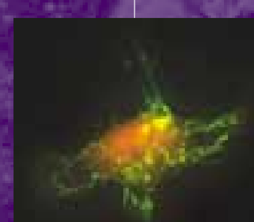
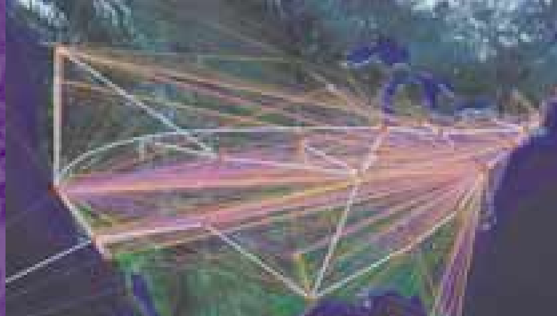
UNIVERSITY OF WASHINGTON

THE RESEARCH UNIVERSITY AND THE FUTURE OF OUR STATE

ANNUAL REPORT 2002





FACTS

STUDENTS	2001–2002	1996–1997	1991–1992
Autumn Enrollment			
Undergraduate	30,005	26,969	25,583
Graduate	9,379	7,829	7,867
Professional	1,705	1,479	1,310
TOTAL	**41,089**	**36,277**	**34,760**
Extension[1]	31,054	28,952	25,338
Number of Degrees Awarded			
Bachelor's	7,505	6,938	5,454
Master's	2,489	2,126	1,948
Doctoral	456	526	399
Professional	476	386	357
TOTAL	**10,926**	**9,976**	**8,158**
INSTRUCTIONAL FACULTY	3,443	3,210	3,042
FACULTY AND STAFF[2]	23,680	20,403	19,543
RESEARCH FUNDING – ALL SOURCES *(in thousands of dollars)*	$ 809,000	$ 510,000	$ 414,000
SELECTED REVENUES *(in thousands of dollars)*			
Gifts, Grants, and Contracts	$ 803,839	$ 521,031	$ 405,792
Auxiliary Enterprises[3] and Other Revenues	879,713	603,987	373,636
State Appropriations	343,656	276,019	264,103
Tuition and Fees[4]	249,861	202,425	132,377
SELECTED EXPENSES *(in thousands of dollars)*			
Instruction, Academic Support, and Student Services	$ 728,501	$ 483,315	$ 409,473
Research and Public Service	471,681	350,922	269,847
Auxiliary Enterprises[3]	651,598	456,298	264,749
Institutional Support and Physical Plant	239,797	164,846	117,609
CONSOLIDATED ENDOWMENT FUNDS[5] *(in thousands of dollars)*	$ 998,000	$ 482,000	$ 204,000
SQUARE FOOTAGE[6] *(in thousands of square feet)*	16,300	15,100	13,700

1 Course registrations

2 Full-time equivalents

3 Includes UWMC

4 Net of scholarship allowances of $35,688,000 in 2001-2002

5 Stated at fair value

6 Gross square footage, all campuses

ANNUAL REPORT 2002

UNIVERSITY OF WASHINGTON

THE RESEARCH UNIVERSITY AND THE FUTURE OF OUR STATE

MESSAGE FROM THE INTERIM PRESIDENT 2

THE RESEARCH UNIVERSITY AND THE FUTURE OF OUR STATE 5

FINANCIAL HIGHLIGHTS 17

FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY INFORMATION 27

BOARD OF REGENTS AND ADMINISTRATIVE OFFICERS *inside back cover*

Message from the Interim President

The man who led the University of Washington during the year described in this report, and for the previous six years, has now departed to head another great public research university: Rutgers, the state university of New Jersey. Dick McCormick grew up at Rutgers and spent many years there as a professor, department chair, and dean. When he was offered its presidency in the fall of 2002, the pull of home and history proved too strong to resist.

The UW will miss Dick McCormick—his energy, his deep commitment to the public mission of the institution, his push for innovation at all levels, his continuing focus on issues of diversity, his drive to make research the province of undergraduates as well as faculty and graduate students, his reaching out to Washingtonians beyond the campus and beyond Puget Sound, and his determination to increase the resources available for the University's work. He leaves behind a strong leadership team, structures for continuing innovation, and what we have come to call a "culture of possibility." We will continue moving forward.

