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Universities*

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**UNIVERSITY OF MAINE SYSTEM  
ANNUAL FINANCIAL REPORT  
YEAR ENDED JUNE 30, 2004**

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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 Director, 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 2004 ANNUAL FINANCIAL REPORT

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Richard L. Pattenaude	University of Southern Maine

## **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 46,000 students and is supported by the efforts of 1,377 regular full-time faculty, 113 regular part-time faculty, 3,376 regular full-time staff, and 416 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)	

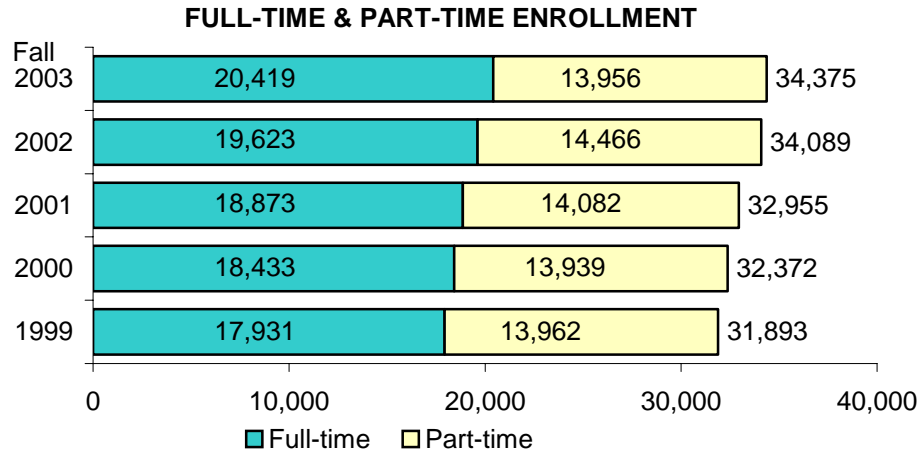
The Lewiston-Auburn College is administered by the University of Southern Maine and houses both University of Southern Maine and University of Maine at Augusta programs. The University College of Bangor is also a campus of the University of Maine at Augusta.

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:

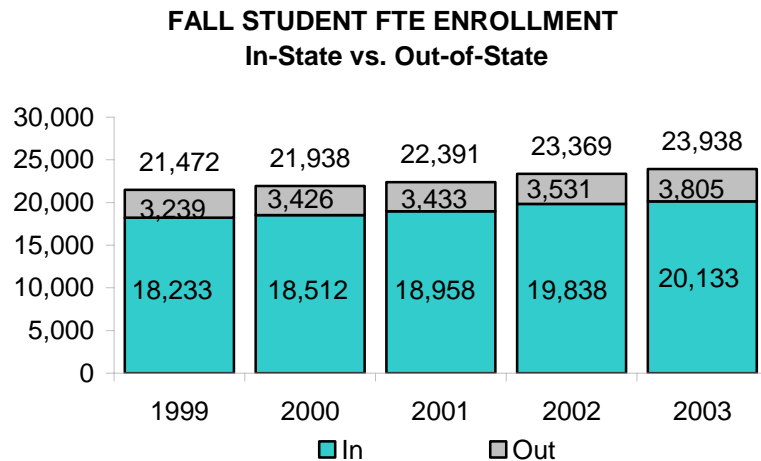
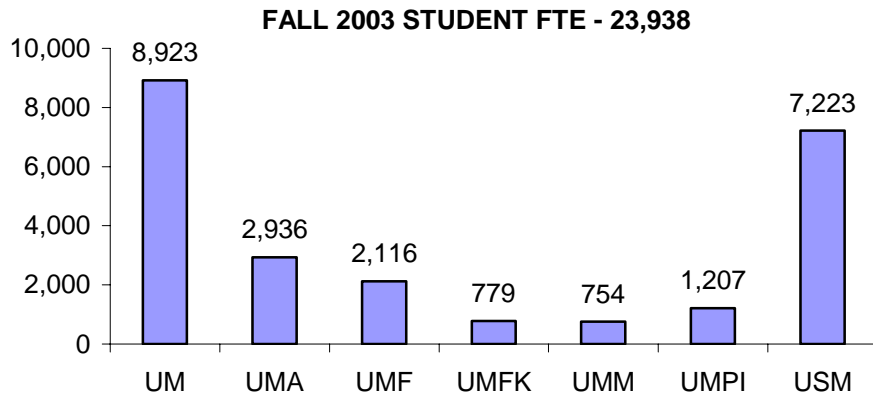
Bath/Brunswick	Oxford Hills
Calais	Saco/Biddeford
Dover-Foxcroft	Sanford
East Millinocket	Rumford/Mexico
Ellsworth	Thomaston
Houlton	

# STUDENT ENROLLMENT

Once again, the University of Maine System experienced a growth in enrollment. 34,375 students were enrolled for the Fall 2003 semester, as compared to 34,089 for the Fall 2002 semester, which represents a 0.8% increase. Of the total student population, 59% were enrolled on a full-time basis and 88% of those enrolled were Maine residents.



Fall full-time equivalent (FTE) enrollment totaled 23,938 and increased 2.4% above the previous year's total of 23,369.



# STUDENT COSTS

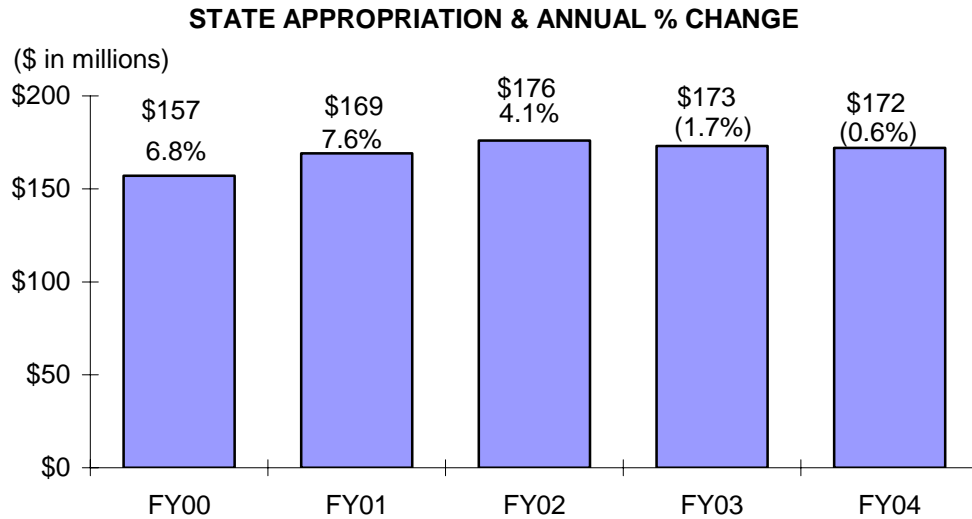
## 2003/2004 COMPREHENSIVE COST OF EDUCATION

<u>Undergraduate</u>	Annual Tuition	Mandatory Fees	Tuition & Mandatory Fees*	Room & Board	Total
<b>In-State</b>					
UM	\$4,710	\$1,204	\$5,914	\$6,156	\$12,070
UMA	3,690	705	4,395	-	4,395
UMF	4,290	500	4,790	5,318	10,108
UMFK	3,690	494	4,184	4,880	9,064
UMM	3,690	485	4,175	5,150	9,325
UMPI	3,690	500	4,190	4,965	9,155
USM	4,320	618	4,938	6,014	10,952
Weighted Average	4,297	820	5,117	5,879	10,996
<b>Out-of-State</b>					
UM	\$13,410	\$1,204	\$14,614	\$6,156	\$20,770
UMA	8,940	705	9,645	-	9,645
UMF	10,470	500	10,970	5,318	16,288
UMFK	8,940	494	9,434	4,880	14,314
UMM	9,630	485	10,115	5,150	15,265
UMPI	9,240	500	9,740	4,965	14,705
USM	12,000	618	12,618	6,014	18,632
Weighted Average	11,616	820	12,436	5,879	18,315
<b>Graduate</b>					
<b>In-State</b>					
UM	\$4,230	\$516	\$4,746	\$6,156	\$10,902
USM	3,870	324	4,194	6,014	10,208
Weighted Average	4,030	420	4,450	5,879	10,329
<b>Out-of-State</b>					
UM	\$12,060	\$516	\$12,576	\$6,156	\$18,732
USM	10,836	324	11,160	6,014	17,174
Weighted Average	11,801	420	12,221	5,879	18,100
<b>Law School</b>					
<b>In-State</b>					
1st Year	\$12,000	\$580	\$12,580	\$6,014	\$18,594
2nd & 3rd Year	11,700	580	12,280	6,014	18,294
Weighted	11,823	580	12,403	6,014	18,417
<b>Out-of-State</b>					
1st Year	\$20,250	\$580	\$20,830	\$6,014	\$26,844
2nd & 3rd Year	19,800	580	20,380	6,014	26,394
Weighted	20,043	580	20,623	6,014	26,637

\* 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.

