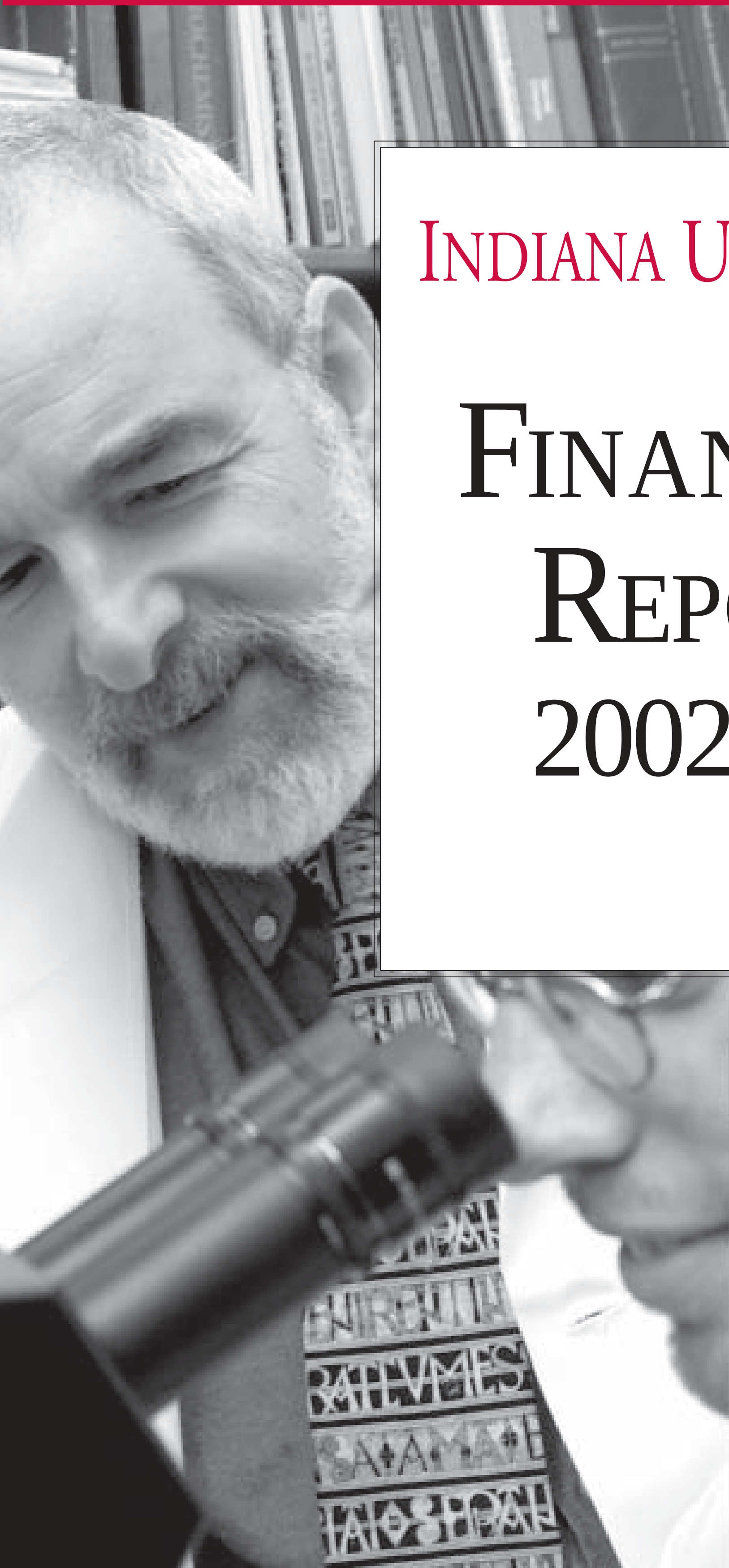
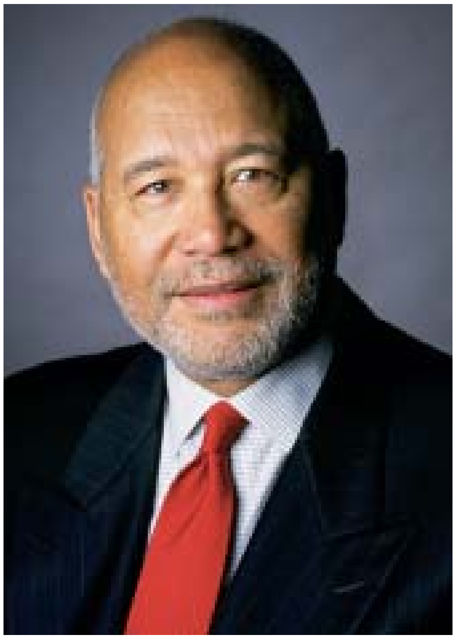


INDIANA UNIVERSITY

FINANCIAL REPORT 2002–03



Adam W. Herbert
President, Indiana University

The Honorable Joseph E. Kernan
Governor, State of Indiana
State House
Indianapolis, IN 46204

Dear Governor Kernan:

On behalf of the Trustees of Indiana University, it is an honor to present IU's 2002-2003 Financial Report.

This report describes how Indiana University is utilizing its resources to "Advance Indiana." We do so by educating the state's citizens, improving their health and quality of life, pushing forward the frontiers of knowledge in a wide range of fields and producing the intellectual capital that will help to build a twenty-first century, knowledge-based economy in Indiana.

IU's primary mission has always been to provide high quality, accessible education to the state's citizens. In this regard, IU's tenth president, William Lowe Bryan, said "What the people want is open paths from every corner of the state, through the schools to the highest and best things which they can achieve. To make such paths, to make them open to the poorest and make them lead to the highest, is the mission of democracy."

IU has been widening those paths to opportunity and to a better life for nearly two centuries. Last spring, IU graduated 14,900 new alumni from its eight campuses and provided medical education in nine cities throughout the state. The University has educated 20 percent of the state's nurses, 35 percent of its teachers, 41 percent of Indiana's physicians, 64 percent of the state's optometrists, 75 percent of Hoosier lawyers, 25 percent of Indiana's judges and 90 percent of its dentists. Moreover, all of our campuses began the 2002-03 academic year with growing and / or record enrollments.

IU students benefit immeasurably from the synergistic relationship between faculty research and teaching. Our faculty members are excelling at both. The university's strength in the life sciences has enabled us to do well in the highly competitive

IU Bloomington

environment of federal and private funding. During the 2002-03 academic year, sponsored research grants and contracts totaled $392 million—two and a half times the total of a decade ago.

With additional support from the $150 million Lilly Endowment grants for the Indiana Genomics Initiative, our goal is to double research activity in the School of Medicine and significantly increase such funding for the science departments on the Bloomington campus. The new Multidisciplinary Science Buildings I and II will provide the space necessary for talented scientists to expand their research programs. Our growing strength as a major cancer and organ transplant center, combined with the great strides we are making on the various aspects of the Indiana Genomics Initiative, creates critical momentum for Indiana University and the state.

Moreover, through the State of Indiana's $6 million allocation in support of IU research in the 2003-05 biennium, the University will further enhance its ability to conduct quality research that will make a difference in the state's ability to transform its economy.

Looking to the future, Indiana University will continue to assist the state in addressing its significant economic growth and development challenges.

IU Southeast

Those efforts will be even more strategic and focused. A major element of our long-range economic development vision has involved the combined strengths of the IU School of Medicine and the sciences faculty on the Bloomington campus. In addition to becoming one of the nation's leaders in genomics research, our goal is to become one of the top five cancer centers in America and the best in the Midwest within the next five years.

IU also is making a difference in Indiana's ability to transform its economy by building a culture of entrepreneurship. ARTI's new Emerging Technologies Center, a business incubator for life sciences and information technology start-ups, promises to be a centerpiece of economic development efforts in Indianapolis.

IU South Bend

These activities and investments, coupled with IU's strong traditions in the liberal arts, will bring exciting returns in scientific discoveries, high-quality education for our students, improved health for Hoosiers and a stronger economy in Indiana.

This financial report demonstrates that Indiana University regards the funding it receives as a public trust. Whether those resources are derived from state appropriations, student fees, donor contributions, grants or contracts, we are committed to utilizing them in ways that reflect the high expectations of those we serve.

Sincerely,

Adam W. Herbert
President

IU Northwest

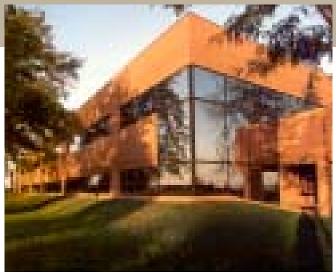
Judith G. Palmer
Vice President and Chief Financial Officer
Indiana University

Greetings to President Adam W. Herbert and Trustees of Indiana University:

It is with pleasure that I present the Indiana University Financial Report for the fiscal year ended June 30, 2003. The financial statements have been prepared in accordance with generally accepted accounting principles and Governmental Accounting Standards Board (GASB) principles. The accompanying notes to the financial statements are an integral part of the financial statements.

