



**KPMG LLP**  
1601 Market Street  
Philadelphia, PA 19103-2499

## **Independent Auditors' Report**

The Board of Trustees  
University of Delaware:

We have audited the accompanying statement of financial position of the University of Delaware as of June 30, 2004, and the related statements of activities, expenses by natural classification, and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University's 2003 financial statements and, in our report dated October 3, 2003, we expressed an unqualified opinion on those financial statements.

We conducted our audit 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of the University of Delaware at June 30, 2004, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

November 11, 2004

UNIVERSITY OF DELAWARE

Statement of Financial Position

June 30, 2004 with Comparative Amounts for 2003  
(Thousands of Dollars)

	2004	2003
<b>Assets</b>		
Cash and cash equivalents	\$ 72,202	54,009
Securities lending collateral	42,386	5,656
Accounts and notes receivable	26,564	19,361
Prepaid expenses and inventories	898	907
Contributions receivable, net	10,103	6,147
Student loan receivables	14,780	14,097
Endowment funds and other investments	1,034,085	861,468
Annuity and life income funds	13,833	13,383
Funds held in trust by others	62,891	58,762
Property, plant and equipment, net of depreciation	666,312	640,109
<b>Total assets</b>	<b>1,944,054</b>	<b>1,673,899</b>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	41,156	26,553
Securities lending collateral payable	42,386	5,656
Deferred revenues and student deposits	5,096	4,562
Obligations under capital leases	10,221	10,913
Notes and bonds payable	158,870	117,002
Annuity and life income funds payable	6,482	6,583
Compensated absences payable	9,761	9,531
Postretirement benefit obligation	96,632	80,472
Advances from federal government for student loans	13,744	13,245
<b>Total liabilities</b>	<b>384,348</b>	<b>274,517</b>
<b>Total net assets</b>	<b>1,559,706</b>	<b>1,399,382</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,944,054</b>	<b>1,673,899</b>

Detail of net assets	Unrestricted	Temporarily		2004	2003
		Restricted	Permanently Restricted		
<b>Operating:</b>					
Designated for program purposes	\$ 46,059	8,986	-	55,045	47,485
Designated for plant and equipment	85,297	5,905	-	91,202	38,715
Contributions receivable	-	10,103	-	10,103	6,147
Invested in property, plant and equipment	497,875	-	-	497,875	519,476
Loan funds	-	-	224	224	214
Annuity and life income funds	-	3,536	3,705	7,241	7,192
Funds held in trust by others	-	-	62,891	62,891	58,762
Endowment funds	575,698	72,948	186,479	835,125	721,391
<b>Total net assets</b>	<b>\$ 1,204,929</b>	<b>101,478</b>	<b>253,299</b>	<b>1,559,706</b>	<b>1,399,382</b>

See accompanying notes to financial statements.

UNIVERSITY OF DELAWARE

Statement of Activities  
 Year ended June 30, 2004 with Comparative Totals for 2003  
 (Thousands of Dollars)

	2004			2003	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
<b>Operating revenue:</b>					
Tuition and fees	\$ 191,853	-	-	191,853	180,531
(less scholarships and fellowships of \$51,513 during 2004, \$47,974 during 2003)					
Contributions	16,555	2,259	-	18,814	16,144
Contracts and other exchange transactions	109,844	-	-	109,844	99,530
State operating appropriations	102,876	-	-	102,876	100,114
Endowment spending payout	36,690	3,653	-	40,343	39,685
Other investments payout (includes net realized gain of \$1,913 during 2004 and \$2,319 during 2003)	6,884	280	-	7,164	7,571
Activities of educational departments	5,554	-	-	5,554	6,528
Sales and services of auxiliary enterprises (less scholarships and fellowships of \$766 during 2004, \$863 during 2003)	69,831	-	-	69,831	66,672
Other revenue	10,068	-	-	10,068	14,107
Net assets released from restrictions	4,426	(4,426)	-	-	-
<b>Total operating revenue</b>	<b>554,581</b>	<b>1,766</b>	<b>-</b>	<b>556,347</b>	<b>530,882</b>
<b>Operating expenses:</b>					
<b>Educational and general:</b>					
Instruction and departmental research	244,055	-	-	244,055	235,975
Sponsored research	83,817	-	-	83,817	77,642
Extension and public service	30,711	-	-	30,711	28,964
Academic support	43,094	-	-	43,094	38,854
Student services	19,558	-	-	19,558	19,064
General institutional support	50,280	-	-	50,280	47,310
Student aid	4,319	-	-	4,319	4,766
Reclassifications of funds	2,234	236	-	2,470	1,290
<b>Total educational and general expenses</b>	<b>478,068</b>	<b>236</b>	<b>-</b>	<b>478,304</b>	<b>453,865</b>
Auxiliary enterprises	61,743	-	-	61,743	60,239
<b>Total operating expenses</b>	<b>539,811</b>	<b>236</b>	<b>-</b>	<b>540,047</b>	<b>514,104</b>
Change in net assets from operating activities	14,770	1,530	-	16,300	16,778
<b>Nonoperating activities:</b>					
Net realized and unrealized investment gains	112,606	15,772	3,941	132,319	6,756
Endowment income	17,808	3,766	336	21,910	22,611
Endowment spending payout	(36,690)	(3,653)	-	(40,343)	(39,685)
Loan funds interest	-	-	-	-	5
Contributions for endowment	63	4,196	13,582	17,841	6,242
Contributions restricted for buildings	4	8,754	-	8,758	8,645
State capital appropriations	5,000	-	-	5,000	5,000
Other	(1,896)	(599)	(1,436)	(3,931)	848
Reclassifications of funds	3,141	(30)	(641)	2,470	1,290
Net assets released from restrictions	7,498	(7,498)	-	-	-
Change in net assets	122,304	22,238	15,782	160,324	28,490
Net assets at beginning of year	1,082,625	79,240	237,517	1,399,382	1,370,892
<b>Net assets at end of year</b>	<b>\$ 1,204,929</b>	<b>101,478</b>	<b>253,299</b>	<b>1,559,706</b>	<b>1,399,382</b>

