due to the construction of the campus' Business Building. Capital expansion is financed through University funds, issuance of debt, as well

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Management's Discussion and Analysis

June 30, 2005 and 2004

as general obligation bonds of the State of California and the California State University system which are not allocated to the campus and thus not reflected in the accompanying financial statements.

These increases in assets are offset by a \$6.3 million decrease in accounts receivable from state appropriations for funds used to construct capital projects.

Liabilities

The \$23.6 million increase in total liabilities from prior year is primarily due to the issuance of a \$25.2 million System-wide revenue bonds. As discussed above, these bonds were used to refinance the San Marcos University Corporation Corps debt in return for a \$25.2 million lease receivable. Accounts payable increased by \$2.6 million due to an increase in accruals for capital construction projects. These increases are offset by a \$3.4 million reduction in deferred revenue.

Net Assets

A significant portion of net assets at the end of the year are invested in capital assets. The increase in net assets of \$8.5 million from the prior year is primarily related to \$10 million in state appropriations for capital projects.

As of June 30, 2004

Assets

The \$17.5 million increase in total assets is primarily due to a \$12.1 million increase in state appropriations receivable as a result of an increase in current year state appropriations for capital projects and a \$1.6 million increase in investments as a result of additional revenue for Extended Education and Parking Services trust funds.

The \$1.6 million increase in capital assets is due to ongoing capital projects. Capital expansion is financed through University funds, issuance of debt, and general obligation bonds of the state of California and the California State University system, which are not allocated to the campus, and thus not reflected in the accompanying financial statements.

Liabilities

The \$1 million decrease in total liabilities from the prior year is primarily due to a \$1.3 million decrease in capital lease obligations as a result of current year payments as well as no additional capital lease agreements were entered into in the current year and a \$2.2 million decrease in accounts payable. These decreases were offset by a \$1 million increase in accrued salaries and benefits and a \$1.2 million increase in deferred revenue as a result of increased student fees.

Net Assets

A significant portion of net assets at the end of the year is invested in capital assets. The increase in net assets of \$18.5 million from the prior year is primarily related to an increase of \$17.1 million in state appropriations from capital projects.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Management's Discussion and Analysis

June 30, 2005 and 2004

Restricted Resources

Net assets of the University include funds that are restricted by donor or law. The following table summarizes which funds are restricted, the type of restriction, and the amount:

	Restricted Net Assets		
	2005	June 30, 2004	2003
Expendable:			
Scholarships and fellowships	\$ 98,764	208,925	341,028
Loans	53,479	51,091	48,292
Capital projects	20,078,277	29,088,185	12,143,055
Debt service	339,498	538,221	255,529
Total restricted net assets – expendable	\$ 20,570,018	29,886,422	12,787,904

As of June 30, 2005

The \$9.3 million decrease in restricted net assets – expendable is primarily due to the decrease in state appropriations received during the year as well as a decrease in state appropriations receivable for capital projects.

As of June 30, 2004

The \$17.1 million increase in restricted net assets – expendable is primarily due to state appropriations for capital projects received during the year. The increase consists of additional state appropriation receivable to be used to fund future capital projects including the construction of the new Business Building which is estimated to cost approximately \$28.6 million.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Management's Discussion and Analysis

June 30, 2005 and 2004

The University's condensed summary of revenues, expenses, and changes in net assets for the years ended June 30, 2005, 2004, and 2003 are as follows:

Condensed Summary of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30,		
	2005	2004	2003
Operating revenues:			
Student tuition and fees, net	\$ 19,944,432	18,162,391	13,735,206
Grants, contracts, and gifts	7,650,686	7,899,917	7,188,345
Sales and services of auxiliary enterprises, net	2,791,347	2,687,295	1,772,277
Other operating revenue	177,575	323,132	765,074
	30,564,040	29,072,735	23,460,902
Operating expenses	87,705,824	91,795,320	87,261,886
Nonoperating revenues (expenses):			
State appropriations, noncapital	53,307,764	54,573,409	55,888,082
Investment income	354,716	140,314	410,440
Interest on capital-related debt	(726,360)	(377,508)	(402,035)
Other nonoperating revenues	2,662,176	904,328	3,429,882
Total nonoperating revenues	55,598,296	55,240,543	59,326,369
Other capital-related revenues:			
State appropriations, capital	10,002,000	26,008,455	8,888,544
Grants and gifts, capital	—	—	300,327
Increase in net assets	8,458,512	18,526,413	4,714,256
Beginning net assets	183,682,252	165,155,839	160,441,583
Ending net assets	\$ 192,140,764	183,682,252	165,155,839

Operating Revenues and Expenses

Operating revenues and expenses come from sources that are connected directly to the University's primary business function. This includes revenues from categories such as tuition and fees, grants, and contracts that will be used for noncapital purposes, and sales and services of auxiliary enterprises. Expenses include categories such as salaries and wages, benefits, supplies and services, student grants and scholarships, and depreciation. In this discussion and analysis, expenses are reported by functional program such as instruction, academic support, and student services.

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Management's Discussion and Analysis

June 30, 2005 and 2004

Operating Revenues

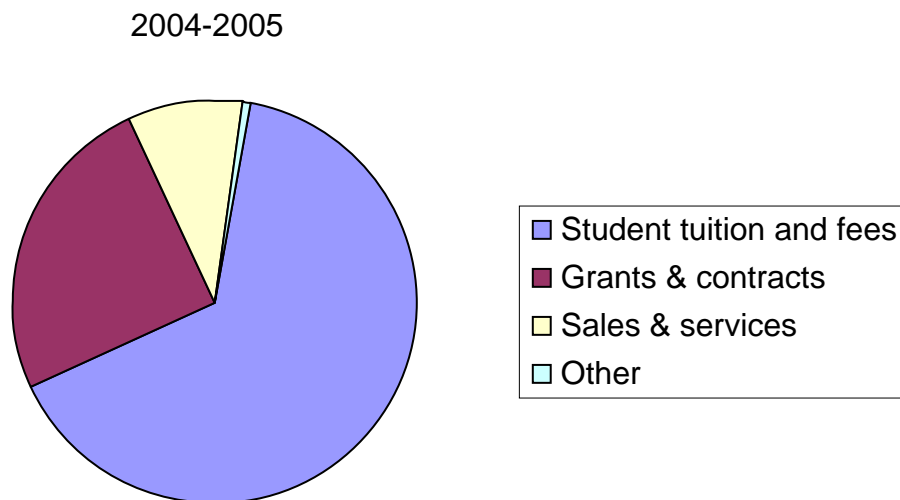
Year Ended June 30, 2005

The University recognized \$30.6 million in operating revenues during this fiscal year, as compared to \$29.1 million in the prior year. Operating revenues comprised 32% of total revenues for the year ended June 30, 2005, compared to 26% of total revenues for the year ended June 30, 2004. Federal and state grants and contracts revenue decreased \$0.2 million from \$7.9 million to \$7.7 million for the fiscal years ended June 30, 2004 and 2005, respectively. Finally, student fees were increased again by the California State University Board of Trustees in 2005 to compensate for the loss of state appropriations for operations. Student fee revenue increased by \$1.7 million, from \$18.2 million in 2004 to \$19.9 million in 2005.

Year Ended June 30, 2004

The University recognized \$29.1 million in operating revenues during this fiscal year, as compared to \$23.5 million in the prior year. Operating revenues comprised 26% of total revenues for both the years ended June 30, 2004 and June 30, 2003. Federal and state grants and contracts revenue increased \$0.7 million from \$7.2 million to \$7.9 million for the fiscal years ended June 30, 2003 and 2004, respectively. Sales and services of auxiliary enterprises increased by \$.9 million primarily due to an increase in parking fees revenue, as a result of an increase in parking fees and an increase in student enrollment. Finally, student fees were increased by the CSU Board of Trustees in 2004 to compensate for the loss of state appropriations for operations. Student fee revenue increased by \$4.5 million, from \$13.7 million in 2003 to \$18.2 million in 2004.

The following charts present the proportional share that each category of operating revenues contributed to the total for fiscal years 2005, 2004, and 2003:

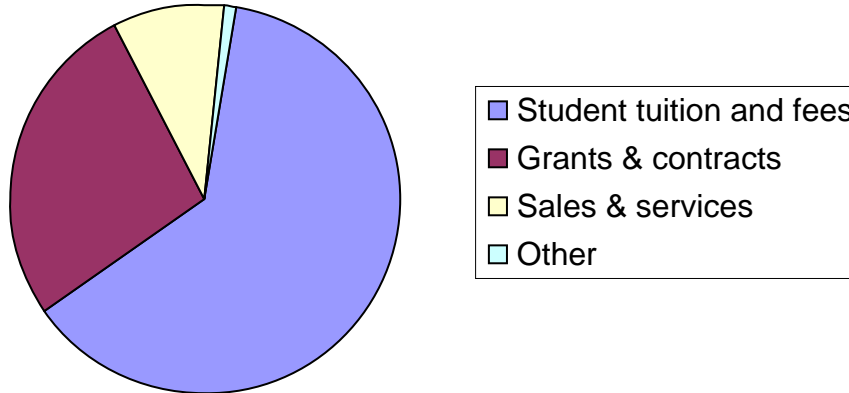


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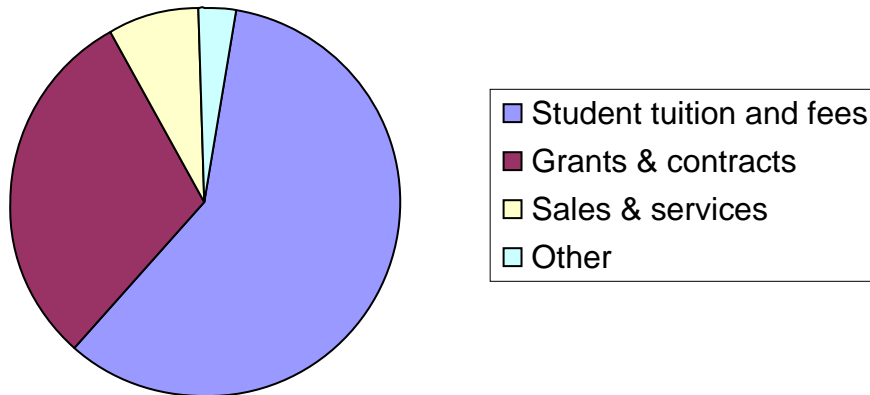
Management's Discussion and Analysis

June 30, 2005 and 2004

2003-2004



2002-2003



Operating Expenses

Year Ended June 30, 2005

The University's operating expenses consist of salaries and fringe benefits of \$58.4 million, supplies and services of \$15.4 million, scholarships and fellowships of \$6.5 million, and depreciation of \$7.3 million. Total operating expenses, excluding depreciation, decreased by \$4.6 million, or 5% due to a decrease of \$5.3 million of scholarship and fellowship expense. Enrollment remained stable for the fiscal year 2004-05, decreasing by 0.9%, and the percentage of students receiving aid remained relatively consistent increasing from approximately 46% in 2004 to 47% in 2005. The increase in depreciation expense of \$.5 million relates to current year capital asset additions.