The statements are intended to provide a summary of the flow of the economic resources of the University during the fiscal year covering the period of July 1, 2002 through June 30, 2003, and the University's financial position at June 30, 2003, with comparative data from the previous fiscal year.

The financial statements have been audited by the Indiana State Board of Accounts. Their opinion on the financial statements appears immediately following the *Notes to the Financial Statements.*



IUPU Columbus

Indiana University's Financial Report is a consolidated financial report including all seven campuses for which Indiana University has fiscal responsibility as well as all auxiliary operations. The information presented in the Management's Discussion and Analysis section of the financial report includes informational indicators of Indiana University's fiscal health. Overall these indicators show that Indiana University continues to have a strong balance sheet reflecting sound and careful fiscal management across the institution. Total revenues of the institution increased in 2002-03 by 7.8% over the previous year while operating expenses grew by 5.74% for the same period. This resulted in an increase in the net assets of the institution of nearly $1.6 million or

3.8% for the fiscal year ending June 30, 2003. This is an encouraging sign given the difficult economic situation which confronted Hoosier citizens and the State of Indiana, including public higher education institutions.

The Financial Statement for Fiscal Year 2002-03 includes a change in the capitalization policy dollar value for moveable equipment. The impact of this change is further explained in the Management's Discussion and Analysis section on expenses.

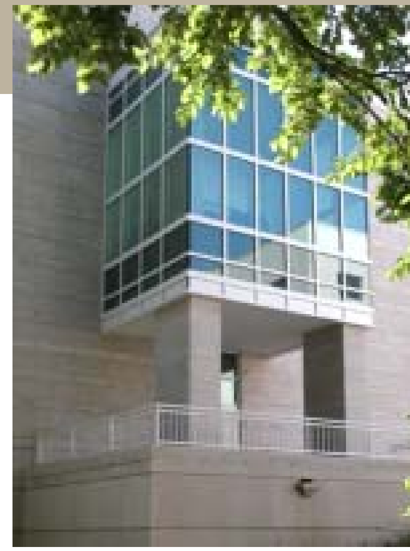
In keeping with the institution's commitment to excellence in financial management, the University continues to establish best practices in numerous areas of its operations. Although the Sarbanes Oxley legislation is not applicable to public higher education institutions, Indiana University is becoming a recognized leader in its efforts to strengthen its internal control environment and to adopt more efficient and effective processes aimed at ensuring increased accountability, transparency, and timeliness with respect to financial reporting. One example of such efforts was the institutional decision to engage an outside consultant to assess the strength of the institution's fiscal internal controls. That report which was presented to the Trustees of Indiana University in September 2003 showed that there were no significant deficiencies in the current internal control structure but did offer recommendations on how to strengthen it even further. Those recommendations are currently being considered for implementation.

IU East

On behalf of all those responsible for the fiscal stewardship of Indiana University's resources, I respectfully submit the Indiana University Financial Report for the fiscal year ending June 30, 2003.

Sincerely,

Judith G. Palmer
Vice President and
Chief Financial Officer



IU Kokomo

IUPUI

Indiana University
Management's Discussion and Analysis

Indiana University presents its audited financial statements for the year ending June 30, 2003, along with comparative data for the year ending June 30, 2002. Three statements are described in the following discussion and analysis: The Statement of Net Assets, which presents the assets, liabilities, and net assets of the institution as of the end of the fiscal year; the Statement of Revenues, Expenses, and Changes in Net Assets, which reflects revenues and expenses recognized during the fiscal year; and the Statement of Cash Flows, which provides information on all of the cash inflows and outflows for the institution by major category during the fiscal year. Analysis will be provided for major variances from fiscal year 2002 to 2003. Included in this review are "Capital Asset and Debt Administration" and the "Economic Outlook."

IUB

IUS

IUSB

IUE

Statement of Net Assets

Total assets at June 30, 2003 were $2.7 billion, an increase of $227.5 million. Capital net assets comprised $1.6 billion of the $2.7 billion in assets.

Total liabilities were $994.2 million at June 30, 2003, compared to $826.9 million from the prior year. Non-current liabilities comprised 61%, or $603 million of the liabilities at June 30, 2003.

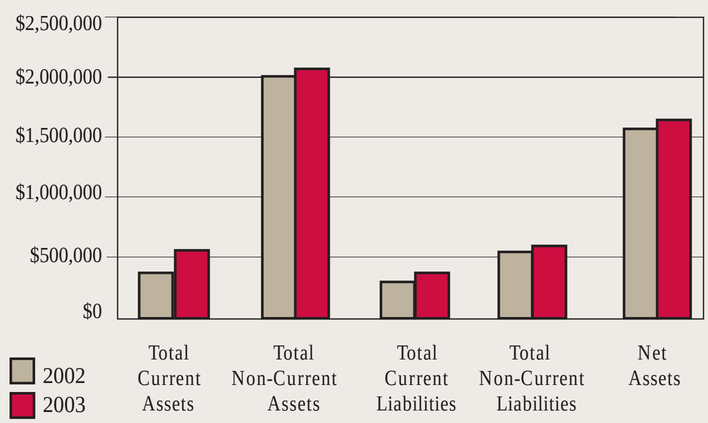
Total net assets at June 30, 2003 were $1.66 billion, a $60.2 million increase over the prior year, or a 3.8% increase in net assets. The breakout of net assets is shown below :
(in thousands of dollars)

Capital assets net of related debt	$ 1,086,535
Restricted net assets	194,969
Unrestricted net assets	379,551
Total net assets	$ 1,661,055

The composition of current and non-current assets and liabilities and net assets is displayed below for both the 2002 and 2003 fiscal year ends:

Comparison of Statement of Net Assets, 2002 and 2003

(in thousands of dollars)



Statement of Revenues, Expenses, and Changes in Net Assets

Revenues

Operating revenues at Indiana University for the June 30, 2003 fiscal year increased by 8.95% over the previous fiscal year. Most components of revenues increased:

- Student fee revenues, after scholarship allowances, were $507.8 million in 2003 compared to $438.8 million in 2002, an overall increase of 15.7%. This increase was due to both an increase in student fee rates and enrollment growth.
- Federal grants and contracts increased 8.5% over the previous fiscal year. This category of revenue includes funds received from the government for financial aid as well as sponsored research revenue.
- $28 million in state and local grants and contracts were received for the fiscal year, a decrease of $3.3 million from the previous year.
- Non-governmental grants and contracts increased by 14%, or $13.3 million. This category will continue to see large increases in the next two years as a $105 million grant received from the Lilly Foundation is spent and the related revenue is recognized.
- Sales and services of educational units decreased from $53.7 million to $50.6 million. This was a 5.7% decrease from 2002.
- Other revenue of $157.5 million was an increase of 4.9% over the previous fiscal year of $150 million. Other revenue includes private practice income and revenue to the School of Medicine for various hospital agreements.
- Auxiliary enterprises also had an increase in revenue of 4%, from $279.8 million to $291.2 million.

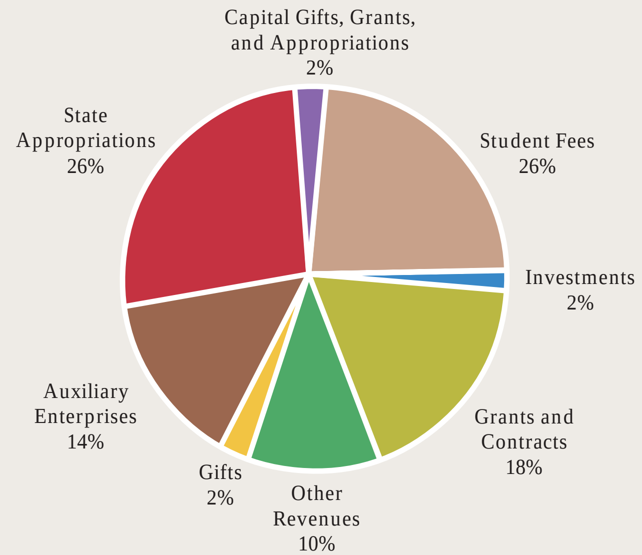
Total non-operating revenues were up 4.98% from June 30, 2002, from $565.8 million to $593.9 million:

- State appropriations, the largest single source of non-operating revenue at the university, increased from $502 million to $511.3 million, or 1.85%.
- Investment revenue saw a major increase of 70.4%, from $20.6 million at June 30, 2002, to $35 million at June 30, 2003. This was a result of partial recovery in investment returns and an increase in the principal invested.
- Gift revenues increased for the fiscal year, from $43.2 million to $47.7 million, an increase of 10.3%.

Other revenues included capital appropriations of $9.5 million, which decreased 12%; capital gifts and grants of $33.8 million, which was a $4.5 million increase from 2002; and additions to permanent endowments of $2 million, which were up $1.08 million from last year.