See accompanying notes to financial statements.

UNIVERSITY OF DELAWARE

Statement of Expenses by Natural Classification  
Year ended June 30, 2004 with Comparative Totals for 2003  
(Thousands of Dollars)

	2004								2003	
	Instruction and Departmental Research	Sponsored Research	Extension and Public Service	Academic Support	Student Services	General Institutional Support	Student Aid	Auxiliary Enterprises	Total	Total
Operating expenses:										
Expenses:										
Salaries and wages	\$ 135,957	38,034	13,925	19,755	8,918	24,358	2,781	5,898	249,626	238,145
Employee fringe benefits	35,621	7,041	3,742	6,549	2,298	8,478	-	1,685	65,414	62,254
Employee postretirement benefits	9,773	1,814	903	1,224	348	1,441	-	322	15,825	11,733
Supplies and general	27,956	22,398	7,814	6,280	4,982	20,630	351	44,575	134,986	130,276
Travel	9,146	2,176	895	478	293	384	38	58	13,468	11,678
Operation and maintenance of plant	16,181	5,793	2,684	3,917	611	4,033	-	-	33,219	33,803 (a)
Information processing	1,552	-	1	(15)	1,820	4,984	-	-	8,342	8,297 (b)
Interest expense	39	604	-	-	146	4	-	4,764	5,557	5,494
Scholarships, fellowships and awards	-	-	-	-	-	-	52,687	-	52,687	49,440
Depreciation	10,479	5,784	1,185	7,420	307	4,285	-	5,731	35,191	33,496
Loss on disposals	327	227	31	46	4	770	-	11	1,416	2,419
Amortization of bond discount	2	26	-	-	24	-	-	56	108	105
Internal service credits	(2,551)	21	(449)	(2,373)	(193)	(19,085)	-	(1,353)	(25,983)	(25,489)
Expense before scholarship allowance	244,482	83,918	30,731	43,281	19,558	50,282	55,857	61,747	589,856	561,651
Reconciliation to statement of activities:										
Scholarship allowance	(427)	(101)	(20)	(187)	-	(2)	(51,538)	(4)	(52,279)	(48,837)
Total expenses	\$ 244,055	83,817	30,711	43,094	19,558	50,280	4,319	61,743	537,577	512,814
Reclassifications of funds									2,470	1,290
Total operating expenses									\$ 540,047	514,104

Note:

(a) Includes salaries and wages of \$18,145, fringe benefits of \$7,648, employee postretirement benefits of \$335 and depreciation expense for plant facilities of \$414 during 2004.

(b) Includes salaries and wages of \$17,562, fringe benefits of \$6,751, employee postretirement benefits of \$210 and depreciation expense for plant facilities of \$405 during 2003.

See accompanying notes to financial statements.

UNIVERSITY OF DELAWARE

Statement of Cash Flows  
 Year ended June 30, 2004 with Comparative Amounts for 2003  
 (Thousands of Dollars)