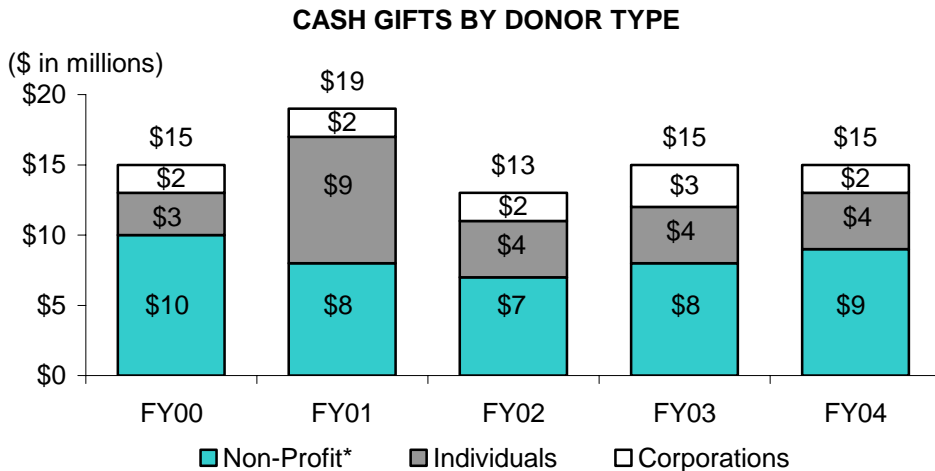
## STATE APPROPRIATION

The Educational & General State Appropriation and the Research & Development State Appropriation received by the University of Maine System decreased in FY04 by approximately \$1 million.



## GIFTS

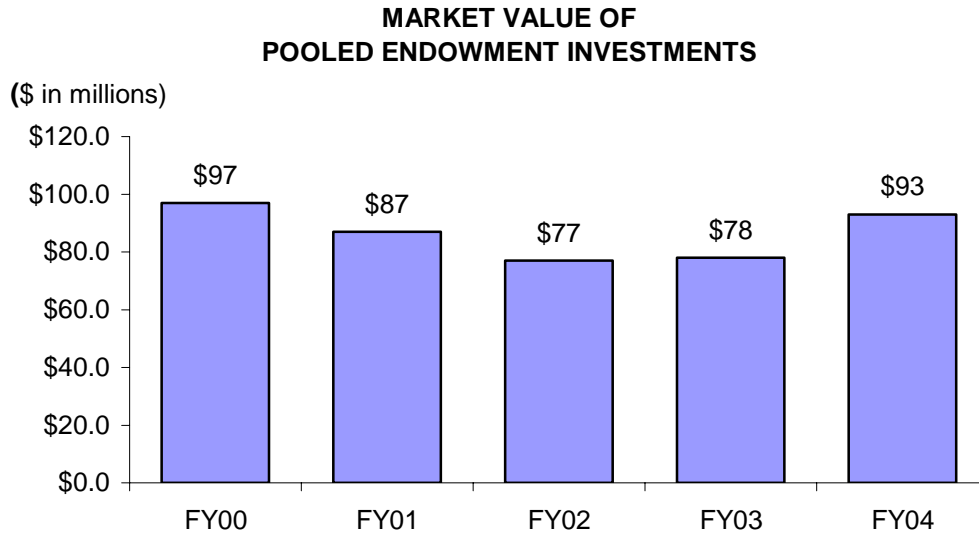
Total giving has remained relatively constant over the past 5 years. It should be noted that the gifts received from individuals during FY01 included a single-donor contribution of \$5 million.



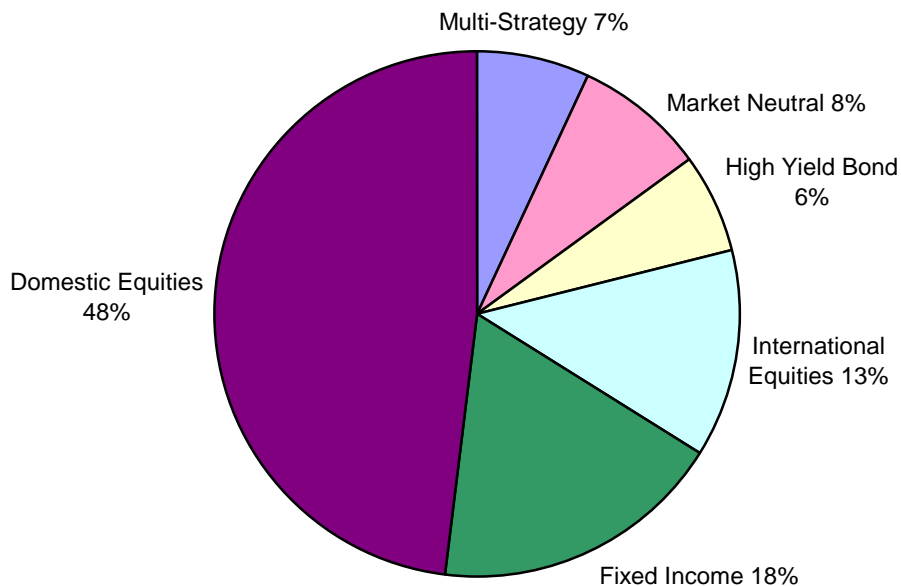
\*Non-Profit includes foundations, governmental agencies, and other non-profit groups

## 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.



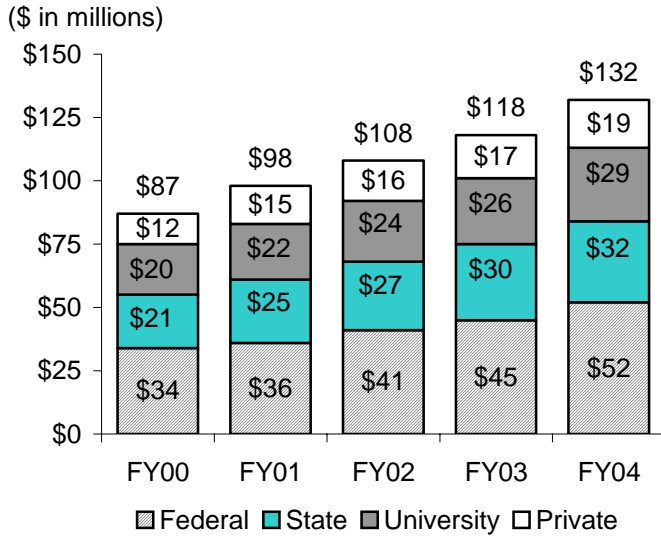
The endowment pooled investments are diversified by asset class to minimize risk while optimizing return. Following is the asset allocation of the pool as of June 30, 2004.



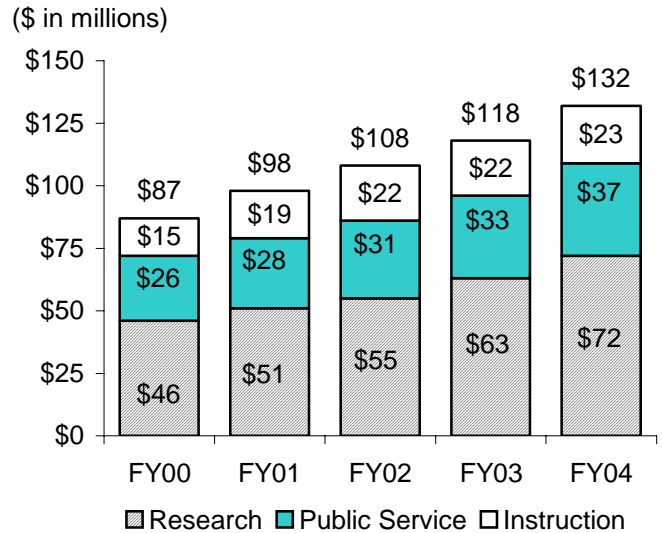
## SPONSORED PROGRAMS

Sponsored programs revenue increased 12% and totaled \$132 million for FY04. Federal funding accounted for 39% of the total sponsored programs revenue. During FY04, 55% of all sponsored programs expenditures were for research.

**REVENUE BY SOURCE**



**EXPENDITURES BY ACTIVITY**





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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, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended, and the statement of financial position of the System's aggregate discretely presented component units as of June 30, 2004, and the related statement of activities for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the aggregate discretely presented component units, are based on the reports of the other auditors.

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. The financial statements of the aggregate discretely presented units were not audited in accordance with *Government Auditing Standards*. 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 and the reports of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended, and the financial position of the System's aggregate discretely presented component units as of June 30, 2004, and the changes in their net assets for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in note 16, the System adopted, effective July 1, 2003, Statement No. 39 of the Governmental Accounting Standards Board (GASB), *Determining Whether Certain Organizations are Component Units (an amendment of GASB Statement 14)*.



The management's discussion and analysis on pages 11 through 19 and the supplementary schedules of funding progress and employers' contributions on page 51 are not a required part 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.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedules of activities (Schedules 1 and 2) for the years ended June 30, 2004 and 2003 are presented for purposes of additional analysis as required by the State of Maine and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2004 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. The report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

KPMG LLP

October 15, 2004

UNIVERSITY OF MAINE SYSTEM  
Management's Discussion and Analysis (unaudited)  
June 30, 2004 and 2003  
(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, 2004 and 2003. 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. Also included for the first time in FY2004 is the Statement of Financial Position and the Statement of Activities for aggregate discretely presented component units. These have been included as required by GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. The MD&A only includes information for the System and not its component units. These financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Revenues and expenses are categorized as either operating or non-operating. Certain significant recurring revenues and expenses including state appropriations, gifts, investment income or loss, and interest expense are considered non-operating. 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.