In summary, total revenues of the institution increased by $145 million, from $1.87 billion to $2 billion, an overall increase of 7.8%. The compositions of these revenues are displayed in this graph:

Total Revenues



Expenses

Operating expenses were $1.87 billion for the 2003 fiscal year. This was an increase over the previous fiscal year of $101.4 million, or 5.74%. Changes in the major categories of expense were:

- Total compensation comprises academic and staff salaries, hourly compensation, and benefits. This category increased by 8.2% for the fiscal year, from $1.1 billion to $1.2 billion. Benefits heavily influenced the increase in this category with a 12.8% increase in benefit expenses over the prior year.
- Student financial aid not classified as a scholarship allowance increased from $67.1 million to $75 million. This 12% increase in financial aid demonstrates a continued effort to increase financial aid for students.
- Energy and utilities had an increase of 3.3%, from $38.5 million in 2002 to $39.8 million in 2003.
- Travel expenses continued to be tightly managed by the institution in 2003 due to non-operating revenue constraints. This expense increased 3.9% in 2003, from $26.4 million to $27.5 million.
- Supplies and general expense increased by 2.5% in 2003, from $389 million to $398.7 million.
- Depreciation expense saw a major decrease since 2002. Current depreciation expense of $101.3 million is $10.8 million less than in 2002. This decrease is a result of a change in the capitalization policy dollar value for moveable equipment.

Non-operating expenses are represented by interest expense. Interest expense increased by 2.8% from $24.4 million in 2002 to $25 million in 2003. In addition, a change in accounting policy requiring a write-down of capital assets resulted in a net decrease of $61.6 million.

The composition of total expenses, including operating and non-operating, are displayed at right by major category.

Capital, Major Gifts, and Extraordinary Items

On the Statement of Revenues, Expenses, and Changes in Net Assets, the net income before Change in Accounting Policy is $121.8 million. This is an increase of $43.3 million from the prior year net income of $78.5 million.

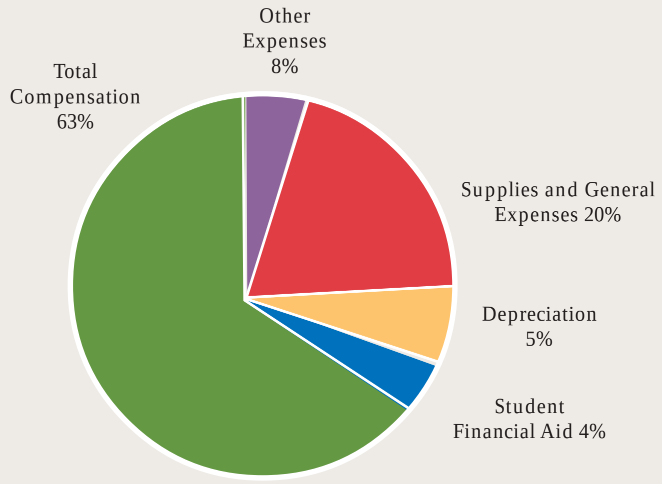
Major gifts were received during the year through the Indiana University Foundation, a separate not-for-profit organization whose primary mission is to raise funds for Indiana University. Major capital projects that benefited from the Foundation's fundraising efforts included the Graduate School of Business Facility at $2 million and the Auxiliary Library facility at $1.3 million. In addition, gifts of capital were significant for the year, totaling $33.8 million.

The university did not have any special and extraordinary items in 2003.

Net Assets

Net assets increased by $60.2 million over the previous fiscal year. Although decreases occurred in capital appropriations, state and local grants and contracts and sales and services of educational units, overall increases in operating and non-operating revenues offset these decreases, while cost containment efforts assisted in keeping the increase in operating expenses to a minimum. Ending net assets were $1.66 billion, compared to ending net assets in 2002 of $1.6 billion. This was a 3.8% increase in net assets.

Total Expenses



Statement of Cash Flows

The Statement of Cash Flows provides a means to assess the financial health of an institution by providing relevant information about the cash receipts and cash payments of an entity during a certain period. It assists the user in determining whether an entity has the ability to generate future net cash flows to meet its obligations as they come due, and to determine the need for external financing.

Cash Flows for the Period
(in thousands of dollars)

	June 30, 2003	June 30, 2002
Net cash provided (used) by:		
Operating activities	($296,150)	($318,019)
Noncapital financing activities	560,048	503,982
Capital and related financing activities	(86,005)	(232,274)
Investing activities	11,283	87,824
Net increase in cash	189,176	41,513
Beginning cash and cash equivalent balances	172,324	130,811
Ending cash and cash equivalent balances	**$ 361,500**	**$ 172,324**

Cash used by operating activities decreased by $22 million. This decrease in the use of cash was impacted by a $71 million increase in cash received from tuition and fees and a $94.6 million increase in cash from research grants and contracts.

Noncapital financing activities increased $56 million. The primary component of this increase was an increase in cash flow of $47.7 million from state appropriations. In 2002, the state deferred one of twelve payments to the university, resulting in a net receipt of only eleven payments. Twelve payments were received in 2003 which resulted in the high increase in cash flow for this category.

Cash flows from capital and related debt increased by $146.3 million. The primary driver of this increase was proceeds from capital debt financing of $110 million and a decrease in the purchase of capital assets of $68.5 million.

Cash flows from investing activities saw a decrease of $76.5 million, impacted primarily by a change in concentration of investments from cash equivalents toward non-current investments.

Cash flow for the 2003–04 fiscal year will be affected by increased tuition rates, which include an additional quality initiative fee assessed incoming freshman. In addition, the university does have plans to issue bonds during the 2003-04 fiscal year. No other substantial changes in cash flow are expected.

Capital Asset and Debt Administration

The institution made significant investments in capital during the 2002–03 fiscal year. New facilities were funded by revenues from new bond issues, bond issues from prior years, state appropriations, and gifts. The more significant facilities that came on line this year were:

- The new Hunt Hall–Science and Campus Service Facilities on the Kokomo campus was occupied at the beginning of the 2002-2003 academic year. The facility houses teaching labs for biology, chemistry, physics, geology, math, information systems and allied health. There is also an advanced technology auditorium, research labs, faculty offices and associated support space. Total cost of the project was $14.9 million and the facility covers 78,954 general square feet.

Hunt Hall, IU Kokomo

Biotechnology Research and Training Center, IUPUI

- The Biotechnology Research and Training Center (BRTC) on the IUPUI campus was completed and occupied in 2003 . This facility was constructed by the Indiana University Foundation at a cost of $26 million. Indiana University has a capital lease on BRTC in the amount of $10.8 million.

Research Institute, IUPUI

- Also on the IUPUI Campus, the Research Institute was completed at a total cost of $24 million.
- Eigenmann Hall, located on the Bloomington Campus and originally constructed in 1968 has undergone a $10.3 million dollar renovation. Eigenmann Hall has historically served as a student dormitory. Although still used for student housing, portions of the Hall were renovated to accommodate a new bookstore facility and additional administrative offices.

Several facilities are being planned and designed that will further enhance the mission of the institution.

- On the IUPUI campus, the Herron School of Art, Eskenazi Hall will undergo a projected $25 million renovation. The renovated facility will provide art studios, classrooms, an auditorium, a gallery, faculty and administrative offices, and a library. The project is estimated to be completed in November, 2004.

Eskenazi Hall, IUPUI

- A Campus Center is planned for the IUPUI Campus. The facility will be a gathering spot for students and will include an array of student lounges and meeting spaces, a food court, and other retail outlets. Additional occupants of the facility will be the bookstore, a 1,000 person multi-purpose room, a theater, Student Life and Diversity Programs, and the campus Enrollment Center. This projected $50 million facility is slated for completion in January, 2006.

Campus Center, IUPUI

• A new $50 million Multidisciplinary Science Building–Phase I is planned for the Bloomington Campus. The facility will house current programs including: The Center for Genomics and Bioinformatics, Proteomics Center, Biochemistry / Biophysics (Gill Center), Bio-organic / Biomaterial, Shared Instrumentation Facilities and administrative and conference space. The project is estimated for completion in April, 2006.

Multidisciplinary Science Building, IUB

Indiana University Student Fee Bonds Series O were issued on February 21, 2003 in the amount of $111,490,000. The Series O Bonds were issued for the principal purpose of providing funds to finance the acquisition, construction, renovation or equipping of:

• A communications technology complex and an informatics complex at the Indianapolis campus,
• A professional education building at the Northwest campus, and
• A library and student center at the Southeast campus.

The funds will also refund certain outstanding bonds and pay related costs associated with all of the Series O activity.

Indiana University Tax-Exempt Commercial Paper Notes, Series 2002, not to exceed $40,000,000 was issued on November 7, 2002. As of June 30, 2003, $35.6 million had been issued of the $40 million issuance. The purpose of the notes was to provide temporary financing or refinancing of costs of certain facilities on various campuses.

The university's rating on debt obligations was last reviewed and updated in winter, 2003. Moody's Investors Service provided a rating of 'Aa2' on February 11, 2003. Standard & Poor's rating of 'AA' was provided on March 31, 2003.