	2004	2003
<b>Cash flows from program activities:</b>		
Change in net assets	\$ 160,324	28,490
Adjustments to reconcile change in net assets to net cash provided by (used by) program activities:		
Depreciation	35,605	33,901
Loss on disposals	1,416	2,419
Amortization of discounts and premiums on notes and bonds payable and under capital lease obligations	108	105
Net realized and unrealized investment gains	(134,232)	(9,075)
Gifts of land, building and equipment	(871)	(1,290)
State capital appropriations	(5,000)	(5,000)
Contributions for endowment	(17,841)	(6,242)
Contributions for buildings, gross	(4,802)	(8,908)
Contributions receivable	(3,956)	263
Endowment income restricted for reinvestment	(336)	(224)
Changes in assets and liabilities:		
Accounts and notes receivable	(7,203)	(339)
Prepaid expenses and inventories	9	(102)
Accounts payable, accrued liabilities and annuity and life income funds payable	14,502	(8,880)
Deferred revenues and student deposits	534	(35)
Compensated absences payable and postretirement benefit obligation	16,390	10,634
<b>Net cash provided by program activities</b>	<b>54,647</b>	<b>35,717</b>
<b>Cash flows from investing activities:</b>		
Proceeds from sales and maturities of investments	1,901,146	2,501,981
Purchases of investments	(1,944,110)	(2,480,550)
Acquisitions of property, plant and equipment	(62,353)	(56,368)
Disbursements of loans to students	(4,031)	(2,940)
Repayments of loans	3,348	3,085
<b>Net cash used for investing activities</b>	<b>(106,000)</b>	<b>(34,792)</b>
<b>Cash flows from financing activities:</b>		
Repayments of principal of notes and bonds payable	(3,080)	(4,450)
Net proceeds from issuance of notes and bonds payable	44,864	-
Payments of principal of capital leases	(716)	(996)
State capital appropriations	5,000	5,000
Endowment income restricted for reinvestment	336	224
Contributions for endowment	17,841	6,242
Contributions for buildings, gross	4,802	8,908
Advances from federal government for student loans	499	105
<b>Net cash provided by financing activities</b>	<b>69,546</b>	<b>15,033</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>18,193</b>	<b>15,958</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>54,009</b>	<b>38,051</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 72,202</b>	<b>54,009</b>
<b>Supplemental data: Interest paid</b>	<b>\$ 5,687</b>	<b>5,566</b>
Noncash capital leases for fixed assets	-	78

See accompanying notes to financial statements.

UNIVERSITY OF DELAWARE

Notes to Financial Statements

June 30, 2004 with Comparative Amounts for 2003

(1) Summary of Significant Accounting Policies

Description of Operations

The University of Delaware, a privately chartered university with public support, is a Doctoral/Research Institution-Extensive, land-grant, sea-grant, space-grant, and urban-grant institution. The University, with origins in 1743, was chartered by the State of Delaware in 1833. A Women's College was opened in 1914, and in 1945 the University became permanently coeducational. The main campus is located in Newark, Delaware, a suburban community of 30,000 situated midway between Philadelphia and Baltimore. Also, courses are offered at the Wilmington campus and at other locations throughout the State, including Dover, Milford, Georgetown, and Lewes.

The significant accounting principles and practices followed by the University are presented below to assist the reader in analyzing the financial statements and accompanying notes.

Basis of Presentation

Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Restricted gifts, which may be expended only for the purpose indicated by the donor/grantor, are maintained in separate accounts in the University's system. Accordingly, net assets of the University and changes therein are classified and reported as follows:

- Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.
- Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the University and/or the passage of time.
- Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, the donors of these assets permit the University to use all of, or part of, the total investment return on related investments for general or specific purposes.

There are three financial statements presented under generally accepted accounting principles for not-for-profit organizations:

Statement of Financial Position

- is a listing of the total assets, total liabilities and net assets as of the end of a fiscal year.

Statement of Activities

- is a summary of the financial activity during a fiscal year and reports the amounts of the changes in unrestricted net assets, temporarily restricted net assets, permanently restricted net assets, and total net assets.

Statement of Cash Flows

- is a summary of the cash receipts and cash payments during a fiscal year.

# UNIVERSITY OF DELAWARE

## Notes to Financial Statements (Continued)

### (1) Summary of Significant Accounting Policies, Continued

#### Basis of Presentation (Continued)

As a supplement to the financial statements, The Statement of Expenses by Natural Classification presents expenses by natural classification within functional categories. Operation and maintenance of plant, depreciation expense and disposals are allocated based on square footage. Postretirement benefit obligation expense and fringe benefit expense are allocated based on salaries and wages. Interest expense and amortization of bond discount are allocated to the functional classification that benefited from the use of the proceeds of the debt.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as released from restrictions between the applicable classes of net assets.

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at an appropriate risk free discount rate of 3.81% for the year ended June 30, 2004 and 2.46% for the year ended June 30, 2003.

Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class. Income and realized and unrealized net gains on investments of endowment and similar funds are reported as follows:

- as increases in permanently restricted net assets if the terms of the gift or the University's interpretation of relevant state law require that they be added to the principal of a permanent endowment fund;
- as increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income;
- as increases in unrestricted net assets in all other cases.

#### Explanation of Reclassifications of Funds

The reclassification of funds between operating and nonoperating includes transfers made in accordance with contractual agreements relative to Federal loan programs, operating funds designated by the University for investment in endowment, and financial transactions between net asset classes.

#### Auxiliary Operations

The operation of auxiliaries is supplementary to the primary educational function of the University. Accordingly, the University annually provides from auxiliary enterprises revenues, provisions for debt service and renewal and replacement of equipment. Auxiliary operations primarily include the residence and dining halls, the bookstore, and student health service.

# UNIVERSITY OF DELAWARE

## Notes to Financial Statements (Continued)

### (1) Summary of Significant Accounting Policies, Continued

#### Cash and Cash Equivalents

Cash equivalents include all highly liquid interest-bearing deposits and short-term investments with maturities of three months or less at time of purchase.