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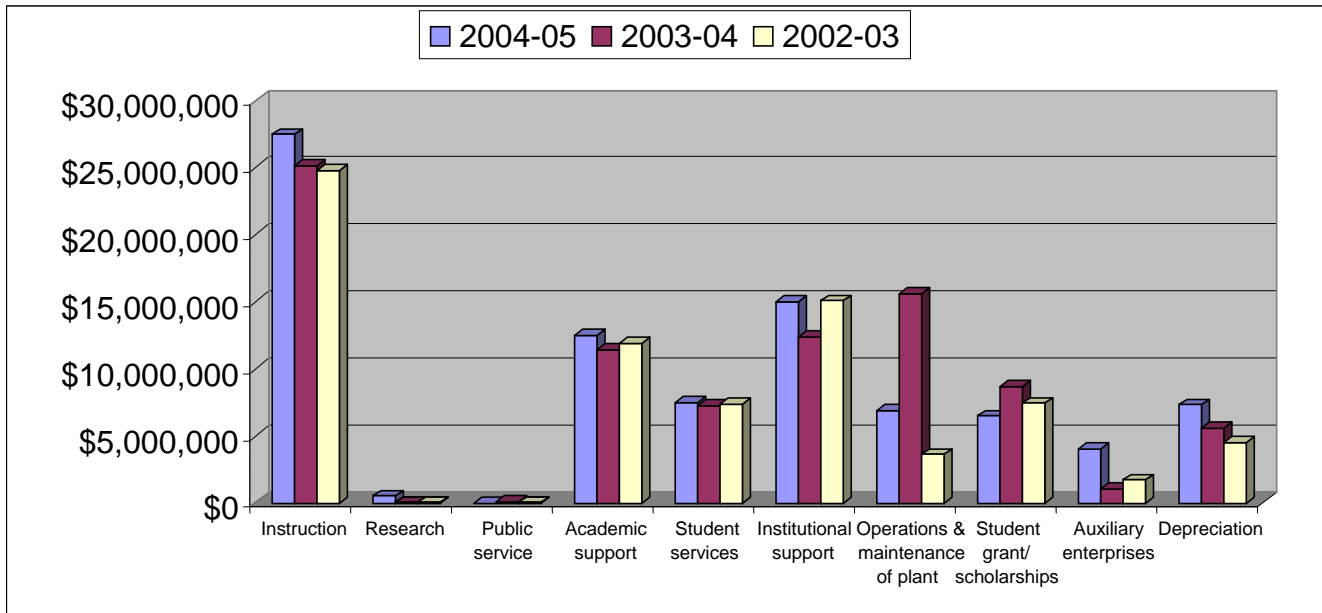
Management’s Discussion and Analysis

June 30, 2005 and 2004

Year Ended June 30, 2004

The University’s operating expenses consist of salaries and fringe benefits of \$57.4 million, supplies and services of \$15.8 million, scholarships and fellowships of \$11.7 million, and depreciation of \$6.8 million. Total operating expenses, excluding depreciation, increased by \$3.3 million, or 4% due to an increase of \$4.7 million of salaries and benefits costs related to health and retirement benefit increases for all employees. The University contribution to the California Employees’ Retirement System (CalPERS) alone increased by \$3 million, or 52%. Student grants and scholarships increased by \$3 million. Enrollment remained stable the fiscal year 2003-04, decreasing by .13%, and the percentage of students receiving aid remained consistent at approximately 46%. In anticipation of budget cuts, expenses related to supplies and other services were reduced by \$4.5 million. The increase in depreciation expense of \$1.2 million relates to current year capital asset additions.

The following chart presents the distribution of resources in support of the University’s mission for fiscal years 2005, 2004, and 2003:



Nonoperating and Other Revenues (Expenses)

Nonoperating and other revenues (expenses) come from sources that are not part of the University’s primary business functions. Included in this classification are categories such as state appropriations, gifts and grants, investment income, and interest on capital-related debt.

Year Ended June 30, 2005

As the University is part of the California State University system, which is an agency of the state of California, the University’s operations are funded primarily from appropriations of state tax revenues. Appropriations used for purposes of acquisition of capital assets totaled \$10 million for the fiscal year ended June 30, 2005, a decrease of \$16 million from the fiscal year ended June 30, 2004. General (noncapital) appropriation revenues

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Management's Discussion and Analysis

June 30, 2005 and 2004

totaled \$53.3 million, a decrease of \$1.3 million from the prior year. For the second consecutive year, the CSU experienced a shift in funding, with reduced state general fund allocation and increased state university fee revenue per student.

Year Ended June 30, 2004

Appropriations used for purposes of acquisition of capital assets totaled \$26 million for the fiscal year ended June 30, 2004, up from \$8.9 million for the fiscal year ended June 30, 2003. General (noncapital) appropriation revenues totaled \$54.6 million, a decrease of \$1.3 million from the prior year. During this period, the CSU experienced a shift in funding, with reduced state general fund allocation and increased state university fee revenue per student.

Capital Assets and Long-Term Debt Obligations

Capital Assets

Capital assets, net of accumulated depreciation are shown below:

	June 30,		
	2005	2004	2003
Land and land improvements	\$ 10,981,328	10,981,328	10,551,554
Buildings and building improvements	108,203,900	112,673,789	75,029,577
Improvements, other than buildings	2,925,873	2,585,504	1,938,015
Infrastructure	13,771,983	14,277,813	14,231,815
Personal property	5,862,522	7,071,786	7,343,774
Intangible assets	102,128	77,108	129,259
Works of art and historical treasures	25,000	25,000	25,000
Construction work in progress (CWIP)	21,096,085	1,877,793	38,761,800
Total capital assets, net of accumulated depreciation	\$ 162,968,819	149,570,121	148,010,794

As of June 30, 2005

At June 30, 2005 and June 30, 2004, the University had \$163 million and \$149.6 million, respectively, in capital assets, net of accumulated depreciation of \$63.8 million and \$56.8 million, respectively. Depreciation expense totaled \$7.3 million and \$6.8 million for the years ended June 30, 2005 and 2004, respectively.

The University did not complete a major project during the fiscal year 2005; however, the Business Building is expected to be completed in December 2005. The Business Building is the primary factor for the increase in CWIP to \$21.1 million from \$1.9 million for the fiscal year ended June 30, 2005 and 2004, respectively.

As of June 30, 2004

At June 30, 2004 and June 30, 2003, the University had \$149.6 million and \$148 million, respectively, in capital assets, net of accumulated depreciation of \$56.8 million and \$50.6 million, respectively. Depreciation expense totaled \$6.8 million and \$5.6 million for the years ended June 30, 2004 and 2003, respectively.

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Management's Discussion and Analysis

June 30, 2005 and 2004

The University completed one major capital project during fiscal year 2004, the Kellogg Library, for a total cost of \$39.2 million.

See note 6 of the notes to the financial statements for further information on capital assets.

Long-term Debt Obligations

Debt outstanding at June 30, 2005, 2004, and 2003 is summarized below by type of debt instrument (in millions):

	June 30,		
	2005	2004	2003
Revenue bonds	\$ 30,715,000	5,580,000	5,665,000
Capital leases	4,516	1,484,068	2,790,874
Other	1,924,062	1,132,548	1,243,827
Total	<u>\$ 32,643,578</u>	<u>8,196,616</u>	<u>9,699,701</u>

The interest rates on outstanding debt range from 2% to 6%.

As of June 30, 2005

At June 30, 2005 and June 30, 2004, the University had \$32.6 million and \$8.2 million, respectively, in long-term debt outstanding. The \$24.4 million increase is primarily due to the issuance of a \$25.2 million System-wide revenue bonds. As discussed above, these bonds were used to refinance the San Marcos University Corporation debt in return for a \$25.2 million lease receivable. The University also incurred \$.8 million of additional debt for the financing of equipment. Offsetting these increases is \$1.5 million for the retirement of the University's capital lease obligations.

As of June 30, 2004

At June 30, 2004 and June 30, 2003, the University had \$8.2 million and \$9.7 million, respectively, in debt outstanding.

Bond Ratings

Moody's Investors Service currently provides an intrinsic rating for the Systemwide Revenue Bonds and the Housing System Revenue Bonds at A1 and the Student Union Revenue Bonds at A2 (however, these bonds are insured to AAA). Standard & Poor's currently rates the Systemwide Revenue Bonds and the Housing System Revenue Bonds at A, and the Student Union Revenue Bonds at BBB+ (however, these bonds are insured to AAA).

See notes 7 through 10 of the notes to the financial statements for further information on long-term debt obligations

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Management's Discussion and Analysis

June 30, 2005 and 2004

Factors Impacting Future Periods

The legislative process has approved the state general fund allocation to the California State University for fiscal year 2005/2006. The allocation provided to the University is \$54.4 million, which is an increase of \$1.1 million from fiscal year 2004/2005. This increase included funds to provide for an overall compensation increase of 3.5% for permanent staff.