UNIVERSITY OF MAINE SYSTEM  
Management's Discussion and Analysis (unaudited)  
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(In Thousands of Dollars)

**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, 2004, 2003, and 2002 is as follows:

<b>Condensed Net Assets Information</b>	2004	2003	2002
Current assets	\$ 168,927	\$ 155,174	\$ 152,253
Noncurrent assets:			
Endowment	92,833	78,344	77,435
Capital assets	440,319	395,695	356,995
Other noncurrent assets	84,068	89,732	109,272
<b>Total assets</b>	<b>786,147</b>	<b>718,945</b>	<b>695,955</b>
Current liabilities	59,891	54,726	56,289
Noncurrent liabilities:			
Long-term debt	141,936	122,557	126,764
Other noncurrent liabilities	71,142	65,641	57,921
<b>Total liabilities</b>	<b>272,969</b>	<b>242,924</b>	<b>240,974</b>
Net Assets:			
Invested in capital assets, net of related debt	326,859	304,930	285,320
Restricted - nonexpendable	47,047	44,225	42,470
Restricted - expendable	81,985	68,935	81,135
Unrestricted	57,287	57,931	46,056
<b>Total net assets</b>	<b>\$ 513,178</b>	<b>\$ 476,021</b>	<b>\$ 454,981</b>

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 2004 increase of \$21,929 and the 2003 increase of \$19,610 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 \$2,822 increase in 2004 and the \$1,755 increase in 2003 is the result of new gifts of \$1,513 and \$2,022, 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 externally imposed conditions on spending. Increased spending for property, plant, and

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equipment is the primary driver behind the reduction in 2003. The increase of \$13,050 in 2004 is primarily the result of improved market conditions impacting the endowment fund.

Although unrestricted net assets are not subject to externally imposed stipulations and are sometimes referred to as "reserves", these assets have been committed to specific projects, operational and capital needs, or endowment funds for committed scholarships. Given both the physical and financial size of the University of Maine System, funds must be readily available to meet emergency needs, fund accounting pronouncement requirements, cover occasional annual operating losses and over-expenditures on capital projects, pay severance arrangements during periods of restructuring and address an excessive maintenance backlog. The decrease in unrestricted net assets for 2004 of \$644 is primarily attributable to a decline in investment income. The increase in unrestricted net assets in 2003 of \$11,875 is attributable to Educational & General and Auxiliary Operations.

The table below summarizes the components of unrestricted net assets as of June 30, 2004.

<b>Unrestricted Net Assets as of June 30, 2004 designated for:</b>	
Specific Projects	\$10,110
Operational and Capital Needs	40,851
Endowment Funds	<u>6,326</u>
<b>Total</b>	<b><u><u>\$57,287</u></u></b>

**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 provided for an annual distribution of 5.5% of the average net market value of the endowment for the prior 12 quarters. For FY05, this rate will be changing to 5.25%.

The System's endowment investments had a fair market value of \$92,833 at June 30, 2004, reflecting an increase of \$14,489 above the fair market value of \$78,344 at June 30, 2003 which is primarily attributable to market value appreciation. Gifts, charitable gift annuities, and investment income (net of investment fees) remained relatively unchanged while spending for scholarships, operations, and various transfers decreased during 2004. The System's endowment investments for 2003 reflected an increase of \$909 primarily as the result of increasing market values.

The total return on the pooled endowments on a net of fees basis for 2004 was 19.2% as compared to 4.8% for 2003. This increase in 2004 reflects solid returns in the equities market. The increase in 2003 reflected the continued performance of the fixed income markets and modest returns in the equities market.

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**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 of \$65,243 in 2004 and \$66,147 in 2003 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 2004 and 2003 were funded primarily with State of Maine capital appropriations and University of Maine System revenue bonds.

Of the total capital additions before depreciation for 2004, \$58,329 represented capital construction. Classroom construction or renovation included the Advanced Manufacturing Center and the Engineering/Science Research Complex at UM and the Bioscience Building, John Mitchell Center, and the Community Education Facility at USM. A new residential hall was constructed at UMFK and sprinkler systems continue to be installed in residential halls across the System. Projects in progress also included the digital library and the Project Enterprise 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 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 were installed in various residential halls across the System. Projects in progress also included the Enterprise Resource Planning (ERP) implementation of PeopleSoft.

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, 2004 and 2003 was \$147,951 and \$128,117, respectively. Of the total debt as of June 30, 2004, \$147,245 was in the form of bonds as compared to \$127,781 as of June 30, 2003. In March 2004 revenue bonds were issued to fund capital construction and to partially refund the 1998 Series A and 2000 Series A Revenue Bonds which will result in reduced debt service payments.

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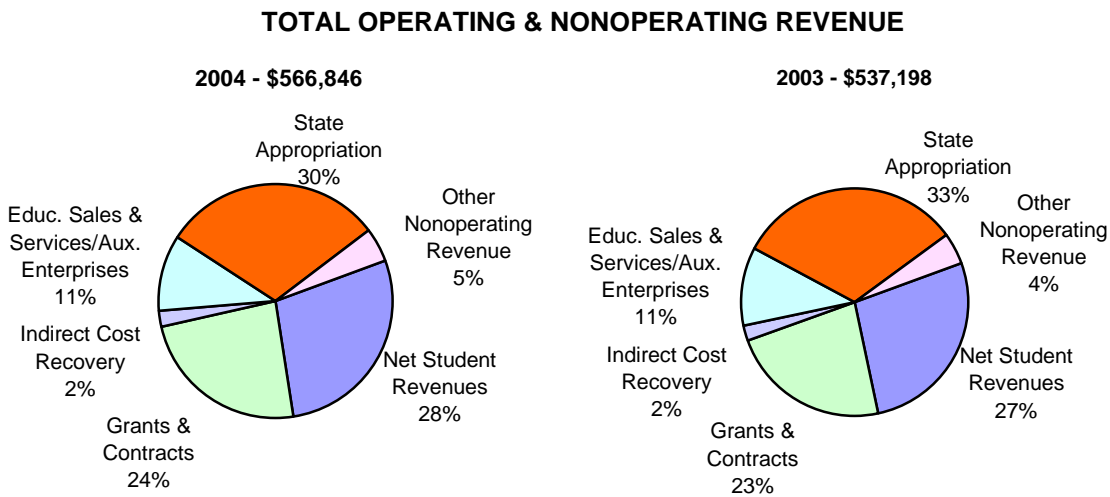
**Condensed Revenues, Expenses, and Changes in Net Assets**

	2004	2003	2002
Operating Revenues:			
Net student revenues	\$ 159,447	\$ 145,708	\$ 131,302
Grants and contracts	134,046	122,439	113,550
Indirect cost recovery	12,873	11,546	10,816
Educational sales and services & Other auxiliary enterprises	60,678	59,937	51,216
Interest income on loans	789	725	739
Total operating revenues	<u>367,833</u>	<u>340,355</u>	<u>307,623</u>
Operating Expenses	<u>552,262</u>	<u>528,111</u>	<u>495,012</u>
Net operating loss	<u>(184,429)</u>	<u>(187,756)</u>	<u>(187,389)</u>
Non-operating revenues (expenses):			
State appropriation - general	172,121	173,050	176,388
Gifts	9,835	11,801	11,037
Endowment income distributed for operations	4,765	5,104	5,271
Investment income	2,625	9,099	6,602
Interest expense	(3,370)	(3,575)	(4,079)
Other nonoperating expenses	(1,328)	-	-
Sub-total	<u>184,648</u>	<u>195,479</u>	<u>195,219</u>
<b>Income before endowment return (net of amount used for operations) and other revenues</b>	<b>219</b>	<b>7,723</b>	<b>7,830</b>
Endowment return (net of amount used for operations)	9,667	(2,211)	(12,338)
Income (loss) before other Revenues	\$ 9,886	\$ 5,512	\$ (4,508)
Other Revenues			
Capital appropriations	20,725	11,452	3,035
Capital grants and gifts	5,033	2,054	3,306
Additions to permanent endowments - gifts	1,513	2,022	1,356
	<u>27,271</u>	<u>15,528</u>	<u>7,697</u>
Increase in Net Assets	37,157	21,040	3,189
Net Assets			
Net Assets - beginning of year	476,021	454,981	451,792
Net Assets - end of year	<u>\$ 513,178</u>	<u>\$ 476,021</u>	<u>\$ 454,981</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 non-operating revenue sources used to fund the System's activities for the years ended June 30, 2004 and 2003.



**Operating Revenues**

Tuition and fees and residence and dining fees are the primary sources of operating revenue and in 2004 totaled \$159,447 after adjusting for scholarship allowances, reflecting an increase of \$13,739 or 9.4% over 2003 revenue of \$145,708. This change is the result of a 7.6% weighted average increase in tuition, a 4.6% 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 2003 after adjusting for scholarship allowances, reflected an increase of \$14,406 or 11.0% over 2002 revenue. This change was the result of a 4.6% weighted average increase in tuition, a 3.9% weighted average increase in room and board rates, an adjustment for reciprocating amounts between student revenues and financial aid, 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 \$11,607 to \$134,046 in 2004 from \$122,439 in 2003. Sponsored program revenues increased in 2003 by \$8,889. 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.

**UNIVERSITY OF MAINE SYSTEM**  
**Management's Discussion and Analysis (unaudited)**  
**June 30, 2004 and 2003**  
**(In Thousands of Dollars)**

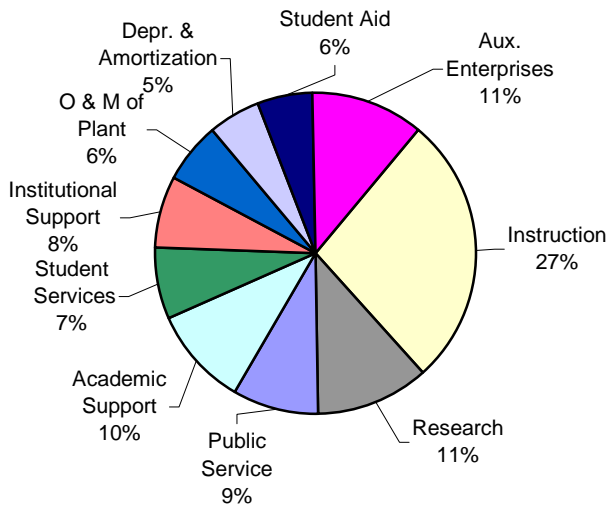
Although not considered an operating revenue, the state appropriation for operations is the largest funding source for educational and general operations. When compared to fiscal year 2003, the state appropriation to the System decreased by \$929 or .5% for 2004 due to state budgetary constraints. The state appropriation for 2003 reflected a decrease of \$3,338 or 1.9% over 2002 funding levels. For fiscal years 2004 and 2003, the general state appropriation covered 93% and 92% respectively of the net operating losses.

