

UNIVERSITY OF ALASKA

(A Component Unit of the State of Alaska)

Financial Statements

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

University of Alaska  
(A Component Unit of the State of Alaska)  
Financial Statements  
June 30, 2006 and 2005

Table of Contents

	Page
Management's Discussion and Analysis	1
Independent Auditors' Report	13
University of Alaska Statements of Net Assets	15
University of Alaska Foundation Statements of Financial Position	17

## MANAGEMENT'S DISCUSSION AND ANALYSIS

indicates that significant resources are held by the foundation for the sole benefit of  
city. However, the university is not accountable for, nor has ownership of, the

### **Statement of Net Assets**

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities (net assets) indicates the financial condition of the university; declined during the year.

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(Unaudited – see accompanying accountants' report)

A summarized comparison of the university's assets, liabilities and net assets at June 30, 2006, 2005 and 2004 follows (\$ in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Current assets	\$ 106,614	\$ 119,109	\$ 109,721
Other assets	251,405	194,918	182,960
Capital assets, net of depreciation	<u>731,010</u>	<u>737,290</u>	<u>760,757</u>
Total assets	<u>1,089,029</u>	<u>1,051,317</u>	<u>1,053,438</u>
Liabilities:			
Current liabilities	80,444	76,600	69,631
Noncurrent liabilities	<u>161,730</u>	<u>140,658</u>	<u>133,576</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(Unaudited – see accompanying accountants' report)

Due to a combination of an improved cash position and the stabilization of interest rate increases by the Federal Reserve, management increased and diversified investments as a strategy in improving the university's financial position. See Note 2 of the financial statements for further information on deposits and investments.

Total liabilities increased 11.5 percent from \$217.3 million at June 30, 2005 to \$242.2 million at June 30, 2006. Increased liabilities are mainly attributed to:

- Long-term debt financing with issuance of Series N general revenue bonds totaling \$24.4 million in fiscal year 2006. A portion of the bonds, \$10.3 million, was used to advance refund other general revenue bonds and redeem a note payable. The remaining bond proceeds of \$14.1 million are dedicated for capital improvement projects.
- The State of Alaska Public Employees' Retirement System (PERS) combined net pension and OPEB obligations increased from \$15.4 million at June 30, 2005 to \$25.4 million at June 30, 2006. The PERS-related obligations are the result of an employer required contribution rate that was lower than the full actuarial rate.

Unrestricted net assets increased \$15.5 million from June 30, 2005 to June 30, 2006. At year end, \$24.7 million of the \$56.4 million total is designated by the Board of Regents for specific purposes or otherwise limited by contractual agreements with external parties. See Note 7 of the financial statements for a detailed list of these designations.

***Fiscal Year 2005 Comparisons (Statement of Net Assets)***

For comparative purposes, significant comments a



**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited – see accompanying accountants' report)

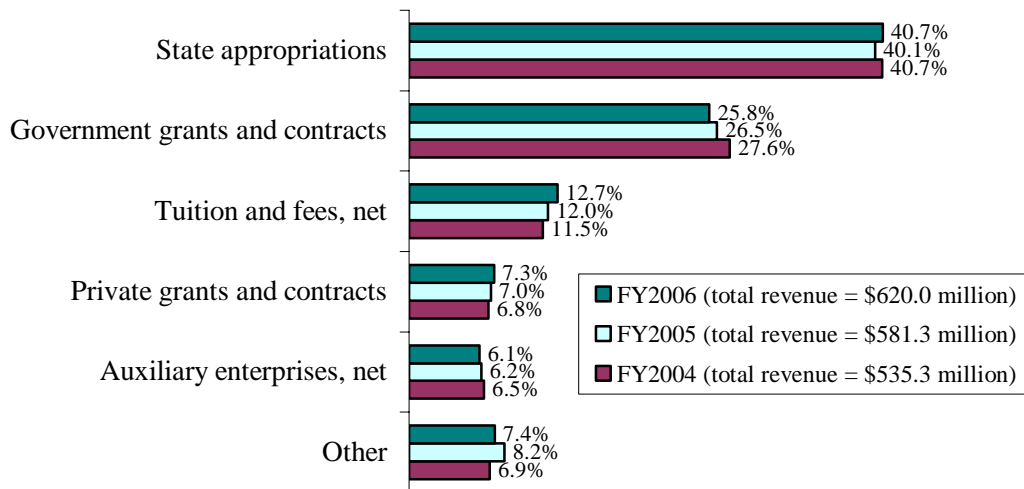
Endowment investment income was approximately \$13.9 million, in 2006 as compared to \$9.7 million, in the prior year. Total return was 12.3% in 2006 and 11% in 2005.

Endowment sales and other proceeds totaled \$5.7 million in 2006 as compared to \$16.5 million in 2005. This category includes yield from, or sales of, trust land, timber and mineral interests, the net proceeds of which are generally deposited to the land grant endowment trust fund.

State of Alaska general fund appropriations continue to be the single major source of revenue for the university, providing \$252.5 million in 2006, as compared to \$232.9 million in 2005. Historically, the Legislature has funded the university at an amount equal to or above the prior period's appropriation.

