



UNIVERSITY OF MAINE SYSTEM
ANNUAL FINANCIAL REPORT
YEAR ENDED JUNE 30, 2003

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Office of Finance and Treasurer
107 Maine Avenue
Bangor, ME 04401-4380

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Questions and complaints about discrimination in any area of the University should be directed to Sally Dobres, Equal Opportunity Coordinator, University of Maine System, Office of Human Resources, 107 Maine Avenue, Bangor, Maine 04401 (207) 621-3199 (voice) or (207) 973-3300 (TTY/TDD). Inquiries or complaints about discrimination in employment or education may also be referred to the Maine Human Rights Commission. Inquiries or complaints about discrimination in employment may be referred to the U.S. Equal Employment Opportunity Commission.

Inquiries about the University's compliance with Title VI of the Civil Rights Act of 1964, which prohibits discrimination on the basis of race, color, and national origin; Section 504 of the Rehabilitation Act of 1973 and Title II of the Americans with Disabilities Act of 1990, which prohibit discrimination on the basis of disability; Title IX of the Education Amendments of 1972, which prohibits discrimination on the basis of sex; and the Age Discrimination Act of 1975, which prohibits discrimination on the basis of age, may also be referred to the U.S. Department of Education, Office for Civil Rights (OCR), Boston, MA 02109-4557, telephone (617) 223-9662 (voice) or (617) 223-9695 (TTY/TDD). Generally, an individual may also file a complaint with OCR within 180 days of alleged discrimination.

UNIVERSITY OF MAINE SYSTEM 2003 ANNUAL FINANCIAL REPORT

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MISSION

The University of Maine System unites seven distinctive public universities in the common purpose of providing first-rate higher education at reasonable cost in order to improve the quality of life for the citizens of Maine. The System, through its Universities, carries out the traditional tripartite mission – teaching, research, and public service. As a System, it extends its mission as a major resource for the State, linking economic growth, the education of its people, and the application of research and scholarship.

UNIVERSITY OF MAINE SYSTEM UNIVERSITIES & CENTERS/COLLEGES

The University of Maine System is a comprehensive public institution of higher education serving approximately 34,000 students and is supported by the efforts of 1,383 regular full-time faculty, 110 regular part-time faculty, 3,196 regular full-time staff, and 407 regular part-time staff members. Nationally recognized as a leader in combining excellence with access in public higher education, the System consists of the following seven universities:

University of Maine (UM)	University of Maine at Machias (UMM)
University of Maine at Augusta (UMA)	University of Maine at Presque Isle (UMPI)
University of Maine at Farmington (UMF)	University of Southern Maine (USM)
University of Maine at Fort Kent (UMFK)	

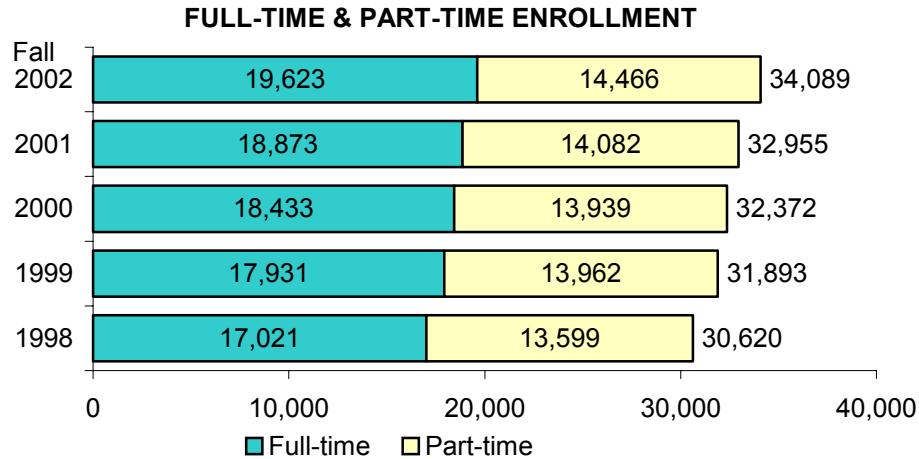
The Lewiston-Auburn College is administered by the University of Southern Maine and houses both University of Southern Maine and University of Maine at Augusta programs. The University College of Bangor is also a campus of the University of Maine at Augusta.

University College offers access to quality public higher education statewide. Students may participate in interactive television (ITV) at several receiving sites throughout the State or may attend at one of the University College locations below that offers both on-site and ITV instruction:

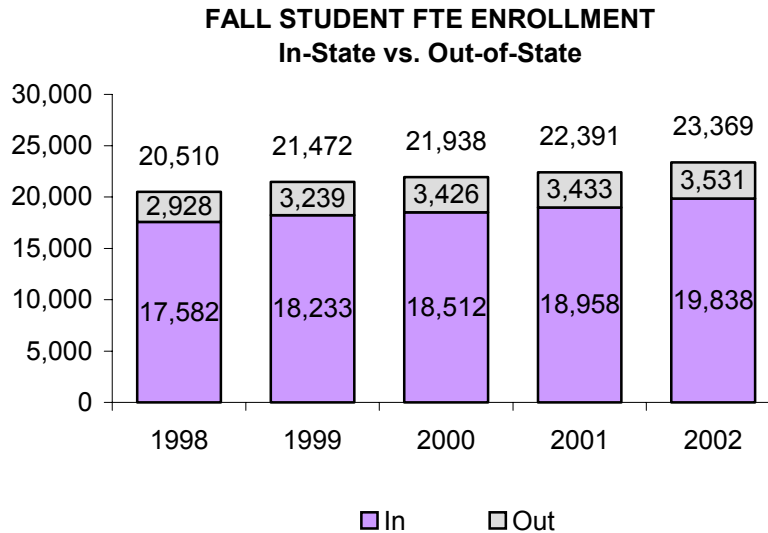
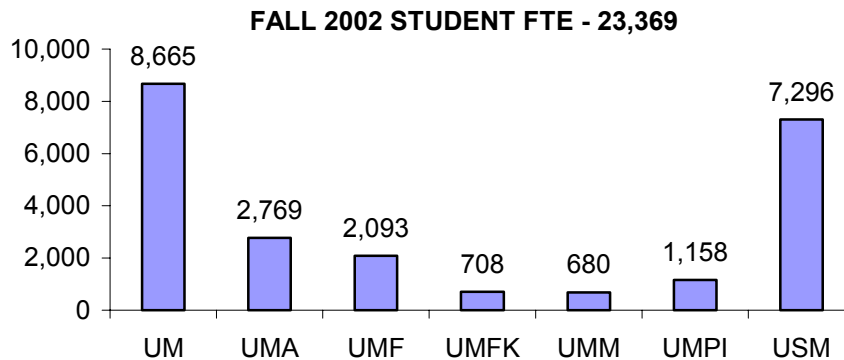
Bath/Brunswick	Houlton
Calais	Saco/Biddeford
Dover-Foxcroft	Sanford
East Millinocket	Rumford/Mexico
Ellsworth	Thomaston

STUDENT ENROLLMENT

Once again, the University of Maine System experienced a growth in enrollment. 34,089 students were enrolled for the Fall 2002 semester, as compared to 32,955 for the Fall 2001 semester, which represents a 3.4% increase. Of the total student population, 58% were enrolled on a full-time basis and 88% of those enrolled were Maine residents.



Fall full-time equivalent (FTE) enrollment totaled 23,369 and increased 4.4% above the previous year's total of 22,391.



STUDENT COSTS

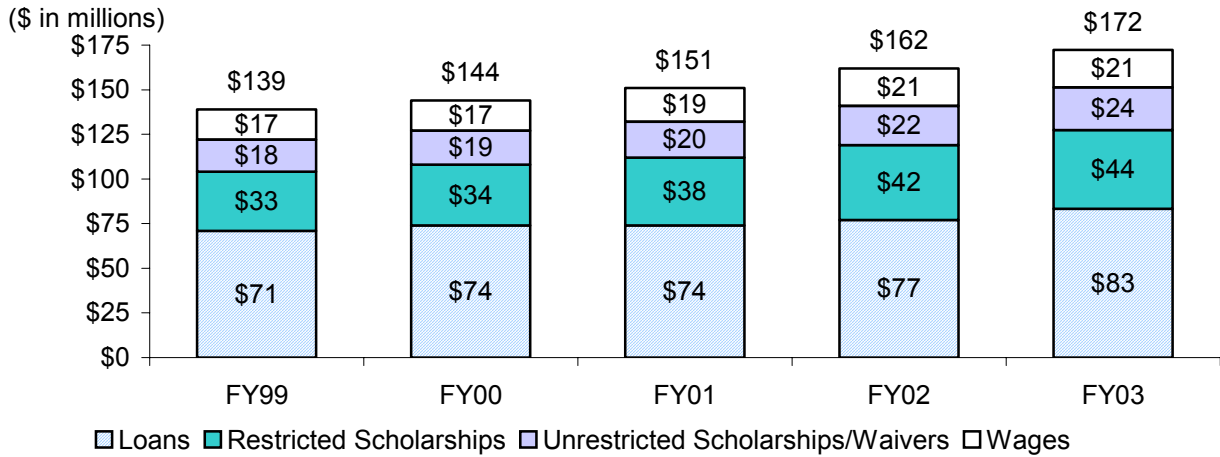
2002/2003 COMPREHENSIVE COST OF EDUCATION

<u>Undergraduate</u>	Annual Tuition	Mandatory Fees	Tuition & Mandatory Fees*	Room & Board	Total
In-State					
UM	\$4,380	\$1,170	\$5,550	\$5,922	\$11,472
UMA	3,420	435	3,855	-	3,855
UMF	3,990	492	4,482	5,064	9,546
UMFK	3,420	404	3,824	4,436	8,260
UMM	3,420	485	3,905	4,880	8,785
UMPI	3,420	430	3,850	4,494	8,344
USM	4,020	606	4,626	5,738	10,364
Weighted Average	3,991	755	4,746	5,621	10,367
Out-of-State					
UM	\$12,450	\$1,170	\$13,620	\$5,922	\$19,542
UMA	8,310	435	8,745	-	8,745
UMF	9,750	492	10,242	5,064	15,306
UMFK	8,310	404	8,714	4,436	13,150
UMM	8,730	485	9,215	4,880	14,095
UMPI	8,580	430	9,010	4,494	13,504
USM	11,190	606	11,796	5,738	17,534
Weighted Average	10,767	755	11,522	5,621	17,143
Graduate					
In-State					
UM	\$3,924	\$514	\$4,438	\$5,922	\$10,360
USM	3,600	324	3,924	5,738	9,662
Weighted Average	3,747	422	4,169	5,621	9,790
Out-of-State					
UM	\$11,214	\$514	\$11,728	\$5,922	\$17,650
USM	10,080	324	10,404	5,738	16,142
Weighted Average	11,028	422	11,450	5,621	17,071
Law School					
In-State	\$10,800	\$568	\$11,368	\$5,738	\$17,106
Out-of-State	18,990	568	19,558	5,738	25,296

* Annual tuition & mandatory fees are based on 15 credit hours per semester for two semesters for undergraduates/law students and on 9 credit hours per semester for two semesters for graduate students.

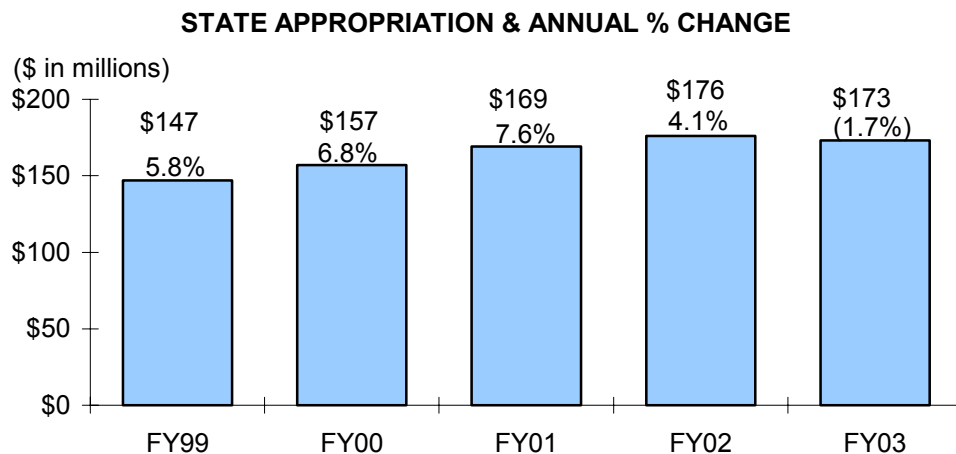
STUDENT FINANCIAL AID

During FY03, more than 26,000 students received some form of financial aid assistance. The total financial aid received by students increased by 6.2% from \$162 million in FY02 to \$172 million in FY03. Of the \$83 million awarded in student loans, \$75 million were federally guaranteed or funded FFELP and Direct Loans.