Economic Outlook

The State of Indiana revenues are significantly down and tax revenue projections are not meeting expectations. The State of Indiana does provide approximately 27% of the total resources for the university during a fiscal year. The State of Indiana's 2001–03 Appropriation Act, HEA 1001, was enacted by the 2001 (regular session) General Assembly and approved by the governor, which gave authority to the state Budget Agency to distribute eleven-twelfths of the budgeted amount for the 2001–02 fiscal year state appropriation for all higher education institutions in the State of Indiana. The state Budget Agency postponed the June distribution until the 2002–03 fiscal year. For Indiana University, this amount was $38.4 million in cash that was not received for such twelfth payment. A receivable was recorded and revenue recognized for the $38.4 million.

The university is not aware of any additional currently known facts, decisions, or conditions that are expected to have significant effect on the financial position or results of operations during this fiscal year beyond those unknown variations having a global effect on virtually all types of business operations.

Overall, the financial position of the university continues to be strong. The academic 2002–03 year brings increased enrollments for all seven campuses.

Indiana University
Statement of Net Assets

(in thousands of dollars)	*Year Ended*	
	June 30, 2003	*June 30, 2002*
Assets		
Current assets		
Cash and cash equivalents	$ 361,500	$ 172,324
Accounts receivable	119,034	115,062
Current portion of notes and pledges receivable	10,871	11,537
Inventories	15,832	15,979
Short-term investments	13,208	10,342
Securities lending assets	31,578	38,512
Other assets	8,236	9,015
Total current assets	560,259	372,771
Non-current assets		
Notes and pledges receivable	68,487	60,934
Investments	429,658	408,462
Capital assets, net	1,596,804	1,585,547
Total non-current assets	2,094,949	2,054,943
Total assets	**$ 2,655,208**	**$ 2,427,714**
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ 213,897	$ 190,133
Deferred revenue	106,801	31,460
Current portion of capital lease obligations	2,063	3,499
Current portion of long-term debt	36,796	37,246
Securities lending liabilities	31,578	38,512
Total current liabilities	391,135	300,850
Non-current liabilities		
Capital lease obligations	12,504	2,423
Notes payable	35,602	-
Assets held in custody for others	35,216	35,473
Bonds payable	512,522	477,609
Other long-term liabilities	7,174	10,499
Total non-current liabilities	603,018	526,004
Total Liabilities	**994,153**	**826,854**
Net Assets		
Invested in capital assets, net of related debt	1,086,535	1,057,120
Restricted for:		
Nonexpendable-Endowments	43,118	37,821
Expendable		
Scholarships, research, instruction and other	92,923	98,433
Loans	17,698	17,920
Capital projects	21,243	55,925
Debt service	19,987	27,022
Unrestricted	379,551	306,619
Total net assets	**1,661,055**	**1,600,860**
Total Liabilities and Net Assets	**$ 2,655,208**	**$ 2,427,714**

Indiana University
Statement of Revenues, Expenses, and Changes in Net Assets

(in thousands of dollars)	*Year Ended*	
	June 30, 2003	*June 30, 2002*
Operating revenues		
Student fees	$ 578,882	$ 501,575
Less scholarship allowance	(71,044)	(62,777)
Federal grants and contracts	231,388	213,234
State and local grants and contracts	28,067	31,372
Nongovernmental grants and contracts	107,684	94,357
Sales and services of educational units	50,619	53,696
Other revenue	157,459	150,093
Auxiliary enterprises (net of scholarship allowance of $9,647 in 2003 and $8,264 in 2002)	291,182	279,830
Total operating revenues	**$ 1,374,237**	**$ 1,261,380**
Operating expenses		
Total compensation and benefits	$ 1,224,622	$ 1,132,319
Student financial aid	74,977	67,076
Energy and utilities	39,778	38,519
Travel	27,468	26,439
Supplies and general expense	398,663	388,964
Depreciation expense	101,308	112,147
Total operating expenses	**1,866,816**	**1,765,464**
Total operating loss	**(492,579)**	**(504,084)**
Non-operating revenues (expenses)		
State appropriations	511,268	502,004
Investments	35,021	20,556
Gifts	47,702	43,245
Interest expense	(25,031)	(24,359)
Net non-operating revenues	568,960	541,446
Income before other revenues, expenses, gains, or losses	76,381	37,362
Capital appropriations	9,500	10,796
Capital gifts and grants	33,818	29,323
Additions to permanent endowments	2,058	974
Total other revenues	45,376	41,093
Increase in net assets before change in accounting policy	121,757	78,455
Cumulative effect of change in accounting policy		
Assets under capitalization level	(61,562)	
Increase in net assets	60,195	78,455
Net assets, beginning of year	1,600,860	1,522,405
Net assets, end of year	**$ 1,661,055**	**$ 1,600,860**

Indiana University
Statement of Cash Flows

(in thousands of dollars)	*Year Ended*	
	June 30, 2003	*June 30, 2002*
Cash Flows from Operating Activities		
Student fees	$ 509,212	$438,147
Grants and contracts	437,598	343,034
Sales and services of educational activities	47,284	53,696
Auxiliary enterprise charges	287,793	280,844
Other operating receipts	155,179	157,187
Payments to employees	(1,224,707)	(1,127,635)
Payments to suppliers	(434,745)	(395,589)
Student aid	(74,977)	(67,076)
Student loans collected	15,259	12,354
Student loans issued	(14,046)	(12,981)
Net cash used in operating activities	**(296,150)**	**(318,019)**
Cash Flows from Noncapital Financing Activities		
State appropriations	511,252	463,570
Gifts and grants received for other than capital purposes	48,781	40,530
Direct lending receipts	151,848	135,438
Direct lending payments	(151,833)	(135,556)
Net cash provided by noncapital financing activities	**560,048**	**503,982**
Cash Flows from Capital and Related Financing Activities		
Capital appropriations	12,822	10,796
Capital grants and gifts received	4,896	34,904
Purchase of capital assets	(144,223)	(212,679)
Proceeds from issuance of capital debt, including refunding activity	110,069	0
Principal payments on capital debt, including refunding activity	(39,940)	(39,280)
Principal paid on capital leases	(3,672)	(3,961)
Interest paid on capital debt and leases	(25,957)	(22,054)
Net cash used in capital and related financing activities	**(86,005)**	**(232,274)**
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	1,708	59,243
Investment income	16,648	36,018
Purchase of Investments	(7,073)	(7,437)
Net cash provided by investing activities	**11,283**	**87,824**
Net increase in cash and cash equivalents	189,176	41,513
Cash and cash equivalents, beginning of year	172,324	130,811
Cash and cash equivalents, end of year	$361,500	$172,324

Indiana University
Statement of Cash Flows

Reconciliation of operating loss to net cash used in operating activities:

(in thousands of dollars)

	Year Ended June 30, 2003	Year Ended June 30, 2002
Operating loss	$ (492,579)	$ (505,377)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	101,308	112,147
Loss on disposal of capital assets	3,845	4,295
Changes in assets and liabilities:		
Accounts receivable	(5,837)	9,940
Prepaid expenses and other assets	764	(6,070)
Inventories	146	750
Accounts payable	10,185	7,008
Deferred revenue	75,341	979
Other liabilities	10,677	57,016
Net cash used in operating activities	**$ (296,150)**	**$ (318,019)**

Indiana University
Notes to the Financial Statements
June 30, 2002 and June 30, 2003

Note 1—Summary of Significant Accounting Policies

Organization: Indiana University (the university) is a state-supported institution that is fiscally responsible for operations and students enrolled on seven campuses. Campuses are located in Bloomington, Indianapolis, Richmond, Kokomo, Gary, South Bend, and New Albany. The financial statements include the individual schools, colleges, and departments as part of the comprehensive reporting entity. The university was established by state legislative act, under Indiana Code Section IC 20-12-23, in 1838, changing the name of its predecessor, Indiana College, to Indiana University. The university's governing body, the Trustees of Indiana University, is comprised of nine members charged by the Indiana General Assembly with policy and decision authority to carry out the programs and missions of the university. Six of the members are appointed by the Governor of Indiana, and three are elected by university alumni. The university is classified as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. Certain revenues of the university may be subject to federal income tax as unrelated business income, as defined in section 513 of the Internal Revenue Code. Note 14 describes organizations related to the university, the nature of such relationships and pertinent financial information of those organizations.

Financial Statement Presentation: Beginning with the fiscal year ended June 30, 2002, the university is required to adopt *Government Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, as amended by GASB Statement No. 35, Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities.* GASB No. 35 allows for public colleges and universities to report as a business type activity under GASB 34 which requires a comprehensive, entity-wide presentation of the university's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows. This presentation replaces the fund group statements previously required under GASB standards.

Basis of Accounting: The accompanying financial statements have been prepared by the university as a special-purpose government entity engaged in business type activities. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services. Accordingly, these financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded when an obligation has been incurred. Eliminations have been made to minimize the "double-counting" of internal activities. Interfund receivables and payables have been eliminated in the Statement of Net Assets. Eliminations have been made in the Statement of Revenues, Expenses, and Net Assets to remove the "doubling-up" effect of internal service fund activity.

The university has the option to apply Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure except for those that conflict with or contradict GASB pronouncements. The policy of the university is to apply FASB Standards according to specific review of appropriateness to individual situations and transactions.