A comparison of operating and nonoperating revenues by source for fiscal year 2006, 2005 and 2004 follows:

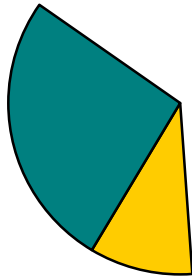
**Operating and Nonoperating Revenues (excluding capital) by Year**



Revenues from federal and other sources for sponsored research and education-related programs increased 5 percent, from \$194.9 million in 2005 to \$205.2 million in 2006. Facility and administrative cost recovery provided \$32.0 million in 2006 as compared to \$31.2 million in 2005. This funding enables the university to expand existing programs a

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(Unaudited – see accompanying accountants' report)

A comparison of operating expenses by functional and natural classification for selected fiscal years follows (see Note 16 of the financial statements for more information):



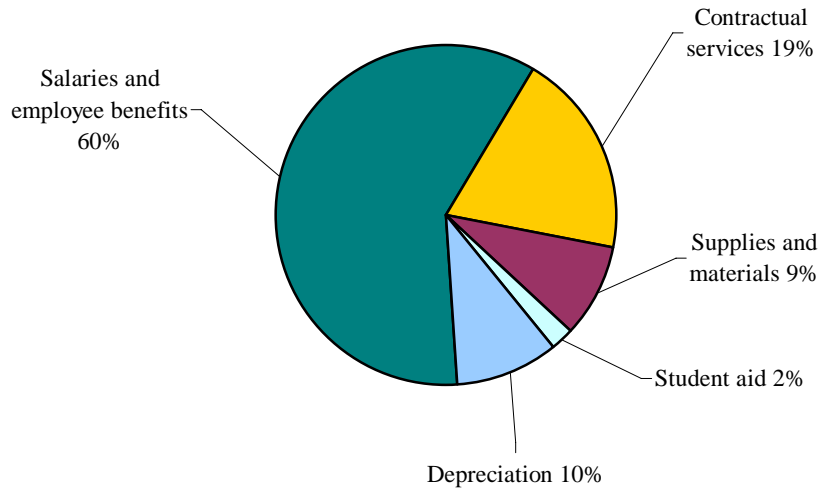


**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited – see accompanying accountants' report)

In addition to the allowances, students participate in governmental financial aid loan programs. The loans are neither recorded as revenue nor expense in the financial statements, but are recorded in the Statements of Cash Flows as direct lending receipts totaling approximately \$64 million and \$57 million in fiscal year 2006 and 2005, respectively.

Institutional support expenses fluctuate due to the accounting method used to record employee benefits. The university employs a central benefits pool concept, and uses a staff benefit rate, to charge estimated employee benefits, such as pension and healthcare costs, to labor recorded in the various functional expense categories. Institutional support expenses are impacted when the amounts charged exceed, or are less than, actual benefits paid to third parties. Over recovery or under recovery of charges in one year are built into the rate building process the following year. When considered in total, operating expenses across all functional categories include the correct amount of employee benefit expense each fiscal year.

**Fiscal Year 2006  
Natural Classification**



**Operating Expenses**

**Natural Classification (in millions)**

	FY2006		FY2005		FY2004	
Salaries and Employee Benefits	\$370.3	59.8%	\$347.6	58.7%	\$319.2	58.1%
Contractual Services	119.7	19.3%	106.1	17.9%	102.1	18.6%
Supplies and Materials	58.2	9.1%	65.8	11.1%	54.4	9.9%
Student Aid	13.4	2.1%	12.8	2.2%	13.0	2.4%
Depreciation	59.8	9.7%	60.1	10.1%	60.5	11.0%
	<u>\$621.4</u>	<u>100.0%</u>	<u>\$592.4</u>	<u>100.0%</u>	<u>\$549.2</u>	<u>100.0%</u>



## MANAGEMENT'S DISCUSSION AND ANALYSIS

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(Unaudited – see accompanying accountants' report)

refund 1997 Series G general revenue bonds and redeem a note payable originally issued for student housing in Anchorage. The advance refunding and note redemption resulted in an economic gain of approximately \$971,000 and the total debt service payments over the next 20 years will decrease by \$1,366,000.

At June 30, 2006, total debt outstanding was \$118.4 million, comprised of \$94.1 million in general revenue bonds, \$22.9 million in notes payable, and \$1.4 million in lease finance contracts. In August 2005, Moody's Investors Service affirmed its previous university credit rating of A1 with stable outlook and Standard & Poor's affirmed its rating of AA-. The University has maintained these ratings since its general revenue issues were first rated in 1992.

Bonds were issued in prior years to finance construction of student residences at three campuses, the West Ridge Research Building, student recreation centers, a research facility to house the International Arctic Research Center, the acquisition and renovation of several properties adjacent to or near the university's campuses, additions to the university's self-operated power, heat, water and telephone utility systems in Fairbanks, purchase of the University Center Building in

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(Unaudited – see accompanying accountants' report)

Beginning July 1, 2006, state legislation and changes to a university-administered plan will affect retirement benefits for new employees as discussed below:

- State legislation enacted in July 2005, requires all new eligible employees hired on or after July 1, 2006 to be participants in newly created defined contribution retirement plans. Under the new plans, public employ

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<b>Assets</b>	2006	2005
Current assets:		
Cash and cash equivalents	\$ 32,885	\$ 57,276
Short-term investments	15,480	1,269
Accounts receivable, less allowance of \$4,096 in 2006 and \$3,882 in 2005	48,127	51,622
Other assets	1,079	889
Inventories	9,043	8,053
Total current assets	106,614	119,109
Noncurrent assets:		
Restricted cash and cash equivalents	9,408	8,400
Notes receivable	5,709	6,125
Endowment investments	126,910	115,119
Endowed land and other assets	39,915	37,698
Long-term investments	62,618	21,351
Assets held in trust	6,845	6,225
Capital assets, net of accumulated depreciation of \$595,629 in 2006 and \$544,897 in 2005	731,010	737,290
Total noncurrent assets	982,415	932,208
Total assets	1,089,029	1,051,317
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	10,833	10,998
Accrued expenses	4,173	4,463
Accrued payroll	22,311	19,871
Deferred revenue	4,565	4,351
Accrued annual leave	9,177	8,891
Deferred lease revenue - current portion	1,281	1,281
Long-term debt - current portion	5,200	4,864
Insurance and risk management	19,769	18,549
Deposits from students and others	3,135	3,332
Total current liabilities	80,444	76,600
Noncurrent liabilities:		
Capital appropriation advances	8,116	6,021
Deferred lease revenue	8,647	9,928
Long-term debt	113,183	103,585
Net pension and OPEB obligations	25,397	15,398
Security deposits and other liabilities	6,387	5,726
Total noncurrent liabilities	161,730	140,658
Total liabilities	242,174	217,258
<b>Net Assets</b>		
Invested in capital assets, net of related debt	608,596	625,727
Restricted:		
Expendable:		
Restricted funds	1,161	1,467
Student loan funds	271	271
Education Trust of Alaska	4,931	4,735
Capital projects	2,267	2,143