In the current economic climate, especially, forward momentum at the University of Washington is critically important to the state as a whole. The 1990s were very good to this region, but we are now in the economic doldrums, with high unemployment, crushing state budget deficits, and widespread anxiety about the state's economic future. It would be easy, but fatal, to lose sight of the fact that the road to that future, whatever the current business cycle, continues to run through research universities. Education and innovation, the products of university teaching and research, are the keys to any kind of economic future that makes sense in the twenty-first century.

In the period covered by this report—well into the economic downturn—companies were still moving to the Puget Sound region to take advantage of UW graduates and research. The UW was still setting records in winning federal research funds. UW spin-off companies were still attracting new investments. National reports were still being published that gave both the UW and the state of Washington top rankings in the creation of new companies and in "economic dynamism." And the UW was still engaged in multiple efforts to boost rural state economies with new technologies and expertise (as illustrated in this report).

It would be foolish to claim that the University alone can cure our current economic malaise. The UW is only one of many strong assets, both public and private, on which the state can build. A region that has given the nation Microsoft, Starbuck's, and Amazon, not to mention Boeing and Nordstrom, has more than one string to its bow.

But it is equally foolish to think that our regional economy can thrive without a first-class research university. That has not happened anywhere in the country. Research universities are at the heart of the new knowledge-based economy. A recent Brookings Institution report on biotechnology, for example, calls the Seattle area one of the five fastest-growing biotech centers in the country—and lists eight UW-related firms among the ten leading biotech companies in the region. And both Boeing and Microsoft are full of UW alumni and research collaborations.

So it should be cause for alarm for Washingtonians when state support for the UW declines. And that has been the case for a decade. The easiest way to measure the decline is in state-appropriated dollars per FTE student, adjusted for inflation. By that measure, state support for the UW has slipped by 16 percent since 1991. That year, state funding for the UW ranked right in the middle of its 24 official peer universities. Today we are down at number 20.

If our state funding were still average—merely average!—we would be receiving almost $92 million more this year in state appropriations than we are. That money would be paying more-competitive faculty salaries (including salaries for positions we now can't afford to fill), supporting basic educational services, keeping class size down, giving students readier access to high-demand courses in science and technology, helping them graduate faster, and renovating our aging campus buildings. In other words, those dollars would be keeping the academic core of the University strong—and that core supports everything else we do.

The bottom line is simple: improved state support is essential if the UW is to continue making its critical contributions to the state's economic future. For the 2003 legislature, coming up with that support will be anything but simple. But it must be done.