**Operating Expenses**

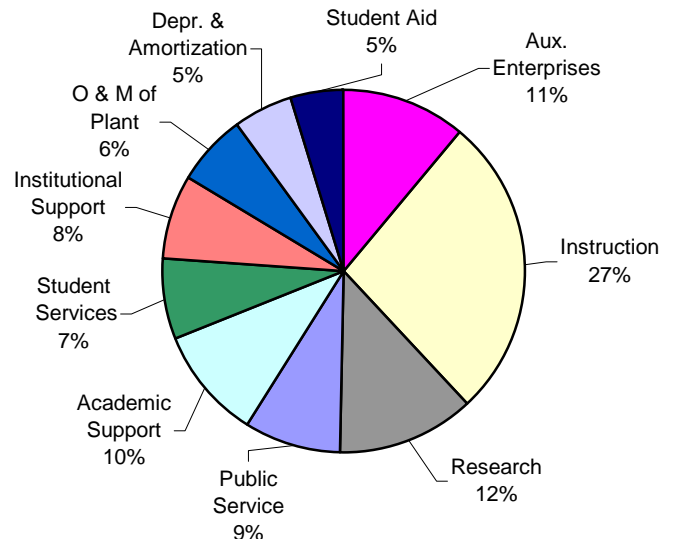
Operating expenses, classified by function, were as follows:

	2004	2003	2002
Instruction	\$147,374	\$142,582	\$135,506
Research	72,216	63,913	57,150
Public service	47,849	45,807	42,386
Academic support	61,336	53,300	50,205
Student services	38,661	37,117	35,214
Institutional support	39,973	40,072	37,350
Operation and maintenance of plant	35,562	34,268	29,671
Depreciation and amortization	20,724	27,511	25,736
Student aid	26,319	24,694	24,846
Auxiliary enterprises	62,248	58,847	56,948
<b>Total</b>	<b>\$552,262</b>	<b>\$528,111</b>	<b>\$495,012</b>

**2004 - \$552,262**



**2003 - \$528,111**

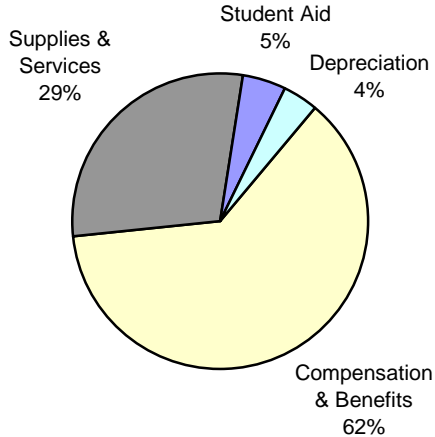


UNIVERSITY OF MAINE SYSTEM  
Management's Discussion and Analysis (unaudited)  
June 30, 2004 and 2003  
(In Thousands of Dollars)

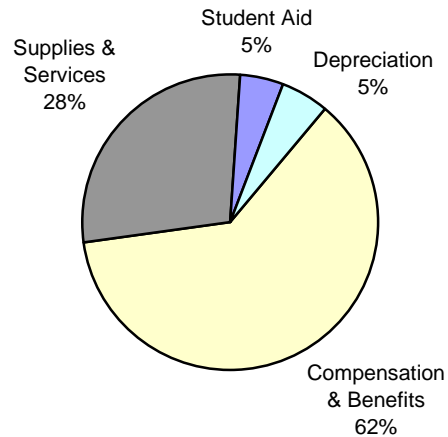
Although the System reports expenses on a functional basis, a comparative summary of the System's expenses based on a natural classification is as follows:

	2004	2003	2002
<b>Operating:</b>			
Compensation and benefits	\$ 344,086	\$ 325,745	\$ 300,307
Supplies and services	161,133	150,161	144,123
Depreciation	20,724	27,511	25,736
Student aid	26,319	24,694	24,846
	<u>552,262</u>	<u>528,111</u>	<u>495,012</u>
<b>Nonoperating:</b>			
Interest and other	4,698	3,575	4,079
<b>Total Expenses</b>	<u>\$ 556,960</u>	<u>\$ 531,686</u>	<u>\$ 499,091</u>

**2004 - \$552,262**



**2003 - \$528,111**



The amount expended for compensation and benefits increased by \$18,341 or 5.6% for 2004 as compared to the increase of \$25,438 or 8.5% for 2003. This increase in 2004 is primarily the result of annual employee compensation increases and employment growth. The 2003 increase in compensation and benefits was 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. 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 2.4% increase in fall full-time equivalent student enrollment and the 1.6% increase in diners and dormitory occupancy for 2004 generated additional revenues but also resulted in additional supplies and services expenditures and employment growth.

UNIVERSITY OF MAINE SYSTEM  
Management's Discussion and Analysis (unaudited)  
June 30, 2004 and 2003  
(In Thousands of Dollars)

### Impact of Future Economic Factors

All sources of operating revenues increased in FY2004 and are expected to increase in FY2005. Total enrollments at the System have been steadily increasing since 1997 with a record number of students entering for the Fall 2003 semester. With the number of Maine high school graduates projected to decline over the next few years, the System is working to offset the potential decline in enrollment by increasing recruitment efforts with out-of-state and non-traditional student populations.

During FY2004, the University of Maine System Senior Staff and Board of Trustees developed a Strategic Plan which was approved at the September 2004 Board of Trustees meeting. The following strategies were identified to close a projected financial structural gap over the next five years:

- Restructure the University System
- Seek restoration of de-appropriated State funding
- Advocate for State appropriation increases
- Adopt reasonable and affordable increases in tuition and fees at levels necessary to augment State appropriations and to sustain academic quality
- Institute System-wide efficiencies
- Increase student enrollment & retention
- Increase university endowments
- Broaden the revenue base through alternative sources of funding

The Strategic Plan features nine strategic directions covering academic quality, administrative structure, cost-effectiveness, and entrepreneurial partnerships. Some of these directions include increased collaboration with the Maine Community College System to assume more associate degree programs currently administered by the UMS, adequate compensation and support for faculty and staff, administrative connection between distance education centers and universities, library enhancements, increased research, require appropriate goals and objectives accountability, centralization of appropriate business/administrative functions, and defining the missions, niches, and interrelationships of the individual universities within the University of Maine System.

University of Maine System management feels that the Strategic Plan will provide the foundation for the System to strengthen Maine's public higher education system, both financially and academically, to ensure that students will have broad access to a high-quality, affordable education.

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 FY2004 state appropriation was originally budgeted at \$177 million. Due to the State's financial situation, the System ultimately received \$172 in state appropriation – a decrease of \$5 million. State appropriation for FY2005 has been budgeted at \$180 million. Although this reflects an increase over the actual amount received for FY2004, this is still below the original budgeted appropriation for FY2003 of \$183 million. 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 FY2005. The System is continuing to seek additional state support and supplemental revenue sources to alleviate the costs paid by students.

**UNIVERSITY OF MAINE SYSTEM**  
**Statements of Net Assets**  
**June 30, 2004 and 2003**  
(In Thousands of Dollars)

<b>ASSETS</b>	<u>2004</u>	<u>2003</u>
<u>Current Assets:</u>		
Cash and cash equivalents (Note 2)	\$ -	\$ 3,507
Short-term investments (Note 3)	131,925	115,210
Accounts, grants, and pledges receivable, net (Note 4)	31,345	31,475
Inventories and prepaid expenses	5,657	4,982
Total Current Assets	<u>168,927</u>	<u>155,174</u>
<u>Noncurrent Assets:</u>		
Deposits with bond trustees (Notes 3 and 6)	37,822	46,806
Accounts, grants, and pledges receivable, net (Note 4)	5,868	3,648
Notes receivable, net (Note 5)	38,374	37,716
Endowment investments (Note 3)	92,833	78,344
Bond issuance costs, net (Note 7)	2,004	1,562
Capital assets, net (Note 6)	440,319	395,695
Total Noncurrent Assets	<u>617,220</u>	<u>563,771</u>
Total Assets	<u>\$ 786,147</u>	<u>\$ 718,945</u>
<b>LIABILITIES</b>		
<u>Current Liabilities:</u>		
Accounts payable	\$ 12,354	\$ 13,432
Deferred revenue and deposits (Notes 8 and 12)	20,348	16,195
Accrued liabilities (Notes 7 and 11)	20,571	18,987
Funds held for others	603	552
Current portion of capital lease obligations (Note 7)	265	206
Current portion of bonds and note payable (Note 7)	5,750	5,354
Total Current Liabilities	<u>59,891</u>	<u>54,726</u>
<u>Noncurrent Liabilities:</u>		
Accrued liabilities (Notes 7 and 11)	33,637	29,772
Funds held for others (Note 3)	5,401	3,379
Capital lease obligations (Note 7)	441	130
Bonds and note payable, net (Note 7)	141,495	122,427
Government advances refundable (Note 9)	32,104	32,490
Total Noncurrent Liabilities	<u>213,078</u>	<u>188,198</u>
Total Liabilities	<u>272,969</u>	<u>242,924</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	326,859	304,930
Restricted:		
Nonexpendable (Note 10)	47,047	44,225
Expendable (Notes 3 and 10)	81,985	68,935
Unrestricted	57,287	57,931
Contingencies (Note 11)	-	-
Total Net Assets	<u>513,178</u>	<u>476,021</u>
Total Liabilities and Net Assets	<u>\$ 786,147</u>	<u>\$ 718,945</u>