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**UNIVERSITY OF ALASKA FOUNDATION**  
**(A Component Unit of the University of Alaska)**  
**Statements of Financial Position**  
**June 30, 2006 and 2005**  
**(in thousands)**

<b>Assets</b>	2006	2005
Cash and cash equivalents	\$ 6,169	\$ 3,794
Interest receivable	135	186
Short-term investments	21	24
Contributions receivable	6,085	7,578
Escrows receivable	206	726
Inventory	79	81
Other assets	454	427
Remainder trust receivable	-	395
Pooled endowment funds	99,098	76,279
Other long-term investments	31,806	40,794
Total assets	\$ 144,053	\$ 130,284
 <b>Liabilities</b>		
Due to the University of Alaska	\$ 1,634	\$ 2,608
Other liabilities	1	15
Remainder trust obligations	346	124
Term endowment liability	1,000	1,000
Total liabilities	2,981	3,747
 <b>Net Assets</b>		
Unrestricted	37,229	31,521
Temporarily restricted	56,212	49,638
Permanently restricted	47,631	45,378
Total net assets	141,072	126,537
Total liabilities and net assets	\$ 144,053	\$ 130,284

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

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**UNIVERSITY OF ALASKA**  
**(A Component Unit of the State of Alaska)**

**UNIVERSITY OF ALASKA FOUNDATION**  
**(A Component Unit of the University of Alaska)**  
**Statements of Activities**  
**For the years ended June 30, 2006 and 2005**  
**(in thousands)**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2006</u>
<b>Revenues, gains and other support</b>				
Contributions	\$ 5,084	\$ 10,868	\$ 2,267	\$ 18,219
Investment income	1,513	1,721	-	3,234
Net realized and unrealized investment gains (losses)	2,157	6,901	-	9,058
Other revenues	1	102	-	103
Actuarial adjustment of remainder trust obligations	-	(1)	30	29
Losses on disposition of other assets	-	(23)	-	(23)
Net assets released from restriction	13,038	(13,038)	-	-
Total revenues, gains and other support	<u>21,793</u>	<u>6,530</u>	<u>2,297</u>	<u>30,620</u>
<b>Expenses and distributions</b>				
Operating expenses	773	-	-	773
Distributions for the benefit of the University of Alaska	15,312	-	-	15,312
Total expenses and distributions	<u>16,085</u>	<u>-</u>	<u>-</u>	<u>16,085</u>
Excess of revenues over expenses	<u>5,708</u>	<u>6,530</u>	<u>2,297</u>	<u>14,535</u>
Transfers between net asset classes	-	44	(44)	-
Increase (decrease) in net assets	5,708	6,574	2,253	14,535
Net assets, beginning of year	<u>31,521</u>	<u>49,638</u>	<u>45,378</u>	<u>126,537</u>
Net assets, end of year	<u>\$ 37,229</u>	<u>\$ 56,212</u>	<u>\$ 47,631</u>	<u>\$ 141,072</u>

Unrestricted

2005

\$	290	\$	10,741	\$	1,512	\$	12,543
	1,405		1,755		-		3,160
	1,316		4,716		-		6,032
	1		89		-		90
	-						

**UNIVERSITY OF ALASKA**  
**(A Component Unit of the State of Alaska)**  
**Statements of Cash Flows**  
**For the Years Ended June 30, 2006 and 2005**  
**(in thousands)**

	2006	2005
<b>Cash flows from operating activities</b>		
Student tuition and fees, net	\$ 77,897	\$ 71,431
Grants and contracts	207,684	198,389
Sales and services, educational departments	3,361	3,446
Sales and services, auxiliary enterprises	37,479	36,161
Federal appropriations	3,150	2,837
Local appropriations	717	705
Other operating receipts	10,796	10,370
Payments to employees for salaries and benefits	(366,640)	(340,613)
Payments to suppliers	(179,853)	(171,847)
Payments to students for financial aid	(13,353)	(12,835)
Net cash used by operating activities	(218,762)	(201,956)
<b>Cash flows from noncapital financing activities</b>		
State appropriations	252,714	233,487
Other receipts, net	-	79
Other payments	(330)	-
Direct lending receipts	64,328	56,558
Direct lending payments	(64,138)	(55,966)
Net cash provided by noncapital financing activities	252,574	234,158
<b>Cash flows from capital and related financing activities</b>		
Capital appropriations, grants and contracts	35,129	15,898
Proceeds from issuance of capital debt	24,355	-
Redemption of general revenue bonds and note payable	(10,266)	-



**UNIVERSITY OF ALASKA**  
**(A Component Unit of the State of Alaska)**  
**Statements of Cash Flows**  
**For the Years Ended June 30, 2006 and 2005**  
**(in thousands)**

**Reconciliation of operating loss to net cash used by operating activities:**

	2006	2005
Operating loss	\$ (280,168)	\$ (273,446)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	59,807	60,135
Changes in assets and liabilities:		
Accounts receivable, net	986	4,782
Other assets	(245)	(243)
Inventories	(990)	8
Accounts payable	113	(967)
Accrued expenses	(1,134)	1,237
Accrued payroll	2,440	6,308
Deferred revenue	214	798
Accrued annual leave	286	740
Deferred lease revenue - current portion	(1,281)	(1,281)
Insurance and risk management	1,220	(42)
Deposits from students and others	(10)	15
Net cash used by operating activities	\$ (218,762)	\$ (201,956)

**Noncash Investing, Capital and Financing Activities:**

**For the Year Ended June 30, 2006**

Additions to capital assets include \$0.5 million expended and capitalized but not paid for at year end.