The Governor's compact with the CSU provides for 2.5% system enrollment growth annually through 2010/11 and adds 3% to 5% in general funding increases per year. The University was able to negotiate a slight increase in full-time equivalent (FTE) for 2005/06 and a greater increase in 2006/2007. This increase was necessary to accommodate the rapid growth in the region and the new academic programs.

The Human and Health Services Programs received a \$200,000 allocation from the Chancellor's office to help develop the nursing program. Gifts from Tri-City Hospital of \$75,000 and \$75,000 from Palomar Pomerado Health are also being managed through the San Marcos Foundation. The U.S. Congress directed two grants to the San Marcos Foundation, one in 2004/2005 for \$347,935 and one in 2005/2006 for \$396,800 to be used in establishing a BS degree program for nursing. Palomar Pomerado Health is spending \$2.5 million to renovate, furnish, and equip a Nursing Education Center in the San Marcos Ambulatory Care Center building that will house the California State University San Marcos School of Nursing and the nursing skills lab. The facility will be leased to the University for \$1 per year. The program will accept 44 basic/generic Bachelor of Science and Nursing students in the nursing program that is expected to begin in Fall 2006.

The California State University Board of Trustees approved construction of a Business Building for CSU San Marcos in 2003/2004 and construction is continuing through 2004/2005. The project addresses the classroom needs of approximately 3,000 full-time equivalent students and will house the College of Business Administration and the programs of History, Literature and Writing, and World Languages and Hispanic Literatures. The total cost of the project is projected to be approximately \$28.6 million and is funded primarily through state appropriations. Occupancy of the new facility is expected occur in January 2006.

The University Foundation received a grant of approximately \$7.7 million to design, construct, and equip the Center for Children and Families.

Parking Services is building a 1,200 space surface lot to open in Fall 2006, and the current construction costs are estimated at \$3.3 million.

In 2005, the University received a donation in the amount of \$2,353,000 to design, construct, and equip an approximately 2,300 square feet conference and dining facility with a 600 square feet covered patio. This project will be the initial phase of additional adjoining facilities designed to support large and medium sized gatherings. The first phase will be named the McMahan House in honor of the donors, JoAn S. and Richard A. McMahan.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Statement of Net Assets

June 30, 2005

Assets	University	Discretely presented component units	Total
Current assets:			
Cash and cash equivalents	\$ 11,547,805	2,917,666	14,465,471
Short-term investments	10,747,027	5,881,267	16,628,294
Accounts receivable, net	3,628,636	2,274,976	5,903,612
Pledges receivable, net	—	817,520	817,520
Prepaid expenses and other assets	2,315,123	349,284	2,664,407
Total current assets	<u>28,238,591</u>	<u>12,240,713</u>	<u>40,479,304</u>
Noncurrent assets:			
Restricted cash and cash equivalents	181,316	—	181,316
Accounts receivable	23,697,935	—	23,697,935
Leases receivable, net of current portion	25,230,000	—	25,230,000
Student loans receivable, net	373,932	—	373,932
Pledges receivable, net	—	1,402,101	1,402,101
Endowment investments	—	11,281,690	11,281,690
Other long-term investments	71,033	—	71,033
Capital assets, net	162,968,819	24,925,120	187,893,939
Other assets	—	239,489	239,489
Total noncurrent assets	<u>212,523,035</u>	<u>37,848,400</u>	<u>250,371,435</u>
Total assets	<u>240,761,626</u>	<u>50,089,113</u>	<u>290,850,739</u>
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	4,326,993	704,510	5,031,503
Accrued salaries and benefits payable	4,285,475	291,890	4,577,365
Deferred revenue	2,636,913	712,416	3,349,329
Accrued compensated absences – current portion	1,608,640	87,116	1,695,756
Capitalized lease obligations – current portion	4,516	—	4,516
Long-term debt obligations – current portion	214,740	—	214,740
Other liabilities	1,081,581	1,077,357	2,158,938
Total current liabilities	<u>14,158,858</u>	<u>2,873,289</u>	<u>17,032,147</u>
Noncurrent liabilities:			
Accrued compensated absences, net of current portion	1,263,955	—	1,263,955
Grants refundable	478,180	—	478,180
Capitalized lease obligations, net of current portion	—	—	—
Long-term debt obligations, net of current portion	32,424,322	26,047,815	58,472,137
Depository accounts	295,547	—	295,547
Total noncurrent liabilities	<u>34,462,004</u>	<u>26,047,815</u>	<u>60,509,819</u>
Total liabilities	<u>48,620,862</u>	<u>28,921,104</u>	<u>77,541,966</u>
Net assets:			
Invested in capital assets, net of related debt	156,463,965	(1,122,695)	155,341,270
Restricted for:			
Nonexpendable – endowments	—	10,876,670	10,876,670
Expendable:			
Scholarships and fellowships	98,764	95,641	194,405
Loans	53,479	—	53,479
Capital projects	20,078,277	454,261	20,532,538
Debt service	339,498	—	339,498
Other	—	2,814,751	2,814,751
Unrestricted	15,106,781	8,049,381	23,156,162
Total net assets	<u>\$ 192,140,764</u>	<u>21,168,009</u>	<u>213,308,773</u>

See accompanying notes to financial statements.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Statement of Net Assets

June 30, 2004

Assets	University	Discretely presented component units	Total
	<u> </u>	<u> </u>	<u> </u>
Current assets:			
Cash and cash equivalents	\$ 9,672,451	2,065,899	11,738,350
Short-term investments	12,593,966	7,383,539	19,977,505
Accounts receivable, net	2,377,470	2,140,384	4,517,854
Pledges receivable, net	—	302,263	302,263
Prepaid expenses and other assets	3,845,882	72,712	3,918,594
Total current assets	<u>28,489,769</u>	<u>11,964,797</u>	<u>40,454,566</u>
Noncurrent assets:			
Restricted cash and cash equivalents	74,765	2,104,054	2,178,819
Accounts receivable	30,025,493	—	30,025,493
Student loans receivable, net	542	—	542
Pledges receivable, net	—	187,913	187,913
Endowment investments	—	10,166,940	10,166,940
Other long-term investments	77,436	—	77,436
Capital assets, net	149,570,121	25,800,363	175,370,484
Other assets	479,452	1,209,254	1,688,706
Total noncurrent assets	<u>180,227,809</u>	<u>39,468,524</u>	<u>219,696,333</u>
Total assets	<u>208,717,578</u>	<u>51,433,321</u>	<u>260,150,899</u>
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	1,733,481	1,499,675	3,233,156
Accrued salaries and benefits payable	4,594,796	382,876	4,977,672
Deferred revenue	6,005,943	276,015	6,281,958
Accrued compensated absences – current portior	1,526,744	119,748	1,646,492
Capitalized lease obligations – current portior	821,939	—	821,939
Long-term debt obligations – current portior	95,000	—	95,000
Other liabilities	858,953	744,688	1,603,641
Total current liabilities	<u>15,636,856</u>	<u>3,023,002</u>	<u>18,659,858</u>
Noncurrent liabilities:			
Accrued compensated absences, net of current portior	1,473,375	—	1,473,375
Grants refundable	419,480	—	419,480
Capitalized lease obligations, net of current portior	662,129	—	662,129
Long-term debt obligations, net of current portior	6,617,548	27,990,000	34,607,548
Depository accounts	225,938	—	225,938
Total noncurrent liabilities	<u>9,398,470</u>	<u>27,990,000</u>	<u>37,388,470</u>
Total liabilities	<u>25,035,326</u>	<u>31,013,002</u>	<u>56,048,328</u>
Net assets:			
Invested in capital assets, net of related deb	141,373,505	1,683,803	143,057,308
Restricted for:			
Nonexpendable – endowments	—	10,573,822	10,573,822
Expendable:			
Scholarships and fellowships	208,925	884,564	1,093,489
Loans	51,091	—	51,091
Capital projects	29,088,185	505,159	29,593,344
Debt service	538,221	—	538,221
Other	—	51,979	51,979
Unrestricted	12,422,325	6,720,992	19,143,317
Total net assets	<u>\$ 183,682,252</u>	<u>20,420,319</u>	<u>204,102,571</u>

See accompanying notes to financial statements.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2005

	<u>University</u>	<u>Discretely presented component units</u>	<u>Total</u>
Revenues:			
Operating revenues:			
Student tuition and fees (net of scholarship allowances of \$2,935,913)	\$ 19,944,432	974,275	20,918,707
Grants and contracts, noncapital:			
Federal	5,473,044	5,178,647	10,651,691
State and local	2,177,642	525,137	2,702,779
Nongovernmental	—	309,952	309,952
Sales and services of educational activities	—	2,824,694	2,824,694
Sales and services of auxiliary enterprises	2,791,347	4,890,403	7,681,750
Other operating revenues	<u>177,575</u>	<u>406,204</u>	<u>583,779</u>
Total operating revenues	<u>30,564,040</u>	<u>15,109,312</u>	<u>45,673,352</u>
Expenses:			
Operating expenses:			
Instruction	27,464,138	2,411,499	29,875,637
Research	526,419	2,966,371	3,492,790
Public service	27,121	2,137,767	2,164,888
Academic support	12,489,035	364,305	12,853,340
Student services	7,486,856	1,534,281	9,021,137
Institutional support	14,978,589	283,003	15,261,592
Operation and maintenance of plant	6,876,488	—	6,876,488
Student grants and scholarships	6,489,624	519,821	7,009,445
Auxiliary enterprise expenses	4,027,286	6,111,725	10,139,011
Depreciation and amortization	<u>7,340,268</u>	<u>1,850,187</u>	<u>9,190,455</u>
Total operating expenses	<u>87,705,824</u>	<u>18,178,959</u>	<u>105,884,783</u>
Operating loss	<u>(57,141,784)</u>	<u>(3,069,647)</u>	<u>(60,211,431)</u>
Nonoperating revenues (expenses):			
State appropriations, noncapital	53,307,764	—	53,307,764
Gifts, noncapital	860,259	3,097,602	3,957,861
Investment income, net	354,716	393,933	748,649
Endowment income	—	909,650	909,650
Interest on capital-related debt	(726,360)	—	(726,360)
Other nonoperating revenues (expenses)	<u>1,801,917</u>	<u>(586,148)</u>	<u>1,215,769</u>
Net nonoperating revenues	<u>55,598,296</u>	<u>3,815,037</u>	<u>59,413,333</u>
Income (loss) before other additions	<u>(1,543,488)</u>	<u>745,390</u>	<u>(798,098)</u>
State appropriations, capital	10,002,000	—	10,002,000
Grants and gifts, capital	<u>—</u>	<u>2,300</u>	<u>2,300</u>
Increase in net assets	8,458,512	747,690	9,206,202
Net assets:			
Net assets at beginning of year	<u>183,682,252</u>	<u>20,420,319</u>	<u>204,102,571</u>
Net assets at end of year	<u>\$ 192,140,764</u>	<u>21,168,009</u>	<u>213,308,773</u>