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM  
Statement of Financial Position – Aggregate Discretely Presented Component Units  
June 30, 2004  
(In Thousands of Dollars)

**ASSETS**

Cash and cash equivalents	\$ 15
Accounts receivable and promises to give	677
Investments	125,879
Other assets	<u>19,661</u>
Total Assets	<u><u>\$ 146,232</u></u>

**LIABILITIES**

Accounts payable and other liabilities	1,837
Notes payable	5,811
Custodial accounts payable	<u>1,332</u>
Total Liabilities	<u><u>8,980</u></u>

**NET ASSETS**

Unrestricted net assets	14,349
Temporarily restricted net assets	30,333
Permanently restricted net assets	<u>92,570</u>
Total Net Assets	<u><u>137,252</u></u>
Total Liabilities and Net Assets	<u><u>\$ 146,232</u></u>

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM  
 Statements of Revenues, Expenses, and Changes in Net Assets  
 Years Ended June 30, 2004 and 2003  
 (In Thousands of Dollars)

	<u>2004</u>	<u>2003</u>
<b>REVENUES</b>		
Operating Revenues:		
Tuition and fees	\$ 156,824	\$ 143,742
Residence and dining fees	46,832	44,426
Less: scholarship allowances	<u>(44,209)</u>	<u>(42,460)</u>
Net student fees	159,447	145,708
Federal, state, and private grants and contracts	134,046	122,439
Recovery of indirect costs	12,873	11,546
Educational sales and services and other auxiliary enterprises	60,678	59,937
Interest income on loans	789	725
Total Operating Revenues	<u>367,833</u>	<u>340,355</u>
<b>EXPENSES</b>		
Operating Expenses:		
Instruction	147,374	142,582
Research	72,216	63,913
Public service	47,849	45,807
Academic support	61,336	53,300
Student services	38,661	37,117
Institutional support	39,973	40,072
Operation and maintenance of plant	35,562	34,268
Depreciation and amortization	20,724	27,511
Student aid	26,319	24,694
Auxiliary enterprises	<u>62,248</u>	<u>58,847</u>
Total Operating Expenses	<u>552,262</u>	<u>528,111</u>
Operating Loss	<u>(184,429)</u>	<u>(187,756)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Noncapital State of Maine appropriations	172,121	173,050
Gifts	9,835	11,801
Endowment income distributed for operations (Note 3)	4,765	5,104
Endowment return, net of amount used for operations (Note 3)	9,667	(2,211)
Investment income (Note 3)	2,625	9,099
Interest expense (Notes 7 and 8)	(3,370)	(3,575)
Other nonoperating expenses	<u>(1,328)</u>	<u>-</u>
Net Nonoperating Revenue	<u>194,315</u>	<u>193,268</u>
Income Before Other Revenues	<u>9,886</u>	<u>5,512</u>
<b>OTHER REVENUES</b>		
State of Maine capital appropriations	20,725	11,452
Capital grants and gifts	5,033	2,054
Additions to permanent endowments - gifts and state appropriation	<u>1,513</u>	<u>2,022</u>
Total Other Revenues	<u>27,271</u>	<u>15,528</u>
Increase in Net Assets	37,157	21,040
<b>NET ASSETS</b>		
Net Assets - beginning of year	<u>476,021</u>	<u>454,981</u>
Net Assets - end of year	<u>\$ 513,178</u>	<u>\$ 476,021</u>

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM  
Statement of Activities – Aggregate Discretely Presented Component Units  
Year Ended June 30, 2004  
(In Thousands of Dollars)

**CHANGES IN UNRESTRICTED NET ASSETS**

Public Support, Revenues, and Reclassification	
Contributions and Memberships	\$ 641
Investment and other income	2,160
Net assets released from restrictions	4,970
Total Support, Revenues, and Reclassification	<u>7,771</u>
Expenses	
Program	5,672
Management and general	805
Fundraising	704
Total Expenses	<u>7,181</u>
Increase in Unrestricted Net Assets	<u>590</u>

**CHANGES IN TEMPORARILY RESTRICTED NET ASSETS**

Contributions	2,160
Investment and other income	14,801
Net assets released from restrictions	<u>(4,865)</u>
Increase in Temporarily Restricted Net Assets	<u>12,096</u>

**CHANGES IN PERMANENTLY RESTRICTED NET ASSETS**

Contributions	8,034
Investment and other income	1,201
Net assets released from restrictions	<u>(105)</u>
Increase in Permanently Restricted Net Assets	<u>9,130</u>
Increase in Total Net Assets	21,816

**NET ASSETS**

Net Assets, beginning of year	<u>115,436</u>
Net Assets, end of year	<u><u>\$ 137,252</u></u>

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM  
Statements of Cash Flows  
Years Ended June 30, 2004 and 2003  
(In Thousands of Dollars)

	<u>2004</u>	<u>2003</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Tuition, residence, dining, and other student fees	\$ 160,182	\$ 144,550
Grants and contracts	146,597	132,774
Educational sales and services and other auxiliary enterprise revenues	60,276	54,846
Payments to and on behalf of employees	(341,051)	(311,407)
Financial aid paid to students	(24,456)	(25,421)
Payments to suppliers	(157,087)	(159,673)
Loans issued to students	(9,102)	(7,767)
Collection of loans to students	7,361	6,838
Interest collected on loans to students	788	725
Other operating receipts	514	515
Net Cash Used For Operating Activities	<u>(155,978)</u>	<u>(164,020)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
State appropriations	171,835	173,336
Noncapital grants and gifts	11,286	10,838
Gifts and appropriations received for permanent endowment	1,513	2,022
Agency transactions	(334)	265
Net Cash Provided By Noncapital Financing Activities	<u>184,300</u>	<u>186,461</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Proceeds from capital debt issuances	44,638	19,980
Capital appropriations	17,762	13,331
Capital grants and gifts	4,090	3,580
Acquisition and construction of capital assets	(66,400)	(63,700)
Issuance costs on capital debt	(729)	(382)
Principal paid on capital debt and leases	(24,453)	(22,856)
Interest paid on capital debt and leases	(4,681)	(5,543)
Net Cash Used For Capital and Related Financing Activities	<u>(29,773)</u>	<u>(55,590)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sales and maturities of investments	476,719	521,776
Purchases of investments	(486,584)	(504,535)
Earnings from investments	7,809	12,181
Net Cash (Used For) Provided By Investing Activities	<u>(2,056)</u>	<u>29,422</u>
Net decrease in cash and cash equivalents	(3,507)	(3,727)
Cash and cash equivalents - beginning of year	<u>3,507</u>	<u>7,234</u>
Cash and cash equivalents - end of year	<u>\$ -</u>	<u>\$ 3,507</u>

See accompanying notes to basic financial statements.

UNIVERSITY OF MAINE SYSTEM  
 Statements of Cash Flows  
 Years Ended June 30, 2004 and 2003  
 (In Thousands of Dollars)

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

	<u>2004</u>	<u>2003</u>
Operating loss	\$ (184,429)	\$ (187,756)
Adjustments to reconcile net operating loss to net cash used by operating activities:		
Depreciation and amortization	20,724	27,511
Changes in assets and liabilities:		
Accounts and grants receivable, net	(60)	(4,348)
Inventories and prepaid expenses	(675)	(187)
Notes receivable, net	(658)	(345)
Accounts payable	2,206	168
Deferred revenue and deposits	3,688	(2,210)
Accrued liabilities	3,612	2,615
Grants refundable	(386)	532
Net cash used for operating activities	<u>\$ (155,978)</u>	<u>\$ (164,020)</u>

**Noncash investing, capital, and financing activities:**

Capital asset additions included in accounts payable as of June 30	<u>\$ 3,947</u>	<u>\$ 7,128</u>
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See accompanying notes to basic financial statements.

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**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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**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, eleven centers, and a central administrative office. All activities of the System are included in the accompanying financial statements, including those of its discretely presented component units (see Note 16). Those 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'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 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.

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**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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**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.

For FY2004 and FY2003, the Investment Committee of the University of Maine System Board of Trustees 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

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**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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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.
- Long-term Pool – This tier consists of funds that will not be required for at least 36 months.

**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.

**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 or more is capitalized. Only capital projects with a projected cost of \$10 or more are capitalized.

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**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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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

Costs for maintenance, repairs and minor renewals and replacements are expensed as incurred; major renewals and replacements are capitalized. Equipment is 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 Statement of Revenues, Expenses, and Changes in Net Assets.

Prior to July 1, 2003, library materials were generally capitalized and depreciated over a ten-year period. Effective July 1, 2003, the System began to expense library materials as incurred. The estimated effect of this change on current and future operations is not expected to be material. The System elected this change to enhance reporting comparability with other state systems. The System will retain the undepreciated library materials balance as a core non-depreciating asset.

The System does not capitalize and 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, including related benefits ultimately payable for such benefit. The System 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.

**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

**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. The most significant estimates in the financial statements include liabilities for self-insured plans, pension and other retirement benefit obligations, as well as allowances for uncollectible receivables. Actual results could differ from those estimates.