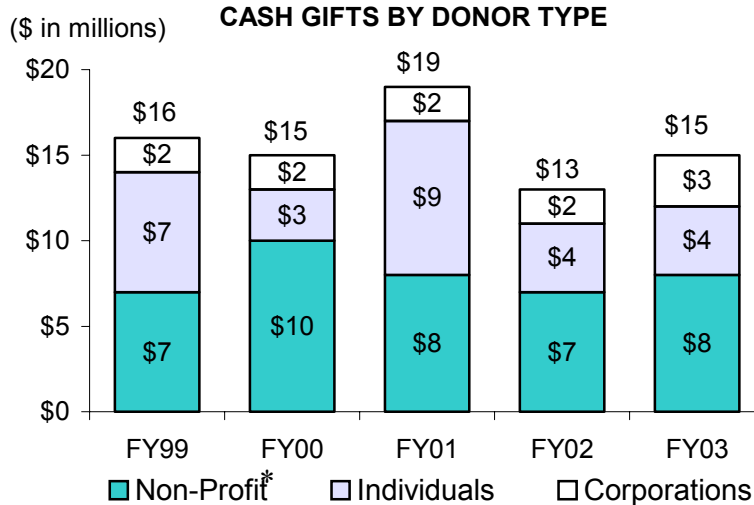
STATE APPROPRIATION

The Educational & General State Appropriation received by the University of Maine System decreased in FY03 by approximately \$3 million.



GIFTS

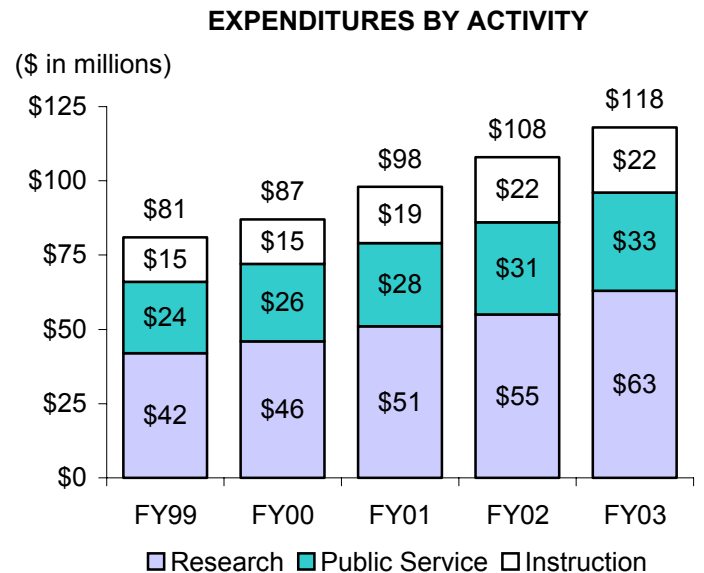
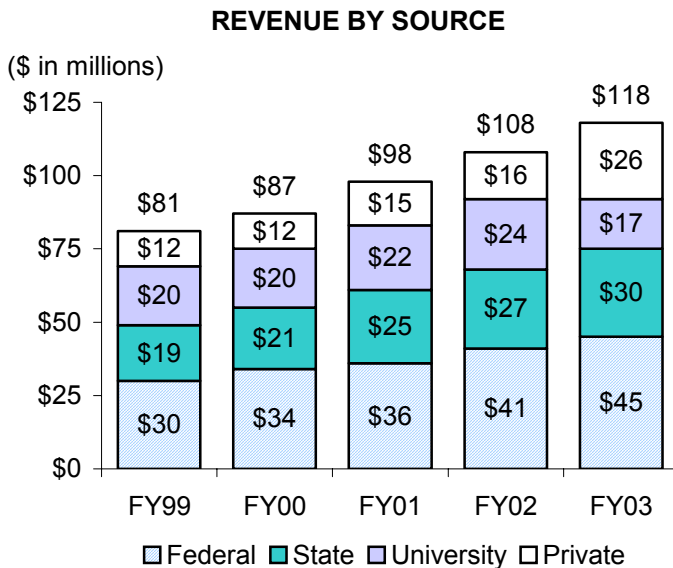
Total cash gifts and pledge payments increased by \$2 million from FY02 to FY03. Total giving has remained relatively constant over the past 5 years. It should be noted that the gifts received from individuals during FY01 included a single-donor contribution of \$5 million.



*Non-Profit includes foundations, governmental agencies, and other non-profit groups

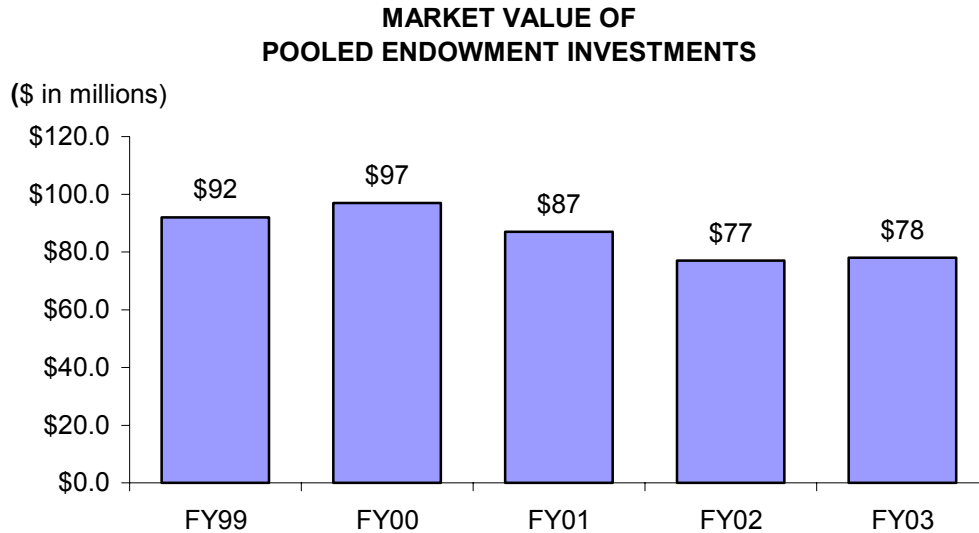
SPONSORED PROGRAMS

Sponsored programs revenue increased 9% and totaled \$118 million for FY03. Federal funding accounted for 38% of the total sponsored programs revenue. During FY03, 53% of all sponsored programs expenditures were for research.

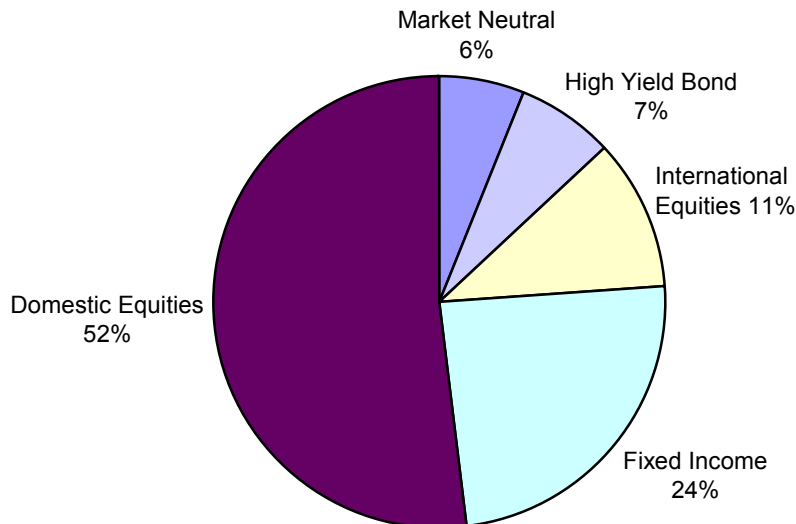


ENDOWMENT

Endowments are gifts received from donors who stipulate that the original amount of the gift (principal) cannot be expended but the income earned and related appreciation can be expended. If the donor established criteria to determine how the expendable amounts can be used, then the endowment is restricted. If the use of funds is left to the discretion of the System, the endowment income is considered unrestricted. The vast majority of gifts received by the System are placed in a single investment pool as well as funds held by the System for others such as the University of Southern Maine Foundation, and investment income is allocated to each endowed fund based on its pro-rata share of the pool.



The endowment pooled investments are diversified by asset class to minimize risk while optimizing return. Following is the asset allocation of the pool as of June 30, 2003:





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Independent Auditors' Report

The Board of Trustees
University of Maine System:

We have audited the accompanying statements of net assets of the University of Maine System (the System), a component unit of the State of Maine, as of June 30, 2003 and 2002, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2003 and 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 10, 2003 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 10 through 17 and the supplementary schedules of funding progress and employers' contributions on page 45 are not required parts of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

October 10, 2003



UNIVERSITY OF MAINE SYSTEM
Management's Discussion and Analysis
June 30, 2003 and 2002
(In Thousands of Dollars)

The following unaudited Management's Discussion and Analysis (MD&A) has been prepared by the management of the University of Maine System ("the System") to provide users with an objective narrative and analysis of the System's financial position based on currently known facts, decisions, and conditions. This discussion includes an analysis of the financial condition and results of activities of the System for the fiscal years ended June 30, 2003 and 2002. As this presentation includes highly summarized information, it should be read in conjunction with the accompanying basic financial statements and related notes.

Overview of the Financial Statements

The University of Maine System's financial statements include three primary components: 1) the Statements of Net Assets, 2) the Statements of Revenues, Expenses, and Changes in Net Assets, and 3) the Statements of Cash Flows. These financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. As of July 1, 2001, the System adopted GASB Statements 34 and 35 and related standards, as described in the Notes to Financial Statements. The adoption of these changes resulted in financial statements with a single-column format. The objectives of these changes are to increase comparability, understandability, and relevance and to focus on the institution as a whole.

Revenues and expenses are categorized as either operating or nonoperating. Certain significant recurring revenues and expenses including state appropriations, gifts, investment income or loss, and interest expense are considered nonoperating. Scholarships and fellowships applied to student accounts are shown as a reduction of student tuition & fees and residence & dining fees revenues while stipends and other payments made directly to students are presented as student aid expenses.

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Net Assets

The Statements of Net Assets present the financial position of the System at the end of the fiscal year and include all assets and liabilities of the System. Net assets is one indicator of the current financial condition of the System and represents the difference between total assets and total liabilities. The change in net assets is an indicator of whether the overall financial condition has improved or deteriorated during the year. A summarized comparison of the System's assets, liabilities, and net assets at June 30, 2003, 2002, and 2001 is as follows:

Condensed Net Assets Information	2003	2002	2001
	(\$ in thousands)		
Current assets	\$ 155,174	\$ 152,253	\$ 143,449
Noncurrent assets:			
Endowment	78,344	77,435	87,919
Capital assets	395,695	356,995	326,471
Other noncurrent assets	89,732	109,272	83,512
Total assets	718,945	695,955	641,351
Current liabilities	54,726	56,289	49,776
Noncurrent liabilities:			
Long-term debt	122,557	126,764	85,222
Other noncurrent liabilities	65,641	57,921	54,561
Total liabilities	242,924	240,974	189,559
Net Assets:			
Invested in capital assets, net of related debt	304,930	285,320	268,984
Restricted - nonexpendable	44,225	42,470	42,286
Restricted - expendable	71,859	81,135	100,012
Unrestricted	55,007	46,056	40,510
Total net assets	\$ 476,021	\$ 454,981	\$ 451,792

Invested in capital assets, net of related debt, represent the System's capital assets less the accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets. The 2003 increase of \$19,610 and the 2002 increase of \$16,336 in this category of net assets reflect the System's renewal and expansion of its capital assets to provide technologically advanced research and teaching facilities for its faculty and students.

Restricted-nonexpendable net assets represent the System's permanent endowment funds. The \$1,755 increase in 2003 and the \$184 increase in 2002 is the result of new gifts of \$2,022 and \$1,356, respectively, less various transfers and reclassifications including valuing the initial gifts at the lower of the original gift amount or year end market value. Restricted-expendable net assets include such items as endowment appreciation, student financial aid, research, and public service and are subject to

UNIVERSITY OF MAINE SYSTEM
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externally imposed conditions on spending. Increased spending for property, plant, and equipment is the primary driver behind the reductions in 2003 and 2002 of \$9,276 and \$18,877, respectively.

Although unrestricted net assets are not subject to externally imposed stipulations, a portion has been earmarked for various institutional programs. The increase in unrestricted net assets for 2003 and 2002 of \$8,951 and \$5,546, respectively, are attributable to Educational & General and Auxiliary Operations.