Lee L. Huntsman

THE RESEARCH UNIVERSITY AND THE FUTURE OF OUR STATE

FIXING GENES – AND LIVES 6

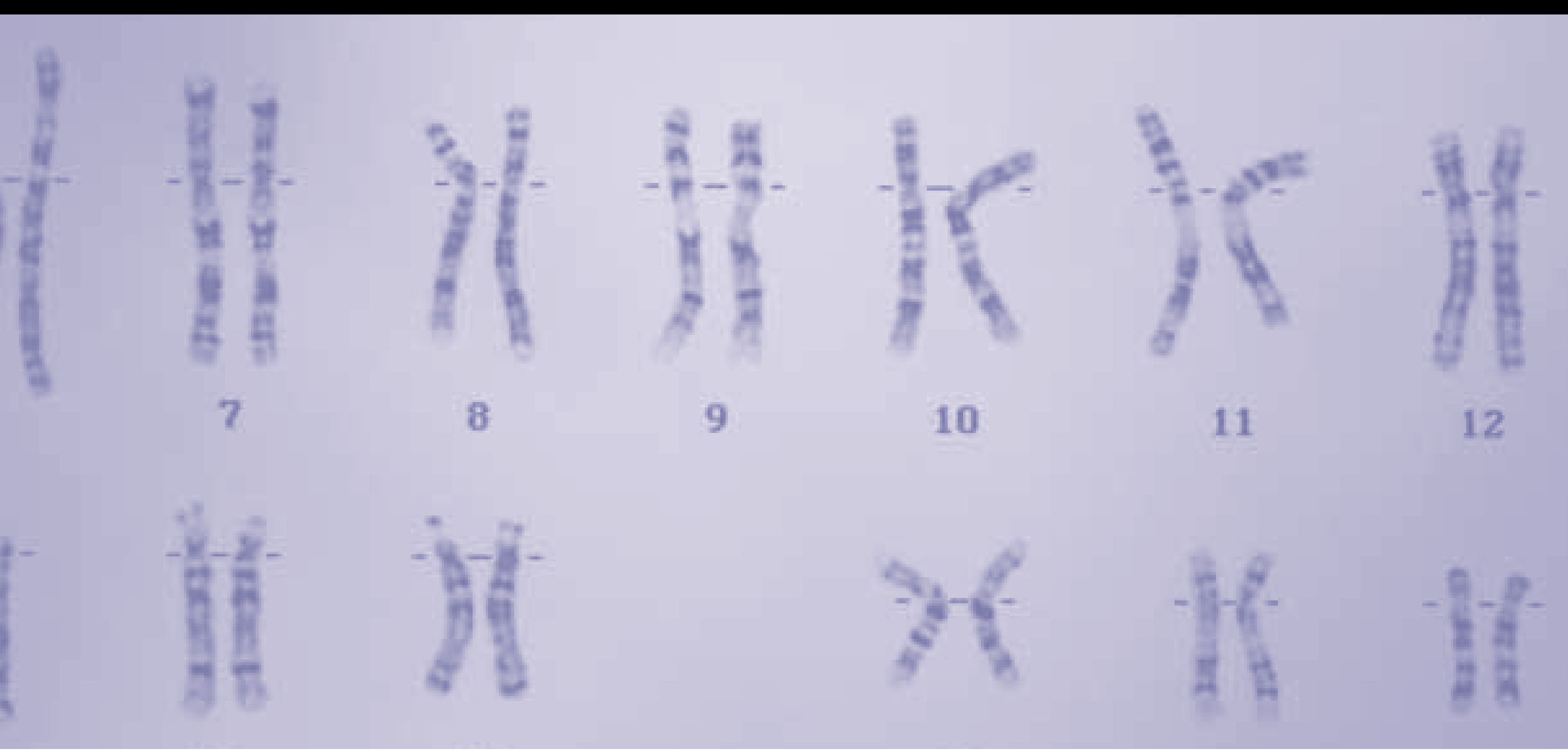
A PERFECT STORM 8

DIGITAL FORESTS 10

STUDENTS INC. 12

CONNECTING RURAL COMMUNITIES 14

Fixing Genes – and Lives



Your small son is happy, healthy, and the focus of all the usual parental hopes and dreams. But at age three or so, the problems begin: frequent falls, difficulty getting up, an odd gait. The eventual diagnosis: Duchenne muscular dystrophy (DMD). Treatments available: none. Prognosis: progressive muscle degeneration ending, implacably, in death from heart or respiratory failure by age 25. "It's a terrible disease," says UW neurology professor Jeffrey Chamberlain. "The emotional impact on families is devastating."

Dr. Chamberlain is a leader in DMD research. His goal is straightforward: "We're trying to find a cure for muscular dystrophy." A 1985 graduate of the UW's Ph.D. program in biochemistry, he was recruited back in 2000 to join the medical school's new division of neurogenetics.

Duchenne, like almost all forms of muscular dystrophy, arises from mutations in a single gene, so it is a prime candidate for gene therapy—the focus of Dr. Chamberlain's research. He works with DMD because it is the most common, best understood, and arguably the cruelest form of the disease—indeed, it is the most common fatal inherited disease of children. But a successful strategy for DMD, he thinks, will apply to other forms of muscular dystrophy as well.