See accompanying notes to financial statements.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2004

	<u>University</u>	<u>Discretely presented component units</u>	<u>Total</u>
Revenues:			
Operating revenues:			
Student tuition and fees (net of scholarship allowances of \$2,554,703)	\$ 18,162,391	821,798	18,984,189
Grants and contracts, noncapital:			
Federal	6,213,973	5,289,012	11,502,985
State and local	1,685,944	617,630	2,303,574
Nongovernmental	—	712,989	712,989
Sales and services of educational activities	—	2,896,221	2,896,221
Sales and services of auxiliary enterprises	2,687,295	4,103,531	6,790,826
Other operating revenues	323,132	997,229	1,320,361
Total operating revenues	<u>29,072,735</u>	<u>15,438,410</u>	<u>44,511,145</u>
Expenses:			
Operating expenses:			
Instruction	27,627,643	2,870,104	30,497,747
Research	53,266	2,939,090	2,992,356
Public service	43,019	1,964,923	2,007,942
Academic support	11,990,877	466,078	12,456,955
Student services	6,689,970	1,700,599	8,390,569
Institutional support	16,813,873	1,119,857	17,933,730
Operation and maintenance of plant	7,074,693	86,192	7,160,885
Student grants and scholarships	11,748,625	368,189	12,116,814
Auxiliary enterprise expenses	2,912,096	3,318,380	6,230,476
Depreciation and amortization	6,841,258	877,089	7,718,347
Total operating expenses	<u>91,795,320</u>	<u>15,710,501</u>	<u>107,505,821</u>
Operating loss	<u>(62,722,585)</u>	<u>(272,091)</u>	<u>(62,994,676)</u>
Nonoperating revenues (expenses):			
State appropriations, noncapital	54,573,409	—	54,573,409
Gifts, noncapital	992,476	1,459,443	2,451,919
Investment income, net	140,314	427,525	567,839
Endowment income	—	1,041,981	1,041,981
Interest on capital-related debt	(377,508)	(809,498)	(1,187,006)
Other nonoperating expenses	(88,148)	(1,019,180)	(1,107,328)
Net nonoperating revenues	<u>55,240,543</u>	<u>1,100,271</u>	<u>56,340,814</u>
Income (loss) before other additions	<u>(7,482,042)</u>	<u>828,180</u>	<u>(6,653,862)</u>
State appropriations, capital	26,008,455	—	26,008,455
Grants and gifts, capital	—	28,100	28,100
Increase in net assets	<u>18,526,413</u>	<u>856,280</u>	<u>19,382,693</u>
Net assets:			
Net assets at beginning of year	<u>165,155,839</u>	<u>19,564,039</u>	<u>184,719,878</u>
Net assets at end of year	<u>\$ 183,682,252</u>	<u>20,420,319</u>	<u>204,102,571</u>

See accompanying notes to financial statements.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Statements of Cash Flows

Years ended June 30, 2005 and 2004

	<u>University</u>	
	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Tuition and fees	\$ 16,577,599	19,319,598
Federal grants and contracts	5,500,044	6,496,697
State and local grants and contracts	2,177,642	1,685,944
Payments to suppliers	(14,195,820)	(17,806,220)
Payments to employees	(59,040,079)	(56,244,914)
Payments to students	(6,727,640)	(11,941,319)
Collections of student loans	188,386	199,376
Sales and services of auxiliary enterprises	2,791,347	2,687,295
Other receipts	266,244	1,644,360
Net cash used in operating activities	<u>(52,462,277)</u>	<u>(53,959,183)</u>
Cash flows from noncapital financing activities:		
State appropriations	52,156,881	55,309,606
Gifts and grants received for other than capital purposes	860,259	992,476
Federal loan program receipts	16,046,234	15,677,638
Federal loan program disbursements	(16,096,406)	(15,733,649)
Monies received on behalf of others	288,029	243,422
Monies disbursed on behalf of others	(290,428)	(194,132)
Other	3,202,090	(82,637)
Net cash provided by noncapital financing activities	<u>56,166,659</u>	<u>56,212,724</u>
Cash flows from capital and related financing activities:		
Proceeds from capital debt	51,205,000	—
State appropriations	16,005,798	13,117,308
Proceeds from sale of capital assets	—	16,986
Acquisition of capital assets	(16,991,769)	(8,423,082)
Transfers to escrow agent	(25,975,000)	—
Principal paid on capital debt and leases	(1,691,762)	(1,503,085)
Loan to auxiliary organization	(25,975,000)	—
Interest paid on capital debt and leases	(470,533)	(678,469)
Net cash provided by (used in) capital and related financing activities	<u>(3,893,266)</u>	<u>2,529,658</u>
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	3,776,176	1,583,522
Purchases of investments	(1,960,103)	(3,410,089)
Investment income received	354,716	140,314
Net cash provided by (used in) investing activities	<u>2,170,789</u>	<u>(1,686,253)</u>
Net increase in cash and cash equivalents	1,981,905	3,096,946
Cash and cash equivalents at beginning of year	<u>9,747,216</u>	<u>6,650,270</u>
Cash and cash equivalents at end of year	<u>\$ 11,729,121</u>	<u>9,747,216</u>

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Statements of Cash Flows

Years ended June 30, 2005 and 2004

	<u>University</u>	
	<u>2005</u>	<u>2004</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (57,141,784)	(62,722,585)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization expense	7,340,268	6,841,258
Change in assets and liabilities:		
Accounts receivable, net	(10,443)	1,487,612
Student loans receivable, net	(49,630)	6,682
Prepaid expenses and other assets	2,010,211	(337,321)
Accounts payable	(900,134)	(2,249,041)
Accrued salaries and benefits	(106,913)	975,069
Accrued compensated absences	(127,524)	171,477
Deferred revenue	(3,369,030)	1,228,773
Depository accounts	69,609	225,508
Other liabilities	(176,907)	413,385
Net cash used in operating activities	<u>\$ (52,462,277)</u>	<u>(53,959,183)</u>
Supplemental schedule of noncash transactions:		
Construction work in process acquired from CO	\$ 432,897	—
Accrued capital asset costs (purchased but unpaid at year end)	3,493,646	—

See accompanying notes to financial statements.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

(1) Organization

California State University, San Marcos (the University) was established as a campus of the California State University under the State of California Education Code to offer undergraduate and graduate instruction for professional and occupational goals emphasizing a broad liberal arts education. As one of 23 campuses in the California State University system (the System), the University is included in the financial statements of the System. Responsibility for the University is vested in the Trustees of the System (the Trustees) who, in turn, appoint the Chancellor, the chief executive officer of the System, and the University president, the chief executive officer of the University.

The University provides instruction for baccalaureate and master degrees, and certificate programs and operates various auxiliary enterprises such as student dormitories and parking facilities. In addition, the University administers a variety of financial aid programs which are funded primarily through state and federal programs.

(2) Summary of Significant Accounting Policies

(a) *Financial Reporting Entity*

In accordance with Governmental Accounting Standards Board (GASB) Statements 34, *Financial Statements – and Management’s Discussion and Analysis – For State and Local Governments*, and No. 35, *Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*, the accompanying financial statements include the accounts of the University and the University’s three recognized auxiliary organizations. These organizations are legally separate entities that provide services primarily to the University’s students and faculty. Separate financial statements are issued for each of the recognized auxiliary organizations and may be obtained from the University.

The discretely presented auxiliary organizations are as follows:

- California State University, San Marcos Foundation
- Associated Students Incorporated of California State University, San Marcos
- San Marcos University Corporation

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

Summary information for the discretely presented auxiliary organizations is as follows:

June 30, 2005	California State University, San Marcos Foundation	Associated Students, Inc. of California State University, San Marcos	San Marcos University Corporation	Total
Current assets	\$ 8,939,760	512,336	2,788,617	12,240,713
Capital assets, net	1,470,841	33,614	23,420,665	24,925,120
Other noncurrent assets	12,920,280	3,000	—	12,923,280
Total assets	23,330,881	548,950	26,209,282	50,089,113
Current liabilities	1,230,011	251,051	1,392,227	2,873,289
Noncurrent liabilities	—	—	26,047,815	26,047,815
Total liabilities	1,230,011	251,051	27,440,042	28,921,104
Invested in capital assets, net of related debt	1,470,841	33,614	(2,627,150)	(1,122,695)
Restricted	14,241,323	—	—	14,241,323
Unrestricted	6,388,706	264,285	1,396,390	8,049,381
Total net assets	\$ 22,100,870	297,899	(1,230,760)	21,168,009