Endowment Investments (Noncurrent Assets)

The System manages its endowment to generate a predictable stream of annual support for current needs, while at the same time preserving the endowment as a whole to ensure funds for future years. The endowment spending rate policy provides for an annual distribution of 5.5% of the average net market value of the endowment for the prior 12 quarters.

The System's endowment investments had a fair market value of \$78,344 at June 30, 2003, reflecting an increase of \$909 above the fair market value of \$77,435 at June 30, 2002. Gifts, charitable gift annuities, and investment income (net of investment fees) increased during 2003 as did spending for scholarships, operations, and various transfers. The System's endowment investments for 2002 reflected a loss of \$10,484 primarily as the result of declining market values.

The total return on the pooled endowments on a net of fees basis for 2003 was 4.8% as compared to (9.1%) for 2002. This increase in 2003 reflects the continued performance of the fixed income markets and modest returns in the equities market. The decrease in 2002 is primarily attributable to the significant declines suffered in the equities markets.

Capital Assets and Debt Activities

The System's facilities are critical to accomplishing the mission of the System as they provide the physical framework and environment necessary to house educational, research, and cultural programs and residential life. The System is continually implementing its long-term capital plan to upgrade older facilities and construct new facilities when necessary.

Capital additions before depreciation totaled \$66,147 in 2003 – up from \$56,224 in 2002. Capital additions primarily consist of replacement, renovation, and new construction of academic, housing, and research facilities as well as investments in equipment, including information technology. Capital asset additions in 2003 and 2002 were funded primarily with State of Maine capital appropriations and University of Maine System revenue bonds.

Of the total capital additions before depreciation for 2003, \$54,567 represented capital construction. Classroom construction or renovation included the Engineering/Science Research Complex, Hitchner Hall, and Aubert Hall at UM and the Bioscience Building and the Community Education Facility at USM. Sprinkler systems are being installed in residential halls across the System. Projects in progress also included the Enterprise Resource Planning (ERP) implementation of PeopleSoft. This software will integrate information and business processes to enable the efficient and effective sharing of information throughout the organization and, thus, maximize productivity. Of the total capital additions before depreciation for 2002, \$44,413 represented capital construction. Construction or renovations during 2002 included the projects listed above as well as the Doris Twitchell Allen Village – Phase II (UM) and Scott Hall (UMF) – both residential halls completed during 2003.

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The System strives to manage all its financial resources effectively including the prudent use of debt to finance capital projects that support the System's mission, thereby placing the System in a better position to achieve its strategic goals. Total debt as of June 30, 2003 and 2002 was \$128,117 and \$131,247, respectively. Of the total debt as of June 30, 2003, \$127,781 was in the form of bonds as compared to \$130,856 as of June 30, 2002. In January 2003 revenue bonds were issued to fund capital construction and to refund the outstanding 1993 Series A and B Revenue Bonds which will result in reduced debt service payments. The System continues to experience lower borrowing costs on the 2002 Series A Revenue Bonds (issued June 2002 - \$45,680) as a result of the associated interest rate swap agreement which reduced interest costs by \$1,057 during 2003.

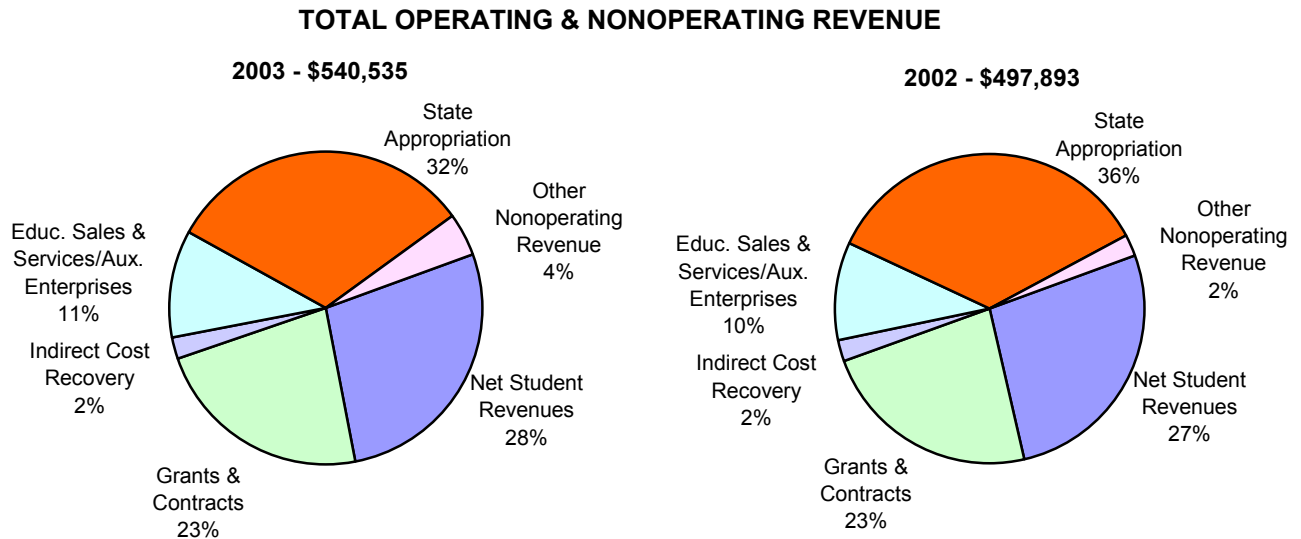
Condensed Revenues, Expenses, and Changes in Net Assets

	2003	2002	2001
	(\$ in thousands)		
Operating Revenues:			
Net student revenues	\$ 149,045	\$ 134,612	\$ 123,395
Grants and contracts	122,439	113,550	104,099
Indirect cost recovery	11,546	10,816	9,243
Educational sales and services & Other auxiliary enterprises	59,937	51,216	49,059
Interest income on loans	725	739	725
Total operating revenues	<u>343,692</u>	<u>310,933</u>	<u>286,521</u>
Operating Expenses	<u>531,448</u>	<u>498,322</u>	<u>472,011</u>
Net operating loss	<u>(187,756)</u>	<u>(187,389)</u>	<u>(185,490)</u>
Non-operating revenues (expenses):			
State appropriation - general	173,050	176,388	169,319
Gifts	11,801	11,037	10,284
Endowment income (loss)	2,893	(7,067)	(7,474)
Investment income	9,099	6,602	10,338
Interest expense	(3,575)	(4,079)	(3,834)
Net nonoperating revenues	<u>193,268</u>	<u>182,881</u>	<u>178,633</u>
Income (loss) before other Revenues	\$ 5,512	\$ (4,508)	\$ (6,857)
Other Revenues			
Capital appropriations	11,452	3,035	19,250
Capital grants and gifts	2,054	3,306	9,600
Additions to permanent endowments - gifts	2,022	1,356	1,840
	<u>15,528</u>	<u>7,697</u>	<u>30,690</u>
Increase in Net Assets	21,040	3,189	23,833
Net Assets			
Net Assets - beginning of year	454,981	451,792	427,959
Net Assets - end of year	<u>\$ 476,021</u>	<u>\$ 454,981</u>	<u>\$ 451,792</u>

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In addition to receiving tuition and fees, the System receives revenue from several other diverse sources such as governmental and privately funded sponsored programs, gifts from individuals, foundations, and corporations, state appropriations, and investment income. The System will continue to seek funding from all sources that will supplement student tuition and thereby allow for the enhancement of its educational offerings and research capabilities.

The following graph illustrates both the operating and nonoperating revenue sources used to fund the System's activities for the years ended June 30, 2003 and 2002.



Operating Revenues

Tuition and fees and residence and dining fees are the primary sources of operating revenue and in 2003 totaled \$149,045 after adjusting for scholarship allowances, reflecting an increase of \$14,433 or 10.7% over 2002 revenue of \$134,612. This change is the result of a 4.6% weighted average increase in tuition, a 3.9% weighted average increase in room and board rates, and an increase in student enrollment and students residing in residence halls. Tuition and fees and residence and dining fees in 2002 increased \$11,217 or 9.1% over 2001 revenue. This change was the result of a 3.9% weighted average increase in tuition, a 6.5% weighted average increase in room and board rates, and an increase in student enrollment and students residing in residence halls.

As state research and development funding continued to leverage federal dollars, grants and contracts revenues increased \$8,889 to \$122,439 in 2003 from \$113,550 in 2002. Sponsored program revenues increased in 2002 by \$9,451. The System receives funding from federal, state, and private sources with the majority of the funding being provided by the federal government for research activities. Funding received from these sources also provides for recovery of indirect costs associated with sponsored programs.

Although not considered an operating revenue, the state appropriation for operations is the largest funding source for educational and general operations. When compared to fiscal year 2002, the state appropriation to the System decreased by \$3,338 or 1.9% for 2003 due to state budgetary constraints. The state appropriation for 2002 reflected an increase of \$7,069 or 4.2% over 2001 funding levels. The

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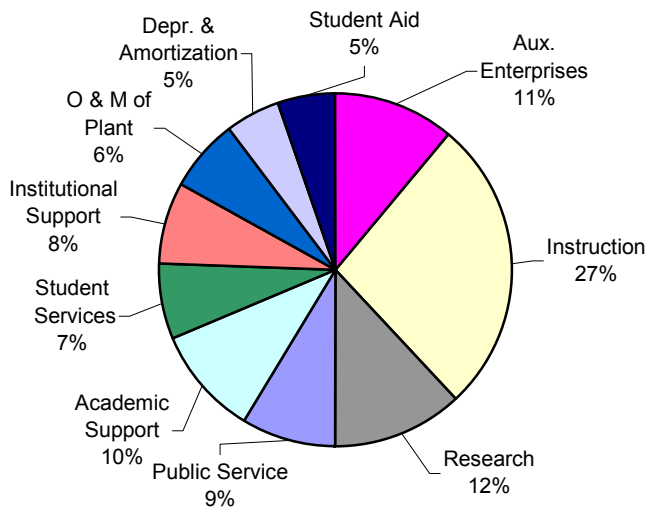
general state appropriation for fiscal year 2003 and 2002 covered 92% and 94% of the net operating loss, respectively.

Operating Expenses

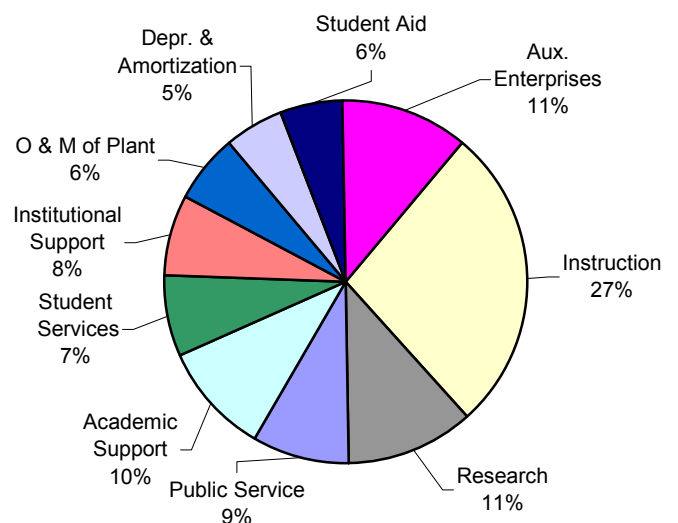
Operating expenses, classified by function, were as follows:

	2003	2002	2001
	(\$ in thousands)		
Instruction	\$142,582	\$135,506	\$128,350
Research	63,913	57,150	50,982
Public service	45,807	42,386	39,357
Academic support	53,300	50,205	47,724
Student services	37,117	35,214	34,445
Institutional support	40,072	37,350	35,841
Operation and maintenance of plant	34,268	29,671	29,284
Depreciation and amortization	27,511	25,736	26,006
Student aid	28,031	28,156	26,903
Auxiliary enterprises	58,847	56,948	53,119
Total	\$531,448	\$498,322	\$472,011

2003 - \$531,448



2002 - \$498,322

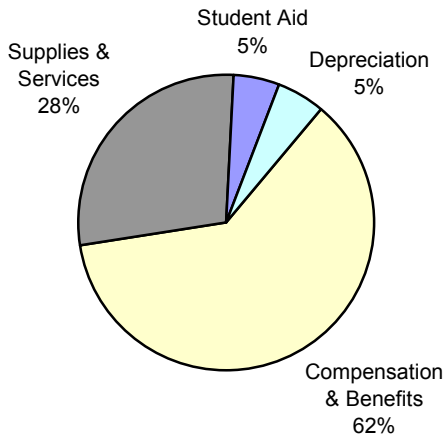


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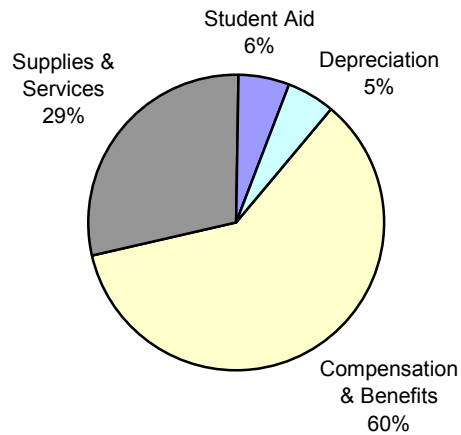
Although the System reports expenses on a functional basis, a comparative summary of the System's expenses based on a natural classification is as follows:

	2003	2002	2001
	(\$ in thousands)		
Operating:			
Compensation and benefits	\$ 325,745	\$ 300,307	\$ 284,671
Supplies and services	150,161	144,123	134,431
Depreciation	27,511	25,736	26,006
Student aid	28,031	28,156	26,903
	531,448	498,322	472,011
Nonoperating:			
Interest	3,575	4,079	3,834
Total Expenses	\$ 535,023	\$ 502,401	\$ 475,845

2003 - \$531,448



2002 - \$498,322



The amount expended for compensation and benefits increased by \$25,438 or 8.5% for 2003 as compared to the increase of \$15,636 or 5.5% for 2002. The 2003 increase for compensation and benefits is primarily the result of an increase in health care costs for current employees and retirees. Health care costs totaled \$44,486 in 2003 and reflected a 43.7% or \$13,532 increase over the \$30,954 expended in 2002. Annual employee compensation increases are also a factor in the overall compensation increase. The 2002 increase in compensation and benefits also reflected an increase in healthcare costs as well as a 3.6% increase in faculty to support the increased student enrollment and growth in sponsored programs. The System continues to work with the State of Maine and other employers to minimize health care costs while also providing quality health-care coverage to employees and retirees. The 4.4% increase in fall student enrollment and the 2.6% increase in diners and dormitory occupancy for 2003 generated additional revenues but also resulted in additional supplies and services expenditures.