Gene therapy involves replacing a defective gene with a working one. One hurdle is devising a carrier that can deliver the payload to cells without setting off an immune reaction. In DMD, the task is complicated by the extremely large size of the dystrophin gene. Step by step, Dr. Chamberlain has moved closer to success. Most recently, working with mice, he has shown that a stripped-down adenovirus can carry the entire dystrophin gene into muscle cells and actually reverse severe muscle damage.

"Now," says Dr. Chamberlain, "we have to find a way to scale up—to deliver the gene to all the muscles." He expects the first human clinical trials, for safety, to begin in two or three years at Children's Hospital.

"There will be a series of increasingly exciting breakthroughs," he predicts, "starting with successful treatment of small muscle groups. We're still years away from a full cure. But we feel we're really on the right track."

"It's a terrible disease. The emotional impact on families is devastating."

"This is a place where you can make your own opportunities."

A Perfect Storm

"I like a frenetic pace," says UW senior Allison Van. After some years in Sequim and graduation from a small Oregon high school, she was eager for the size and multiplicity of the University of Washington. "I knew there was such amazing research here," she says, "so many people, so much going on, that I could be caught up in this storm of activity."

She quickly signed on as an environmental-studies major, pursuing a longtime interest. By sophomore year, ready for "something new and different," she joined a UW student team for a project in Wapato, a multi-ethnic farming community on the Yakama Indian Reservation. There, says Allison, "I got interested in the idea that communities deserve to have more say in the use of land and also need better information to make informed decisions." By the end of the year, she had added another major to her program: community and environmental planning.

As a junior, after two years of self-confessed "math phobia," she plucked up her courage, took calculus, and "realized that I wanted to go into science." So she added a third major: biology. "Conservation biology is the field I really want to end up in," she says, "but the environmental studies background gives me a deeper understanding of the economic and political sides of ecology."

Just to make sure the frenetic pace didn't flag, Allison also worked as the national communications specialist for Earth Day Network, interned for the Environmental Protection Agency, and worked on salmon conservation at the Northwest Fisheries Science Center.

In March 2003, Allison will graduate with three bachelor's degrees and two major national awards: a Morris Udall Scholarship, for undergraduates in fields related to the environment, and a Harry S. Truman Scholarship, to support graduate study in preparation for public-service careers. She plans to earn a Ph.D. in zoology and then work in developing communities abroad, "to bridge the passions I've always had for both environmental issues and social issues."

Of the UW, Allison says, "This is a place where you can make your own opportunities." Naming more than a dozen faculty and staff who have mentored and helped her, she adds, "I've been the beneficiary of something that's really incredible. When you go to a public institution, you need to take away a sense of obligation."

Digital Forests

Bob Playfair and his sister grew up on their small family tree farm in Stevens County. Three creeks run through the property. When salmon, steelhead, and bulltrout were put on the endangered-species list and the state developed its new Forests and Fish regulations, the Playfairs faced a dilemma. Along their creeks, timberland carefully nurtured by two generations was now off limits for harvest. The economic loss would be significant. But Bob Playfair also worried about unintended environmental consequences. His long knowledge of Eastern Washington forests, chronically threatened by fire, insects, and disease, told him that the creekside woods needed a partial "regeneration cut"—now illegal.

Small private landowners like Playfair, together with tribal owners, hold more than a quarter of Washington's forestland. The state, recognizing the hardships the new rules might cause for small operations, included a provision for "alternate plans" that could bend the rules a bit if they achieved the desired ecological ends. But such plans require a level of analysis and documentation beyond the means of many owners like Playfair.

So a consortium of small private and tribal forest owners from around the state approached the UW and WSU for help. The owners knew there were cutting-edge technologies that could turn their holdings into "virtual forests" and help them explore and project a whole range of management options, together with their environmental and economic consequences. But such technology had not yet made it to their world of small, rural woodlands.

Now it's on its way. The Rural Technology Initiative (RTI) is a federally funded pilot program established in 2000 by the UW College of Forest Resources and the WSU Department of Natural Resource Science. RTI runs training programs for small forest owners in the Landscape Management System (free software), Global Positioning Systems, Geographic Information System, and other new technologies.