Cash Equivalents: The university considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. The university invests operating cash in investments with varying maturities. Investment maturities are evaluated as of the financial statement date for purposes of liquidity classification.

Investments: Investments are carried at fair value as of the balance sheet date in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* Unrealized gains and losses are reported as investment income in the Statement of Revenues, Expenses, and Changes in Net Assets.

Notes and Pledges Receivable: Notes receivable consist primarily of student loans. A pledge receivable is recorded at the time the pledge is measurable, probable of collection, and all applicable eligibility requirements have been met.

Capital Assets: Capital assets are recorded at cost at the date of acquisition, or at fair market value at the date of the gift for contributed assets. Effective July 1, 2002, the university changed its capitalization threshold for moveable equipment from $1,000 to $5,000. Assets with a total cost of $199,434,956 and accumulated depreciation of $137,872,769 were removed from the accounting records. The result is reflected as a cumulative effect of the change in accounting policy of $61,562,187 (expense). This amount represents assets previously capitalized but not meeting the new capitalization threshold. Capital assets also include land improvements and infrastructure costing in excess of $75,000. Buildings and building renovations that increase or enhance the useful life of the building and cost the lesser of $75,000 or twenty percent of the historical cost of the existing building are capitalized. Art and museum objects purchased by or donated to the university are capitalized. Depreciation expense is computed using the straight-line method over the estimated useful lives of the respective assets, generally five to twenty years for moveable equipment, ten years for library books, ten to forty years for infrastructure and land improvements and fifteen to forty years for buildings and building components. Useful lives for all capital assets are established using a combination of the American Hospital Association guidelines, Internal Revenue Service guidelines, and actual university experience. Land and capitalized art and museum collections are not depreciated.

Deferred Revenue: Deferred revenue is recorded for amounts received for student tuition and fees and for certain auxiliary goods and services prior to year end, but which relate to the subsequent fiscal year. Amounts received on contract and grant sponsors that have not yet been earned are also recorded as deferred revenue.

Compensated Absences: Liabilities for compensated absences have been recorded for vacation leave based on actual earned amounts for eligible employees who qualify for termination payments. Liabilities for sick leave have been recorded for those employees who have earned and are eligible for termination payments for accumulated sick days on termination or retirement.

Net Assets: The university's net assets are classified for financial reporting in the following net asset categories:

- *Invested in capital assets, net of related debt:* This component of net assets includes capital assets, net of accumulated depreciation and outstanding principal debt balances related to the acquisition, construction, or improvement of those assets.
- *Restricted net assets—expendable:* Restricted expendable net assets are those resources that the university is legally or contractually obligated to spend in accordance with externally imposed restrictions.
- *Restricted net assets—nonexpendable*: Nonexpendable restricted net assets are subject to externally imposed stipulations that the principal is to be maintained in perpetuity and invested for the purpose of producing present and future income, which may be either expended or added to principal. Such assets include the permanent endowment funds.
- *Unrestricted net assets:* Unrestricted net assets are not subject to externally imposed restrictions and are used primarily for meeting expenses for academic and general operations of the university.

When an expense is incurred for which both restricted and unrestricted resources are available, the decision whether to apply restricted or unrestricted resources first is a management matter, and the decision is made based on the particular relevant facts and circumstances.

Revenues: The university has classified its revenues as either operating or non-operating revenues as follows:

- Operating revenues: Operating revenues result from exchange transactions, such as student tuition and fees (net of scholarship discounts and allowances), government and other grants and contracts, and sales and services of auxiliary enterprises (net of scholarship discounts and allowances).
- Non-operating revenues: Non-operating revenues include those that derive from non-exchange transactions such as gifts. Other revenues classified as non-operating revenues by GASB Statement No. 34 include significant revenue sources that are relied upon for operations, such as state appropriations and investment income.

Scholarship Discounts and Allowances: Student tuition and fees and other student revenues are reported net of scholarship discounts and allowances in the Statement of Revenues, expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university and the amounts paid by students and/or third parties making payments on behalf of students.

Reclassifications: Certain reclassifications have been made to the 2002 financial statements to conform to the 2003 presentation. Lines affected are Supplies and General Expense and Total Compensation and Benefits on the Statement of Revenues, Expenses, and Changes in Net Assets; and Accounts Payable and Accrued Liabilities, Current Portion of Capital Lease Obligations, Expendable Restricted Net Assets, and Unrestricted Net Assets on the Statement of Net Assets. These reclassifications have been made for comparative purposes and do not constitute a restatement of prior periods.

NOTE 2 – CASH AND CASH EQUIVALENTS, INVESTMENTS, AND SECURITIES LENDING

Three external portfolio managers, under the oversight of university staff, are currently managing the investing of operating cash. The portfolio managers include Merganser Capital Management Corporation, Reams Asset Management Company, and Western Asset Management Company. The primary money market fund utilized for investing the university's most liquid operating cash pool is the Common Fund, which is organized as a bank common trust fund. Money market funds provided by the university's custodial bank and primary depository banks are also used for investing cash on deposit on an overnight basis. The carrying amount of the university's demand deposits reflects overdraft positions, as the university minimizes its cash position and does not fund outstanding checks until presented for payment, although payments are recorded when the checks are issued. These funds are also under the oversight of university staff. The investment of operating cash is in accordance with the policies set forth by the Trustees of Indiana University, under the authority granted to establish and carry out written policies for the investment of such funds by state statute (IC 20-12-1-2). University financial policy defines the policy for authorizing and spending investment income.

Investments are recorded at fair value. They are held in the form of pooled funds, trust accounts, separately owned securities (that cannot be pooled for legal or practical reasons) and demand deposit accounts.

The university's investments are categorized below to give an indication of the level of risk assumed by the university at year-end. Category I includes investments that are insured or registered or for which the securities are held by the university or its agent in the university's name. Category II includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the university's name. Category III includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent but not in the university's name. At June 30, 2003, the university did not have any assets in Category II or Category III.

(in thousands of dollars)	***June 30, 2003***	***June 30, 2002***	***Change***
Investments—Category I			
Corporate Bonds			
Not on Securities Loan	$ 91,449	$ 103,698	$ (12,249)
On securities loan for securities or letter of credit collateral	523	2,011	(1,488)
Miscellaneous Bonds			
Not on Securities Loan	174,682	148,050	26,632
Commercial Paper			
Not on Securities Loan	0	1,099	(1,099)
Treasury Notes			
Not on Securities Loan	10,422	329	10,093
On securities loan for securities or letter of credit collateral	2,977	0	2,977
Federal Agencies			
Not on Securities Loan	15,985	4,609	11,376
On securities loan for securities or letter of credit collateral	7,551	927	6,624
Subtotal	**303,589**	**260,723**	**42,866**
Investments—Not Categorized:			
Investments held by broker-dealers under securities loans with cash collateral			
Corporate Bonds	23,350	12,088	11,262
U.S. Government and Agency Securities	17,931	36,067	(18,136)
Securities Lending Short-term Cash Collateral Investment Pool	31,578	38,512	(6,934)
Short-term Investments	359,072	182,021	177,051
Total	**$ 735,520**	**$ 529,411**	**$ 206,109**

State statutes and Board of Trustees policy permit the university to lend securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The university's custodial bank manages the securities lending program and receives cash, U.S. government securities, or irrevocable letters of credit as collateral. Non-cash collateral cannot be pledged or sold unless the borrower defaults. Cash collateral is invested in a short-term investment pool. Cash collateral may also be invested separately in "term loans," in which case the investments match the loan term. These loans can be terminated on demand by either lender or borrower. Securities collateralized by U.S. government securities and irrevocable letters of credit that are on loan at year-end are classified in the preceding schedule of custodial credit risk according to the category for the collateral received on the securities lent. U.S. securities are loaned versus collateral valued at 102% of the fair value of the securities plus any accrued interest. Marking to market is performed every business day and the borrower is required to deliver additional collateral when necessary so that the total collateral held by the university will at least equal the fair value plus accrued interest of the borrowed securities. At year-end, the university has no credit risk exposure to borrowers because the amounts the university owes the borrowers exceed the amounts the borrowers owe the university. All security loans can be terminated on demand by either the university or the borrowers. The short-term non-cash collateral investment pool had a fair value of $11.352 million at June 30, 2003, and $3.013 million at June 30, 2002. Cash received as securities lending collateral as of June 30, 2003 was $31,578 million.

Note 3 - Accounts Receivable

Accounts receivable consisted of the following at June 30, 2003 and June 30, 2002

(in thousands of dollars)

	June 30, 2003	*June 30, 2002*
Student accounts	$ 25,624	$ 18,337
Auxiliary enterprises and other operating activities	30,770	29,413
State appropriations	38,450	38,345
Federal, state, and other grants and contracts	10,213	13,773
Capital gifts and appropriations	10,527	11,419
Other	3,450	3,775
Total accounts receivable	**$ 119,034**	**$ 115,062**

Note 4 - Notes and Pledges Receivable

Notes and pledges receivable consisted of the following at June 30, 2003 and June 30, 2002:

(in thousands of dollars)

	June 30, 2003	June 30, 2002
Operating receivables	$ 113	$ 105
Student loans receivable	71,571	72,366
Pledge receivable, net	7,674	
	$ 79,358	*$ 72,471*

During the year, the university entered into a lease purchase agreement with the Indiana University Foundation to finance a portion of the cost of construction and equipping of the Biotechnology Research and Training Center on the Indianapolis campus (see Note 10). Private funds held by the foundation solely for the use of the university, were used for related construction costs of $15,566,500. The foundation transferred rights to the facility to the university through an unconditional promise to give the university use of the facility over a 20 year period. The university currently occupies and maintains the facility. This promise to give is reflected at net present value of $7,673,542, as a pledge receivable of the university.