**o. Reclassifications**

Certain fiscal year 2003 items in the accompanying financial statements have been reclassified, without effect on total net assets, to conform to the fiscal year 2004 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		
2004	\$ 567	\$ -	\$ 2,344	\$ 2,911	\$ -
2003	\$ 643	\$ -	\$ 5,407	\$ 6,050	\$ 3,507

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**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, 2004, categorization of the System's investments is as follows:

	Category			Not Categorized	Total Carrying Value
	1	2	3		
Short-term investments	\$ -	\$ -	\$ -	\$ 131,925	\$ 131,925
Endowment investments	28,021	-	136	64,676	92,833
Deposits with bond trustees	100	-	1,196	36,526	37,822
Total Investments	<u>\$28,121</u>	<u>\$ -</u>	<u>\$ 1,332</u>	<u>\$ 233,127</u>	<u>\$ 262,580</u>

At June 30, 2003, categorization of the System's investments is 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>

Income related to the System's investments for fiscal year 2004 was as follows:

	Net Gains (Losses)	Investment Fees	Interest and Dividends	Total Return
Endowment investments	<u>\$ 11,542</u>	<u>\$ (696)</u>	<u>\$ 3,586</u>	<u>\$ 14,432</u>
Short-term investments	\$ (448)	\$ (696)	\$ 3,429	\$ 2,285
Deposits with bond trustees	-	-	340	340
Total other investment income	<u>\$ (448)</u>	<u>\$ (696)</u>	<u>\$ 3,769</u>	<u>\$ 2,625</u>

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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	\$ 1,481	\$ (663)	\$ 2,075	\$ 2,893
Short-term investments	\$ 2,562	\$ (535)	\$ 6,526	\$ 8,553
Deposits with bond trustees	(27)	(1)	574	546
Total other investment income	\$ 2,535	\$ (536)	\$ 7,100	\$ 9,099

The System's investments are comprised of the following at June 30, 2004:

	Short Term	Endowment	Deposits with Bond Trustees	Total
Equity securities	\$ -	\$ 62,804	\$ -	\$ 62,804
Fixed income securities	106,451	22,687	3,078	132,216
State pool	25,474	-	-	25,474
Money funds, savings, CD's	-	755	1,296	2,051
Multi-strategy	-	6,587	-	6,587
Guaranteed investment contracts	-	-	33,448	33,448
Total investments	\$ 131,925	\$ 92,833	\$ 37,822	\$ 262,580

The System's investments are 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	\$ 115,210	\$ 78,344	\$ 46,806	\$ 240,360

**Short-term Investments**

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

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**Endowment Investments**

Except for certain gifts invested separately at the request of the donors (\$291 at June 30, 2004 and \$489 at June 30, 2003), 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, 2004 and 2003 are \$5,401 and \$3,379, respectively, and are 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 is as follows at June 30:

	<u>2004</u>	<u>2003</u>
Restricted - expendable	\$33,841	\$25,190
Unrestricted	<u>6,326</u>	<u>5,308</u>
Total available for spending	<u>\$40,167</u>	<u>\$30,498</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 include the following at June 30:

	2004			2003		
	Total	Current Portion	Noncurrent Portion	Total	Current Portion	Noncurrent Portion
Student and other accounts receivable	\$ 11,650	11,551	99	\$ 11,971	\$ 10,927	\$ 1,044
Grants receivable	24,179	20,709	3,470	22,133	21,571	562
Pledges receivable	3,468	571	2,897	3,401	867	2,534
Total gross receivables	39,297	32,831	6,466	37,505	33,365	4,140
Less allowance for doubtful accounts	(1,809)	(1,486)	(323)	(2,166)	(1,890)	(276)
Less discount on pledges receivable	(275)	-	(275)	(216)	-	(216)
Total receivables, net	<u>\$ 37,213</u>	<u>\$ 31,345</u>	<u>\$ 5,868</u>	<u>\$ 35,123</u>	<u>\$ 31,475</u>	<u>\$ 3,648</u>

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

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**5. NOTES RECEIVABLE**

Notes receivable include the following at June 30:

	<u>2004</u>	<u>2003</u>
Perkins Loans	\$33,872	\$33,591
Nursing Loans	1,037	1,017
Institutional Loans	<u>3,993</u>	<u>3,555</u>
	38,902	38,163
Less allowance for doubtful accounts	<u>(528)</u>	<u>(447)</u>
Total loans receivable, net	<u>\$38,374</u>	<u>\$37,716</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, 2004 is as follows:

	Beginning <u>Balance</u>	<u>Additions</u>	<u>Reclasses</u>	<u>Retirements</u>	Ending <u>Balance</u>
Land	\$ 11,837	\$ -	\$ 67	\$ -	\$ 11,904
Library Materials	25,686	-	-	-	25,686
Construction in Progress	33,398	58,329	(37,178)	-	54,549
Total Nondepreciable Assets	<u>70,921</u>	<u>58,329</u>	<u>(37,111)</u>	<u>-</u>	<u>92,139</u>
Land Improvements	30,300	114	725	-	31,139
Buildings & Improvements	409,680	-	30,249	-	439,929
Equipment	89,303	6,800	6,137	(16,194)	86,046
Total Depreciable Assets	<u>529,283</u>	<u>6,914</u>	<u>37,111</u>	<u>(16,194)</u>	<u>557,114</u>
Less Accumulated Depreciation:					
Land Improvements	15,809	1,397	-	-	17,206
Buildings & Improvements	125,396	9,740	-	-	135,136
Equipment	63,304	9,482	-	(16,194)	56,592
Total Accumulated Depreciation	<u>204,509</u>	<u>20,619</u>	<u>-</u>	<u>(16,194)</u>	<u>208,934</u>
Net Depreciable Assets	<u>324,774</u>	<u>(13,705)</u>	<u>37,111</u>	<u>-</u>	<u>348,180</u>
Total Capital Assets	<u>\$ 395,695</u>	<u>\$ 44,624</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 440,319</u>

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Capital asset activity for the year ended June 30, 2003 is 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	47,775	54,567	(68,944)	-	33,398
Total Nondepreciable Assets	<u>59,146</u>	<u>54,567</u>	<u>(68,478)</u>	<u>-</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	50,017	5,559	-	(3,579)	51,997
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	24,096	5,794	-	(3,579)	26,311
Total Accumulated Depreciation	<u>220,120</u>	<u>27,447</u>	<u>-</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>-</u>	<u>350,460</u>
Total Capital Assets	<u>\$ 356,995</u>	<u>\$ 38,700</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 395,695</u>

Additions to capital assets in 2004 and 2003 include \$1,756 and \$1,556 of interest costs less \$546 and \$1,181, respectively, of interest earnings on unexpended revenue bond proceeds. Additions to equipment in 2004 and 2003 include \$702 and \$175, respectively of equipment acquired through capital leases.

As of June 30, 2004 and 2003, \$33,830 and \$42,920, respectively, in proceeds from the 2004, 2003, 2002, 2000, and 1998 revenue bond issuances remain 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, 2004 are \$33,826 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 total \$29,462 at June 30, 2004.

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**7. LONG-TERM LIABILITIES**

Changes in long-term liabilities during the year ended June 30, 2004 consist of the following:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Leases, notes, and bonds payable:					
Capital lease obligations	\$ 336	\$ 703	\$ (333)	\$ 706	\$ 265
Bonds and notes payable	127,781	43,754	(24,290)	147,245	5,750
Total leases and bonds payable	<u>128,117</u>	<u>44,457</u>	<u>(24,623)</u>	<u>147,951</u>	<u>6,015</u>
Accrued liabilities:					
Workers' compensation - Note 11	5,145	890	(1,153)	4,882	1,216
Health insurance - Note 11	5,135	42,784	(43,319)	4,600	4,600
Other employee benefit programs - Note 13	27,354	17,473	(13,332)	31,495	2,867
Other	11,125	12,596	(10,490)	13,231	11,888
Total accrued liabilities	<u>48,759</u>	<u>73,743</u>	<u>(68,294)</u>	<u>54,208</u>	<u>20,571</u>
Total long-term liabilities	<u>\$ 176,876</u>	<u>\$ 118,200</u>	<u>\$ (92,917)</u>	<u>\$ 202,159</u>	<u>\$ 26,586</u>

Changes in long-term liabilities during the year ended June 30, 2003 consist 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:					
Workers' compensation - Note 11	2,714	3,611	(1,180)	5,145	1,266
Health insurance - Note 11	7,618	38,942	(41,425)	5,135	5,135
Other employee benefit programs - Note 13	24,535	8,533	(5,714)	27,354	2,751
Other	10,409	12,050	(11,334)	11,125	9,835
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>

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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 \$4,300 for the year ended June 30, 2004 and \$4,034 for the year ended June 30, 2003.