RTI also funds research by graduate students, including case studies that measure the impact of Forests and Fish rules on individual landowners. The Playfair tree farm is the subject of one such study by UW forestry student Elaine Oneil. The Playfairs hope to use the technical tools provided by RTI to show that an alternate management plan for their creekland is biologically sound.

For many small owners, the real "alternate plan" is selling out to developers. Says Elaine, "That would be the worst environmental outcome. We're trying to provide the tools to keep these lands in forestry."

"We're trying to provide the tools to keep these lands in forestry."

Students Inc.

Are entrepreneurs born or made? Can you teach the skills and attitudes that have made the UW and the state of Washington national leaders in the creation of new companies? The UW business school is betting that you can, and the Cogelix team is a case in point.

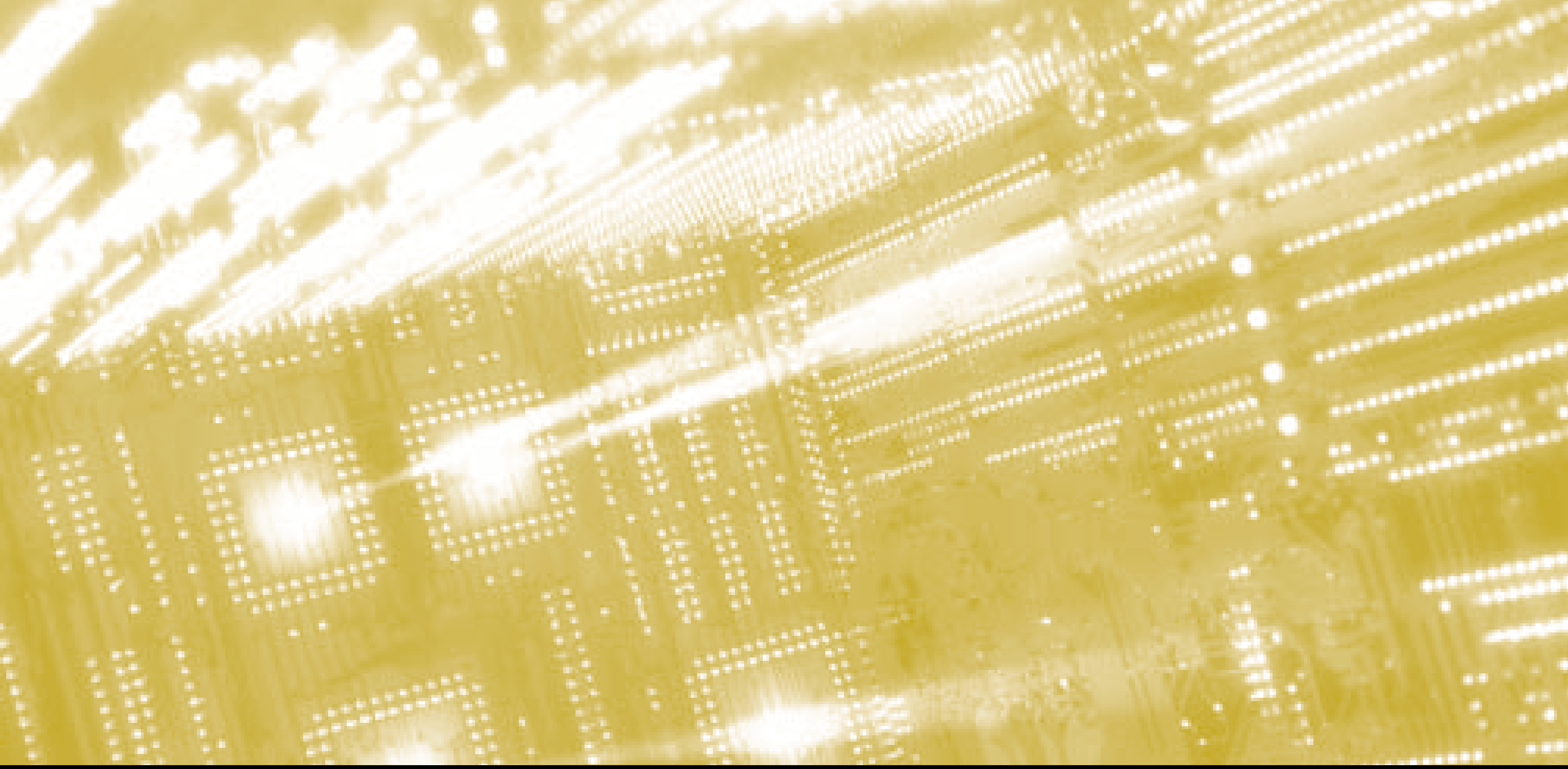
Dennis Luo and Mark Laliberte (MBA students), David Craig (Ph.D. student in bioengineering), and Paul Mathew (law student) met as the business school's first Washington Research Foundation Capital/Gates Technology Entrepreneurship Fellows. They spent the summer of 2001 poring over patents from UW and Pacific Northwest National Laboratory (PNNL) researchers, looking for commercial potential. By the end of the summer, the team had zeroed in on a new PNNL technology for treating cancer. And their cross-disciplinary relationship had clicked. "We thought, 'This is a lot of fun,'" says Luo. "'How much farther could we take it?'"