#### Investments

Investments in stocks, bonds, notes, mortgages and other investment vehicles are stated at fair market value.

#### Endowment Funds

The endowment funds are subdivided into appropriate net asset classifications. The permanently restricted endowment funds, primarily consisting of funds whose income is unrestricted, represent gifts received under circumstances indicating a stipulation of the donor that principal is not to be expended. Temporarily restricted and unrestricted endowment funds represent funds received under circumstances where there is no requirement to maintain the principal and which the University has designated for long-term investment purposes.

#### Compensated Absences Payable

Compensated absences payable represents vacation time earned by full-time professional and salaried staff employees, but not yet taken as of fiscal year end. An employee is entitled to receive pay in lieu of vacation upon termination. Employees may accrue a maximum of 25 days to 40 days based upon years of service. Compensated absences payable amounted to \$9,761,000 and \$9,531,000 as of June 30, 2004 and 2003, respectively.

#### Operating Versus Nonoperating

The nonoperating section of the Statement of Activities represents the activities of the University's endowment, gains/losses on other investments, capital contributions restricted for plant, and funds set aside for loans to faculty, staff and students. All other University activities are accounted for in the operating section of the Statement of Activities.

#### Taxes

The Internal Revenue Service has ruled that the University is a tax-exempt institution under Section 501(c)(3) of the Internal Revenue Code; accordingly, no provision for taxes has been made in the financial statements on activities related to its exempt function.

#### Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amount of revenue and expenses during the reporting period. Actual results could differ from these estimates.

#### Reclassification

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

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(2) Blue Hen Hotel LLC

Effective May 4, 2001, the University entered into a Limited Liability Company Agreement (Agreement) with the Shaner Hotel Group Limited Partnership (Shaner) to form the Blue Hen Hotel LLC (the Company). The Company was established to develop, finance, construct, manage, and operate a hotel on the main campus of the University. In connection with the Agreement, the University contributed land and guaranteed \$11,500,000 of variable rate Demand Bonds issued by the Company in September 2001. Shaner is contributing its expertise and resources in developing the site for the hotel. As a result of their respective capital contributions, the Blue Hen Hotel LLC, is owned 75% by the University and 25% by Shaner. Accordingly, the Company's financial statements have been consolidated into the University's financial statements. The impact on the operating revenues and expenses in the statement of activities is not material and the Company does not expect to begin operations of the hotel until fiscal year 2005. See note 9 for impact of interest rate swap.

(3) Contributions Receivable and Conditional Promises

Contributions receivable, net, at June 30, 2004 and 2003 are summarized as follows:

	2004 <u>(000's)</u>	2003 <u>(000's)</u>
Unconditional promises expected to be collected in:		
Less than one year	\$ 2,408	3,034
One year to five years	<u>7,695</u>	<u>3,113</u>
	\$ <u>10,103</u>	<u>6,147</u>

The unamortized discount for contributions to be received after one year amounted to \$682,000 in 2004 and \$77,000 in 2003. As of June 30, 2004, the University has two outstanding pledges for \$20,000,000 that are conditional upon the University filling conditions. Such pledges will be recorded in the financial statements when the conditions are met.

(4) Student Loan Programs

The student loan programs consist primarily of the National Direct Student Loan/Perkins and Nursing Student Loan Programs. The United States Government provides 75% of the funds for the Perkins loans, and 90% for Nursing Student loans. The University provides 25% and 10% of the funds, respectively, to support these programs.

An estimate of the fair value of loans receivable from students under government loan programs cannot be made because the notes are not marketable and can only be assigned to the U.S. government or its designees.

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(5) Investments

Investments are recorded at fair market value. Included in investments are endowment funds and other investments, annuity and life income funds, and funds held in trust by others. The cost and market value at June 30, 2004 and 2003 were as follows:

	<u>2004 (000's)</u>		<u>2003 (000's)</u>	
	<u>Cost</u>	<u>Market</u>	<u>Cost</u>	<u>Market</u>
US government obligations	\$ 118,637	119,620	103,770	106,661
Corporate obligations	107,846	109,301	122,115	127,315
Stock and convertible securities	273,385	342,540	260,354	287,592
University mortgages	11,085	11,085	15,428	15,428
International investments	109,473	162,665	123,546	139,257
Other	263,329	268,005	253,843	227,607
Money market and other liquid funds	<u>97,571</u>	<u>97,593</u>	<u>30,863</u>	<u>29,753</u>
Total	\$ <u>981,326</u>	<u>1,110,809</u>	<u>909,919</u>	<u>933,613</u>

Included in investments is \$41,421,000 and \$5,494,000 of securities pledged to creditors, which represent the University's participation in securities lending transactions as of June 30, 2004 and 2003, respectively. The University's policy is to require collateral of 102 percent of the then-current market value of transferred securities as of the close of trading of the preceding business day. Acceptable collateral includes cash or money market securities. The collateral held at June 30, 2004 and 2003 amounted to \$42,386,000 and \$5,656,000, respectively. The University has recognized the market value of the collateral and related payable for such transactions on the Statement of Financial Position.