The university purchased equipment through a lease purchase contract totaling \$0.9 million.

Losses on capital asset disposals totaled \$1.5 million.

Interest expense on general revenue bond financed projects totaling \$0.5 million was capitalized during the year.

The university recorded a \$10.0 million pension and other postemployment benefit expense for the state-administered PERS defined benefit plan.

**For the Year Ended June 30, 2005**

Additions to capital assets include \$2.2 million expended and capitalized but not paid for at year end.

The university purchased equipment through a lease purchase contract totaling \$0.2 million.

Losses on equipment disposals totaled \$2.3 million.

Interest expense on general revenue bond financed projects totaling \$0.3 million was capitalized during the year.

The university recorded a \$15.4 million pension and other postemployment benefit expense for the state-administered PERS defined benefit plan.

## NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

### 1. Organization and Summary of Significant Accounting Policies:

#### Organization and Basis of Presentation:

The University of Alaska (university) is a constitutionally created corporation of the State of Alaska which is authorized to hold title to real and personal property and to issue debt in its own name. The university is a component unit of the State of Alaska for purposes of financial reporting. As an instrumentality of the State of Alaska, the university is exempt from federal income tax under Internal Revenue Code Section 115, except for unrelated business activities as covered under Internal Revenue Code Sections 511 to 514.

The University of Alaska Foundation (foundation) is a legally separate, non profit component unit of the university. The foundation was established to solicit donations and to hold and manage such assets for the exclusive benefit of the university. Resources managed by the foundation and distributions made to the university are governed by the foundation's Board of Trustees. Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, required the university to include the foundation as part of its financial statements to better report resources benefiting the university. The university is not accountable for, nor has ownership of, the foundation's resources. The foundation's financial statements include the Statement of Financial Position and the Statement of Activities and these statements are presented in their original audited format according to Financial Accounting Standards Board (FASB) pronouncements.

In preparing the financial statements, management is required to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the statement of net assets. Actual results could differ from those estimates. The more significant accounting and reporting policies and estimates applied in the preparation of the accompanying financial statements are discussed below.

GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- **Unrestricted Net Assets:** Assets, net of related liabilities, which are not subject to externally-imposed restrictions. Unrestricted net assets may be designated for specific purposes by the Board of Regents or may otherwise be limited by contractual agreements with outside parties.
- **Restricted Net Assets:**
  - Expendable** – Assets, net of related liabilities, which are subject to externally-imposed restrictions that may or will be met by actions of the university and/or that expire with the passage of time.
  - Non-expendable** – Assets, net of related liabilities, which are subject to externally-imposed restrictions requiring that they be maintained permanently by the university.
- **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.

## NOTES TO FINANCIAL STATEMENTS

### Summary of Significant Accounting Policies:

The accompanying financial statements have been prepared on the economic resources measurement focus and the accrual basis of accounting. All significant intra-university transactions have been eliminated. The university reports as a business type activity, as defined by GASB Statement No. 35. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The university has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The university has elected not to apply FASB pronouncements issued after the applicable date.

### **Cash and Cash Equivalents**

All highly liquid investments, not held for long-term investment, with original maturities of three months or less are reported as cash and cash equivalents.

### **Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or market.

### **Investments**

Investments are stated at fair value. Investments in fixed income and equity marketable securities are stated at fair value based on quoted market prices. Investments in private partnership interests are valued using the most current information provided by the general partner. General partners typically value privately held companies at cost as adjusted based on recent arms' length transactions. Public companies are valued using quoted market prices and exchange rates, if applicable. Real estate partnerships and funds are valued based on appraisals of properties held and conducted by third-party appraisers retained by the general partner or investment manager. General partners of marketable alternatives provide values based on quoted market prices and exchange rates for publicly held securities and valuation estimates of derivative instruments. General partners of oil and gas partnerships use third-party appraisers to value properties. Valuations provided by the general partners and investment managers are evaluated by management and management believes such values are reasonable at June 30, 2006.

## NOTES TO FINANCIAL STATEMENTS

Depreciation is computed on a straight-line basis with useful lives of building and building components ranging from 12 to 50 years, 10 to 35 years for infrastructure and other improvements, and 5 to 11 years for equipment. Library and museum collections are not depreciated because they are preserved and cared for and have an extraordinarily long useful life.

### **Endowments**

Endowments consist primarily of the land grant endowment trust fund established pursuant to the 1929 federal land grant legislation and its related inflation proofing funds. Alaska Statute 14.40.400 provides that the net income from the sale or use of grant lands must be held in trust in perpetuity. At June 30, 2006 and 2005 the accumulated net earnings and appreciation on investments is \$46.7 million and \$37.3 million, respectively. These amounts, which are recorded in the restricted expendable net asset category, are available for expenditure in accordance with spending policies established by the Board of Regents in its capacity as trustee. Alaska Statute 14.40.400 provides the Board of Regents with authority to manage the endowments under the total return principles which are intended to preserve and maintain the purchasing power of the endowment principal. The investable resources of the fund are invested in the consolidated endowment fund, a unitized investment fund. The annual spending allowance is currently based on five percent of a five-year moving average of the invested balance. Withdrawals of net earnings appreciation to meet the spending allowance are limited to the unexpended accumulated net earnings of the endowments.

### **Operating Activities**

The university's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net assets are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Certain significant revenue streams relied upon for operations are recorded as non-operating revenues, as defined by GASB Statement No. 35, including state appropriations and investment earnings.

### **Tuition Allowances**

Student tuition and fee revenues and certain other revenues from students are reported net of tuition allowances in the statement of revenues, expenses and changes in net assets. Tuition allowances are the difference between the stated charge for tuition and room and board provided by the university and the amount paid by the student and/or third parties making payments on the students' behalf.