The four continued their individual studies, but they also worked through the business school's new Center for Technology Entrepreneurship (CTE) to explore all the issues of taking the cancer technology to market. They had access to researchers around the campus and at PNNL in Richland, to UW technology-transfer experts, to the teaching and mentoring of business professors, to venture capitalists, to people in the field. "When you're putting together something like this," says Luo, "you have to be able to talk fluently to all kinds of people. I can't imagine a program that could break down the barriers so quickly as CTE."

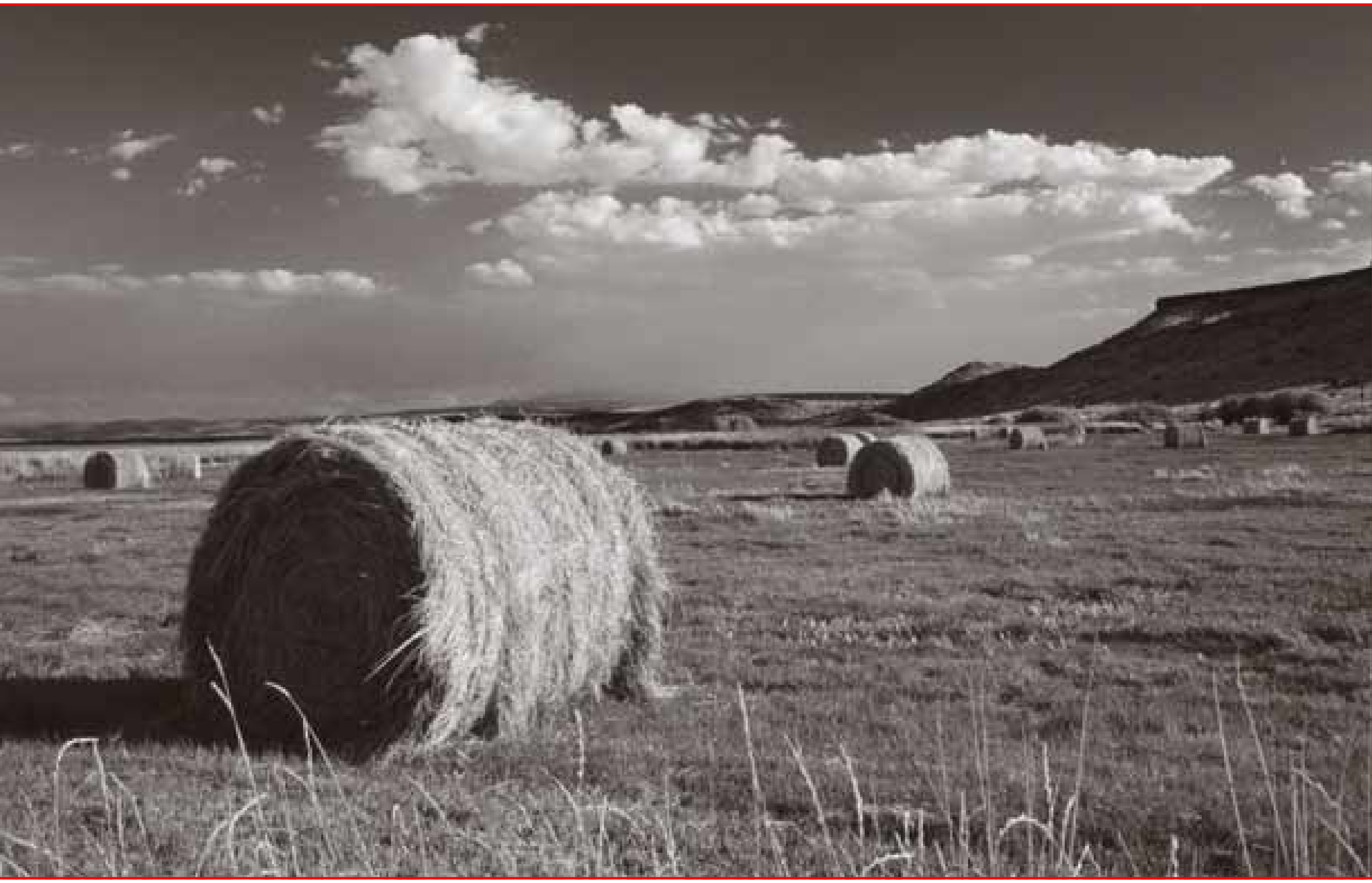
By spring 2002, the team had produced a business plan for a company called Cogelix. The plan placed "unofficial third" in the national *MBA Jungle* competition (out of 220 entries)—and first in the UW's own business-plan competition.