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Impact of Future Economic Factors

With the exception of the state appropriation, all sources of operating and nonoperating revenues increased in FY2003 and are expected to increase in FY2004. Total enrollments at the System have been steadily increasing since 1997 with a record number of students entering for the Fall 2002 semester. Enrollments for the Fall 2003 semester are again expected to increase. The University of Maine System and the Maine Community College System have established a collaborative agreement which will allow students from the community colleges to more easily transfer into the University of Maine System's bachelor degree programs. With the anticipated growth in student enrollment, it is expected that auxiliary enterprises, which are designed to be self-supporting, will continue to expand and generate revenue in excess of expenditures.

The System continues to face the need to offer competitive salaries that will aid in attracting and retaining highly developed faculty and staff. The dramatic escalation in health-care costs this past year and the anticipated increases in the future have further burdened the System financially in the area of compensation and benefits. The System will continue to negotiate with health-care providers to obtain the lowest costs combined with the best comprehensive plan as well as seek alternative healthcare partnerships to help reduce the System's costs in this area.

As the result of changes in market conditions and prudent investment strategies during 2003, the System realized endowment income and an increase in investment income. The System will continue to implement its long-term investment strategy of maximizing total returns in conjunction with appropriate risk levels while maintaining a spending rate policy that will protect the System's funds from temporary market volatility.

The System remains committed to its long-term capital plan to revitalize existing facilities and undertake new construction. Consultants will be retained to analyze the need to balance building maintenance, renovations, and new construction with financial resources. A comprehensive strategic facilities plan will be developed which will address both the System's current need to provide technologically advanced research and teaching facilities and future potential growth.

From a fiscal perspective, the most significant economic factor is the State of Maine's continued financial difficulties and its impact on the System. The System's FY2003 state appropriation was originally set at \$183 million. Due to the State's financial situation, the System ultimately received \$173 in state appropriation – a decrease of \$10 million. State appropriation for FY2004 has been budgeted at \$178 million. Although this reflects an increase over the actual amount received for FY2003, this is still below the original budgeted appropriation for FY2003. Due to the direct correlation between the amount of state financial support and the amount of educational costs borne by the students, the System was forced to implement a weighted average tuition increase of 7.6% for FY2004. The System is continuing to seek additional state support and supplemental revenue sources to alleviate the costs paid by students.

While it is impossible to predict the financial future of the System, management believes that the System has sufficient strategies in place to manage future economic uncertainties.

UNIVERSITY OF MAINE SYSTEM
 Statements of Net Assets
 June 30, 2003 and 2002
 (In Thousands of Dollars)

ASSETS	<u>2003</u>	<u>2002</u>
Current Assets:		
Cash and cash equivalents (Note 2)	\$ 3,507	\$ 7,234
Short-term investments (Note 3)	115,210	113,416
Accounts, grants, and pledges receivable, net (Note 4)	31,475	26,808
Inventories and prepaid expenses	4,982	4,795
Total Current Assets	155,174	152,253
Noncurrent Assets:		
Deposits with bond trustees (Notes 3 and 6)	46,806	64,287
Accounts, grants, and pledges receivable, net (Note 4)	3,648	6,272
Notes receivable, net (Note 5)	37,716	37,371
Endowment investments (Note 3)	78,344	77,435
Bond issuance costs, net (Note 7)	1,562	1,342
Capital assets, net (Note 6)	395,695	356,995
Total Noncurrent Assets	563,771	543,702
Total Assets	\$ 718,945	\$ 695,955
LIABILITIES		
Current Liabilities:		
Accounts payable	\$ 13,432	\$ 11,355
Deferred revenue and deposits (Note 12)	16,195	18,390
Accrued liabilities (Notes 7 and 11)	18,987	21,554
Funds held for others	552	507
Current portion of capital lease obligations (Note 7)	206	171
Current portion of bonds payable (Note 7)	5,354	4,312
Total Current Liabilities	54,726	56,289
Noncurrent Liabilities:		
Accrued liabilities (Notes 7, 11, and 13)	29,772	23,722
Funds held for others (Note 3)	3,379	2,241
Capital lease obligations (Note 7)	130	220
Bonds payable, net (Note 7)	122,427	126,544
Grants refundable (Note 9)	32,490	31,958
Total Noncurrent Liabilities	188,198	184,685
Total Liabilities	242,924	240,974
NET ASSETS		
Invested in capital assets, net of related debt	304,930	285,320
Restricted:		
Nonexpendable (Note 10)	44,225	42,470
Expendable (Notes 3 and 10)	71,859	81,135
Unrestricted	55,007	46,056
Contingencies (Note 11)		
Total Net Assets	476,021	454,981
Total Liabilities and Net Assets	\$ 718,945	\$ 695,955

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM
 Statements of Revenues, Expenses, and Changes in Net Assets
 June 30, 2003 and 2002
 (In Thousands of Dollars)

	<u>2003</u>	<u>2002</u>
REVENUES		
Operating Revenues:		
Tuition and fees	\$ 147,079	\$ 132,928
Residence and dining fees	44,426	41,335
Less: scholarship allowances	(42,460)	(39,651)
Net student fees	149,045	134,612
Federal, state, and private grants and contracts	122,439	113,550
Recovery of indirect costs	11,546	10,816
Educational sales and services and other auxiliary enterprises	59,937	51,216
Interest income on loans	725	739
Total Operating Revenues	343,692	310,933
EXPENSES		
Operating Expenses:		
Instruction	142,582	135,506
Research	63,913	57,150
Public service	45,807	42,386
Academic support	53,300	50,205
Student services	37,117	35,214
Institutional support	40,072	37,350
Operation and maintenance of plant	34,268	29,671
Depreciation and amortization	27,511	25,736
Student aid	28,031	28,156
Auxiliary enterprises	58,847	56,948
Total Operating Expenses	531,448	498,322
Operating Loss	(187,756)	(187,389)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	173,050	176,388
Gifts	11,801	11,037
Endowment income (loss) (Note 3)	2,893	(7,067)
Investment income (Note 3)	9,099	6,602
Interest expense (Notes 7 and 8)	(3,575)	(4,079)
Net Nonoperating Revenue	193,268	182,881
Income (Loss) Before Other Revenues	5,512	(4,508)
OTHER REVENUES		
Capital appropriations	11,452	3,035
Capital grants and gifts	2,054	3,306
Additions to permanent endowments - gifts	2,022	1,356
Total Other Revenues	15,528	7,697
Increase in Net Assets	21,040	3,189
NET ASSETS		
Net Assets - beginning of year (Note 17)	454,981	451,792
Net Assets - end of year	\$ 476,021	\$ 454,981

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM
 Statements of Cash Flows
 Year Ended June 30, 2003 and 2002
 (In Thousands of Dollars)

	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Tuition, residence, dining, and other student fees	\$ 147,887	\$ 134,435
Grants and contracts	132,774	132,212
Educational sales and services and other auxiliary enterprise revenues	54,846	51,136
Payments to and on behalf of employees	(311,407)	(304,691)
Financial aid paid to students	(28,758)	(28,301)
Payments to suppliers	(159,673)	(136,691)
Loans issued to students	(7,767)	(6,852)
Collection of loans to students	6,838	5,891
Interest collected on loans to students	725	739
Other operating receipts	515	425
Net Cash Used For Operating Activities	<u>(164,020)</u>	<u>(151,697)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
State appropriations	173,336	176,388
Noncapital grants and gifts	10,838	10,149
Gifts and appropriations received for permanent endowment	2,022	1,356
Agency transactions	265	1,623
Net Cash Provided By Noncapital Financing Activities	<u>186,461</u>	<u>189,516</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from capital debt issuances	19,980	46,238
Capital appropriations	13,331	6,788
Capital grants and gifts	3,580	3,632
Acquisition and construction of capital assets	(63,700)	(52,139)
Issuance costs on capital debt	(382)	(558)
Principal paid on capital debt and leases	(22,856)	(3,911)
Interest paid on capital debt and leases	(5,543)	(5,436)
Net Cash Used For Capital and Related Financing Activities	<u>(55,590)</u>	<u>(5,386)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and maturities of investments	521,776	306,016
Purchases of investments	(504,535)	(340,388)
Earnings from investments	12,181	8,044
Net Cash Provided By (Used For) Investing Activities	<u>29,422</u>	<u>(26,328)</u>
Net (decrease) increase in cash and cash equivalents	(3,727)	6,105
Cash and cash equivalents - beginning of year	<u>7,234</u>	<u>1,129</u>
Cash and cash equivalents - end of year	<u>\$ 3,507</u>	<u>\$ 7,234</u>

See accompanying notes to basic financial statements

UNIVERSITY OF MAINE SYSTEM
 Statements of Cash Flows
 Year Ended June 30, 2003 and 2002
 (In Thousands of Dollars)

	<u>2003</u>	<u>2002</u>
Reconciliation of net operating loss to net cash used for operating activities:		
Operating loss	\$ (187,756)	\$ (187,389)
Adjustments to reconcile net operating loss to net cash used by operating activities:		
Depreciation and amortization	27,511	25,736
Changes in assets and liabilities:		
Accounts and grants receivable, net	(4,348)	5,238
Inventories and prepaid expenses	(187)	(640)
Notes receivable, net	(345)	(423)
Accounts payable	168	(64)
Deferred revenue and deposits	(2,210)	3,433
Accrued liabilities	2,615	2,289
Grants refundable	532	123
Net cash used for operating activities	<u>\$ (164,020)</u>	<u>\$ (151,697)</u>
 Noncash capital activities:		
Capital asset additions included in accounts payable as of June 30	<u>\$ 7,128</u>	<u>\$ 5,163</u>

See accompanying notes to basic financial statements

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

1. SIGNIFICANT ACCOUNTING POLICIES

a. Organization

The University of Maine System ("the System"), a component unit of the State of Maine, consists of seven Universities, ten centers, and a central administrative office. All activities of the System are included in the accompanying financial statements. Not included in the accompanying financial statements are several independent organizations which operate for the benefit of the System, including the University of Maine Foundation (Note 15) and several other foundations and alumni associations. These organizations are not-for-profit entities controlled by separate governing boards whose goals are to support the System. They receive funds primarily through donations and contribute funds to the System for student scholarships and institutional support.

b. Basis of Presentation

The accompanying financial statements of the System have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

The System adopted GASB Statements 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* and 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*, and related standards as of July 1, 2001.

The System’s policy for defining operating activities in the Statements of Revenues, Expenses, and Changes in Net Assets are those that generally result from exchange transactions such as payments received for services and payments made for the purchase of goods and services. Certain other transactions are reported as nonoperating activities in accordance with GASB Statement No. 35. These nonoperating activities include the System’s operating and capital appropriations from the State of Maine, net investment income, gifts, and interest expense.