### **Lapse of State Appropriations**

Alaska Statutes provide that unexpended balances of one-year appropriations will lapse on June 30 of the fiscal year of the appropriation; however, university receipts in excess of expenditures may be expended by the university in the next fiscal year.

## NOTES TO FINANCIAL STATEMENTS

### 2. Deposits and Investments:

Deposits and investments at June 30, 2006 were as follows (\$ in thousands):

<u>Investment Type</u>	<u>Operating</u>	<u>Capital Funds</u>	<u>Endowment</u>	<u>College Savings Program</u>	<u>Total</u>
Cash and Deposits	\$ (4,892)	\$ -	\$ -	\$ -	\$ (4,892)
Repurchase Agreement	8,870	-	-	-	

## NOTES TO FINANCIAL STATEMENTS

Deposits and investments at June 30, 2005 were as follows (\$ in thousands):

<u>Investment Type</u>	<u>Operating</u>	<u>Capital Funds</u>	<u>Endowment</u>	<u>College Savings Program</u>	<u>Total</u>
Cash and Deposits	\$ (5,143)	\$ -	\$ -	\$ -	\$ (5,143)
Repurchase Agreement	7,895	-	-	-	7,895
Short Term Fund	58,875	2,674	7,645	-	69,194
Intermediate Term Fund	1,269	-	459	-	1,728
Private Hedge Funds	14,042	-	5,229	-	19,271
Money Market Mutual Funds	-	6,843	89	506	7,438
Equities:					
Domestic	-	-	36,230	2,131	38,361
International	-	-	12,754	-	12,754
Emerging Markets	-	-	-	-	-

## NOTES TO FINANCIAL STATEMENTS

Certain funds held in trust for the benefit of the university are not included in the financial statements as the university has only limited control over their administration. These funds are in the custody of independent fiduciaries and at June 30, 2006 had an estimated fair value of approximately \$6.9 million.

At June 30, 2006, the university has approximately \$76.8 million in investments which are not readily marketable. Approximately \$40.1 million is invested in the consolidated endowment fund managed by the foundation and \$36.7 million is invested in private hedge funds within the university's operating funds. These investments represent 30% of total deposits and investments and 9% of net assets at June 30, 2006. These investment instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such difference could be material.

Disclosures for deposits and investments are presented according to GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (GASB 40). Accordingly, the following information addresses various risk categories for university deposits and investments and the investment policies for managing that risk.

### Credit Risk:

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university does not have a policy regarding credit risk since it does not normally invest its operating and capital funds in individual debt securities. The consolidated endowment fund investment policy requires all purchases of debt securities to be of investment grade and marketable at the time of purchase unless otherwise approved by the foundation's investment committee. At June 30, 2006, investments consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (\$ in thousands):

<u>Investment Type</u>	<u>Rating</u>	<u>Operating</u>	<u>Capital Funds</u>	<u>Endowment</u>	<u>College Savings Program</u>
Money Market Mutual Fund	AAA	-	\$ 3,522	-	-
Money Market Mutual Funds	Not Rated	-	-	\$ 651	\$ 154
Short Term Fund	AAA	\$ 31,584	\$ 2,960	\$ 5,818	-
Intermediate Term Fund	AA+	\$ 15,479	-	\$ 457	-
Multi-Strategy Bond Fund	AA	\$ 20,075	-	-	-
Balanced Portfolio	Not Rated	-	-	-	\$ 90
Private Hedge Funds	Not Rated	\$ 36,662	-	\$ 6,111	-
Debt-related:					
Corporate	BAA	-	-	\$ 153	-
Corporate	A	-	-	\$ 2,062	-
Corporate	AA	-	-	\$ 1,224	-
Corporate	AAA	-	-	\$ 276	-
Federal Agency	AA	-	-	\$ 143	-
Federal Agency	AAA	-	-	\$ 2,176	-
Fixed Income Funds	BAA	-	-	\$ 279	-
Fixed Income Funds	Not Rated	-	-	\$ 9,947	\$ 4,034
Commercial Paper	A-1	-	\$ 1,708	-	-

## NOTES TO FINANCIAL STATEMENTS

### Concentration of Credit Risk:

Concentration of credit risk is the risk of loss attributed to the magnitude of the university's investment in a single issuer. GASB 40 requires disclosure when the amount invested with a single issuer, by investment type, exceeds 5 percent or more of that investment type. At June 30, 2006, the university did not have any material concentrations of credit risk.

The consolidated endowment fund investment policy limits debt investments to 5 percent by issuer (except for mutual and pooled funds and U.S. government and agencies) for each specific managed portfolio within the consolidated endowment fund unless approved by the treasurer. The university does not have a policy regarding concentration of credit risk since it does not normally invest its operating and capital funds in individual debt investments.

### Interest Rate Risk:

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The university uses the modified duration measurement to evaluate interest rate risk. Modified duration measures a debt investment's exposure to fair value changes arising from changing interest rates. For example, a modified duration of 2 means that for a rise in interest rates of 1 percent, the value of the security would decrease 2 percent. The university does not have a policy regarding interest rate risk. At June 30, 2006, the university had the following debt investments and corresponding modified duration (\$ in thousands):

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Fair Value

College



## NOTES TO FINANCIAL STATEMENTS

At June 30, 2006, the university does not have custodial credit risk. Deposits of the university are covered by Federal Depository Insurance or securities pledged by the university's counterparty to its repurchase agreement held at the Bank of New York. The collateral is held in the name of the university and at June 30, 2006, provided \$11.5 million coverage in excess of deposits.