University mortgages of approximately \$11,085,000 and \$15,428,000 as of June 30, 2004 and 2003, respectively, represent mortgages extended to University employees at favorable interest rates.

Included in investments are unexpended bond proceeds of approximately \$41,530,000 and \$7,085,000 as of June 30, 2004 and 2003, respectively. These amounts will be used for the renovation, construction, and capital improvement of University facilities and primarily relate to the 2004 Bonds (see note 9).

Included in the Other category of investments are pooled funds that use stock index futures and options in combination with short-term and other liquid debt instruments to approximate the total return of the Standard & Poor's 500 Index. The derivatives are not used to leverage the underlying cash position of this investment, but rather to meet the endowment asset allocation and spending policy targets. The futures contracts and options are stated at fair market value based on their quoted daily settlement prices.

UNIVERSITY OF DELAWARE  
Notes to Financial Statements (Continued)

(5) Investments, Continued

Dividends and interest from investments during the periods were as follows:

	2004 <u>(000's)</u>	2003 <u>(000's)</u>
Operating (a)	\$ 5,533	5,657
Loan Funds interest	-	5
Endowment (b)	<u>21,910</u>	<u>22,611</u>
	<u>\$ 27,443</u>	<u>28,273</u>

(a) Includes interest from Auxiliary Operations, Activities of Educational Departments and Continuing Education of \$282,000 in 2004 and \$405,000 in 2003.

(b) Includes earnings of funds held in trust by others distributed to the University of \$1,794,857 in 2004 and \$2,105,000 in 2003.

(6) Annuity and Life-Income Funds

The University held \$13,833,000 and \$13,383,000 in investments related to annuity and life-income funds as of June 30, 2004 and 2003, respectively. A related liability of \$6,482,000 and \$6,583,000 as of June 30, 2004 and 2003, respectively, represents the present value of future annuity payments due under these agreements, and was calculated for each annuity using discount rates and actuarial assumptions consistent with American Council of Gift Annuities standards.

The University's annuity and life income funds include charitable gift annuities, charitable remainder annuity trusts, and charitable remainder unitrusts.

The University is required by the laws of certain states to maintain reserves against charitable gift annuities. Such reserves amounted to \$2,115,000 and \$2,055,000 as of June 30, 2004 and 2003, respectively.

(7) Property, Plant and Equipment

Land is recorded at cost or appraised value at time of receipt if contributed, including land deeded by the Board of Trustees of Delaware College to the State of Delaware in the early 1900's and thereafter used by the University, as successor, for the purposes of the University.

Buildings are recorded at cost of initial construction, including buildings on land deeded to the State and thereafter used for the purposes of the University. Costs of major renovations to buildings are capitalized. Costs of equipment in excess of \$5,000 with a useful life expectancy of two or more years are also capitalized.

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(7) Property, Plant and Equipment, Continued

The University uses the straight-line method of depreciation for its plant assets based on the following estimated useful lives:

	Estimated lives <u>(years)</u>
Land improvements	15
Buildings	40
Equipment and furnishings	5 - 20

Property, plant and equipment as of June 30, 2004 and 2003 consisted of the following:

	2004 <u>(000's)</u>	2003 <u>(000's)</u>
Land and improvements	\$ 37,404	36,597
Buildings	751,011	736,400
Equipment and furnishings	257,450	241,445
Collections and works of art	6,522	6,435
Capital Leasehold	14,460	14,460
Construction in progress	<u>46,463</u>	<u>19,122</u>
Total property, plant and equipment	1,113,310	1,054,459
Less accumulated depreciation	<u>(446,998)</u>	<u>(414,350)</u>
Total property, plant and equipment, net	\$ <u>666,312</u>	<u>640,109</u>

(8) Obligations Under Capital Leases

The University has obligations under capital leases that amounted to \$10,221,000 and \$10,913,000 as of June 30, 2004 and 2003, respectively. The majority of the University's obligation at June 30, 2004 (\$10,193,000) was a building lease with Delaware Technology Park for the Delaware Biotechnology Institute, a unit of the University. The lease consists of annual lease payments ranging from \$345,000 to \$935,000 to be paid over a 20-year term. Other leases are related to computer hardware and software.

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(8) Obligations Under Capital Leases, Continued

The aggregate amount of principal and interest payments on the University's obligations under capital leases are due as follows:

	Principal (000's)	Interest (000's)	Total (000's)
2005	403	572	975
2006	399	550	949
2007	417	529	946
2008	437	507	944
2009	462	483	945
Thereafter	<u>8,103</u>	<u>3,137</u>	<u>11,240</u>
	\$ <u>10,221</u>	<u>5,778</u>	<u>15,999</u>

(9) Notes and Bonds Payable

Indebtedness at June 30, 2004 and 2003 consisted of the following:

	2004 (000's)	2003 (000's)
Series 1993 Revenue Bonds (a)	\$ -	13,295
Series 1997 Revenue Bonds (b)	15,500	15,500
Series 1998 Revenue Bonds (c)	31,300	31,300
Series 2001A Revenue Bonds (d)	25,220	25,295
Series 2001B Revenue Bonds (e)	20,600	21,100
Series 2004A Revenue Bonds (f)	12,070	-
Series 2004B Revenue Bonds (g)	40,835	-
Blue Hen Hotel LLC Bonds (h)	11,500	11,500
University Learning Center Line of Credit (I)	2,081	-
Note payable (j)	<u>534</u>	<u>564</u>
	159,640	118,554
Less discounts on notes and bonds payable	<u>(770)</u>	<u>(1,552)</u>
Notes and bonds payable	\$ <u>158,870</u>	<u>117,002</u>

(a) Series 1993 Revenue Bonds

In August 1993, the University issued \$53,500,000 of Series 1993 Revenue Bonds. A portion of the Series 1993 Revenue Bonds was placed in an irrevocable trust and used to purchase government securities to provide for the principal and interest on a portion of the Series 1989 Revenue Bonds.

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(9) Notes and Bonds Payable, Continued

The remaining portion of the Series 1993 Revenue Bonds was used to renovate, construct and equip certain of the University's facilities. The 1993 Revenue Bonds bear interest rates ranging from 2.75% to 5.5%, mature at various dates through November, 2018 and are secured by a pledge of gross revenues received by the University from the operation of all project facilities including the Student Center fee, and certain parking and bookstore revenues. The Series 1993 Revenue Bonds were refunded by the Series 2001A and 2004A Revenue Bonds.

(b) Series 1997 Revenue Bonds

In May 1997, the University issued \$15,500,000 of Series 1997 Revenue Bonds to fund a portion of the costs to renovate and equip certain housing facilities for students. The 1997 Bonds bear interest rates ranging from 5% to 5.375%, mature at various dates through November 1, 2022 and are secured by a pledge of gross revenues received by the University for operation of its existing facilities located on the University's main campus which provide housing, dining or health care services for students; the Student Center fees; and certain parking and bookstore revenues.

(c) Series 1998 Revenue Bonds

In July 1998, the University issued \$31,300,000 of Series 1998 Revenue Bonds. A portion of the 1998 Revenue Bonds was placed in an irrevocable trust and used to purchase government securities to provide for principal and interest on a portion of the remaining unrefunded 1989 Revenue Bonds.

The purpose of the remaining portion of the Series 1998 Revenue Bonds was to fund a portion of the costs to renovate, construct and equip certain housing facilities for students. The 1998 Revenue Bonds bear interest at flexible rates for interest periods determined by the remarketing agent. A 5% interest cost through 2008 is anticipated based on an existing interest rate exchange agreement.

The 1998 Revenue Bonds mature at various dates through November 1, 2023 and are secured by a pledge of gross revenues received by all project facilities as noted in (a) above.

(d) Series 2001A Revenue Bonds

In June 2001, the University issued \$25,610,000 of Series 2001A Revenue Bonds. The proceeds of these Series 2001A Revenue Bonds were placed in an irrevocable trust and used to purchase government securities to provide for the principal and interest on a portion of the Series 1993 Revenue Bonds.

The Series 2001A Revenue Bonds will initially bear interest at a Weekly Rate and will continue to bear interest at a Weekly Rate until converted to bear interest at a Daily, Flexible, Term or Fixed Rate to maturity. The interest rate to be in effect for a particular period of time will be set by the Remarketing Agent and will never exceed 12% per annum. Interest cost was approximately 4.15% through at least fiscal 2004 based on an existing interest rate exchange agreement. The series 2001A Bonds mature on November 1, 2018, but are subject to redemption and mandatory tender for purchase prior to maturity.

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(9) Notes and Bonds Payable, Continued

(e) Series 2001B Revenue Bonds

In September 2001, the University issued \$21,200,000 of Series 2001B Revenue Bonds. A portion of these Series 2001B Revenue Bonds were used to retire the Series 2000 Revenue Notes. The remaining portion of the Series 2001B Revenue Bonds were used to renovate, construct and equip: sprinkler systems, a parking deck and office building and other capital improvements.

The Series 2001B Revenue Bonds will initially bear interest at a Daily Rate and will continue to bear interest at a Daily Rate until converted to bear interest at a Weekly, Flexible, Term or Fixed Rate to maturity. The interest rate to be in effect for a particular period of time will be reset by the Remarketing Agent and will never exceed 12% per annum. A 4.05% interest cost through at least fiscal year 2007 is anticipated based on an existing interest rate exchange agreement. The Bonds are secured by a pledge of gross revenues received by the University from the operations of all project facilities including housing, dining, parking and other revenue-producing facilities. The Series 2001B Revenue Bonds mature on November 1, 2026, but are subject to redemption and mandatory tender for purchase prior to maturity.