Note 5 – Endowment Funds

The pooled endowment funds are currently managed for the university by the Indiana University Foundation. The funds are invested in accordance with the investment policy for the Consolidated Endowment Fund of the Trustees of Indiana University. The funds held by endowments, funds functioning as endowments, and agency funds are used to acquire pooled shares. The value of the pooled shares is determined each quarter on the basis of the total fair value of pooled investments and the number of pooled shares outstanding. Income from pooled funds is distributed pro rata to each participating fund according to the number of pooled shares it holds. At June 30, 2003, pooled shares were invested in pooled long-term and pooled short-term funds with a mix of 79% equities and 21% fixed investments. Pooled funds at cost were $106,838,300 and had a fair value of $99,017,720 at June 30, 2003.

Indiana University Foundation also manages three additional endowment funds that provide scholarships to University students. These funds are also invested in accordance with the investment policy for the Consolidated Endowment Fund of the Trustees of Indiana University. The funds receive income on a monthly basis and are invested in the same manner as the pooled endowment funds. These endowment funds at cost were $12,251,574 with a fair value of $10,091,844 at June 30, 2003.

The endowment fund for Riley Hospital for Children is managed as an investment pool by the Riley Children's Foundation. The funds are invested in accordance with the Riley Children's Foundation investment policy. These funds are used to acquire pooled shares. The value of the pooled shares is determined each quarter on the basis of the total fair value of the pooled investments and the number of pooled shares outstanding. Income is distributed pro rata to each participating fund according to the number of shares in holds. At June 30, 2003, these funds were invested with a mix of 59% equities and 41% fixed investments with a cost of $5,419,652 and a fair value of $5,527,728.

The State of Indiana holds an endowment fund valued at $785,242 on behalf of Indiana University. Income from this endowment is received and distributed on a yearly basis. Real estate investments at June 30, 2003 amounted to $842,475 at cost.

In addition to the above, Indiana University shares with Purdue University and the Indianapolis Center for Advanced Research, the income from a trust held by a major bank. The fair value of the principal of this trust at June 30, 2003 was $32,290,317. The trust principal is not included on the university's financial statements.

NOTE 6—CAPITAL ASSETS

(in thousands of dollars)

	Year Ended June 30, 2003				
	Balance June 30, 2002	*Additions*	*Retirements*	*Assets under Capitalization Threshold*	*Balance June 30, 2003*
Assets not being depreciated					
Land	$ 46,384	$ 41	$	$	$ 46,425
Art and museum objects	53,135	4,579			57,714
Construction in progress—infrastructure		736			736
Construction in progress—land improvements		310			310
Construction in progress—fabricated equipment	10,316	3,329	78		13,567
Construction in progress—buildings	30,039	9,061			39,100
Total capital assets not being depreciated	139,874	18,056	78		157,852
Other capital assets					
Infrastructure	132,537	1,118			133,655
Land improvements	5,688	2,223			7,911
Equipment	489,598	43,005	33,615	199,435	299,553
Library books	125,122	21,670			146,792
Buildings	1,901,599	89,259	87		1,990,771
Leasehold improvements	2,400	2,701			5,101
Total other capital assets	2,656,944	159,976	33,702	199,435	2,583,783
Less accumulated depreciation fo					
Infrastructure	92,214	5,095		15	97,294
Land improvements	466	418			884
Equipment	318,103	33,436	29,903	137,857	183,779
Library books	47,198	15,097			62,295
Buildings	753,134	47,216	32		800,318
Leasehold improvements	156	105			261
Total accumulated depreciation other capital assets	1,211,271	101,367	29,935	137,872	1,144,831
Capital assets, net	**$ 1,585,547**	**$ 76,665**	**$ 3,845**	**$ 61,563**	**$ 1,596,804**

NOTE 7—ACCOUNTS PAYABLE

Accounts payable consisted of the following at June 30, 2003 and June 30, 2002
(in thousands of dollars)

	June 30, 2003	*June 30, 2002*
Accrued payroll	$ 62,562	$ 66,236
Accrual for compensated absences	29,829	28,375
Interest payable	7,960	8,823
Held for student loans	26,393	25,891
Vendor and other payables	87,153	60,808
Total accounts payable and accrued liabilities	**$ 213,897**	**$ 190,133**

NOTE 8—LONG-TERM LIABILITIES

Long-term liability activity, as presented below, includes current and non-current portions of debt. Long term liabilities at June 30, 2003 and June 30, 2002 were as follows: 21

(in thousands of dollars):

	Balance June 30, 2002	*Additions*	*Reductions*	*Balance June 30, 2003*	*Current Portion*
Bonds payable	$ 514,855	$ 116,607	82,144	$ 549,318	$36,796
Capital lease obligations	5,922	12,317	3,672	14,567	2,063
Tax exempt commercial paper		35,602		35,602	
Total bonds, capital leases and notes payable	520,777	164,526	85,816	599,487	38,859
Other liabilities:					
Assets held in custody for others	35,473		257	35,216	
Other	38,874	3,732	5,603	37,003	29,829
Total Long-term Liabilities	$ 595,124	$ 168,258	$ 91,675	$ 671,706	$ 68,688

Compensated absences typically have been liquidated from the general and auxiliary enterprise funds.

Note 9 – Bonds and Notes Payable

Indiana University is authorized by acts of the Indiana General Assembly to issue bonds and notes for the purposes of financing construction of student union buildings, halls of music and housing, athletic, parking, and academic facilities. The outstanding long-term bond and note indebtedness at June 30, 2003, was $579,866,548. The amount outstanding as of June 30, 2003 for bonds issued under Indiana Code (IC) 20-12-6 is $476,425,548, plus $55,639,126 in accreted value of outstanding capital appreciation bonds.

The issues are serial and term bonds and notes payable with maturities extending to August 1, 2022. A separate fee replacement appropriation is received from the State of Indiana on an annual basis. The appropriation represented the amount required to make principal and interest payments for financing certain academic and student facilities.

Indiana Code 20-12-9.5 permits the use of debt in the form of temporary borrowing in anticipation of future long-term borrowing for capital projects, when such long-term borrowing is authorized under other sections of the Indiana Code. On November 14, 2002, The University issued Tax-Exempt Commercial Paper (TECP) as interim financing for certain approved facilities on various campuses. To date, such funds have been used to finance University Apartments, a student housing complex on the Indianapolis campus. TECP are notes payable that will be refinanced with some form of permanent financing at a future date. The interest rate and term of the notes are subject to market conditions on the maturity date of the notes. The number of days to maturity may not exceed 270 days, with the final maturity of the notes being August 1, 2012.

As of June 30, 2003, outstanding indebtedness from bonds and notes is as follows:

(in thousand of dollars)

Bonding Authority Outstanding	*Interest Rates*	*Final Maturity*	*Principal*
Indiana Code 20-12-6 / Acts of 1965—Academic Facilities	2.00 to 7.25%	2022	$ 476,426
Indiana Code 20-12-7 / Acts of 1929—Student Union Buildings, Halls of Music, and Athletic Facilities	6.25 to 6.60%	2009	2,170
Indiana Code 20-12-8 / Acts of 1927—Housing, Parking, and Hospital Facilities	1.25 to 6.00%	2020	$65,669
Indiana Code 20-12-—Tax Exempt Commercial Paper	0.95 to 1.10 %	2012	35,602
			579,867
Add unamortized bond premium			5,053
Total			$584,920

The university has two series of variable rate bonds outstanding. The Student Residence System Bonds, Series 1998, were issued in June of 1998 to finance the renovation of the Willkie Quadrangle. The Facility Revenue Bonds, Series 2000, were issued in December of 2000 to finance the construction of parking facilities. Both are included above in the category titled Indiana Code 20-12-8 - Housing, Parking, and Hospital Facilities. The variable interest rate is determined by the remarketing agent, based on prevailing market conditions. While in variable rate mode, interest on these series is calculated on the basis of a 365 or 366-day year, for the actual number of days elapsed. During the 2002-03 fiscal year, the university extended the term of the credit facility on both variable rate bond issues through June 30, 2006.