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, 2004 are 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>		
2005	\$ 265	\$ 30	\$ 1,366	\$ 1,661
2006	168	17	788	973
2007	135	10	426	571
2008	92	5	311	408
2009	46	2	241	289
2010-2014	-	-	367	367
2015-2019	-	-	15	15
Total minimum lease payments	<u>\$ 706</u>	<u>\$ 64</u>	<u>\$ 3,514</u>	<u>\$ 4,284</u>

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**Bonds and Note Payable**

Bonds and note payable consist of the following at June 30:

	<u>2004</u>	<u>2003</u>
<b>2004 Series A Revenue Bonds (\$43,270)</b>		
Serial bonds, maturing from 2005 to 2029, with annual principal payments from \$335 to \$5,080 and coupon interest rates from 2.0% to 5.0%. Issued to partially refund the 1998A and 2000A Series Revenue Bonds and to provide funding for capital projects.	\$ 36,860	\$ -
4.25% Term Bonds, due March 1, 2034	6,410	-
Add: unamortized premium	2,763	-
Less: unamortized deferred amount on refunding of 1998A and 2000A bonds	<u>(2,405)</u>	<u>-</u>
Total 2004 Series A Bonds	<u>43,628</u>	<u>-</u>
<b>2003 Series A Revenue Bonds (\$19,970)</b>		
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.	18,435	19,970
Add: unamortized premium	184	199
Less: unamortized deferred redemption fee on 1993 bonds	<u>(320)</u>	<u>(355)</u>
Total 2003 Series A Bonds	<u>18,299</u>	<u>19,814</u>
<b>2002 Series A Revenue Bonds (\$43,020)</b>		
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.	41,500	42,710
Add: unamortized premium	<u>2,181</u>	<u>2,422</u>
Total 2002 Series A Bonds	<u>43,681</u>	<u>45,132</u>
<b>2000 Series A Revenue Bonds (\$41,725)</b>		
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%.	11,565	27,520
5.60% Term Bonds, due March 1, 2020	2,385	3,560
5.50% Term Bonds, due March 1, 2030	5,435	5,435
Add: unamortized premium	<u>72</u>	<u>119</u>
Total 2000 Series A Bonds	<u>19,457</u>	<u>36,634</u>
<b>1998 Series A Revenue Bonds (\$29,540)</b>		
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%.	6,455	7,230
5.00% Term Bonds, due March 1, 2018	5,495	8,965
5.00% Term Bonds, due March 1, 2024	10,540	10,540
Less: unamortized discount	<u>(457)</u>	<u>(534)</u>
Total 1998 Series A Bonds	<u>22,033</u>	<u>26,201</u>
Total bonds payable, net	<u>147,098</u>	<u>127,781</u>
<b>US Department of Agriculture Note</b>		
Part of a \$326 combination grant and loan award. Loan portion is \$246 of which \$147 has been advanced. The loan is payable monthly over a period not to exceed ten years with interest at a variable rate equal to the average market yield on Treasury securities of comparable maturity to the loan (4.77% at June 30, 2004).	<u>147</u>	<u>-</u>
Total bonds and note payable	<u>\$ 147,245</u>	<u>\$ 127,781</u>

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Costs associated with the issuance of the 2004, 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 2004, 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 and note payable for the next five years and in subsequent five-year periods are as follows at June 30, 2004:

Year Ending June 30:	<u>Principal</u>	<u>Interest</u>
2005	\$ 5,654	\$ 6,587
2006	5,975	6,525
2007	5,945	6,302
2008	6,226	6,078
2009	5,677	5,833
2010-2014	59,090	22,040
2015-2019	21,975	10,904
2020-2024	17,515	6,367
2025-2029	8,620	3,167
2030-2034	8,550	986
	<u>\$ 145,227</u>	<u>\$ 74,789</u>

Interest costs related to the Revenue Bonds for fiscal year 2004 and fiscal year 2003 were \$5,092 and \$5,113, respectively. These amounts are net of savings of \$843 and \$1,057, respectively, from an interest swap on the 2002 Series A Revenue Bonds – see Note 8. Of the total interest costs, \$1,756 and \$1,556 was capitalized as part of capital assets for the respective years ended June 30, 2004 and 2003 – see Note 6.

**Refunding of Debt – Fiscal Year 2004**

On March 31, 2004, the System issued 2004 Series A Revenue Bonds to advance refund a total of \$18,975 in 2000 Series A and 1998 Series A Revenue Bonds and to fund new capital projects. The principal amount of debt refunded through in-substance defeasance and still outstanding at June 30, 2004 was \$18,975. Refunding bond proceeds of \$21,284 were placed in an escrow account to pay the interest due on the refunded 2000A and 1998A bonds and to retire the bonds on their respective call dates of September 1, 2010 and September 1, 2008. The total amount to be paid from the escrow account is \$25,245. As of June 30, 2004 the balance of the escrow account was \$21,451. The escrow account is invested to yield enough earnings to pay the difference between the June 30, 2004 balance and the required future payments.

The transaction to advance refund a portion of the 2000A and 1998A bonds met the requirements of an “in-substance defeasance” as defined by accounting principles generally accepted in the United States of America, and as a result, the liability for the refunded bonds has been removed from the FY2004 financial statements.

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This refunding resulted in a deferred amount on refunding of \$2,509, of which the unamortized balance was \$2,405 as of June 30, 2004. This represents the difference between the reacquisition price and the carrying value of the refunded bonds. The unamortized portion of this amount is reported in the accompanying Statements of Net Assets as a reduction of the 2004 Series A Revenue Bonds. Amortization of this deferred amount will be charged to operations as additional interest expense through the year 2017 using the effective-interest method. The System completed the refunding to reduce its total debt service payments over the following thirteen years by \$1,006 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$792.

**Refunding of Debt – Fiscal Year 2003**

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-interest method. The System completed the refunding to reduce its total debt service payments over the following 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.

In an effort to maximize total savings, the System terminated the swap on April 1, 2004 for a net gain of \$2,291, which is being amortized over the remaining life of the related 2002 Series A Revenue Bonds. The unamortized amount as of June 30, 2004 was \$2,218 and is included in deferred revenue and deposits in the accompanying 2004 Statement of Net Assets.

**Terms**

The swap agreement was originally scheduled to mature on March 1, 2012 when the related bonds mature. The swap's notional amount at inception matched the \$43,020 bonds. The swap's notional amount declined with the payment of principal on the bonds each March 1. Under the swap, the System paid the counterparty monthly payments based on the weighted average rate per The Bond

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Market Association Municipal Swap Index (BMA) (0.98% at June 30, 2003). In turn, the counterparty paid the System a fixed rate twice a year. The fixed rate received from the counterparty was designed to give the System the coupon rate (ranges from 4.833% to 5.307%) 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 was an asset of \$3,406. The fair value represents the estimated amount due to the System if the agreement was terminated on that date and is based on discounted cash flow analysis incorporating option pricing models that consider market interest rates and other factors.

**9. GOVERNMENT ADVANCES 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, 2004 and 2003 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 are comprised of the following as of June 30:

	<u>2004</u>	<u>2003</u>
Restricted - Nonexpendable:		
Endowment funds	\$ <u>47,047</u>	\$ <u>44,225</u>
Restricted - Expendable:		
Student financial aid	\$ 25,333	\$ 19,771
Capital assets and retirement of debt	15,842	9,317
Loans	9,949	9,653
Academic support	8,310	7,438
Research and public service	5,944	5,595
Library	2,341	3,559
Other	<u>14,266</u>	<u>13,602</u>
Total restricted - expendable	<u>\$ 81,985</u>	<u>\$ 68,935</u>

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**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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## **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.

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 retention obligation for general liability is capped at \$300, 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 retention levels has been included in the accompanying Statements of Net Assets as part of current accrued liabilities. As of June 30, 2004 and 2003 certain legal claims existed for which the probability or amount of payment could not be determined. The System, however, does not expect these amounts, 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 primary 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). In FY2004, the System purchased commercial specific and aggregate excess workers' compensation insurance which limits the exposure for any one incident to \$750 and provides coverage in the event that total claims exceed expectations.

The System's health insurance plan is financed through a minimum premium contract with a commercial carrier. The contract in effect at June 30, 2004 ends December 31, 2004. The plan allows the System to benefit from favorable claims experience, should paid claims be less than the maximum claim liability under the contract. As of June 30, 2004, the System's paid claims for the six months then ended had not reached the maximum claim liability amount for the same six month period. 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, 2004, and 2003, the

**UNIVERSITY OF MAINE SYSTEM**  
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**June 30, 2004 and 2003**  
**(\$ in thousands)**

estimated liability for claims incurred but not paid was \$4,600 and \$4,620 and is included in accrued liabilities 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., incur allowable costs) are not included in the System's financial statements. The total of such awards as of June 30, 2004 and 2003 was \$50,131 and \$45,899, respectively.

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, 2004 and 2003 System's totaled \$10,183 and \$9,431, 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 (income) for each of these plans was as follows for the years ended June 30:

	<u>2004</u>	<u>2003</u>
<u>Faculty and Professional Employees:</u>		
Basic Retirement Plan	\$ 16,300	\$ 15,300
Incentive Plan	2,090	1,875
 Classified Employees - All Plans	<u>(811)</u>	<u>720</u>
 Total net pension expense	<u>\$ 17,579</u>	<u>\$ 17,895</u>

**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

**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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 \$6,400 in fiscal 2004 and \$6,100 in fiscal 2003.

**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 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 regular 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. Actuarial valuations, utilizing the projected unit credit actuarial cost method and 30-year declining-period, dollar amortization, were performed as of June 30, 2004 and 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 actuarial liability and actuarial value of assets at June 30.

	<u>2004</u>	<u>2003</u>
Actuarial accrued liability	\$ 21,219	\$ 19,980
Actuarial value of assets	-	-
Unfunded actuarial accrued liability	<u>\$ 21,219</u>	<u>\$ 19,980</u>

**UNIVERSITY OF MAINE SYSTEM**  
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**(\$ in thousands)**

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 noncurrent accrued liabilities (see other employee benefit programs in Note 7). Three-year trend information through June 30, 2004, which provides an indication of the progress made in accumulating sufficient assets to pay benefits when they become due, 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
2004	\$ 2,330	\$ 789	\$ 1,029	\$ 2,090	\$ 689	33%	\$1,401	\$14,022
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

## 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 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.

**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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 \$1,200 in fiscal 2004 and \$1,100 in fiscal 2003.

**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, 2004 and 2003, 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. Actuarial valuation, utilizing the projected unit credit actuarial cost method and 10-year declining-period, dollar amortization, were performed as of June 30, 2004 and 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>2004</u>	<u>2003</u>
Actuarial accrued liability	\$ 70,032	\$ 69,802
Actuarial value of assets	72,476	75,058
Unfunded actuarial accrued liability	<u>\$ (2,444)</u>	<u>\$ (5,256)</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.