(f) Series 2004A Revenue Bonds

In April 2004, the University issued \$12,070,000 of Series 2004A Revenue Bonds. Approximately \$8,041,000 of these Series 2004A Revenue Bonds were used to retire the Series 1993 Revenue Notes. The retirement of the Series 1993 Revenue Notes resulted in a loss on extinguishment of debt of approximately \$313,000, which is included in other nonoperating activities on the statement of activities. The remaining portion of the Series 2004A Revenue Bonds are being used to construct a parking garage, demolish existing University dormitories, construct three new dormitory buildings, and other capital improvements.

The Series 2004A Revenue Bonds will bear interest rates ranging from 2.0% to 5.0%, maturing over various dates through November, 2010 and are secured by a pledge of gross revenues received by the University from the operations of all project facilities including housing, dining, parking and other revenue-producing facilities.

(g) Series 2004B Revenue Bonds

In April 2004, the University issued \$40,835,000 of Series 2004B Variable Rate Demand Revenue Bonds. The Series 2004B Revenue Bonds are being used to construct a parking garage, demolish existing University dormitories, construct three new dormitory buildings, and other capital improvements.

The Series 2004B Revenue Bonds will initially bear interest at a Daily Rate and will continue to bear interest at a Daily Rate until converted to bear interest at a Weekly, Flexible, Term or Fixed Rate to maturity. The interest rate to be in effect for a particular period of time will be reset by the Remarketing Agent and will never exceed 12% per annum. A 3.25% interest cost through at least fiscal year 2008 is anticipated based on an existing interest rate exchange agreement. The Bonds are secured by a pledge of gross revenues received by the University from the

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(9) Notes and Bonds Payable, Continued

(g) Series 2004B Revenue Bonds, Continued

operations of all project facilities including housing, dining, parking and other revenue-producing facilities. The Bonds are secured by a pledge of gross revenues received by the University from the operations of all project facilities including housing, dining, parking and other revenue-producing facilities. The Series 2004B Revenue Bonds mature on November 1, 2034, but are subject to redemption and mandatory tender for purchase prior to maturity.

(h) Blue Hen Hotel LLC Bonds

In September 2001, the Blue Hen Hotel LLC, a Company owned 75% by the University and consolidated into the University's financial statements, issued \$11,500,000 of Blue Hen Hotel LLC Variable Rate Demand Bonds, Series 2001 (Series 2001), which were also guaranteed by the University. The Series 2001 Bonds will fund the design, construction and startup operating costs of a hotel.

The Series 2001 Bonds will initially bear interest at a Weekly Rate and will continue to bear interest at a Weekly Rate until converted to bear interest at a Daily, Flexible, Term or Fixed Rate to maturity. The interest rate to be in effect for a particular period of time will be reset by the Remarketing Agent and will never exceed 18% per annum. A 5.70% interest cost through at least fiscal year 2007 is anticipated based on an existing interest rate exchange agreement. The Series 2001 Bonds mature on September 1, 2027, but are subject to redemption and mandatory tender for purchase prior to maturity.

(i) Early Learning Center Line of Credit

On December 1, 2003, the University obtained a \$5,000,000 line of credit to renovate the University Early Learning Center facility. The interest rate is a variable rate of 65% of the Bank's National Commercial Rate (2.6% at June 30, 2004) and there is an outstanding balance of \$2,081,000 at June 30, 2004. The line of credit expires in December 2009.

(j) Note Payable

The University's note payable bears an interest rate of 3.0%. The note payable at June 30, 2004 and 2003 consisted of \$534,000 and \$564,000 respectively, for the United States Department of Housing and Urban Development Loan.

The carrying amount of variable rate long-term debt approximates fair value because these financial instruments bear interest at rates which approximate current market rates for loans with similar maturities and credit quality. The fair value of fixed and variable rate Revenue Bonds (par amount of \$145,525,000) approximates \$146,303,000. Such amount has been estimated by discounting the future cash outflows associated with such debt by current market rates for loans with similar maturities and credit quality.

Certain long-term debt obligations expose the University to cash flow risk related to changes in interest rates. Management believes it is prudent and cost effective to hedge some of its

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(9) Notes and Bonds Payable, Continued

exposure to interest rate risk. To achieve this objective, management has interest rate swap agreements for approximately \$129,455,000 (including \$11,500,000 related to the Blue Hen Hotel LLC, see note 2) of long-term debt obligations as of June 30, 2004 and 2003. In accordance with Statement of Financial Accounting Standard (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, not-for profit organizations shall recognize the gain or loss on a hedging instrument as a change in net assets in the period of change. Accordingly for the year ended June 30, 2004, the University has recognized an unrealized gain of \$2,360,000 (including a loss of \$1,505,000 related to the Blue Hen Hotel LLC) in the statement of activities for the increase in fair value of its interest rate swaps and a corresponding increase in the fair value of its other investments in the statement of financial position.