The System applies all pronouncements and interpretations issued by the Financial Accounting Standards Board (FASB) on or before November 30, 1989, to the extent they do not conflict with GASB pronouncements.

c. Net Assets

The System’s net assets (assets minus liabilities) are classified for accounting purposes in the following four categories:

Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, repair or improvement of those assets. This category excludes the portion of debt attributable to unspent bond proceeds.

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

Restricted – nonexpendable: Net assets subject to externally imposed conditions that the System maintain them in perpetuity.

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

Unrestricted: All other categories of net assets. Unrestricted net assets may be designated by actions of the System's Board of Trustees.

The System has adopted a policy of generally utilizing restricted – expendable resources, when available, prior to unrestricted resources.

d. Cash and Cash Equivalents

The System considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

e. Investments

The System's investment in the State of Maine Pool is reported at amortized cost, which approximates fair value. All other investments are reported at fair value.

Endowment: The System follows the pooled investment concept for its endowed funds, whereby all invested funds are included in one investment pool, except for investments of certain endowed funds that are otherwise restricted and are separately invested. Investment income is allocated to each endowed fund participating in the pool based on its pro-rata share of the pool. Net assets are included in the following net asset categories:

- Restricted nonexpendable if the terms of the gift require that they be added to the principal of a permanent endowment fund.
- Restricted expendable if the terms of the gift impose restrictions on the current use of income earned on the endowment or net gains recognized on the endowment.
- Unrestricted net assets in all other cases.

The Investment Committee of the University of Maine System Board of Trustees has established a policy whereby the Endowment's expendable income objective is 5.5% of the average of the previous twelve quarter-end fair values. The income produced by the fund, including realized gains, can be used to meet this spending objective.

Authorized Investment Vehicles:

Short-term Investments: The Investment Committee of the University of Maine System Board of Trustees has approved the following three-tiered approach regarding the System's short-term investments:

- Cash Pool (bank accounts, state pool) – This tier consists of funds that will be needed within a one-month period, that are invested in a portfolio of highest quality short-term

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

fixed-income securities (treasury obligations, agency securities, bankers acceptances, money market funds, CDs, commercial paper) with daily to 3-day liquidity. The average quality of the portfolio will be at least "AA".

- Intermediate Pool – This tier is invested in a diversified portfolio, in accordance with investment manager guidelines, consisting primarily of fixed income securities with a normal average duration of 1 to 3 years. Investments in the intermediate tier may consist of securities rated from "B" to "Aaa" quality, with a maximum of 10% below Baa and in private placements determined by the manager to be of similar credit quality. The overall average quality rating of this pool will be at least "A".
- Long-term Pool – This tier consists of funds that will not be required for at least 36 months. The assets are to be invested in accordance with the diversification and investment guidelines recommended by the System's investment manager(s).

Endowment Investments: The fund will be diversified both by asset class and within asset classes. In order to have a reasonable probability of consistently achieving the Fund's return objectives, the following asset allocation policy has been adopted:

• Equity securities	60-80%
• Fixed income securities	20-40%
• Cash	0-10%

Deposits with bond trustees: These monies are invested in accordance with the governing bond covenants and arbitrage certificates.

f. Inventories

Inventories are stated at cost. Cost is determined using the first-in, first-out method.

g. Gifts and Pledges

Gifts are recorded at their fair value at the date of gift. Promises to donate to the System are recorded as receivables and revenues when the System has met all applicable eligibility and time requirements. Since the System cannot fulfill the time requirement for gifts to endowments until the gift is received, pledges to endowments are not reported. Pledges receivable are reported net of amounts deemed uncollectible, and after discounting to the present value of the expected future cash flows. Because of uncertainties with regard to their realizability and valuation, bequests and intentions to give and other conditional promises are not recognized as assets until the specified conditions are met.

h. Grants and Contracts and Capital Appropriations

The System records a receivable and corresponding revenue for these funding sources at the point all eligibility requirements (e.g., allowable costs are incurred) are met.

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

i. Capital Assets

Capital assets are recorded at cost when purchased or constructed and at fair value at date of donation. In accordance with the System's capitalization policy, only equipment (including equipment acquired under capital leases) with a unit cost of \$5,000 or more is capitalized. Only capital projects with a projected cost of \$10,000 or more are capitalized. Library materials are generally capitalized and depreciated over a ten-year period. Interest costs on debt related to capital assets, net of investment income on unspent bond proceeds, are generally capitalized during the construction period. Software costs are capitalized and depreciated and include amounts paid to third parties and certain internal labor costs incurred to acquire and implement the software.

Depreciation and amortization of assets acquired under capital leases are recorded on a straight-line basis over the estimated useful lives of the related assets, principally as follows:

	<u>Years</u>
Buildings	30 - 60
Improvements	20 - 40
Equipment	5 - 15
Library books and materials	10

Costs for maintenance, repairs and minor renewals and replacements are expensed as incurred; major renewals and replacements are capitalized. Equipment and library books and materials are removed from the financial statements during the fiscal year following the year they become fully depreciated. When land, buildings, and improvements are retired or otherwise disposed of, the asset and accumulated depreciation accounts are adjusted and any resulting gain or loss is reflected in the Statements of Revenues, Expenses, and Changes in Net Assets.

The System does not capitalize or depreciate its collections of historical treasures and works of art because it is the System's policy that:

- Works of art and historical treasures are to be held for public exhibition, education, or research in furtherance of public service, rather than for financial gain.
- Works of art and historical treasures are to be protected, kept unencumbered, cared for, and preserved.
- The proceeds from sales of works of art and historical treasures are to be used to acquire other items for the collections.

j. Deferred Revenue and Deposits

Deferred revenue in the Statements of Net Assets consists primarily of deposits and advance payments received for tuition and fees related to certain summer programs and tuition received for the following academic year. The deferred revenue is presented net of related expenses for the summer programs (e.g., salaries, student aid, etc.).

k. Compensated Absences

Employees earn the right to be compensated during absences for annual vacation leave. The accompanying Statements of Net Assets reflect an accrual for the amounts earned and ultimately

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
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payable for such benefit. The System manages and accounts for the vacation leave hours on a last-in, first-out basis. A portion of this liability is classified as current and represents the System's estimate of vacation time that will be paid during the next fiscal year to employees leaving the System.

I. Net Student Fees

Student tuition, dining, residence, and other fees are presented net of scholarships and fellowships applied to students' accounts. Certain other scholarship amounts are paid directly to, or refunded to, the student and are generally reflected as expenses.

m. Tax Status

The System is exempt from income taxes under Section 115 of the Internal Revenue Code as a governmental entity. It has also been recognized by the Internal Revenue Service as an organization described in Section 501(c)(3) of the Code.

n. Use of 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 dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

o. Reclassifications

Certain fiscal year 2002 items in the accompanying financial statements have been reclassified, without effect on total net assets, to conform to the fiscal year 2003 presentation.

2. CASH AND CASH EQUIVALENTS

The following summary presents the amount of the System's deposits representing cash and cash equivalents that are fully insured or collateralized with securities held by the System or by its agent in the System's name (Category 1); collateralized with securities held by the pledging financial institution's trust department or agent in the System's name (Category 2); and not collateralized (Category 3), at June 30:

	Category			Bank Balance	Carrying Amount
	1	2	3		
2003	\$ 643	\$ -	\$ 5,407	\$ 6,050	\$ 3,507
2002	\$ 5,628	\$ -	\$ 8,757	\$ 14,385	\$ 7,234

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

3. INVESTMENTS

The System categorizes investments according to the level of risk assumed by the System. Category 1 includes investments that are insured, registered, or held by the System or its agent in the System's name. Category 2 includes investments that are uninsured and unregistered for which the securities are held by the bank's trust department or agent in the System's name. Category 3 includes investments that are uninsured and unregistered for which the securities are held by the bank, or its trust department or agent, but not in the System's name. Certain investments, e.g., state pool and mutual funds, are not categorized because they are managed investment pools.

At June 30, 2003, categorization of the System's investments was as follows:

	Category			Not Categorized	Total Carrying Value
	1	2	3		
Short-term investments	\$ -	\$ -	\$ -	\$ 115,210	\$ 115,210
Endowment investments	27,283	-	393	50,668	78,344
Deposits with bond trustees	100	-	1,148	45,558	46,806
Total Investments	<u>\$27,383</u>	<u>\$ -</u>	<u>\$ 1,541</u>	<u>\$ 211,436</u>	<u>\$ 240,360</u>

At June 30, 2002, categorization of the System's investments was as follows:

	Category			Not Categorized	Total Carrying Value
	1	2	3		
Short-term investments	\$ -	\$ 10,091	\$ 15,134	\$ 88,191	\$ 113,416
Endowment investments	45,046	-	379	32,010	77,435
Deposits with bond trustees	100	3,195	531	60,461	64,287
Total Investments	<u>\$45,146</u>	<u>\$ 13,286</u>	<u>\$ 16,044</u>	<u>\$ 180,662</u>	<u>\$ 255,138</u>

Income related to the System's investments for fiscal year 2003 was as follows:

	Net Gains (Losses)	Investment Fees	Interest and Dividends	Total Return
Endowment investments	<u>\$ 1,481</u>	<u>\$ (663)</u>	<u>\$ 2,075</u>	<u>\$ 2,893</u>
Short-term investments	\$ 2,562	\$ (535)	6,526	\$ 8,553
Deposits with bond trustees	(27)	(1)	574	546
Total other investment income	<u>\$ 2,535</u>	<u>\$ (536)</u>	<u>\$ 7,100</u>	<u>\$ 9,099</u>

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

Income related to the System's investments for fiscal year 2002 was as follows:

	Net Gains (Losses)	Investment Fees	Interest and Dividends	Total Return
Endowment investments	\$ (8,527)	\$ (484)	\$ 1,944	\$ (7,067)
Short-term investments	\$ 44	\$ (28)	4,336	\$ 4,352
Deposits with bond trustees	16	(1)	2,235	2,250
Total other investment income	<u>\$ 60</u>	<u>\$ (29)</u>	<u>\$ 6,571</u>	<u>\$ 6,602</u>

The System's investments were comprised of the following at June 30, 2003:

	Short Term	Endowment	Deposits with Bond Trustees	Total
Equity securities	\$ -	\$ 53,348	\$ -	\$ 53,348
Fixed income securities	99,276	24,207	4,099	127,582
State pool	15,934	-	-	15,934
Money funds, savings, CD's	-	789	1,248	2,037
Guaranteed investment contracts	-	-	41,459	41,459
Total investments	<u>\$ 115,210</u>	<u>\$ 78,344</u>	<u>\$ 46,806</u>	<u>\$ 240,360</u>

The System's investments were comprised of the following at June 30, 2002:

	Short Term	Endowment	Deposits with Bond Trustees	Total
Equity securities	\$ -	\$ 52,487	\$ -	\$ 52,487
Fixed income securities	51,106	22,867	3,681	77,654
State pool	37,085	-	-	37,085
Money funds, savings, CD's	-	2,081	631	2,712
Guaranteed investment contracts	-	-	59,975	59,975
Government agency obligations	25,225	-	-	25,225
Total investments	<u>\$ 113,416</u>	<u>\$ 77,435</u>	<u>\$ 64,287</u>	<u>\$ 255,138</u>

Short-term Investments

The System's short-term investments are available to fund operations or other purposes as deemed by System management.

UNIVERSITY OF MAINE SYSTEM
Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

Endowment Investments

Except for certain gifts invested separately at the request of the donors (\$489 at June 30, 2003 and \$476 at June 30, 2002), the System's endowment is managed as a pooled investment fund by external investment advisors.

The University of Maine at Augusta Foundation, the University of Maine at Farmington Alumni Foundation, the University of Maine at Fort Kent Foundation, the University of Southern Maine Foundation, and the John L. Martin Scholarship Fund, Inc. have elected to participate in the System's endowment pool through a management agreement. The fair values of these investments at June 30, 2003 and 2002 were \$3,379 and \$2,241, respectively, and were reported as funds held for others in the accompanying Statements of Net Assets.

Under State of Maine law, the System may spend realized and unrealized appreciation on endowments in addition to earnings on the funds. Total Endowment accumulated income and gains available to the System for spending was as follows at June 30:

	<u>2003</u>	<u>2002</u>
Restricted - expendable	\$25,190	\$27,361
Unrestricted	5,308	5,271
Total available for spending	<u>\$30,498</u>	<u>\$32,632</u>

Deposits With Bond Trustees

Deposits with bond trustees are comprised of debt service reserves required by bond covenants and unexpended revenue bond proceeds.