**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

**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 2004 the System funded \$595 of employer contributions to the Basic Plan through the transfer of excess assets from the Defined Benefit Plan. Aggregate net annual pension plan cost for the Basic Plan, ORSP and Defined Benefit Plan for the year ended June 30, 2004 was \$2,177. Without the transfers of excess assets from the Defined Benefit Plan, the System's total expense for the Basic Plan and ORSP for the year ended June 30, 2004 would have been \$2,772.

During fiscal 2003, 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 year ended June 30, 2003 was \$720. Without transfers of excess assets from the Defined Benefit Plan, the System's total expense for the Basic Plan and ORSP for the year ended June 30, 2003 would have been \$2,627.

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, 2004, including changes in the NPO (which is included in accrued liabilities in the accompanying Statements of Net Assets - see other employee benefit programs in Note 7), 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
2004	\$ (620)	\$ 54	\$ 244	\$ (810)	\$ -	-	\$ (810)	\$ 26
2003	\$ 741	\$ 7	\$ 28	\$ 720	\$ -	-	\$ 720	\$ 836
2002	\$ 81	\$ 3	\$ 8	\$ 76	\$ -	-	\$ 76	\$ 115

**14. POSTEMPLOYMENT HEALTH PLAN**

The System provides postemployment health insurance to retirees meeting certain age and years-of-service requirements. As of June 30, 2004 and 2003, there were approximately 1,700 persons (including widows/widowers) receiving postemployment health benefits.

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**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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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, 2004 and 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, 2004 and 2003, there were approximately 150 and 200 persons, respectively, 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 the postemployment health plan on a pay-as-you-go basis. Total gross costs for the year ended June 30, 2004 and 2003 were \$10,500 and \$9,200, respectively, with the participants contributing \$2,400 and \$1,900, respectively toward the costs.

#### **15. PASS THROUGH GRANTS**

During fiscal year 2004 and 2003, the System distributed \$10,134 and \$9,313, 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.

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**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

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**16. COMPONENT UNITS**

Effective July 1, 2003, the System adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* (GASB 39), which establishes criteria for determining whether certain related organizations should be reported as component units based on the nature and significance of their relationship with a primary government and clarifies reporting requirements for those organizations.

The System is supported in part by several foundations and alumni associations that raise funds on the System's behalf. The System determined that certain of those entities meet the criteria under GASB 39 for inclusion as discretely presented component units of the System and, accordingly, has presented them in the accompanying financial statements as of and for the year ended June 30, 2004.

The discretely presented component units are private, not-for-profit organizations that report under FASB standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. Accordingly, certain presentation features and revenue recognition criteria used by the component units are different than those followed by the System under GASB. Under GASB, all changes in net assets are reported in a single statement of revenues, expenses, and changes in net assets, whereas under FASB such changes are reported in three net asset classes – unrestricted, temporarily restricted and permanently restricted – based solely on the existence or absence of donor-imposed restrictions. These FASB net asset classes are not necessarily equivalent from a financial reporting standpoint to the System's unrestricted, restricted expendable and restricted nonexpendable net asset classes, respectively, under GASB. In addition, under FASB principles, unconditional pledges of permanently restricted net assets are recognized at the date the promise becomes unconditional, whereas under GASB such amounts are recognized when received in cash. No modifications have been made to the component unit financial information in the System's financial reporting entity for these or other differences.

The System's major discretely presented component unit is the University of Maine Foundation ("the Foundation"), which is a legally separate, tax-exempt organization that acts primarily as a fund-raising organization to supplement the resources that are available to the System in support of its programs. The board of directors of the Foundation is self-perpetuating and independent of the System's Board of Trustees. Although the System does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the System by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of, the System (specifically the University of Maine), the Foundation is considered a component unit of the System and is discretely presented in the System's financial statements.

During the year ended June 30, 2004, the Foundation distributed \$3,485 to the System for both restricted and unrestricted purposes. The Foundation has reported this amount as part of its total program expenses.

**UNIVERSITY OF MAINE SYSTEM**  
**Notes To Financial Statements**  
**June 30, 2004 and 2003**  
**(\$ in thousands)**

Condensed financial information of the Foundation is as follows as of and for the year ended June 30, 2004:

<b><u>Assets</u></b>	
Investments at fair value	\$ 107,659
Other	20,266
Total Assets	<u>\$ 127,925</u>
<b><u>Liabilities and Net Assets</u></b>	
Notes payable and other liabilities	<u>\$ 8,980</u>
Net Assets:	
Unrestricted	6,797
Temporarily restricted	27,303
Permanently restricted	84,845
Total Net Assets	<u>118,945</u>
Total Liabilities and Net Assets	<u>\$ 127,925</u>
<b>Changes in Unrestricted Net Assets:</b>	
Revenues and other support:	
Contributions and net assets released from restrictions	\$ 5,403
Investment income and other revenue	598
Total revenues and other support	<u>6,001</u>
Expenses:	
Program	5,003
Other	1,076
Total expenses	<u>6,079</u>
Decrease in unrestricted net assets	<u>(78)</u>
<b>Changes in Temporarily Restricted Net Assets:</b>	
Contributions and net assets released from restrictions	(2,705)
Investment income and other revenue	13,282
Increase in temporarily restricted net assets	<u>10,577</u>
<b>Changes in Permanently Restricted Net Assets:</b>	
Contributions and net assets released from restrictions	7,874
Investment income and other revenue	1,042
Increase in permanently restricted net assets	<u>8,916</u>
Increase in total net assets	19,415
Net assets, beginning of year	<u>99,530</u>
Net assets, end of year	<u>\$ 118,945</u>

Complete financial statements for the Foundation can be obtained from its offices at Two Alumni Place, Orono, ME 04469-5792.

**UNIVERSITY OF MAINE SYSTEM**  
**Required Supplemental Information – Retirement Plans**  
**Schedules of Funding Progress, Employers' Contributions, and Related Note**  
**Year ended June 30, 2004**  
**(Unaudited)**  
**(\$ in thousands)**

**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)
<b>Incentive Retirement Plan for Faculty and Professionals</b>						
2004	\$ —	\$ 21,219	\$ 21,219	—	\$ 130,216	16.3%
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%
<b>Retirement Plan for Classified Staff</b>						
2004	\$ 72,476	\$ 70,032	\$ (2,444)	103.5%	\$ 7,279	(33.6%)
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%)

**Schedules of Employers' Contributions**

Year ended June 30	Annual required contribution	Percentage contributed	Annual required contribution	Percentage contributed
	<b>Incentive Retirement Plan for Faculty and Professionals</b>		<b>Retirement Plan for Classified Staff</b>	
2004	\$ 2,330	30%	\$ (620)	—
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	—

**Note to Schedules**

The information presented in the required supplementary schedules as of June 30, 2004 was determined using the actuarial valuation as of June 30, 2004 with the following significant assumptions:

	<b>Incentive Retirement Plan for Faculty and Professionals</b>	<b>Retirement Plan for Classified Staff</b>
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	23 years	3 years
Asset valuation method	N/A	5-year smoothing of differences between actual and expected returns
Actuarial assumptions:		
Investment rate of return	6.25%	6.50%
Projected salary increases	4.00%	4.00%
Cost-of-living adjustments	N/A	N/A

**UNIVERSITY OF MAINE SYSTEM**  
**Supplemental Information Required by the State of Maine**  
**Schedules of Activities**  
**(\$ in thousands)**

**Year Ended June 30, 2004**

**Schedule 1**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants/ Contributions</u>	<u>Capital Grants/ Contributions</u>	<u>Net (Expense) Revenue</u>
University of Maine System	\$ 556,960	\$ 220,914	\$ 171,186	\$ 5,033	\$ (159,827)

General Revenues:

Unrestricted interest and investment earnings	2,625
Additions to permanent endowments - gifts	1,038
Additions to permanent endowments - State appropriation	475
State of Maine noncapital appropriation	172,121
State of Maine capital appropriation	20,725
Loss on assets held for sale	-
Extraordinary item - loss on bond redemption	-
Total Revenues and Extraordinary Items	<u>196,984</u>
Change in Net Assets	37,157
Net Assets, Beginning of Year	476,021
Net Assets, End of Year	<u>\$ 513,178</u>

**Year Ended June 30, 2003**

**Schedule 2**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants/ Contributions</u>	<u>Capital Grants/ Contributions</u>	<u>Net (Expense) Revenue</u>
University of Maine System	\$ 531,686	\$ 206,370	\$ 148,679	\$ 2,054	\$ (174,583)

General Revenues:

Unrestricted interest and investment earnings	9,099
Additions to permanent endowments - gifts	2,022
State of Maine noncapital appropriation	173,050
State of Maine capital appropriation	11,452
Loss on assets held for sale	-
Extraordinary item - loss on bond redemption	-
Total Revenues and Extraordinary Items	<u>195,623</u>
Change in Net Assets	21,040
Net Assets, Beginning of Year	454,981
Net Assets, End of Year	<u>\$ 476,021</u>



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**Report on Internal Control Over Financial Reporting and on Compliance and  
Other Matters 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 financial statements of the University of Maine System (the System), a component unit of the State of Maine, as of and for the years ended June 30, 2004 and 2003, and the System's aggregate discretely presented component units as of and for the year ended June 30, 2004, and, based on our audits and the reports of other auditors, have issued our report thereon dated October 15, 2004. Our report refers to the System's adoption, effective July 1, 2003, of Statement No. 39 of the Governmental Accounting Standards Board (GASB), *Determining Whether Certain Organizations are Component Units (an amendment of GASB Statement 14)*. 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. The financial statements of the aggregate discretely presented units were not audited in accordance with *Government Auditing Standards*.

**Internal Control over Financial Reporting**

In planning and performing our audits, 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 financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud 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 the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the System in a separate letter dated October 15, 2004.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 15, 2004