Principal and Interest requirements to maturity for bonds and notes are as follows :

(in thousands of dollars)

Fiscal Year End	*Bond Principal*	*Note Principal*	*Total Principal*	*Bond Interest*	*Note Interest*	*Total Interest*	*Total Payment*
2004	$ 36,540	$	$ 36,540	$ 22,703	367	$ 23,070	$ 59,610
2005	42,579		42,579	21,225	367	21,592	64,171
2006	33,402		33,402	30,996	367	31,363	64,765
2007	34,491		34,491	30,713	367	31,080	65,571
2008	35,078		35,078	29,803	367	30,170	65,248
2009-2013	152,652	35,602	188,254	120,110	1,496	121,606	309,860
2014-2018	122,067		122,067	50,178		50,178	172,245
2019-2023	87,456		87,456	6,286		6,286	93,742
Total	$ 544,265	$ 35,602	$ 579,867	$ 312,014	$ 3,331	$ 315,345	$ 895,212

On March 6, 2003, the university issued Indiana University Student Fee Bonds, Series O, in the amount of $111,490,000. The purpose of the issue was to provide for a partial advance refunding of Indiana University Student Fee Bonds, Series K and Series M. The issue also included new money, which will finance the following projects: the Communications Technology Complex and Informatics Complex on the Indianapolis campus, the Professional Education Building on the Northwest campus, and the Library and Student Center on the Southeast campus. The true interest cost for the entire bond issue was 4.26%. The refunding portion of the transaction generated debt service savings of $2,105,110, with a net present value savings of $2,050,660.

In prior years, the university has defeased the following bond issues either with cash or by issuing new debt. United States Treasury obligations have been purchased in amounts sufficient to pay principal and interest payments when due, through maturity, and have been deposited in irrevocable trust with the trustee. Neither the defeased bonds nor the related trusts are reflected on the university's books. As of June 30, 2003, defeased bonds outstanding may be summarized as follows:

(in thousands of dollars)

Principal Defeasance Date	*Description of Bonds*	*Final Maturity Date*	*Outstanding*
October 1, 1985	Building Facilities Fee Bonds, Series H-M	2010	$ 18,855
March 2, 1998	Dormitory Revenue Bonds, Series 1964	2003	108

NOTE 10—LEASE OBLIGATIONS

The university leases certain facilities. Most of the facility leases include renewal options and some provide for escalation of rent based on changes in operating cost. Some leases are in substance lease-purchases and as such are recorded as capital lease obligations. Indiana Code 20-12-5.5 permits the use of debt in the form of long-term capital lease-purchase agreements. The schedule below includes a lease-purchase agreement between Indiana University Foundation and The Trustees of Indiana University, which was securitized and sold as Certificates of Participation, Series 2003A, in April of 2003 in the amount of $10,830,000. The true interest cost (TIC) for the entire certificate issue was 4.50%. The proceeds of the Series 2003A Certificates were used to finance a portion of the cost of construction and equipping of the Biotechnology Research and Training Center (BRTC) on the Indianapolis campus, and capitalized interest thereon.

Future minimum payments of all significant leases with initial or remaining terms of one year or more at June 30, 2003 are as follows:

(in thousands of dollars)

	Capital	**Operating**
2004	$2,504	$8,192
2005	1,915	5,873
2006	1,276	5,256
2007	1,131	3,479
2008	1,002	2,031
2009-13	4,282	8,115
2014-18	4,239	6,929
2019-23	4,221	6,430
2024-28		197
Total future minimum payments	$20,570	$46,502
Less: amounts representing interest	(6,003)	
Present Value of Future Minimum Lease Payments	$14,567	

NOTE 11—FEDERAL OBLIGATIONS UNDER STUDENT LOAN PROGRAMS

Student Loans are funded principally from allocations received from the federal government under the Carl D. Perkins, Health Professions, and Nursing Loan programs. The collections, including interest from these programs, are loaned to students. One-tenth of the original funding for these programs was contributed by the university. The institutional match for new federal funding is currently one-third.

During the fiscal year, the federal government advanced $280,619 for the Perkins Loan Program, and $191,953 for Health Professions and Nursing Loan Programs. Liabilities at year end for loan programs were as follows:

(in thousands of dollars)

Federal Share of Interest Collections on Federal Capital Contribution Student Loans	$ 26,393
Federal Student Loan Advances	
Perkins Loans	$ 23,298
Health Professions Loans	11,109
Nursing Loans	809
	35,216
Total	$ 61,609

Note 12 – Risk Management

The university is exposed to various risks of loss: torts, theft, damage, or destruction of assets; errors or omissions; job-related illnesses or injuries to employees; health and other medical benefits provided to employees and their dependents. The university handles these risks of loss through combinations of risk retention and commercial insurance. For buildings and contents the university is self-insured for the first $1 million per occurrence. For comprehensive general and automobile liabilities, the university is self-insured for the first $1 million, and in addition, has excess liability umbrella policies. The university has a commercial malpractice and professional liability policy in the amount of $250,000 for each claim and $750,000 annually in aggregate. The university is self-insured for the first $500,000 of any worker's compensation claim. Excess commercial coverage for up to $1 million exists for employer's liability claims. Worker's compensation claims above $500,000 have $125 million limits.

The university has a total of six health care plans for full-time appointed employees and three health care plans for retirees. Four employee plans and one retiree plan are self-funded. For the fiscal year ended on June 30, 2003, the university's contributions to these health care plans totaled $78,312,015. For the same period, employees, COBRA participants and retirees made contributions totaling $17,116,606

For university-sponsored self-funded health care plans, there is a liability for incurred but unpaid claims. This liability is estimated to be no more than 25% of the paid self-funded claims during fiscal year 2002-2003, which equals $14,772,625. In addition, a liability of $4,948,278 for claims fluctuation has been recorded as of June 30, 2003.

Separate funds have been established to account for the liability of "incurred but unpaid" health care claims, as well as any unusual catastrophic claims experience. All organization units of the university are charged fees based on estimates of the amounts necessary to pay the above health care coverage, including premiums and claims, and to maintain necessary reserves.

Note 13 – Retirement Plans

As of June 30, 2003, the university provides retirement plan coverage to 17,466 active employees, in addition to contributing to Social Security for all non-student employees.

The university contributes to the Public Employees' Retirement Fund (PERF), a defined benefit pension plan with an annuity savings account provision. The Public Employees' Retirement Fund (PERF) is an agent multiple-employer public employee retirement system, which provides retirement benefits to plan members and beneficiaries. All nonexempt employees with at least a 50% FTE appointment are eligible to participate in the PERF plan. On June 30, 2003, there were 7,353 active university employees covered by this retirement plan. State statutes (IC 5-10.2 and 5-10.3) give the university authority to contribute to the plan and govern most requirements of the system. The PERF retirement benefit consists of the pension provided by employer contributions plus an annuity provided by the member's annuity savings account. The annuity savings account consists of member's contributions, set by state statute at three percent of compensation, plus the interest credited to the member's account. The university has elected to make the contributions on behalf of the member. PERF issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204 or by calling (317) 233-4162.

Funding Policy and Annual Pension Cost

The contribution requirements of plan members for PERF are established by the Board of Trustees of PERF. The university's annual pension cost for the current year and related information, as provided by the actuary, is presented below.

The university's accrued liability is the same percent as the entire State of Indiana. The contributions actually made by the university for fiscal year 2003 were $15,815,422. This amount is representative of a 5.2% contribution by the university for pension benefits and a 3% contribution by the university for the annuity savings account provisions.

The actuarial cost method used was the entry age method. The amortization method used was the level percentage of projected payroll method, using an amortization period of 40 years beginning with the July 1, 1997 valuation. The asset valuation method used was a four-year smoothed market approach.

Actuarial assumptions included were a 7.25% investment rate of return, a 5% projection for future salary increases which was comprised of a 4% attribution for inflation and a 1% attribution for Merit / Seniority, and a 2% cost of living adjustment.

The following schedules show the funding progress, net pension obligation and trend information for PERF:

	June 30, 2002
Annual Required Contribution	$ 9,075,212
Interest on Net Pension Obligation	(121,631)
Adjustment to Annual Required Contribution	132,277
Annual Pension Cost	9,085,858
Contributions Made	(9,332,188)
Decrease in Net Pension Obligation	(246,330)
Net Pension Obligation, Beginning of Year	(1,677,666)
Net Pension Obligation, End of Year	$ (1,923,996)

The actuarial information above represents the period ending June 30, 2002. The June 30, 2003 information concerning the PERF funding and obligation was not available from the actuary at the time of this report.

Annual Pension Year Ending	*Percentage of Cost (APC)*	*NetPension APC Contributed*	*Obligation*
06-30-00	7,643,511	147%	(870,389)
06-30-01	8,308,830	109%	(1,677,666)
06-30-02	9,085,858	102%	(1,923,966)

Appointed Academic and Exempt Staff, with at least 50% FTE, are covered by the IU Retirement Plan. This is a defined contribution plan under IRC 403 (b) with four contribution levels. During the fiscal year ending June 30, 2003, Indiana University contributed $60,664,077 to TIAA-CREF and $9,563,655 to Fidelity Investments for the IU Retirement Plan. On June 30, 2003, 8,054 employees were directing university contributions to TIAA-CREF and 1,813 to Fidelity Investments.

TIAA-CREF issues an annual financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by writing the Teachers Insurance and Annuity Association / College Retirement Equities Fund, 730 Third Avenue, New York, NY 10017-3206.