### Foreign Currency Risk:

Foreign currency risk is the risk that changes in exchange rates could have an adverse affect on an investment's value for investments denominated in foreign currencies. GASB 40 requires disclosure of value in U.S. dollars by foreign currency denomination and investment type. The university does not have a policy regarding foreign currency risk. At June 30, 2006, the university had foreign currency risk in the endowment funds as follows (\$ in thousands):

<u>Foreign Currency</u>	<u>Equity Market Value</u>
Australian Dollar	

## NOTES TO FINANCIAL STATEMENTS

### 4. Assets Held in Trust:

Assets held in trust include operating funds of the Education Trust of Alaska (Trust). The Trust was established pursuant to state statute on April 20, 2001 by the Board of Regents to facilitate administration of the state's Internal Revenue Code (IRC) Section 529 College Savings Program. The program is a nationally marketed college savings program developed in accordance with IRC Section 529 and includes the resources of the university's former Advance College Tuition (ACT) Program. Participant account balances of approximately \$2.2 billion and \$1.7 billion at June 30, 2006 and 2005, respectively, are not included in the financial statements.

Assets of the Trust are invested in various mutual funds at the direction of T. Rowe Price Associates, Inc., the program manager. The net assets of the Trust, which include a reserve for University of Alaska (UA) Tuition Value Guarantees, are available for payment of program administrative costs, benefits and other purposes of the Trust. Based on actuarial studies, management estimates reserve requirements for the UA Tuition Value Guarantees to be approximately \$1.9 million and \$1.5 million at June 30, 2006 and 2005, respectively.

### 5. Endowed Land and Other Assets:

Endowed land and other assets consist of real property and timber and other rights. By Acts of Congress in 1915 and 1929, approximately 110,000 acres of land was granted to the territory of Alaska to be held in trust for the benefit of the university. The lands were managed by the territory, and later the state of Alaska. In accordance with a 1982 agreement, the lands were subsequently transferred to the Board of Regents, as trustee. In 1982 and 1988 certain state lands including timber and other rights were transferred to the trust as replacement for lands disposed of or adversely affected during the period of administration by the territory and the state. These lands and property interests were recorded at their fair value as of the date of transfer. The net proceeds from timber, land and other rights are deposited in the land grant endowment trust fund described under Endowments in Note 1 above. At June 30, 2006 and 2005, approximately 83,400 and 83,600 acres, respectively, were held in trust at no basis because fair value at the date of transfer was not determinable.

On July 25, 2005, Alaska's governor approved a transfer of approximately 250,000 acres of State of Alaska land to the university. As provided by Alaska Statute 14.40.365, the lands will be conveyed to the university by July 1, 2008 with the exception of one 52,000 acre forestry research parcel being transferred in 50 years. The intent of the Legislature is to provide the university with an equitable land grant as originally envisioned in the federal land grant of 1915 and to provide the university ownership of a significant portfolio of income producing land to help fund public higher education in the State of Alaska. Proceeds and royalties received from property development will be deposited into the land grant trust endowment fund. The lands will be recorded at zero basis as no determinable fair value is available at the time of transfer.

## NOTES TO FINANCIAL STATEMENTS

### 6. Capital Assets:

A summary of capital assets follows (\$ in thousands):

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>
Capital assets not depreciated				
Land	\$ 27,360	\$ 184	\$ 415	\$ 27,129
Construction in progress	55,018	44,553	60,849	38,722
Library and museum collections	51,402	1,951	-	53,353

## NOTES TO FINANCIAL STATEMENTS

7. Unrestricted Net Assets:

At June 30, unrestricted net assets included the following (\$ in thousands):

	<u>2006</u>	<u>2005</u>
Designated:		
Auxiliaries	\$ 9,763	\$ 9,997
Working capital fund	4,715	4,715
Working capital advances	(33)	(3,369)
Service centers	9,674	6,329
Renewal and replacement funds	4,411	3,664
Quasi-endowment funds	78	79
Net pension and OPEB obligations	(25,397)	(15,398)
Employee benefit funds	2,587	(2,802)
Endowment earnings	10,302	9,879
Encumbrances	<u>8,566</u>	<u>7,764</u>
Total designated	24,666	20,858
Undesignated	<u>31,728</u>	<u>20,043</u>
Total unrestricted net assets	<u><b>\$,756,394</b></u>	

NOTES TO FINANCIAL STATEMENTS

Long-term debt consisted of the following at June 30, 2006 and 2005 (\$ in thousands):

	2006	2005
<p><u>Revenue bonds payable</u> 1.40% to 5.45% general revenue bonds due serially to 2036, secured by a pledge of unrestricted current fund revenue generated from tuition, fees, recovery of facilities and administrative costs, sales and services of educational departments, miscellaneous receipts and auxiliaries.</p>	\$ 94,090	\$ 81,045
<p><u>Note payable – capital construction</u> 1.826% assisted note to the Alaska Housing Finance Corporation (AHFC) to finance construction of Anchorage campus housing, payable beginning August 1999 to February 2024.</p>	22,924	26,614
<p><u>Installment contracts</u> 2.68% to 5.44% installment contracts for the purchase of air traffic control simulation equipment and vehicles due in quarterly installments through June 2016.</p>	1,369	790
	\$ 118,383	\$ 108,449

On August 31, 2005, the university issued Series N general revenue bonds totaling \$24,355,000. The bonds mature annually each October 1, through 2035 and bear coupon interest rates ranging from 3 percent to 5 percent. Series N bond proceeds totaling \$14,055,000 are being used for capital improvement projects, and the remaining \$10,300,000 was used to advance refund 1997 Series G general revenue bonds and redeem a note payable originally issued for student housing in Anchorage. The advance refunding and note redemption resulted in an economic gain of approximately \$971,000 and total debt service payments over the next 20 years will decrease by \$1,366,000.

In fiscal year 2006, the state reimbursed the university for debt service of \$1,413,366 on Series K general revenue bonds. Subject to annual appropriation, the state will reimburse the university for principal and interest on \$19,330,000 of the remaining bond principal. Annual debt service on this portion of the bonds is approximately \$1.4 million.