4. ACCOUNTS, GRANTS, AND PLEDGES RECEIVABLE

Accounts, grants, and pledges receivable included the following at June 30:

	<u>2003</u>			<u>2002</u>		
	<u>Total</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>	<u>Total</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Student and other accounts receivable	\$ 11,971	\$ 10,927	\$ 1,044	\$ 10,623	\$ 10,080	\$ 543
Grants receivable	22,133	21,571	562	20,257	17,816	2,441
Pledges receivable	3,401	867	2,534	4,262	538	3,724
Total gross receivables	37,505	33,365	4,140	35,142	28,434	6,708
Less allowance for doubtful accounts	(2,166)	(1,890)	(276)	(1,785)	(1,626)	(159)
Less discount on pledges receivable	(216)	-	(216)	(277)	-	(277)
Total receivables, net	<u>\$ 35,123</u>	<u>\$ 31,475</u>	<u>\$ 3,648</u>	<u>\$ 33,080</u>	<u>\$ 26,808</u>	<u>\$ 6,272</u>

In accordance with GASB 34, grants receivable related to the acquisition of capital assets is reported as a noncurrent receivable even though collection is expected within the next twelve months.

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5. NOTES RECEIVABLE

Notes receivable included the following at June 30:

	<u>2003</u>	<u>2002</u>
Perkins Loans	\$33,591	\$33,473
Nursing Loans	1,017	999
Institutional Loans	<u>3,555</u>	<u>3,303</u>
	38,163	37,775
Less allowance for doubtful accounts	<u>(447)</u>	<u>(404)</u>
Total notes receivable, net	<u>\$37,716</u>	<u>\$37,371</u>

Collections of the notes receivable may not be used to pay current liabilities, as the proceeds are restricted for making new loans. Accordingly, notes receivable are recorded in the accompanying Statements of Net Assets as noncurrent assets.

6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003 was as follows:

	Beginning <u>Balance</u>	<u>Additions</u>	<u>Reclasses</u>	<u>Retirements</u>	Ending <u>Balance</u>
Land	\$ 11,371	\$ -	\$ 466	\$ -	\$ 11,837
Construction in Progress	<u>47,775</u>	<u>54,567</u>	<u>(68,944)</u>	-	<u>33,398</u>
Total Nondepreciable Assets	<u>59,146</u>	<u>54,567</u>	<u>(68,478)</u>	-	<u>45,235</u>
Land Improvements	27,720	-	2,580	-	30,300
Buildings & Improvements	346,634	-	63,046	-	409,680
Equipment	93,598	6,021	2,852	(13,168)	89,303
Library Materials	<u>50,017</u>	<u>5,559</u>	-	<u>(3,579)</u>	<u>51,997</u>
Total Depreciable Assets	<u>517,969</u>	<u>11,580</u>	<u>68,478</u>	<u>(16,747)</u>	<u>581,280</u>
Less Accumulated Depreciation:					
Land Improvements	14,437	1,372	-	-	15,809
Buildings & Improvements	116,666	8,730	-	-	125,396
Equipment	64,921	11,551	-	(13,168)	63,304
Library Materials	<u>24,096</u>	<u>5,794</u>	-	<u>(3,579)</u>	<u>26,311</u>
Total Accumulated Depreciation	<u>220,120</u>	<u>27,447</u>	-	<u>(16,747)</u>	<u>230,820</u>
Net Depreciable Assets	<u>297,849</u>	<u>(15,867)</u>	<u>68,478</u>	-	<u>350,460</u>
Total Capital Assets	<u>\$ 356,995</u>	<u>\$ 38,700</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 395,695</u>

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Capital asset activity for the year ended June 30, 2002 was as follows:

	Beginning <u>Balance</u>	<u>Additions</u>	<u>Reclasses</u>	<u>Retirements</u>	Ending <u>Balance</u>
Land	\$ 11,371	\$ -	\$ -	\$ -	\$ 11,371
Construction in Progress	36,019	44,413	(32,657)	-	47,775
Total Nondepreciable Assets	<u>47,390</u>	<u>44,413</u>	<u>(32,657)</u>	<u>-</u>	<u>59,146</u>
Land Improvements	26,334	-	1,386	-	27,720
Buildings & Improvements	315,888	-	30,746	-	346,634
Equipment	98,654	6,211	525	(11,792)	93,598
Library Materials	44,417	5,600	-	-	50,017
Total Depreciable Assets	<u>485,293</u>	<u>11,811</u>	<u>32,657</u>	<u>(11,792)</u>	<u>517,969</u>
Less Accumulated Depreciation:					
Land Improvements	13,115	1,322	-	-	14,437
Buildings & Improvements	108,924	7,742	-	-	116,666
Equipment	63,817	12,896	-	(11,792)	64,921
Library Materials	20,355	3,741	-	-	24,096
Total Accumulated Depreciation	<u>206,211</u>	<u>25,701</u>	<u>-</u>	<u>(11,792)</u>	<u>220,120</u>
Net Depreciable Assets	<u>279,082</u>	<u>(13,890)</u>	<u>32,657</u>	<u>-</u>	<u>297,849</u>
Total Capital Assets	<u>\$ 326,472</u>	<u>\$ 30,523</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 356,995</u>

Additions to equipment in 2003 and 2002 included \$176 and \$555, respectively, of equipment acquired through capital leases. As of June 30, 2003 and 2002, \$42,920 and \$57,322, respectively, in proceeds from the 2003, 2002, 2000, and 1998 revenue bond issuances remained unspent. These amounts are included in the accompanying Statements of Net Assets as part of deposits with bond trustees.

Also remaining unspent as of June 30, 2003 and 2002 were \$35,520 and \$32,165, respectively, in capital appropriations awarded by the State of Maine. These amounts are not included in the accompanying financial statements because the System has not met all eligibility requirements, e.g., incurred costs.

Both the revenue bond and capital appropriation monies are earmarked for specific projects, some of which are included in capital assets in the accompanying Statements of Net Assets.

Outstanding commitments on uncompleted construction contracts totaled approximately \$24,784 at June 30, 2003 and \$22,628 at June 30, 2002.

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7. LONG-TERM LIABILITIES

Changes in long-term liabilities during the year-ended June 30, 2003 consisted of the following:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Leases and bonds payable:					
Capital lease obligations	\$ 391	\$ 175	\$ (230)	\$ 336	\$ 206
Bonds payable	130,856	19,805	(22,880)	127,781	5,354
Total leases and bonds payable	<u>131,247</u>	<u>19,980</u>	<u>(23,110)</u>	<u>128,117</u>	<u>5,560</u>
Accrued liabilities:					
Accrued vacation	10,295	3,807	(2,861)	11,241	99
Workers' compensation	2,714	3,611	(1,180)	5,145	1,266
Health insurance	7,618	38,942	(41,425)	5,135	5,135
Incentive retirement	11,914	1,235	(528)	12,621	-
Other	12,735	15,541	(13,659)	14,617	12,487
Total accrued liabilities	<u>45,276</u>	<u>63,136</u>	<u>(59,653)</u>	<u>48,759</u>	<u>18,987</u>
Total long-term liabilities	<u>\$ 176,523</u>	<u>\$ 83,116</u>	<u>\$ (82,763)</u>	<u>\$ 176,876</u>	<u>\$ 24,547</u>

Changes in long-term liabilities during the year-ended June 30, 2002 consisted of the following:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Leases and bonds payable:					
Capital lease obligations	\$ 47	\$ 555	\$ (211)	\$ 391	\$ 171
Bonds payable	88,877	45,682	(3,703)	130,856	4,312
Total leases and bonds payable	<u>88,924</u>	<u>46,237</u>	<u>(3,914)</u>	<u>131,247</u>	<u>4,483</u>
Accrued liabilities:					
Accrued vacation	9,158	4,040	(2,903)	10,295	82
Workers' compensation	2,698	1,183	(1,167)	2,714	1,303
Health insurance	4,644	26,604	(23,630)	7,618	7,618
Incentive retirement	10,512	2,095	(1,333)	11,274	-
Other	15,674	13,374	(15,673)	13,375	12,551
Total accrued liabilities	<u>42,686</u>	<u>47,296</u>	<u>(44,706)</u>	<u>45,276</u>	<u>21,554</u>
Total long-term liabilities	<u>\$ 131,610</u>	<u>\$ 93,533</u>	<u>\$ (48,620)</u>	<u>\$ 176,523</u>	<u>\$ 26,037</u>

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Lease Obligations

The System leases certain equipment and real estate under leases with terms exceeding one year. The rent expense related to these operating leases amount to approximately \$11,400 for the year ended June 30, 2003 and approximately \$10,300 for the year ended June 30, 2002.

Future minimum lease payments under capital leases and under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2003 were as follows:

<u>Year Ending June 30,</u>	<u>Capital Leases</u>		<u>Operating Leases</u>	<u>Total</u>
	<u>Principal</u>	<u>Interest</u>		
2004	\$ 206	\$ 11	\$ 1,905	\$ 2,122
2005	82	4	1,461	1,547
2006	28	2	742	772
2007	20	1	271	292
2008	-	-	125	125
2009-2013	-	-	401	401
2014-2018	-	-	29	29
Total minimum lease payments	<u>\$ 336</u>	<u>\$ 18</u>	<u>\$ 4,934</u>	<u>\$ 5,288</u>

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Bonds Payable

Bonds payable consisted of the following at June 30:

	<u>2003</u>	<u>2002</u>
2003 Series A Revenue Bonds (\$19,970)		
Serial bonds, maturing from 2004 to 2032, with annual principal payments from \$145 to \$1,610 and coupon interest rates from 3.0% to 4.75%. Issued to refund the 1993A and 1993B Series Revenue Bonds.	\$ 19,970	\$ -
Add: unamortized premium	199	-
Less: unamortized deferred redemption fee on 1993 bonds	(355)	-
Total 2003 Series A Bonds	<u>19,814</u>	<u>-</u>
2002 Series A Revenue Bonds (\$43,020)		
Serial Bonds, maturing from 2002 to 2012, with annual principal payments from \$310 to \$1,525 and coupon interest rates from 2.0% to 5.375%. A balloon payment of \$31,915 is due in 2012.	42,710	43,020
Add: unamortized premium	<u>2,422</u>	<u>2,640</u>
Total 2002 Series A Bonds	<u>45,132</u>	<u>45,660</u>
2000 Series A Revenue Bonds (\$41,725)		
Serial Bonds, maturing from 2001 to 2015, with annual principal payments from \$1,490 to \$4,465 and coupon interest rates from 4.5% to 5.75%.	27,520	29,075
5.60% Term Bonds, due March 1, 2020	3,560	3,560
5.50% Term Bonds, due March 1, 2030	5,435	5,435
Add: unamortized premium	<u>119</u>	<u>129</u>
Total 2000 Series A Bonds	<u>36,634</u>	<u>38,199</u>
1998 Series A Revenue Bonds (\$29,540)		
Serial Bonds, maturing from 2000 to 2011, with annual principal payments from \$660 to \$1,050 and coupon interest rates from 3.95% to 4.75%.	7,230	7,975
5.00% Term Bonds, due March 1, 2018	8,965	8,965
5.00% Term Bonds, due March 1, 2024	10,540	10,540
Less: unamortized discount	<u>(534)</u>	<u>(498)</u>
Total 1998 Series A Bonds	<u>26,201</u>	<u>26,982</u>
1993 Series B Refunding Bonds (\$15,600)		
Serial Bonds, maturing through 2009, with annual principal payments from \$260 to \$595 and coupon interest rates from 3.15% to 5.25%.	-	3,595
5.50% Term Bonds, due March 1, 2015	-	4,295
5.50% Term Bonds, due March 1, 2020	<u>-</u>	<u>4,805</u>
Total 1993 Series B Bonds	<u>-</u>	<u>12,695</u>
1993 Series A Revenue Bonds (\$19,315), maturing through 2009 with annual principal payments from \$725 to \$2,750 and coupon interest rates from 2.3% to 5.2%.	<u>-</u>	<u>7,320</u>
Total bonds payable, net	<u>\$ 127,781</u>	<u>\$ 130,856</u>

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Costs associated with the issuance of the 2003, 2002, 2000 and 1998 Series A Revenue Bonds have been reported in the accompanying Statements of Net Assets as bond issuance costs, net and are being amortized over the life of the related bond issuance. The discount on the 1998 Series A Revenue Bonds and the premiums on the 2003, 2002, and 2000 Series A Revenue Bonds are also being amortized over the life of the respective bond issuances using the effective interest method.

Principal and interest payments on bonds payable for the next five years and in subsequent five-year periods were as follows at June 30, 2003:

Year Ending June 30:	Fixed-Rate Bonds		Interest Rate	Total
	Principal	Interest	Swap, Net *	
2004	\$ 5,145	\$ 6,120	\$ (1,163)	\$ 10,102
2005	5,305	5,846	(1,161)	9,990
2006	5,505	5,640	(1,147)	9,998
2007	5,430	5,425	(1,134)	9,721
2008	5,700	5,212	(1,118)	9,794
2009-2013	56,690	20,556	(4,227)	73,019
2014-2018	20,075	8,235	-	28,310
2019-2023	13,945	4,076	-	18,021
2024-2028	5,235	1,396	-	6,631
2029-2032	2,900	299	-	3,199
	<u>\$ 125,930</u>	<u>\$ 62,805</u>	<u>\$ (9,950)</u>	<u>\$ 178,785</u>

* In conjunction with its June 2002 issuance of fixed-rate revenue bonds, the System entered into an interest rate swap agreement with a financial institution counterparty. This column represents the projected net amount that the System would receive under the swap contract if interest rates were to remain unchanged during the remaining life of the swap. See note 8 for more information.