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

<u>June 30, 2005</u>	<u>California State University, San Marcos Foundation</u>	<u>Associated Students, Inc. of California State University, San Marcos</u>	<u>San Marcos University Corporation</u>	<u>Total</u>
Revenues:				
Student tuition and fees	\$ —	974,275	—	974,275
Grants and contracts, noncapital	6,003,768	9,968	—	6,013,736
Sales and services of educational activities	2,824,694	—	—	2,824,694
Sales and services of auxiliary enterprises, net	1,481,013	—	3,409,390	4,890,403
Other	—	194,792	211,412	406,204
Total operating revenues	<u>10,309,475</u>	<u>1,179,035</u>	<u>3,620,802</u>	<u>15,109,312</u>
Expenses:				
Instruction	2,411,499	—	—	2,411,499
Research	2,966,371	—	—	2,966,371
Public service	2,137,767	—	—	2,137,767
Academic support	364,305	—	—	364,305
Student services	1,326,028	208,253	—	1,534,281
Institutional support	283,003	—	—	283,003
Student grants and scholarships	519,821	—	—	519,821
Auxiliary enterprise expenses	2,081,558	850,450	3,179,717	6,111,725
Depreciation and amortization	255,927	16,155	1,578,105	1,850,187
Total operating expenses	<u>12,346,279</u>	<u>1,074,858</u>	<u>4,757,822</u>	<u>18,178,959</u>
Operating income (loss)	(2,036,804)	104,177	(1,137,020)	(3,069,647)
Nonoperating revenues, net	<u>3,810,088</u>	<u>4,949</u>	<u>—</u>	<u>3,815,037</u>
Income (loss) before other additions	1,773,284	109,126	(1,137,020)	745,390
Grants and gifts, capital	<u>2,300</u>	<u>—</u>	<u>—</u>	<u>2,300</u>
Increase (decrease) in net assets	1,775,584	109,126	(1,137,020)	747,690
Beginning net assets, July 1, 2004	<u>20,325,286</u>	<u>188,773</u>	<u>(93,740)</u>	<u>20,420,319</u>
Ending net assets, June 30, 2005	<u>\$ 22,100,870</u>	<u>297,899</u>	<u>(1,230,760)</u>	<u>21,168,009</u>

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

June 30, 2004	California State University, San Marcos Foundation	Associated Students, Inc. of California State University, San Marcos	San Marcos University Corporation	Total
Current assets	\$ 9,604,115	389,009	1,971,673	11,964,797
Capital assets, net	1,683,803	44,100	24,072,460	25,800,363
Other noncurrent assets	<u>10,611,601</u>	<u>3,000</u>	<u>3,053,560</u>	<u>13,668,161</u>
Total assets	<u>21,899,519</u>	<u>436,109</u>	<u>29,097,693</u>	<u>51,433,321</u>
Current liabilities	1,574,233	247,336	1,201,433	3,023,002
Noncurrent liabilities	<u>—</u>	<u>—</u>	<u>27,990,000</u>	<u>27,990,000</u>
Total liabilities	<u>1,574,233</u>	<u>247,336</u>	<u>29,191,433</u>	<u>31,013,002</u>
Invested in capital assets, net of related debt	1,683,803	—	—	1,683,803
Restricted	12,015,524	—	—	12,015,524
Unrestricted	<u>6,625,959</u>	<u>188,773</u>	<u>(93,740)</u>	<u>6,720,992</u>
Total net assets	<u>\$ 20,325,286</u>	<u>188,773</u>	<u>(93,740)</u>	<u>20,420,319</u>

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

<u>June 30, 2004</u>	<u>California State University, San Marcos Foundation</u>	<u>Associated Students, Inc. of California State University, San Marcos</u>	<u>San Marcos University Corporation</u>	<u>Total</u>
Revenues:				
Student tuition and fees	\$ —	821,798	—	821,798
Grants and contracts, noncapital	6,608,996	10,635	—	6,619,631
Sales and services of educational activities	2,896,221	—	—	2,896,221
Sales and services of auxiliary enterprises, net	1,384,742	—	2,718,789	4,103,531
Other	—	221,574	775,655	997,229
Total operating revenues	<u>10,889,959</u>	<u>1,054,007</u>	<u>3,494,444</u>	<u>15,438,410</u>
Expenses:				
Instruction	2,648,574	221,530	—	2,870,104
Research	2,939,090	—	—	2,939,090
Public service	1,960,458	4,465	—	1,964,923
Academic support	440,116	25,962	—	466,078
Student services	1,566,963	133,636	—	1,700,599
Institutional support	362,517	757,340	—	1,119,857
Operation and maintenance of plant	—	86,192	—	86,192
Student grants and scholarships	368,189	—	—	368,189
Auxiliary enterprise expenses	1,660,178	—	1,658,202	3,318,380
Depreciation and amortization	217,511	23,112	636,466	877,089
Total operating expenses	<u>12,163,596</u>	<u>1,252,237</u>	<u>2,294,668</u>	<u>15,710,501</u>
Operating income (loss)	(1,273,637)	(198,230)	1,199,776	(272,091)
Nonoperating revenues (expenses), net	<u>1,903,983</u>	<u>5,786</u>	<u>(809,498)</u>	<u>1,100,271</u>
Income (loss) before other additions	630,346	(192,444)	390,278	828,180
Grants and gifts, capital	<u>28,100</u>	<u>—</u>	<u>—</u>	<u>28,100</u>
Increase (decrease) in net assets	658,446	(192,444)	390,278	856,280
Beginning net assets, July 1, 2003	<u>19,666,840</u>	<u>381,217</u>	<u>(484,018)</u>	<u>19,564,039</u>
Ending net assets, June 30, 2004	<u>\$ 20,325,286</u>	<u>188,773</u>	<u>(93,740)</u>	<u>20,420,319</u>

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

The auxiliary organizations are presented in the accompanying financial statements as component units due to the nature and significance of their relationship with the University. The relationships are such that exclusion of these organizations from the reporting entity would render the financial statements incomplete, primarily due to the activities that the organizations carry out on behalf of the University, such as research, grant administration, foodservice, and academic support. The auxiliary organizations are discretely presented to allow the financial statement users to distinguish them from the University. The University has elected not to present the statements of cash flows for the discretely presented auxiliary organizations.

The financial statements present only the statements of net assets, statements of revenues, expenses, and changes in net assets, and statements of cash flows of the University and do not purport to, and do not, present fairly the financial position of the California State University System as of June 30, 2005 and 2004 and its changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

(b) *Basis of Presentation*

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with U.S. generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB). Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

The financial statements required by GASB Statements Nos. 34 and 35 include a statement of net assets, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows. As a public institution, the University is considered a special-purpose government under the provisions of GASB Statement No. 35. The University records revenue in part from fees and other charges for services to external users and, accordingly, has chosen to present its financial statements using the reporting model for special-purpose governments engaged only in business-type activities. This model allows all financial information for the University to be reported in a single column in each of the financial statements, accompanied by aggregated financial information for the auxiliary organizations. In accordance with the business-type activities reporting model, the University prepares its statements of cash flows using the direct method.

The auxiliary organizations included in these financial statements apply the accounting and reporting standards promulgated by the Financial Accounting Standards Board (FASB).

(c) *New Accounting Pronouncement*

For the fiscal year ended June 30, 2005, the University implemented GASB Statement No. 40, *Deposits and Investment Risk Disclosures – an Amendment of GASB Statement No. 3*. This statement addresses common deposits and investment risks related to credit risks, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also are

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

required to be disclosed. Implementation of GASB Statement No. 40 did not have an impact on the University's financial statements as of and for the year ended June 30, 2005 but required additional disclosures related to deposits and investment risks (see note 3).

(d) *Election of Applicable FASB Statements*

The University has elected not to adopt the pronouncements issued by the Financial Accounting Standards Board (FASB) after November 30, 1989.

(e) *Classification of Current and Noncurrent Assets and Liabilities*

The University considers assets to be current that can reasonably be expected, as part of its normal business operations, to be converted to cash and be available for liquidation of current liabilities within 12 months of the statement of net assets date. Liabilities that reasonably can be expected, as part of normal University business operations, to be liquidated within 12 months of the statement of net assets date are considered to be current. All other assets and liabilities are considered to be noncurrent.

(f) *Cash Equivalents*

The University considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents.

(g) *Investments*

Investments are reflected at fair value using quoted market prices. Realized and unrealized gains and losses are included in the accompanying statements of revenues, expenses, and changes in net assets as investment income, net.

(h) *Capital Assets*

Capital assets are stated at cost or estimated historical cost if purchased, or if donated, at estimated fair value at date of donation. Capital assets, including infrastructure, with a value of \$5,000 or more and with a useful life of one year or more are capitalized. Title to all assets, whether purchased, constructed, or donated, is held by the State of California. Although title is not with the University for land and buildings, the University has exclusive use of these assets and is responsible for the maintenance of these assets and thus has recorded the cost of these assets on the accompanying financial statements. Capital assets, with the exception of land and land improvements, works of art and historical treasures, and construction work in progress, are depreciated on a straight-line basis over their estimated useful lives, which range from 3 to 45 years. Library books, unless considered rare collections, are capitalized and depreciated over a 10-year period. Periodicals and subscriptions are expensed as purchased. Works of art and historical treasures are valued at cost if purchased or the fair market value at the date of donation if contributed. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend its life are expensed as incurred.

Depreciation expense is shown separately in the statements of revenues, expenses, and changes in net assets rather than being allocated among other categories of operating expenses.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

(i) ***Deferred Revenue***

Deferred revenue consists primarily of fees collected in advance for summer and fall terms and continuing education programs.

(j) ***Compensated Absences***

University employees accrue annual leave at rates based on length of service and job classification.

(k) ***Grants Refundable***

The University periodically receives contributions from the federal government in support of its operation of the Federal Perkins and Nursing Loan programs, approved Title IV loan programs. The federal government has the ability to terminate its support of these programs at any time and to request the University to return those contributions that it has made on a cumulative basis. Accordingly, the federal contributions received and retained by the University at year end are considered to be liabilities of the University, and are reflected as such in the accompanying statements of net assets.

(l) ***Net Assets***

The University's net assets are classified into the following 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 conditions that the University retain them in perpetuity. Net assets in this category consist of endowments held by the University or its related auxiliaries.

Restricted – expendable: Net assets subject to externally imposed conditions that can be fulfilled by the actions of the University or by the passage of time.

Unrestricted: All other categories of net assets. In addition, unrestricted net assets may be designated for use by management of the University or have legislative or bond indenture requirements associated with their use. These requirements limit the area of operations for which expenditures of net assets may be made, and require that unrestricted net assets be designated to support future operations in these areas. Campus housing programs are a primary example of operations that have unrestricted net assets with designated uses.

The University has adopted a policy of generally utilizing restricted – expendable funds, prior to unrestricted funds, when an expense is incurred for purposes for which both are available.