Under the terms of the 1992 General Revenue Bonds Trust Indenture, the university is required to maintain a reserve account with a trustee at an amount equal to one-half of the maximum annual general revenue bond debt service. The balance in the reserve account at June 30, 2006 and 2005 was \$4.0 million and \$3.7 million, respectively. The reserve balance at June 30, 2006 includes a reserve fund policy, purchased with the issuance of Series L, totaling \$0.6 million.

In fiscal year 2006 and prior years, the university defeased housing system revenue bonds and certain general revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Trust assets and related liabilities for the defeased bonds are not included in the university’s financial statements. At June 30, 2006 and 2005, outstanding defeased bonds were \$8.0 million and \$0.3 million, respectively.

## NOTES TO FINANCIAL STATEMENTS

9. Deferred Lease Revenue:

In fiscal year 1997, the university entered into an agreement to construct a facility and establish the International Arctic Research Center (IARC). The university received \$19,215,000 through a Japanese non-profit corporation to support the construction of the IARC in exchange for a commitment to provide research facilities to various Japanese research organizations and agencies for a period of 25 years, including lease extensions. The Japanese research organizations began occupying the IARC in fiscal year 1999. The deferred lease revenue at June 30, 2006 is \$9,927,750 and is reduced at the rate of \$1,281,000 per year with a corresponding increase to other operating revenue.

10. Long-term Liabilities:

Long-term liability activity was as follows (\$ in thousands):

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Amounts due within one year
Capital appropriation advances	\$ 6,021	\$ 4,119	\$ 2,024	\$ 8,116	\$ -
Deferred lease revenue	11,209	-	1,281	9,928	1,281
Long-term debt	108,449	25,218	15,284	118,383	5,200
Security deposits and other liabilities	5,726	662	1	6,387	-
Net pension and OPEB obligations	<u>15,398</u>	<u>9,999</u>	<u>-</u>	<u>25,397</u>	<u>-</u>
	<u>\$ 146,803</u>	<u>\$ 39,998</u>	<u>\$ 18,590</u>	<u>\$ 168,211</u>	<u>\$ 6,481</u>

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Amounts due within one year
Capital appropriation advances	\$ 8,633	\$ 1,479	\$ 4,091	\$ 6,021	\$ -
Deferred lease revenue	12,490	-	1,281	11,209	1,281
Long-term debt	113,094	221	4,866	108,449	4,864
Security deposits and other liabilities	5,495	752	521	5,726	-
Net pension and OPEB obligations	<u>-</u>	<u>15,398</u>	<u>-</u>	<u>15,398</u>	<u>-</u>
	<u>\$ 139,712</u>	<u>\$ 17,850</u>	<u>\$ 10,759</u>	<u>\$ 146,803</u>	<u>\$ 6,145</u>

11. Capital Appropriations and Construction Commitments:

Major construction projects of the university are funded primarily by State of Alaska appropriations and university revenue bonds. The appropriations are financed through state-issued general obligation bonds or capital project bonds issued by the Alaska Housing Finance Corporation, a component unit of the State of Alaska, while other appropriations are received directly from the state or state agencies.

Unexpended and unbilled capital funds appropriated by the State of Alaska in prior years, which are not reflected as appropriation revenue or receivables on the university's books at June 30, 2006, totaled \$64.6 million. In addition, unexpended proceeds of university-issued general revenue bonds designated for construction projects totaled \$4.6 million at June 30, 2006.

Construction commitments at June 30, 2006 aggregated \$22.6 million. At June 30, 2006, the university had received \$8.1 million from State of Alaska capital appropriations and other sources in advance of expenditures.

NOTES TO FINANCIAL STATEMENTS

12. Pension Plans:

Substantially all regular employees participate in either the State of Alaska Public Employees' Retirement System (PERS), an agent multiple-employer public employees' retirement system, the State of Alaska Teachers' Retirement System (TRS), a cost-sharing multiple-employer plan, or the University of Alaska Optional Retirement Plan (ORP), a single-employer defined contribution plan. In addition, substantially all regular employees and faculty classified as temporary participate in the University of Alaska Pension Plan, a supplemental single-employer defined contribution plan. None of the retirement systems or plans own any notes, bonds or other instruments of the university.

Defined Benefit Plans:

State of Alaska Public Employees' Retirement System (PERS)

*Plan Description*

The university contributes to PERS, a defined benefit, agent multiple-employer public employee retirement system established and administered by the State of Alaska (State). PERS provides pension, postemployment health care, death and disability benefits to eligible participants. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature.

Each fiscal year, PERS issues a publicly available financial report which includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907) 465-4460.

*Funding Policy and Annual Pension Cost*

Employee contribution rates are 7.5% for peace officers and firefighters and 6.75% for other employees, as required by State statute. The funding policy for PERS provides for periodic employer contributions at actuarially determined rates that, expressed as a percentage of annual covered payroll, are sufficient to accumulate the assets to pay benefits when due. However, the 2006 actuarially determined rate was 23.05% of applicable gross pay and the employer contribution rate was capped at 15.58% in accordance with PERS board policy that limited yearly increases to 5 percentage points.

The university's annual pension cost for the current year and related information is as follows:

	<u>Pension</u>	<u>Postemployment healthcare</u>	<u>Total</u>
Contribution rates:			
Employee:			
Peace officers and firefighters	4.50%	3.00%	7.50%
Other employees	4.05%	2.70%	6.75%
Employer	9.34%	6.24%	15.58%
Annual pension/OPEB cost	\$18,116,634	\$12,107,981	\$30,224,615
Contributions made	\$12,123,562	\$8,102,600	\$20,226,162
Actuarial assumptions:			
Inflation rate	3.50%	Same	
Investment return	8.25%	Same	
Projected salary increase:			
Inflation	3.50%	N/A	
Productivity and merit:			
Peace officers and firefighters	2.50%	N/A	
Others	2.00%	N/A	
Health cost trend	N/A	11.50%	

## NOTES TO FINANCIAL STATEMENTS

An actuarial valuation as of June 30, 2003 set the contribution rates for the year ended June 30, 2006. The projected unit credit method was used and the initial unfunded accrued liability and future gains/losses are being amortized on a 25-year fixed period level percentage of pay. Effective June 30, 2002, the asset valuation method recognizes 20 percent of the investment gain or loss in each of the current and preceding four years. This method will be phased in over the next five years.