Interest costs related to the Revenue Bonds for fiscal year 2003 were \$5,113 and were net of \$1,057 in savings from the interest swap noted above and in Note 8. Interest costs related to the Revenue Bonds for fiscal year 2002 were \$4,591. Of the total interest costs, \$1,556 and \$522 was capitalized for the respective years ended June 30, 2003 and 2002.

Refunding of Debt

On January 23, 2003, the System issued 2003 Series A Revenue Bonds to help refund outstanding 1993 Series A and B Revenue Bonds and to fund capital construction projects in the amount of \$4,115. The 1993 bonds were refunded using a combination of the refunding bond proceeds, debt service reserves related to the 1993 bonds, and monies the System had budgeted for the March 1, 2003 debt service payment on the 1993 bonds. These monies were deposited into an escrow account and were used to retire the 1993 bonds on March 1, 2003.

The refunding resulted in the System having to pay a redemption premium of \$371. The unamortized portion of this amount is reported in the accompanying Statements of Net Assets as a reduction of the 2003 Series A Revenue Bonds. Amortization of the redemption premium will be charged to operations as an offset to interest expense through the year 2020 using the effective-

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interest method. The System completed the refunding to reduce its total debt service payments over the next seventeen years by \$1,160 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$1,117.

8. INTEREST RATE SWAP

Objective

As a means to lower its borrowing costs, the System entered into an interest rate swap in connection with the issuance of its \$43,020 Series A Revenue Bonds (see note 7) in June 2002. The purpose of the agreement was to swap the fixed rate on the underlying debt for a variable rate for the term of the debt, and not for any speculative purposes. The swap effectively reduced the System's fixed interest rate on the bonds to a synthetic variable rate of 1.35% at June 30, 2003 and 1.60% at June 30, 2002.

Terms

The bonds finally mature and the swap terminates on March 1, 2012. The swap's notional amount at inception matched the \$43,020 bonds. The swap's notional amount declines with the payment of principal on the bonds each March 1. Under the swap, the System pays the counterparty monthly payments based on the weighted average rate per The Bond Market Association Municipal Swap Index (BMA) (0.98% and 1.23% at June 30, 2003 and 2002, respectively). In turn, the counterparty pays the System a fixed rate twice a year. The fixed rate received from the counterparty (ranges from 4.833% to 5.307%) is designed to give the System the coupon rate payable by the System to the bondholders each March 1 and September 1.

Fair Value

The fair value of the swap, as provided by the counterparty, at June 30, 2003 and 2002 was an asset of \$3,406 and \$165, respectively. These fair values represent the estimated amounts due to the System if the agreement were cancelled on those dates and are based on discounted cash flow analysis incorporating option pricing models that consider market interest rates and other factors. Such values represent estimates only and may or may not actually be realized. Interest rate volatility, time to maturity, and outstanding principal will affect the swap's fair value at subsequent reporting dates. If the System repays the debt on schedule, the fair value of the swap will reach zero at its final maturity.

Credit Risk

The swap's fair value represented the System's credit exposure to the counterparty as of June 30, 2003 and 2002. Should the counterparty to this transaction fail to perform according to the terms of the swap contract, the System would face a maximum possible loss equivalent to the swap's fair value. As of June 30, 2003, the swap counterparty was rated Aa2 by Moody's Investors Services, AAA by Fitch Ratings, and AA+ by Standard & Poor's. To mitigate credit risk, if the counterparty's credit quality falls below A-(S&P)/A3(Moody's), the counterparty is obligated, on demand of the System, to provide and maintain collateral (cash or U.S. Treasury securities) having certain values required by the swap in order to provide security for payment of the positive value of the swap to the System.

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Interest Rate Risk

The swap increases the System's exposure to variable interest rates. As BMA increases, the System's net payment on the swap increases.

Termination Risk

Either party may terminate the swap if the other party is in default of the swap or has failed to maintain certain ratings. The System may terminate the swap at any time. If at the time of termination the swap has a negative fair value, the System would be liable to the counterparty for that amount.

9. GRANTS REFUNDABLE

The System participates in the Federal Perkins Loan and Nursing Loan Programs. These programs are funded through a combination of Federal and Institutional resources. The portion of these programs that has been funded with Federal funds is ultimately refundable to the U.S. Government upon the termination of the System's participation in the programs. The portion that would be refundable if the programs were terminated as of June 30, 2003 and 2002 has been included in the accompanying Statements of Net Assets as a noncurrent liability.

10. RESTRICTED NET ASSETS

The System is the recipient of funds that are subject to various external constraints upon their use, either as to purpose or time. These funds were comprised of the following as of June 30:

	<u>2003</u>	<u>2002</u>
Restricted - Nonexpendable:		
Endowment funds	\$ 44,225	\$ 42,470
Restricted - Expendable:		
Student financial aid	\$ 19,771	\$ 20,937
Other	13,602	14,365
Capital assets and retirement of debt	12,241	21,322
Loans	9,653	9,238
Academic support	7,438	6,970
Research and public service	5,595	4,663
Library	3,559	3,640
Total restricted - expendable	<u>\$ 71,859</u>	<u>\$ 81,135</u>

11. COMMITMENTS AND CONTINGENCIES

The System participates in a number of federal programs subject to financial and compliance audits. The amount of expenditures that may be disallowed by the granting agencies cannot be determined at this time, although the System does not expect these amounts, if any, to be material to the financial statements.

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The System is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries; and natural disasters. The System manages these risks through a combination of participation in a public entity risk pool, commercial insurance policies purchased in the name of the System, and through self-insurance programs for workers' compensation claims and physical damage to automobiles.

The System's annual self-insurance obligation for general liability is capped at \$240, except for educator's legal liability risks which are subject to a \$100 per loss retention with no annual cap. The System's estimate of the amount payable under these self-insurance plans has been included in the accompanying Statements of Net Assets as part of current accrued liabilities. As of June 30, 2003 and 2002 certain legal claims existed for which the probability or amount of payment could not be determined. The System, however, does not expect the ultimate costs, if any, to be material to the financial statements.

The System participates in a public entity risk pool with the State of Maine. The System pays an annual premium to the State of Maine for its property and boiler insurance coverage. The risk pool is self-sustaining through member premiums and reinsures through commercial companies for claims in excess of coverage provided by the fund. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

It is the policy of the System not to purchase commercial insurance for the risk of loss related to workers' compensation. Instead, the System's management believes it is more economical to manage its risk internally and to set aside assets for claims settlement. The liability for unpaid claims is based on the requirements of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The System's estimated liability for workers' compensation claims is included in accrued liabilities in the accompanying Statements of Net Assets (see note 7).

The System's health insurance plan is financed through a minimum premium contract with a commercial carrier. The plan allows the System to benefit from favorable claim experience, should paid claims be less than the maximum claim liability under the contract. As of June 30, 2003, the System's paid claims had reached the maximum claim liability amount. Under a traditional premium arrangement, a component of the premium paid to the insurance carrier each month covers the terminal liability, or claims incurred during the period of coverage but not paid until after the period of coverage. However, under this minimum premium contract, the System retains the terminal liability component until the contract is terminated. As of June 30, 2003, the terminal liability was \$4,620 and is included as a liability in the accompanying Statements of Net Assets (see note 7).

The System continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

12. UNEXPENDED GRANTS

Generally, grants and contracts awarded to the System, but for which it has not fulfilled the eligibility requirements, e.g., incurred allowable costs, are not included in the System's financial statements. The total of such awards as of June 30, 2003 and 2002 was \$45,899 and \$48,421, respectively.

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In certain circumstances, however, the System receives cash in advance of fulfilling its obligations. In such situations, the System reports the cash as an asset and reports an offsetting deferred revenue liability in the Statements of Net Assets. Outstanding advances as of June 30, 2003 and 2002 System's totaled \$9,431 and \$7,267, respectively.

13. PENSION PLANS

The System has several single-employer pension plans, each of which is described in more detail below. The System's pension expense for these plans was as follows for the years ended June 30:

	<u>2003</u>	<u>2002</u>
<u>Faculty and Professional Employees:</u>		
Basic Retirement Plan	\$ 15,300	\$ 14,600
Incentive Plan	1,875	1,588
Classified Employees - All Plans	720	76
Total pension expense	\$ 17,895	\$ 16,264

Faculty and Professional Employee Plans

Contributory Retirement Plan

Eligible salaried employees participate in the University of Maine System Retirement Plan for Faculty and Professional Employees (Contributory Plan), a defined contribution retirement plan administered by the Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF). The Board of Trustees and collective bargaining agreements establish mandatory employee and employer contribution rates.

All full-time employees are eligible once employment begins. Part-time employees are eligible upon achieving the equivalent of five years of continuous, full-time, regular service. All eligible employees are required to participate when they reach thirty years of age. The System contributes an amount equal to 10% of each participant's base salary, and each participant contributes 4% of base salary. Participant and System contributions are fully and immediately vested. Participants may direct up to 100% of existing accumulations and/or future contributions to selected investment vehicles outside of TIAA/CREF. Upon separation from the System, participants may withdraw up to 100% of their account balances, or transfer funds to other investment alternatives subject to Internal Revenue Service limitations and the contractual provisions of the Contributory Plan.

Employee contributions made to the Contributory Plan were \$6,100 in fiscal 2003 and \$5,900 in fiscal 2002.

Incentive Retirement Plan

Employees enrolled in the Contributory Plan may elect to retire at any age after 55. Such employees, except for represented faculty who became employed on or after July 1, 1996, also participate in the University of Maine System Incentive Retirement Plan (Incentive Plan), a defined

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benefit plan, which was established on July 1, 1975. The Board of Trustees has authority to establish and amend provisions under the Incentive Plan. The Incentive Plan provides that eligible retiring employees with at least 10 years of continuous, full-time, regular equivalent service immediately prior to retirement will receive a benefit equivalent to 1½% times their completed years of service times their final annual base salary (up to a maximum of 27 years). This amount is to be paid as a lump-sum contribution to the participant's TIAA or CREF account. Employees do not make contributions under the Incentive Plan.

The Incentive Plan, which is funded on a termination basis (i.e., when costs become due and payable), holds no assets. The latest actuarial valuation, utilizing the projected unit credit actuarial cost method and 30-year declining-period, level-dollar amortization, was performed as of June 30, 2003. Interest was assumed to compound at an annual rate of 6.25%, and salaries were assumed to increase at an annual rate of 4%.

Summarized below are the accrued actuarial liability and actuarial value of assets at June 30.

	<u>2003</u>	<u>2002</u>
Actuarial accrued liability	\$19,980	\$17,824
Actuarial value of assets	-	-
Unfunded accrued actuarial liability	<u>\$19,980</u>	<u>\$17,824</u>

The net pension obligation (NPO) represents the cumulative difference between annual pension cost and employer contributions to the plan. The NPO is included in the accompanying Statements of Net Assets in non-current accrued liabilities (see Note 7). Three-year trend information through June 30, 2003, which provides an indication of the progress made in accumulating sufficient assets to pay benefits when they become due, was as follows:

	(a)	(b)	(c)	(d) (a)+(b)-(c)	(e)	(f) (e)/(d)	(g) (d)-(e)	
Fiscal Year Ended June 30	Annual Required Contribution (ARC)	Interest on NPO	ARC Adjustment	Annual Pension Cost (APC)	Employer Contributions Made	Percentage of APC Contributed	Change in NPO	Ending NPO Balance
2003	\$ 2,073	\$ 705	\$ 903	\$ 1,875	\$ 528	28%	\$ 1,347	\$ 12,621
2002	\$ 1,768	\$ 688	\$ 868	\$ 1,588	\$ 1,333	84%	\$ 255	\$ 11,274
2001	\$ 1,679	\$ 643	\$ 798	\$ 1,524	\$ 789	52%	\$ 735	\$ 11,019

Classified Employees

Basic Retirement Plan

The Defined Contribution Program of the Basic Retirement Plan for Classified Employees (Basic Plan) was created on July 1, 1998 in accordance with Section 403(b) of the Internal Revenue Code. Classified employees hired July 1, 1998 or later participate in the Basic Plan. Most eligible employees who were hired before July 1, 1998 and who were younger than age 50 as of

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(\$ in thousands)

June 30, 1998 rolled over to the Basic Plan the value of their accrued benefit in the Defined Benefit Retirement Plan for Classified Staff (Defined Benefit Plan, as described further below), which until that time was the primary pension plan for classified employees. Eligible employees who were hired before July 1, 1998 and aged 50 or older on June 30, 1998 could elect to roll over to the Basic Plan the value of their accrued benefit in the Defined Benefit Plan or remain in the Defined Benefit Plan.