(m) ***Classification of Revenues and Expenses***

The University considers operating revenues and expenses in the statements of revenues, expenses, and changes in net assets to be those revenues and expenses that result from exchange transactions or from other activities that are connected directly to the University's primary functions. Exchange

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

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transactions include charges for services rendered and the acquisition of goods and services. Certain other transactions are reported as nonoperating revenues and expenses or capital contributions in accordance with GASB Statement 35. These nonoperating activities include the University's operating and capital appropriations from the State of California, net investment income, gifts, and interest expense.

The State of California appropriates funds to the System on an annual basis. The appropriations are, in turn, allocated among the campuses by the Office of the Chancellor. Appropriations are recognized as revenue when authorization is received, and are reported as either noncapital appropriations when used to support general operations or capital appropriations when used for capital projects.

Student tuition and fee revenue, and sales and services of auxiliary enterprises, including revenues from student housing programs, are presented net of scholarships and fellowships applied to student accounts. Certain other scholarship amounts are paid directly to, or refunded to, the student and are reflected as expenses.

(n) *Income Taxes*

The System was established under the State of California Education Code as an agency of the State of California. As a campus of the System, the University is generally not subject to federal or state income taxes. However, the University remains subject to income taxes on any net income that is derived from a trade or business, regularly carried on and not in furtherance of the purpose for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole.

(o) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the accompanying financial statements. Actual results could differ from those estimates.

(p) *Reclassifications*

Certain 2004 amounts have been reclassified to conform to the 2005 presentation. Such reclassifications had no effect on the previously reported change in net assets.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

(3) Cash and Cash Equivalents and Investments

The University's cash and cash equivalents and investments as of June 30, 2005 and 2004 are classified in the accompanying financial statements as follows:

	June 30	
	2005	2004
Cash and cash equivalents	\$ 11,547,805	9,672,451
Restricted cash and cash equivalents	181,316	74,765
Total cash and cash equivalents	11,729,121	9,747,216
Short-term investments	10,747,027	12,593,966
Other long-term investments	71,033	77,436
Total investments	10,818,060	12,671,402
Total cash and cash equivalents and investments	\$ 22,547,181	22,418,618

(a) Cash and Cash Equivalents

At June 30, 2005 and 2004, cash and cash equivalents consisted of demand deposits held at the State Treasury and petty cash. Total cash and cash equivalents of \$11,729,121 and \$9,747,216 had a corresponding carrying value balance with the State Treasury of \$12,948,101 and \$5,889,231 at June 30, 2005 and 2004, respectively. The differences related primarily to deposits in transit and outstanding checks.

(b) Investments

At June 30, 2005 and 2004, the University's investment portfolio consists primarily of investments held in the California State University Investment Pool, an internal investment pool, as well as interest-bearing accounts held in the State Treasury. For the California State University Investment Pool, separate accounting is maintained as to the amounts allocable to the various funds and programs.

Investment Policy

State law and regulations require that surplus monies of the University must be invested. The primary objective of the University's investment policy is to safeguard the principal. The secondary objective is to meet the liquidity needs of the University. The third objective is to return an acceptable yield. The University's investment policy authorizes funds held in local trust accounts under Education Code Sections 89721 and 89724 to be invested in any of the securities authorized by Government Code Section 16430 and Education Code Section 89724, subject to certain limitations. In general, the University's investment policy permits investments in obligations of the federal and California state governments, certificates of deposit, and certain other investment instruments.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the University manages its exposure to interest rate risk is by purchasing a combination of short-term and mid-term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or nearing maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The University monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio. The weighted average maturity of the University's investment portfolio for each investment type as of June 30, 2005 is presented in the table below.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

The following table presents the fair value, weighted average maturity, and actual rating by investment type of the University's investment portfolio as of June 30, 2005:

Investment type	Fair value	Weighted average maturity (in years)	Rating as of year-end			
			AAA	Aa	A	Not rated
Money market mutual funds	\$ 454,768	—	\$ 135,052	—	—	319,716
Certificates of deposit	239,352	0.80	—	63,804	175,548	—
U.S. agency securities	3,646,127	1.66	3,646,127	—	—	—
Mortgage-backed securities	494,660	12.13	494,660	—	—	—
Corporate and fixed income securities	<u>2,577,022</u>	2.09	<u>221,985</u>	<u>321,380</u>	<u>2,033,657</u>	<u>—</u>
Total	7,411,929		<u>\$ 4,497,824</u>	<u>385,184</u>	<u>2,209,205</u>	<u>319,716</u>
Not subject to ratings:						
U.S. treasury securities	566,466					
State of California Surplus Money Investment Fund	2,746,857					
Bank of America	71,033					
Union Bank	<u>21,775</u>					
Total investments	<u>\$ 10,818,060</u>					

Concentration of Credit Risk

The University's investment policy contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

As of June 30, 2004, the University's investments at fair value are as follows:

	2004		
	Current	Noncurrent	Total
State of California Surplus Money			
Investment Fund	\$ 2,542,200	—	2,542,200
Metropolitan West Short-Term Fund	7,035,445	—	7,035,445
Metropolitan West Medium-Term Fund	2,988,370	—	2,988,370
Other	27,951	77,436	105,387
Total	\$ 12,593,966	77,436	12,671,402

For information regarding the investments of the individual discretely presented auxiliary organizations, please refer to the separately issued auxiliary organizations' reports.

(4) Accounts Receivable

Accounts receivable at June 30 consisted of the following:

	2005		
	Current	Noncurrent	Total
State appropriations	\$ 2,840,161	23,697,935	26,538,096
Auxiliary organizations	141,260	—	141,260
Student accounts	155,337	—	155,337
Government grants and contracts	111,408	—	111,408
Other	540,296	—	540,296
	3,788,462	23,697,935	27,486,397
Less allowance for doubtful accounts	(159,826)	—	(159,826)
Total	\$ 3,628,636	23,697,935	27,326,571

	2004		
	Current	Noncurrent	Total
State appropriations	\$ 1,689,278	29,701,734	31,391,012
Auxiliary organizations	33,050	—	33,050
Student accounts	119,191	—	119,191
Government grants and contracts	7,589	—	7,589
Other	574,987	323,759	898,746
	2,424,095	30,025,493	32,449,588
Less allowance for doubtful accounts	(46,625)	—	(46,625)
Total	\$ 2,377,470	30,025,493	32,402,963

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

(5) Lease Receivable

In the current year, the University entered into a lease agreement with the San Marcos University Corporation. The lease agreement is the result of a transaction whereby the University refinanced certain San Marcos University Corporation bonds used to build campus housing that was placed into service in August 2003. The University Corp debt was refinanced through the issuance of System-wide revenue bonds Series 2005A that are recorded as a long term-liability with the University. In return for the University refinancing the San Marcos University Corporation Debt, the University entered into a 30-year lease agreement whereby the San Marcos University Corporation agreed to lease the campus housing facilities. Lease payments are due twice a year on May 1 and November 1.

Lease payments are due to the University as follows:

Fiscal year ending:		
2006	\$	—
2007		225,000
2008		275,000
2009		330,000
2010		385,000
2011-2015		2,935,000
2016-2020		4,105,000
2021-2025		5,265,000
2026-2030		6,765,000
2031-2033		<u>4,945,000</u>
Total lease receivable		25,230,000
Less current portion		<u>—</u>
Long-term lease receivable, net of current portion	\$	<u><u>25,230,000</u></u>

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

(6) Capital Assets

Capital assets activity for the year ended June 30, 2005 consisted of the following:

	Balance June 30, 2004	Additions	Retirements	Transfers	Balance June 30, 2005
Nondepreciable capital assets:					
Land and land improvements	\$ 10,981,328	—	—	—	10,981,328
Works of art and historical treasures	25,000	—	—	—	25,000
Construction work in progress	1,877,793	20,166,973	—	(948,681)	21,096,085
Total nondepreciable capital assets	12,884,121	20,166,973	—	(948,681)	32,102,413
Depreciable capital assets:					
Buildings and building improvements	138,732,654	214,112	—	104,000	139,050,766
Improvements, other than buildings	12,603,678	—	—	844,681	13,448,359
Infrastructure	20,233,216	—	—	—	20,233,216
Personal property:					
Equipment	11,881,672	198,962	(508,416)	—	11,572,218
Library books and materials	9,134,641	254,591	—	—	9,389,232
Intangible assets	878,303	83,674	—	—	961,977
Total depreciable capital assets	193,464,164	751,339	(508,416)	948,681	194,655,768
Total cost	206,348,285	20,918,312	(508,416)	—	226,758,181
Less accumulated depreciation:					
Buildings and building improvements	(26,086,311)	(4,627,163)	—	—	(30,713,474)
Improvements, other than buildings	(10,018,174)	(504,312)	—	—	(10,522,486)
Infrastructure	(5,955,403)	(505,830)	—	—	(6,461,233)
Personal property:					
Equipment	(7,621,320)	(1,169,698)	329,070	—	(8,461,948)
Library books and materials	(6,295,761)	(474,611)	—	—	(6,770,372)
Intangible assets	(801,195)	(58,654)	—	—	(859,849)
Total accumulated depreciation	(56,778,164)	(7,340,268)	329,070	—	(63,789,362)
Net capital assets	\$ 149,570,121	13,578,044	(179,346)	—	162,968,819

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

Capital assets activity for the year ended June 30, 2004 consisted of the following:

	Balance June 30, 2003	Additions	Retirements	Transfers	Balance June 30, 2004
Nondepreciable capital assets:					
Land and land improvements	\$ 10,551,554	—	—	429,774	10,981,328
Works of art and historical treasures	25,000	—	—	—	25,000
Construction work in progress	38,761,800	6,864,365	—	(43,748,372)	1,877,793
Total nondepreciable capital assets	49,338,354	6,864,365	—	(43,318,598)	12,884,121
Depreciable capital assets:					
Buildings and building improvements	97,301,388	—	—	41,431,266	138,732,654
Improvements, other than buildings	11,422,200	—	—	1,181,478	12,603,678
Infrastructure	19,688,200	—	—	545,016	20,233,216
Personal property:					
Equipment	11,574,506	835,920	(689,592)	160,838	11,881,672
Library books and materials	8,411,844	722,797	—	—	9,134,641
Intangible assets	878,303	—	—	—	878,303
Total depreciable capital assets	149,276,441	1,558,717	(689,592)	43,318,598	193,464,164
Total cost	198,614,795	8,423,082	(689,592)	—	206,348,285
Less accumulated depreciation:					
Buildings and building improvements	(22,271,810)	(3,947,893)	—	133,392	(26,086,311)
Improvements, other than buildings	(9,484,185)	(533,989)	—	—	(10,018,174)
Infrastructure	(5,456,385)	(499,018)	—	—	(5,955,403)
Personal property:					
Equipment	(6,792,540)	(1,362,483)	667,095	(133,392)	(7,621,320)
Library books and materials	(5,850,037)	(445,724)	—	—	(6,295,761)
Intangible assets	(749,044)	(52,151)	—	—	(801,195)
Total accumulated depreciation	(50,604,001)	(6,841,258)	667,095	—	(56,778,164)
Net capital assets	\$ 148,010,794	1,581,824	(22,497)	—	149,570,121

For information regarding the capital assets of the individual discretely presented auxiliary organizations, please refer to the separately issued auxiliary organizations' reports.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

(7) Lease Obligations

The University is obligated under various capital and operating leases and installment purchase agreements for the acquisition of equipment and facility rentals.