The university's net pension obligation for fiscal year 2006 was as follows:

Annual required contribution	\$ 17,936,334
Interest on net pension obligation	761,443
Adjustment to annual required contribution	<u>(581,143)</u>
Annual pension cost	18,116,634
Contributions made	<u>(12,123,562)</u>
Increase in net pension obligation	5,993,072
Net pension obligation beginning of year	<u>9,579,149</u>
Net pension obligation end of year	<u><u>\$ 15,572,221</u></u>

Three year trend information for pension benefits follows:

<u>Year ended June 30</u>	<u>APC</u>	<u>Percentage of APC contributed</u>	<u>NPO</u>
2004	\$4,729,156	100%	-
2005	\$17,712,969	45.92%	\$9,579,149



## NOTES TO FINANCIAL STATEMENTS

## NOTES TO FINANCIAL STATEMENTS

The ORP is comprised of two layers of participants, the original ORP or ORP Tier 1, and ORP Tier 2

## NOTES TO FINANCIAL STATEMENTS

certain medical insurance, disability and death benefits. As part of the legislation, the PERS and TRS boards were eliminated and replaced with the Alaska Retirement Management Board (ARMB).

University of Alaska ORP Tier 3, an employer funded defined contribution plan, is effective for new participants hired on or after July 1, 2006. The ORP Tier 3 employee contribution rate is 8% and the employer contribution rate is 12%. Employees are vested after 3 years of service.

On or after July 1, 2006, each new eligible employee will have a choice to participate in the applicable state plan or ORP Tier 3.

### 13. Insurance and Risk Management:

The university is exposed to a wide variety of risks including property loss, bodily and personal injury, intellectual property, errors and omissions, aviation and marine. Exposures are handled with a combination of self-insurance, commercial insurance, and membership in a reciprocal risk retention group. The university is self-insured up to the maximum of \$2 million per occurrence for casualty claims and \$250,000 for property claims. Commercial carriers provide coverage in excess of these amounts. Health care, workers' compensation and unemployment claims are fully self-insured.

Liabilities have been established to cover estimates for specific reported losses, estimates for unreported losses based upon past experience modified for current trends, and estimates of expenses for investigating and settling claims.

Changes in applicable liability amounts follow (\$ in thousands):

	<u>Balance</u> <u>July 1, 2005</u>	<u>Provision</u> <u>for Claims</u>	<u>Claims</u> <u>Payment</u>	<u>Balance</u> <u>June 30, 2006</u>
Health	\$ 6,259	\$ 41,359	\$ (41,214)	\$ 6,404
General liability	7,134	1,110	(726)	7,518
Workers' compensation	5,036	2,068	(1,326)	5,778
Unemployment	<u>120</u>	<u>383</u>	<u>(434)</u>	<u>69</u>
	<u>\$ 18,549</u>	<u>\$ 44,920</u>	<u>\$ (43,700)</u>	<u>\$ 19,769</u>
	<u>Balance</u> <u>July 1, 2004</u>	<u>Provision</u> <u>for Claims</u>	<u>Claims</u> <u>Payment</u>	<u>Balance</u> <u>June 30, 2005</u>
Health	\$ 6,505	\$ 39,412	\$ (39,658)	\$ 6,259
General liability	7,267	625	(758)	7,134
Workers' compensation	4,686	1,784	(1,434)	5,036
Unemployment	<u>133</u>	<u>584</u>	<u>(597)</u>	<u>120</u>
	<u>\$ 18,591</u>	<u>\$ 42,405</u>	<u>\$ (42,447)</u>	<u>\$ 18,549</u>

### 14. Commitments and Contingencies:

Amounts received and expended by the university under various federal and state grants, contracts and other programs are subject to audit and potential disallowance. From time to time the university is named as a defendant in legal proceedings or cited in regulatory actions related to the conduct of its operations. In the normal course of business, the university also has various other commitments and contingent liabilities which are not reflected in the accompanying financial statements. In the opinion of management, the university will not be affected materially by the final outcome of any of these legal proceedings, environmental investigations, audit adjustments, or other commitments and contingent liabilities.

## NOTES TO FINANCIAL STATEMENTS

In addition, the university received a vendor clai

NOTES TO FINANCIAL STATEMENTS

Year ended June 30, 2005

	<u>Compensation &amp; Benefits</u>	<u>Contractual Services</u>	<u>Supplies &amp; Materials</u>	<u>Other</u>	<u>Student Aid</u>	<u>Depre- ciation</u>	<u>Total</u>
Instruction	\$ 120,892	\$ 19,191	\$ 9,688	\$ 281	\$ -	\$ -	\$ 150,052
Academic support	30,019	5,960	4,975	36	-	-	40,990
Research	74,189	34,917	9,819	8	-	-	118,933
Public service	19,101	9,544	2,397	184	-	-	31,226
Student services	25,734	7,674	2,769	(144)	-	-	36,033
Operations and maintenance	20,446	10,138	13,569	800	-	-	44,953
Institutional support	49,368	5,864	7,127	1,029	-	-	63,388
Student aid	-	-	-	-	12,822	-	12,822
Auxiliary enterprises	7,884	12,766	13,112	165	-	-	33,927
Depreciation	-	-	-	-	-	60,135	60,135
	<u>\$ 347,633</u>	<u>\$ 106,054</u>	<u>\$ 63,456</u>	<u>\$ 2,359</u>	<u>\$ 12,822</u>	<u>\$ 60,135</u>	<u>\$ 592,459</u>

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress for PERS  
(\$ in thousands):

(Unfunded)