The aggregate amount of principal payments on the University's note and bonds payable are due as follows (000's):

2005	\$	3,872
2006		4,097
2007		4,192
2008		5,092
2009		5,322
Thereafter		<u>136,295</u>
	\$	<u>158,870</u>

(10) Employee Benefit Plans

Substantially all faculty and professional employees are provided pension benefits under the University's Retirement Annuity Program administered principally by the Teachers Insurance and Annuity Association and Fidelity Investments. The policy of the University is to pay its share of the annual premium accrued in connection with the University Retirement Annuity Program; there are no unfunded benefits. Pension plan expense for the University Retirement Annuity Program was \$17,519,000 in 2004 and \$17,022,000 in 2003. Expenses under the State of Delaware Pension Plan, which covers all other employees, were \$4,028,000 in 2004 and \$4,069,000 in 2003.

In addition to retirement benefits, the University also provides postretirement benefits primarily for medical insurance to retired employees who are not eligible under the State of Delaware Pension Plan. As of June 30, 2004 the University has not funded these benefits.

Net periodic postretirement benefit cost for 2004 and 2003 includes the following components:

	2004	2003
	<u>(000's)</u>	<u>(000's)</u>
Service Cost	\$ 5,630	3,849
Interest Cost	8,090	6,703
Amortization of Unrecognized Loss	<u>4,182</u>	<u>1,391</u>
Net Periodic Postretirement Benefit Cost	\$ <u>17,902</u>	<u>11,943</u>

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(10) Employee Benefit Plans, Continued

The accumulated postretirement benefit obligation at June 30, 2004 and 2003 is as follows:

	2004 <u>(000's)</u>	2003 <u>(000's)</u>
Benefit obligation at June 30	\$ 141,260	137,444
Unrecognized Net Loss	<u>(44,628)</u>	<u>(56,972)</u>
Accrued postretirement benefit obligation	\$ <u>96,632</u>	<u>80,472</u>

Change in plan assets for 2004 and 2003 includes the following:

	2004 <u>(000's)</u>	2003 <u>(000's)</u>
Employer contributions	\$ 1,742	1,547
Benefits paid	\$ (1,742)	(1,547)

The accumulated postretirement benefit obligation was determined using a discount rate of 6.25% in 2004 and 6.0% in 2003 and a health care cost trend rate of 10.25% in 2004 and 11.0% in 2003. This rate gradually decreases to 5% by the year 2011 and remains constant thereafter. Increasing the assumed health care cost trend rate by 1% in each year and holding all other assumptions constant would increase the accumulated postretirement benefit obligation by approximately \$28,139,000 and \$28,688,000 at June 30, 2004 and 2003, respectively, and increase the aggregate of the service and interest cost components of the net periodic postretirement benefit cost by approximately \$3,225,000 and \$3,144,000 for the years ended June 30, 2004 and 2003, respectively.

The University's expected contributions to the plan are as follows for the year ended June 30, 2005:

	<u>(000's)</u>
Expected Employer Contributions	\$ 2,045
Expected Employee Contributions	<u>-</u>
	\$ <u>2,045</u>

At June 30, 2004, the University's expected future benefit payments for future service are as follows:

Year ended June 30:	<u>(000's)</u>
2005	\$ 2,045
2006	2,450
2007	2,880
2008	3,345
2009	3,875
2010 through 2014	<u>27,544</u>
	\$ <u>42,139</u>

UNIVERSITY OF DELAWARE

Notes to Financial Statements (Continued)

(10) Employee Benefit Plans, Continued

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law on December 8, 2003. In accordance with the FASB Staff Position FAS 106-2, effective July 1, 2004, the University has made an election to defer recognition of the effects of the law in the accounting for its plan under FAS 106 and in providing disclosures related to the plan until authoritative guidance on the accounting for the federal prescription drug subsidy is issued. Any measures of the Accumulated Postretirement Benefit Obligation or Net Periodic Postretirement Benefit Cost in these financial statements do not reflect the effects of the Act on the plan. Authoritative guidance is pending and, when issued, could require the University to change previously reported information.

(11) Scholarship Allowance

The University provides financial assistance to eligible students to partially offset the direct costs of tuition, on-campus housing, and meal contracts. These scholarship allowances are presented as a reduction of tuition and sales of auxiliary enterprises.

Scholarships are funded from unrestricted resources, as well as funds from donors, sponsors and endowment income restricted to use for student financial assistance.

The table below identifies this financial assistance by source and by student classification for the year ended June 30, 2004.

	Undergraduate <u>(000's)</u>	Graduate <u>(000's)</u>	Total <u>(000's)</u>
Unrestricted	\$ 14,092	25,659	39,751
Federal	786	309	1,095
State	7,483	78	7,561
Private gifts	1,756	174	1,930
Endowment	<u>1,923</u>	<u>19</u>	<u>1,942</u>
Total	\$ <u>26,040</u>	<u>26,239</u>	<u>52,279</u>

An additional \$4,319,000 of University-provided financial assistance was utilized by students for books, supplies and off-campus living expenses.

(12) Fundraising Costs

Fundraising costs were \$4,130,000 and \$3,816,000 for the years ended June 30, 2004 and 2003, respectively.

(13) Contingencies

The University is party to certain claims and litigation arising in the ordinary course of business. In the opinion of management, the resolution of such claims and litigation will not materially affect the University's financial position, statement of activities or cash flows.