Fidelity Investments issues an annual financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by writing to: Fidelity Investments, 82 Devonshire Street, Boston, MA 02109.

In addition to the above, the university provides early retirement benefits to Appointed Academic and Exempt Staff Grade 16 and above. On June 30, 2003, there were 1,656 active employees covered by IUSERP (IU Supplemental Early Retirement Plan); a defined contribution in compliance with IRC 401(a), with participant accounts at TIAA-CREF and Fidelity. During the fiscal year ended June 30, 2003, the university contributed $2,814,963 to IUSERP. The same class of employees hired prior to January 1, 1989, are covered by the 18 / 20 Retirement Plan, a combination of IRC 457 and 403 (b) provisions. The 18 / 20 Retirement Plan allows this class of faculty and administrators to retire as early as age 64, assuming 18 years of participation in the plan and 20 years of continuous university service. During fiscal year 2002-2003, the university contributed $34,231,908 for payments to 333 individuals receiving 18 / 20 Retirement Plan payments. In accordance with GASB guidelines, the university has no future unfunded liability related to these early retirement plans.

The university has established a new early retirement plan for approximately 114 employees, to accommodate IRS requirements, and as authorized by the Trustees of Indiana University. This new plan is called the IU Replacement Retirement Plan. It is a single-employer plan and is qualified under IRC Section 401(a), with normal benefits payable for the participant's lifetime. Trust and recordkeeping activities are outsourced to the TIAA-CREF Trust Company. The first annual required contribution made by the university to this plan equaled $1,749,345.00; there are no employee contributions. There were no participant benefits paid during this period.

FUNDING POLICY AND ANNUAL PENSION COST
The university's annual pension cost for the current year and related information, as provided by the actuary, is provided below.

The actuarial cost method used to calculate liabilities is the projected accrued benefit actuarial cost method with a normal cost determined for participants who have not yet attained the assumed full retirement age. Under the asset valuation method used, the actuarial value of assets is equal to the fair value on the valuation date adjusted for employer contributions receivable.

Actuarial assumptions include a 7% asset rate of return and future salary increases at 4% compounded annually.

The following schedule shows the funding policy contributions for the plan year ending June 30, 2003 for the IU Replacement Retirement Plan:

(in thousands of dollars)

	June 30, 2003
Cost of benefits earned during the year	$807
Amortization of unfunded actuarial accrued liabilities	828
Interest	114
Annual required contribution	$1,749

The university provides term life insurance benefits for former employees with Retiree status. (Retiree status is based on age and service at termination.) This benefit is underwritten through an insurance company. During fiscal year 2003, the university contributed $722,391 to this coverage.

NOTE 14—RELATED ORGANIZATIONS

The Indiana university Foundation is an independent corporation formed for the exclusive purpose of obtaining and disbursing funds for the sole benefit of the university. At June 30, 2003, the stated value of the net assets of the foundation was $950.7 million. These assets are not included in the financial statements of the university.

The university is also a beneficiary of the Riley Children's Foundation (formerly James Whitcomb Riley Memorial Association). In 1922 the association presented the James Whitcomb Riley Hospital for Children to Indiana University. On May 2, 1996, the James Whitcomb Riley Hospital for Children separated from Indiana University and is now part of Clarian Health Partners Inc. Over the years the university has been the major beneficiary of the foundation. Riley Children's Foundation net assets of $161 million at June 30, 2003 are not included in the financial statements of the university.

The Advanced Research and Technology Institute (ARTI) is an independent not-for-profit corporation formed on January 1, 1997, to serve IU in developing new applications for technologies and services that originate within the university community. ARTI was formed, in part, by consolidating the former IU functions of the Technology Transfer Office and the Licensing and Trademarks Office. These offices, together with the office of Corporate Relations, will provide new opportunities for faculty and students to partner and collaborate with the corporate sector. The ARTI technology transfer office handles the intellectual property protection and promotion of new inventions and research capabilities, and oversees the licensing of patents, copyrights, and trademarks between the university and corporations. The Office of Corporate Relations is the point of contact for IU faculty and businesses. The Licensing and Trademarks Office oversees the use of the Indiana University name and its marks, logos, insignias, seals, designs, and symbols. At June 30, 2003, the stated value of the net assets of ARTI was $3.1 million. The net assets of ARTI are not included in the financial statements of the university.

NOTE 15 – FUNCTIONAL EXPENSES

The university's operating expenses by functional classification are as follows:

Year Ended June 30, 2003

(in thousands of dollars)

	Natural Classification						
Functional Classification	*Compensation and Benefits*	*Utilities*	*Supplies and Expenses*	*Scholarships*	*Depreciation*	*Travel*	*Total*
Instructional	$ 541,832	$ 34	61,685	5,560		6,899	616,010
Research	128,287	334	63,404	2,871		6,566	201,462
Public Service	78,473	118	39,991	3,094		3,310	124,986
Academic Support	107,468	14	40,477	464		2,973	151,396
Student Services	40,602	3	13,799	137		1,015	55,556
Institutional Support	60,775	110	88,790	44		2,209	151,928
Physical Plant	42,222	37,607	37,641			107	117,577
Scholarships & Fellowships	7,511		2,535	59,242		72	69,360
Auxiliary Enterprises	217,452	1,558	50,341	3,565		4,317	277,233
Depreciation					101,308		101,308
Total Operating Expense	**$ 1,224,622**	**$ 39,778**	**$ 398,663**	**$ 74,977**	**$ 101,308**	**$ 27,468**	**$ 1,866,816**

Year Ended June 30, 2002

(in thousands of dollars)

	Natural Classification						
Functional Classification	*Compensation and Benefits*	*Utilities*	*Supplies and Expenses*	*Scholarships*	*Depreciation*	*Travel*	*Total*
Instructional	$ 499,797	$ 43	$ 33,955	$ 9,087		$ 6,122	$ 549,004
Research	114,382	521	33,950	5,410		5,992	160,255
Public Service	73,353	28	32,160	6,448		3,601	115,590
Academic Support	105,604	221	33,379	905		2,845	142,954
Student Services	38,026	2	7,721	210		981	46,940
Institutional Support	74,178	1,589	144,365	537		2,129	222,798
Physical Plant	39,926	35,301	23,607			119	98,953
Scholarships & Fellowships	6,795		52	37,562		100	44,509
Auxiliary Enterprises	180,258	814	79,775	6,917		4,550	272,314
Depreciation					112,147		112,147
Total Operating Expenses	**$ 1,132,319**	**$ 38,519**	**$ 388,964**	**$ 67,076**	**$ 112,147**	**$ 26,439**	**$ 1,765,464**

Note 16— Segment Information

(in thousands of dollars)

Parking Operations exist on all seven campuses at Indiana University. Parking spaces and services are provided by these auxiliary entities to students, staff, faculty and the general public and are located on properties owned by Indiana University. The Bloomington, Indianapolis, Kokomo and South Bend campuses have Parking Revenue Bonds which classify them as a segment. The condensed financial statements for these four parking operations are as follows:

Condensed Statement of Net Assets

(in thousands of dollars)

	June 30, 2003	*June 30, 2002*
Assets		
Current assets	$ 15,681	$ 12,233
Capital assets (book value)	47,854	47,506
Total Assets	63,535	59,739
Liabilities		
Current liabilities	4,075	3,271
Long-term liabilities	41,724	44,128
Total liabilities	45,799	47,399
Net Assets		
Invested in capital assets, net of related debt	4,294	2,391
Unrestricted	13,442	9,949
Total net assets	**$ 17,736**	**$ 12,340**

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

Operating revenues	$ 14,849	$ 14,108
Depreciation expense	1,784	(2,398)
Other operating expenses	6,576	(6,903)
Net operating income	6,489	4,807
Non-operating revenues		
Interest income	1	5
Interest expense	(1,835)	(2,260)
Change in net assets before change in accounting policy	4,655	2,552
Cumulative effect of change in accounting policy		
Assets under capitalization level	(169)	
Net Assets		
Net assets—beginning of year	12,340	11,213
Net transfers	910	(1,198)
Adjustments		(227)
Net assets end of year	**$ 17,736**	**$ 12,340**

Condensed Statement of Cash Flows

Net cash provided (used) by:		
Operating activities	$ 7,180	$ 6,238
Capital and related financing activities	(3,266)	(3,374)
Investing activities	(999)	(797)
Net increase in cash	2,915	2,067
Beginning cash and cash equivalent balances	11,571	9,504
Ending cash and cash equivalent balances	**$ 14,486**	**$ 11,571**

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INDEPENDENT AUDITORS' REPORT

TO: THE OFFICIALS OF INDIANA UNIVERSITY, BLOOMINGTON, INDIANA

We have audited the accompanying basic financial statements of Indiana University, a component unit of the State of Indiana, as of and for the years ended June 30, 2003 and 2002. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In accordance with Government Auditing Standards, we have also issued our report dated October 29, 2003, on our consideration of Indiana University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. The report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit. This report will be issued in the University's Single Audit report prepared in accordance with OMB Circular A-133.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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October 29, 2003

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as of June 30, 2003

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as of June 30, 2003

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