Capital leases consist primarily of leases of certain facilities and office equipment. Total capital assets related to capital leases have a carrying value of \$978,668 and \$1,592,639 at June 30, 2005 and 2004, respectively. Substantially all of these assets are pledged as security for the related leases. The leases bear interest at rates ranging from 2% to 6% and have terms expiring in various years through 2006.

Operating leases consist primarily of leases for the use of real property and have terms expiring in various years through fiscal year 2012. The leases can be canceled if the state does not provide adequate funding.

Future minimum lease payments under capital and operating leases having remaining terms in excess of one year are as follows:

	<u>Capital leases</u>	<u>Operating leases</u>
Year ending June 30:		
2006	\$ 4,516	655,780
2007	—	345,272
2008	—	356,462
2009	—	368,043
2010	—	354,470
2011	—	366,876
2012	—	379,717
	<hr/>	<hr/>
Total minimum lease payments	4,516	\$ 2,826,620
	<hr/>	<hr/>
Less amount representing interest	—	
	<hr/>	
Present value of future minimum lease payments	\$ 4,516	
	<hr/>	

Rent expense under operating leases for the years ended June 30, 2005 and 2004 totaled \$648,479 and \$1,052,740, respectively.

Lease financing is provided to the System for the construction of various System and campus facilities through its participation with the State of California in the State Public Works Board Lease Revenue Bond Program. Certain capital assets recorded by the University may have been financed under these arrangements. However, since the obligation for the repayment of this financing rests with the System and the proceeds of such financing are not readily identifiable with a campus or project, a substantial portion of such financing is not allocated to the individual campuses of the System. Unallocated Lease Revenue Bonds outstanding for the System as of June 30, 2005 and 2004 totaled \$546,127,000 and \$576,338,000, respectively.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

(8) Long-term Debt Obligations

(a) *General Obligation Bond Program*

The General Obligation Bond program of the State of California has provided capital outlay funds for the three segments of California Higher Education through voter-approved bonds. Each of the approved bond programs provides a pool of available funds which is allocated on a project-by-project basis among the University of California, the California State University, and the Community Colleges. Financing provided to the University through State of California General Obligation Bonds is not allocated to the System by the State of California. This debt remains the obligation of the state and is funded by state tax revenues. Accordingly, such debt is not reflected in the accompanying financial statements. Total General Obligation Bond debt carried by the state related to California State University projects is approximately \$534,097,000 and \$436,819,000 as of June 30, 2005 and 2004, respectively.

(b) *Revenue Bond Programs*

The Revenue Bond Act of 1947 provides the trustees with the ability to issue revenue bonds to fund five specific self-supporting programs and the health facilities program. The statute has enabled the Trustees to finance construction projects for student housing, student unions, parking facilities, health facilities, continuing education, and auxiliary organization facilities.

The housing program provides on-campus housing primarily for students. Housing is a self-supporting program deriving its revenues from fees collected for the use of the residence facilities. Funds are used for current operating expenses, maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The student union program provides facilities and programs aimed at creating and enhancing learning experiences outside the classroom by promoting interaction among students, faculty, and staff. The student union program is self-supporting and derives its revenues primarily from student fees and interest income. Funds are used for maintenance and repair, and improvements to facilities, and interest and principal payments on outstanding bonds. After payment of all authorized charges, the balances of these funds are available for transfer to the campus auxiliary organization that has contracted with the University to operate the facility. The operating entity may derive additional revenue from facility subrental, recreational and commercial activities, and interest income.

The parking program provides parking facilities. The parking program is self-supporting and derives its revenues primarily from student fees and interest income. Funds are used for construction, repair and maintenance, and principal and interest payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The health facilities program provides facilities on campus in which to provide health services to students. The health facilities program derives its revenues primarily from student fees and interest income. Funds are used for current operating expenses, maintenance and repair, improvements to

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Notes to Financial Statements

June 30, 2005 and 2004

facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The continuing education program provides nonstate-supported courses to students. The continuing education program is self-supporting and derives its revenues primarily from student fees and interest income. Funds are used for current operating expenses, maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The auxiliary organization program provides for certain additional facilities on campus for the benefit of students and staff. The auxiliary organization program derives its revenues primarily from lease income received by the campus from the auxiliary organization using the facility. Funds are used for current operating expenses, maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The Systemwide Revenue Bond program, formerly the Housing Revenue Bond program, was approved by the Trustees in fiscal year 2003. This program provides funding for various construction projects, including student residence and dining halls facilities, continuing education buildings, student unions, parking facilities, health facilities, and auxiliary organization facilities at designated campuses within the System as specified by the individual bond documents. It is designed to provide lower cost debt and greater flexibility to finance revenue bond projects of the System. Rather than relying on specific pledged revenues to support specific debt obligations, this program pools several sources of revenue as the pledge for the related revenue-producing projects. The System's total outstanding balance of revenue bond indebtedness under the Systemwide Revenue Bond program was \$1,510,223,000 and \$898,283,000 at June 30, 2005 and 2004, respectively. The University's portion of the total outstanding balance under this program was \$30,715,000 and \$5,580,000 at June 30, 2005 and 2004, respectively.

Senior to the Systemwide Revenue Bonds are the Student Union Revenue Bonds Series A, B, C, and D, Parking Revenue Bonds Series A and B, and Headquarters Building Authority Lease Revenue Bonds Series B. At June 30, 2005 and 2004, the University had no outstanding balance for these senior bonds.

(c) Revenue Bond Anticipation Notes

In 2005, these Revenue Bond Anticipation Notes were issued and converted to Systemwide Revenue Bonds; therefore, the University has no Revenue Bond Anticipation Notes outstanding at June 30, 2005 and 2004.

(d) Koch Financial Corporation

The Koch Financial Corporation debt obligation was established to fund the building of a Thermal Energy Storage Tank in a cooperative effort with San Diego Gas & Electric in an effort to promote energy conservation and provide the University with energy savings costs.

CALIFORNIA STATE UNIVERSITY, SAN MARCOS

Notes to Financial Statements

June 30, 2005 and 2004

Long-term debt obligations of the University consist of the following as of June 30:

<u>Description</u>	<u>Interest rate</u>	<u>Fiscal maturity date</u>	<u>Original issue amount</u>	<u>Amount outstanding at June 30,</u>	
				<u>2005</u>	<u>2004</u>
Systemwide Revenue Bonds:					
2002A - Student Union	3.0% – 5.5%	2033	\$ 5,665,000	5,485,000	5,580,000
2005A - Auxiliary Org	2.5% – 5.0%	2038	25,230,000	25,230,000	—
Other:					
Koch Financial Corporation	5%	2012	2,000,000	1,015,338	1,132,548
Koch Financial Corporation	4%	2010	495,936	495,936	—
Koch Financial Corporation	4%	2006	1,018,282	342,401	—
GE Capital	4%	2009	129,646	70,387	—
Total long-term debt				32,639,062	6,712,548
Less current portion				(214,740)	(95,000)
Long-term debt, net of current portion				\$ 32,424,322	6,617,548

Long-term debt principal obligations and related interest mature in the following fiscal years:

	<u>Principal</u>	<u>Interest</u>
Year ending June 30:		
2006	\$ 214,740	1,571,283
2007	901,284	1,563,903
2008	615,235	1,529,827
2009	684,561	1,505,887
2010	752,636	1,478,842
2011 – 2015	4,075,606	6,867,342
2016 – 2020	4,935,000	5,763,975
2021 – 2025	6,365,000	4,354,885
2026 – 2030	8,145,000	2,547,519
2031 – 2035	5,950,000	456,000
	\$ 32,639,062	27,639,463

Long-term debt obligations of the discretely presented auxiliary organizations have been issued to purchase or construct facilities for University related uses. For information regarding the long-term debt obligations of the individual discretely presented auxiliary organizations, please refer to the separately issued auxiliary organizations' reports.

(9) Advance Refundings

Current Year Refundings

In April 2005, the University defeased certain bonds of the discretely presented auxiliary organizations (refunded bonds) by placing a portion of the proceeds from the issuance of the Systemwide Revenue

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Notes to Financial Statements

June 30, 2005 and 2004

Bonds Series 2005A refunding bonds in an irrevocable trust with the State Treasurer to provide for all future debt service payments on the refunded bonds. The proceeds from the Series 2005A refunding bonds were used to purchase U.S. government securities that were placed in an escrow account. The investments and fixed earnings from the investments are considered sufficient to fully service the defeased debt until the debt is called or matured. The amount of the University's current year defeased bonds outstanding as of June 30, 2005 totaled \$25,230,000.