Full-time employees are eligible to participate in the Basic Plan once employment begins. Part-time employees are eligible once they have achieved the equivalent of five years of continuous, full-time regular service. Upon separation from the System, participants may withdraw up to 100% of their account balances, or transfer funds to other investment alternatives subject to Internal Revenue Service limitations and the contractual provisions of the Basic Plan.

Employees hired July 1, 1998 or later are required to contribute at least 1% and may contribute up to 4% of base pay to the Basic Plan. Their contributions are matched 100% by the System. Employees hired prior to July 1, 1998 and who have less than five years of completed service may voluntarily contribute up to 4% of base pay and receive a 100% match from the System.

Employees who (1) have five or more years of completed service and (2) do not participate in the Defined Benefit Plan automatically receive System contributions equal to 6% of their base pay. These employees may also voluntarily contribute 1% to 4% of their base pay and receive a 100% match from the System.

Employee contributions made to the Basic Plan were \$1,300 in fiscal 2003 and \$1,300 in fiscal 2002.

Defined Benefit Plan

The Defined Benefit Plan is maintained for eligible employees who chose not to join the Basic Plan. Normal retirement benefits are paid to participants who attain age 65 and retire. The monthly retirement benefit is based on a formula specified by policy in collective bargaining agreements.

Early retirement benefits are paid to participants who retire upon the attainment of age 55 and who have completed five years of continuous service. The benefit is computed in accordance with the normal retirement benefit, but is reduced by an actuarial factor because benefits will be paid over a longer period of time. No reduction is made if an employee retires after attaining 62 years of age with 25 or more years of service. Deferred vested benefits are paid to participants who have attained five or more years of continuous service. Participants are also eligible for disability and death benefits.

The Defined Benefit Plan holds investment assets consisting principally of equities, bonds and cash equivalents to fund benefits. At June 30, 2003 and 2002, these assets exceeded the Defined Benefit Plan's actuarial accrued liability. Because the Defined Benefit Plan is a separate trust, its assets and liabilities are not included in the accompanying financial statements. The actuarial accrued liability is a standardized measure representing the actuarial present value of credited projected pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits estimated to be payable in the future, as a result of employee service rendered to date. The most recent actuarial valuation, utilizing the projected unit credit actuarial

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(\$ in thousands)

cost method and 10-year declining-period, level-dollar amortization, was performed as of June 30, 2003. Interest was assumed to compound at an annual rate of 6.5%, and salaries were assumed to increase at annual rate of 4%.

Summarized below are the accrued actuarial liability and actuarial value of assets at June 30:

	<u>2003</u>	<u>2002</u>
Actuarial accrued liability	\$ 69,802	\$ 58,005
Actuarial value of assets	75,058	68,644
Unfunded accrued actuarial liability	<u>\$ (5,256)</u>	<u>\$ (10,639)</u>

Employees who participate in the Defined Benefit Plan may also participate in the Optional Retirement Savings Plan (ORSP). The ORSP is a voluntary, employee-funded defined contribution plan. Employees may contribute up to 4% of their base pay and receive a 100% match from the System. The ORSP is administered by TIAA-CREF.

Funding of Basic and Defined Benefit Plans

While the Basic Plan and Defined Benefit Plan are administratively separate, they are both part of the Retirement Plan for Classified Employees and covered by the same plan document. In accordance with Section 414(k) of the Internal Revenue Code, the System may elect to fund employer contributions to the Basic Plan and ORSP from excess assets in the Defined Benefit Plan, subject to certain limitations. During fiscal 2003 and 2002, the System funded all employer contributions to the Basic Plan through the transfer of excess assets from the Defined Benefit Plan. Aggregate net annual pension cost for the Basic Plan, ORSP and Defined Benefit Plan for the years ended June 30, 2003 and 2002 was \$720 and \$76. Without transfers of excess assets from the Defined Benefit Plan, the System's total expense for the Basic Plan and ORSP for the years ended June 30, 2003 and 2002 would have been \$2,627 and \$2,455, respectively.

The NPO balance of the Defined Benefit Plan at transition was zero, since all actuarially determined required contributions were made by the System prior to that date. Annual required contributions and other metrics shown below accordingly reflect the funded status of the Defined Benefit Plan, as well as expected benefits attributable to the Basic Plan and ORSP. Three-year trend information through June 30, 2003, including changes in the NPO (which is included in non-current accrued liabilities in the accompanying Statements of Net Assets), was as follows:

Fiscal Year Ended June 30	(a) Annual Required Contribution (ARC)	(b) Interest on NPO	(c) ARC Adjustment	(d) (a)+(b)-(c) Annual Pension Cost (APC)	(e) Employer Contributions Made	(f) (e)/(d) Percentage of APC Contributed	(g) (d)-(e) Change in NPO	Ending NPO Balance
2003	\$ 741	\$ 7	\$ 28	\$ 720	\$ -	-	\$ 720	\$ 836
2002	\$ 81	\$ 3	\$ 8	\$ 76	\$ -	-	\$ 76	\$ 115
2001	\$ (290)	\$ 24	\$ 68	\$ (334)	\$ -	-	\$ (334)	\$ 39

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Notes To Financial Statements
June 30, 2003 and 2002
(\$ in thousands)

14. POSTEMPLOYMENT HEALTH PLAN

The System provides postemployment health insurance to retirees meeting certain age and years-of-service requirements. As of June 30, 2003, there were approximately 1,700 persons (including widows/widowers) receiving postemployment health benefits.

The System subsidizes the cost of insurance for the following persons:

- Retired from the System with at least 10 years of full-time regular service and has reached age 65 or
- A former employee approved for long-term disability benefits regardless of age or service

The subsidy for those meeting the above requirements is 100% of the cost for the retiree and 50% of the costs for eligible dependents. With certain restrictions, dependents are eligible to continue coverage at the 50% rate after the death of a retiree meeting the above criteria. As of June 30, 2003, there were approximately 1,500 persons receiving a subsidy from the System.

The following persons may also participate in the System's health insurance plan after retirement; however, they must pay 100% of the cost for themselves and their dependents:

- Retired from the System with at least 10 years of full-time regular service and has reached age 55 but is under age 65 or
- Retired from the System at age 65 or older but had not met the years-of-service requirement

As of June 30, 2003, there were approximately 200 persons participating in the plan but not receiving a subsidy from the System.

Health insurance coverage for eligible persons is provided as part of the System's regular health insurance contract. Persons eligible for a subsidy from the System may not convert their benefit into an in-lieu payment to secure coverage under independent plans.

The System finances and accounts for the postemployment health plan on a pay-as-you-go basis. Total gross costs for the years ended June 30, 2003 and 2002 were \$9,200 and \$6,500, respectively, with the participants contributing \$1,900 and \$1,500, respectively toward those costs.

15. FOUNDATIONS

The System is supported in part by several foundations and alumni associations that raise funds on the System's behalf. The largest of these foundations is the University of Maine Foundation ("UM Foundation"), an independent not-for-profit organization. Total gifts and income received by the System from the UM Foundation during the fiscal years ended June 30, 2003 and 2002 were \$3,600 and \$4,200, respectively. The reported fair market value of the UM Foundation's assets at June 30, 2003 and 2002 was \$108,400 and \$101,100, respectively.

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(\$ in thousands)

Under currently effective accounting principles, the UM Foundation and the other Foundations are not considered component units of the System; thus, their financial statements are not included with those of the System as of June 30, 2003 and 2002. However, in May 2002, GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, which establishes new criteria for evaluating the need to include supporting foundations and alumni associations in the System's financial statements as component units of the System. The System has reviewed the criteria and concluded that the UM Foundation meets the definition of a component unit under GASB Statement 39. During fiscal year 2004, the System will determine which of its other foundations and alumni associations should be considered component units and included in the System's June 30, 2004 financial statements.

Determination of the UM Foundation as a component unit is based on the nature and significance of the UM Foundation's relationship with the System and is not based on legal control, and does not affect the UM Foundation's ongoing operations. The UM Foundation will remain an independent, not-for-profit corporation operating as a tax-exempt 501(c)(3) organization under the US Internal Revenue Code. Voting members of the UM Foundation will continue to elect its Board of Directors. The Board has responsibility for the overall policy of the UM Foundation, subject to the ultimate control by the UM Foundation's membership.

16. PASS-THROUGH GRANTS

During fiscal year 2003 and 2002, the System distributed \$9,313 and \$9,279, respectively, for student loans through the U.S. Department of Education Federal Direct Lending Program. These distributions and related funding sources are not included as expenses and revenues nor as cash disbursements and cash receipts in the accompanying financial statements.

17. RECONCILIATION OF FISCAL 2002 BEGINNING NET ASSETS

The System adopted the provisions of GASB Statements No. 34 and 35 as of July 1, 2001. Following is a reconciliation of total fund balances as of June 30, 2001 as originally reported to total net assets as of July 1, 2001:

Total fund balances as originally reported, June 30, 2001	\$461,697
Federal portion of Perkins and Nursing Loan Programs	(27,958)
Library materials net of depreciation	24,062
Other	<u>(6,009)</u>
Total net assets, July 1, 2001	<u>\$451,792</u>

UNIVERSITY OF MAINE SYSTEM

Required Supplementary Information - Retirement Plans
Schedules of Funding Progress, Employers' Contributions, and Related Note
Year ended June 30, 2003

(Unaudited)

(In thousands of dollars)

Schedules of Funding Progress

Actuarial valuation (date as of June 30)	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll (b-a)/(c)
Incentive Retirement Plan for Faculty and Professionals						
2003	\$ —	\$ 19,980	\$ 19,980	—	\$ 127,531	15.7%
2002	\$ —	\$ 17,824	\$ 17,824	—	\$ 100,463	17.7%
2001	\$ —	\$ 15,371	\$ 15,371	—	\$ 96,599	15.9%
2000	\$ —	\$ 14,739	\$ 14,739	—	\$ 92,883	15.9%
1999	\$ —	\$ 14,220	\$ 14,220	—	\$ 89,311	15.9%
1998	\$ —	\$ 13,704	\$ 13,704	—	\$ 85,876	16.0%
Retirement Plan for Classified Staff						
2003	\$ 75,058	\$ 69,802	\$ (5,256)	107.5%	\$ 8,770	(59.9%)
2002	\$ 68,644	\$ 58,005	\$ (10,639)	118.3%	\$ 9,276	(114.7%)
2001	\$ 69,230	\$ 55,033	\$ (14,197)	125.8%	\$ 9,730	(145.9%)
2000	\$ 73,928	\$ 57,601	\$ (16,327)	128.3%	\$ 10,365	(157.5%)
1999	\$ 71,783	\$ 55,592	\$ (16,191)	129.1%	\$ 11,039	(146.7%)
1998	\$ 68,373	\$ 51,475	\$ (16,898)	132.8%	\$ 11,373	(148.6%)

Schedules of Employers' Contributions

Year ended June 30	Annual required contribution	Percentage contributed	Annual required contribution	Percentage contributed
Incentive Retirement Plan for Faculty and Professionals		Retirement Plan for Classified Staff		
2003	\$ 2,073	25%	\$ 741	—
2002	\$ 1,768	75%	\$ 81	—
2001	\$ 1,679	47%	\$ (290)	—
2000	\$ 1,603	53%	\$ 28	—
1999	\$ 1,530	52%	\$ 62	—
1998	\$ 1,434	56%	\$ 610	42%

Note to Schedules

The information presented in the required supplementary schedules as of June 30, 2003 was determined using the actuarial valuation as of June 30, 2003 with the following significant assumptions:

	Incentive Retirement Plan for Faculty and Professionals	Retirement Plan for Classified Staff
Actuarial cost method	Projected unit credit	Projected unit credit
Amortization method	30-year declining period, level dollar	10-year declining period, level dollar
Remaining amortization period	24 years	4 years
Asset valuation method	N/A	5-year smoothing of differences between actual and expected returns
Actuarial assumptions:		
Investment rate of return	6.25%	6.5% (8% for 6/30/1998)
Projected salary increases	4.00%	4.00%
Cost-of-living adjustments	N/A	N/A



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**Report on Compliance and on Internal Control over
Financial Reporting Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
University of Maine System:

We have audited the basic financial statements of the University of Maine System (the System), a component unit of the State of Maine, as of and for the year ended June 30, 2003, and have issued our report thereon dated October 10, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the System's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Audit Committee of the Board of Trustees, management, and federal and state awarding agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

October 10, 2003



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