(10) Long-term Liabilities Activity

Long-term liabilities activity for the year ended June 30, 2005 was as follows:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Current portion</u>
Accrued compensated absences	\$ 3,000,119	1,399,220	(1,526,744)	2,872,595	1,608,640
Capitalized lease obligations (note7)	1,484,068	—	(1,479,552)	4,516	4,516
Long-term debt obligations (note 8):					
2002A System-wide Revenue Bonds (Student Union)	5,580,000	—	(95,000)	5,485,000	90,000
2005A System-wide Revenue Bonds (Auxiliary Org)	—	25,230,000	—	25,230,000	—
Bond Anticipation Note (Auxiliary Org)	—	25,975,000	(25,975,000)	—	—
Koch Financial Corporation	1,132,548	—	(117,210)	1,015,338	—
Koch Financial Corporation	—	495,936	—	495,936	87,361
Koch Financial Corporation	—	1,018,282	(675,881)	342,401	—
GE Capital	—	106,387	(36,000)	70,387	37,379
Total long-term liabilities	\$ 11,196,735	54,224,825	(29,905,387)	35,516,173	1,827,896

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

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Current portion</u>
Accrued compensated absences	\$ 2,828,642	1,698,221	(1,526,744)	3,000,119	1,526,744
Capitalized lease obligations (note7)	2,790,874	—	(1,306,806)	1,484,068	821,939
Long-term debt obligations (note 8):					
Student Union Revenue Bonds	5,665,000	—	(85,000)	5,580,000	95,000
Koch Financial Corporation	1,243,827	—	(111,279)	1,132,548	—
Total long-term liabilities	\$ 12,528,343	1,698,221	(3,029,829)	11,196,735	2,443,683

(11) Pension Plan and Postretirement Benefits

(a) Plan Description

The University, as an agency of the State of California, contributes to the California Public Employees' Retirement System (CalPERS). The state's plan with CalPERS is an agent

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multiple-employer defined benefit pension plan. For the University, the plan acts as a cost-sharing multiple-employer defined-benefit pension plan which provides a defined-benefit pension and postretirement benefit program for substantially all eligible University employees. CalPERS functions as an investment and administrative agent for its members. The plan also provides survivor, death, and disability benefits. Eligible employees are covered by the Public Employees' Medical and Hospital Care Act (PEMHCA) for medical benefits.

CalPERS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS annual financial report may be obtained from the California Public Employees' Retirement System Executive Office – 400 P Street – Sacramento, California 95814.

(b) Funding Policy

University personnel are required to contribute 5% of their monthly earnings in excess of \$513 to CalPERS. The University is required to contribute at an actuarially determined rate; the current rate is approximately 17.02% of annual covered payroll. The contribution requirements of the plan members are established and may be amended by CalPERS.

The University's contributions to CalPERS for the most recent three fiscal years were equal to the required contributions and were as follows:

2003	\$	2,839,040
2004		5,886,722
2005		6,522,662

(c) Faculty Early Retirement Program

During the fiscal year ended June 30, 2004, the System implemented the Faculty Early Retirement Program, which was authorized by Executive Order S-8-04 issued by the Governor on May 6, 2004. In order to enroll in the program, participants must meet the CalPERS retirement eligibility requirements of age 50 or more on the date of retirement and have five years or more of service credit. Eligible employees who elect to participate in this program will receive two additional years of service credit in their retirement income calculation if their 1) separation date is no earlier than May 5, 2004, and no later than July 27, 2004, and 2) CalPERS retirement date is no earlier than May 6, 2004, and no later than July 28, 2004. In return, the System must contribute to CalPERS an amount representing the actuarial equivalent of the value of this benefit. The early retirement benefit is not dependent upon future services and, therefore, has already been earned as of June 30, 2004 by those who have elected to participate in the program. As of June 30, 2005 and 2004, the University's estimated liability of \$0 and \$480,574, respectively, has been recorded as a component of accrued salaries and benefits payable.

(12) Self-insurance Claims Liability

The System and certain auxiliary organizations have established a public entity risk pool, California State University Risk Management Authority (CSURMA), a blended component unit of the System, to manage centrally workers' compensation, industrial and nonindustrial disability, and general organizational risks.

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The System's self-insurance claims liability includes estimated amounts that will be required for future payments of claims that have been reported and claims related to events that have occurred but not been reported. The estimated liability is actuarially determined using individual-case basis valuations and statistical analyses. Although considerable variability is inherent in such estimates, management believes that the liability is a reasonable estimate at June 30, 2005 and 2004.

Changes in the System's self-insurance claims liability for the two years ended June 30, 2005 are as follows:

Liability at June 30, 2003	\$ 104,371,000
Incurred claims and changes in estimates	49,591,000
Claim payments	<u>(35,251,000)</u>
Liability at June 30, 2004	118,711,000
Incurred claims and changes in estimates	33,419,000
Claim payments	<u>(34,491,000)</u>
Liability at June 30, 2005	117,639,000
Less current portion	<u>(39,633,000)</u>
Long-term liability at June 30, 2005, net of current portion	<u>\$ 78,006,000</u>

The University maintains excess general liability insurance coverage provided by Schools Excess Liability Program (SELF), a Joint Powers Authority, with coverage for individual claims between \$1,000,000 and \$49,000,000 per occurrence. The University purchases excess workers' compensation insurance provided by the Insurance Corporation of Hanover (ICH) to limits of \$50,000,000 in excess of \$2,500,000 self-insured retention and coverage from American Home Assurance Company (AIG) for limits of \$50,000,000 in excess of \$50,000,000. There have been no settlements in the most recent three fiscal years that have exceeded insurance limits. Although the University maintains excess policies with SELF, ICH, AIG, and other insurers, the ultimate responsibility for payment of claims resides with the University.

The University's allocation of the System's total self-insurance claims liability as of both June 30, 2005 and 2004 was approximately 2%. This allocation reflects the University's estimated share of the ultimate cost of settling claims relating to events that have occurred on or before June 30, 2005 and 2004.

The University's receivable due from CSURMA totaled \$1,627,100 and \$479,452 at June 30, 2005 and 2004, respectively, which is recorded as a component of prepaid expenses and other assets in the accompanying financial statements. The receivable balance is a result of amounts paid by the University to CSURMA prior to year end in excess of the University's share of the estimated losses.

(13) Commitments and Contingencies

Federal grant programs are subject to review by the grantor agencies, which could result in requests for reimbursement to grantor agencies for disallowed expenditures. Management believes that it has adhered to the terms of its grants and that any disallowed expenditures resulting from such review would not have a material effect on the financial position of the University.

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Contractual commitments for construction projects unexpended as of June 30, 2005 and 2004 totaled \$12,123,332 and \$22,661,173, respectively. These expenditures will be funded primarily from state appropriations.

The University is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the University's financial position, changes in net assets, or liquidity.

(14) Classification of Operating Expenses

The University has elected to report operating expenses by functional classification in the statements of revenues, expenses, and changes in net assets, but to provide the natural classification of those expenses as an additional disclosure. For the years ended June 30, 2005 and 2004, operating expenses by natural classification consisted of the following:

<u>2005</u>	<u>Salaries</u>	<u>Benefits</u>	<u>Scholarships and fellowships</u>	<u>Supplies and other services</u>	<u>Depreciation</u>	<u>Total</u>
Functional classification:						
Instruction	\$ 18,138,444	6,676,060	—	2,649,634	—	27,464,138
Research	384,751	128,463	—	13,205	—	526,419
Public service	20,701	372	—	6,048	—	27,121
Academic support	7,604,836	2,596,696	—	2,287,503	—	12,489,035
Student services	4,687,553	1,530,764	—	1,268,539	—	7,486,856
Institutional support	7,893,048	2,858,006	—	4,227,535	—	14,978,589
Operation and maintenance of plant	2,692,178	1,093,580	—	3,090,730	—	6,876,488
Student grants and scholarships	—	—	6,489,624	—	—	6,489,624
Auxiliary enterprise expenses	1,540,255	603,881	—	1,883,150	—	4,027,286
Depreciation	—	—	—	—	7,340,268	7,340,268
Total	\$ <u>42,961,766</u>	<u>15,487,822</u>	<u>6,489,624</u>	<u>15,426,344</u>	<u>7,340,268</u>	<u>87,705,824</u>

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<u>2004</u>	<u>Salaries</u>	<u>Benefits</u>	<u>Scholarships and fellowships</u>	<u>Supplies and other services</u>	<u>Depreciation</u>	<u>Total</u>
Functional classification:						
Instruction	\$ 19,105,174	6,592,728	—	1,929,741	—	27,627,643
Research	5,657	—	—	47,609	—	53,266
Public service	15,870	—	—	27,149	—	43,019
Academic support	7,446,635	2,645,559	—	1,898,683	—	11,990,877
Student services	3,704,484	1,658,269	—	1,327,217	—	6,689,970
Institutional support	9,047,813	3,403,024	—	4,363,036	—	16,813,873
Operation and maintenance of plant	1,878,874	783,361	—	4,412,458	—	7,074,693
Student grants and scholarships	—	—	11,748,625	—	—	11,748,625
Auxiliary enterprise expenses	796,111	307,901	—	1,808,084	—	2,912,096
Depreciation	—	—	—	—	6,841,258	6,841,258
Total	\$ 42,000,618	15,390,842	11,748,625	15,813,977	6,841,258	91,795,320

(15) Transactions with Related Entities

The System is an agency of the State of California and, as such, processes substantially all of its revenue and expenditure activity through the Office of the California State Controller. State appropriations allocated to the University through the Office of the Chancellor aggregated \$63,309,764 and \$80,581,864 for the years ended June 30, 2005 and 2004, respectively. State appropriations receivable aggregated \$26,538,096 and \$31,391,012 at June 30, 2005 and 2004, respectively. The University also received lottery appropriations from the State of California in the amount of \$395,000 and \$392,000 for the years ended June 30, 2005 and 2004, respectively, which are included in other nonoperating revenues and expenses.

As headquarters for the System, the Office of the Chancellor administers certain activities centrally for the individual campuses. Primary among these activities are management of capital projects, debt administration, and risk pool administration. The costs associated with the operations of the Office of the Chancellor are not allocated to the individual universities' financial statements.