Today, Luo and Laliberte are business partners in Cogelix, Mathew is an adviser, and Craig will join the company as soon as he completes his Ph.D. The team has put together strong scientific and business advisory boards and is optimistic about the company's chances. But, says chief operating officer Luo, "Whether Cogelix succeeds or fails, the experience CTE has given us is invaluable."

PNNL's Erik Stenehjem helped spearhead the creation of CTE. "It was a natural combination," he says. "PNNL had technologies and the business school had aspiring entrepreneurs." The goal? "To build a program that would contribute to this region's reputation as a national center for entrepreneurship. To date, the collaboration has exceeded our expectations."



"I can't imagine a program that could break down the barriers so quickly"



Connecting Rural Communities

"I know from growing up here that there really is a digital divide."

The town of Omak sits on the western edge of the Colville Indian Reservation in the Okanogan Highlands of central Washington. "I know from growing up here that there really is a digital divide," says tribal member Jeremy Orr. "We didn't really have access to technology." But Jeremy went off to the University of Washington, majored in electrical engineering, and polished his programming and Web skills at a dot-com. Now he is back in Omak, running a community technology center for the UW-Okanogan Region Community Partnership.

The new center, funded in October 2001 by a federal grant, is meant to bring both computer skills and high-speed Internet access to a rural and tribal community deeply rooted in the Okanogan. The UW's partners in the project are the Colville Tribal Enterprise Corporation, which provides the facility, and Wenatchee Valley College North, whose students help out at the center.

The center's 15 computers are busy. "Several different generations come through here," says Jeremy. "Middle-school kids get introduced to technology. I teach a weekly class to people who are trying to upgrade skills and find jobs. One of my old high-school friends is now tearing it up on the Internet. And I do a lot of classes for tribal employees, so they can run tribal government and businesses better."

Like similar programs in the Yakima Valley and the Olympic Peninsula, the Okanogan partnership was initiated by the UW's Office of Educational Partnerships and Learning Technologies. The programs put University expertise at the service of rural societies that are seeking new opportunities, economic development, and healthier communities. Local leaders in all three areas, working with UW faculty and staff, have identified technology as a key to opening new doors. The technology centers, and the skills they impart, connect people to the wider world without requiring them to leave homes and cultures behind.

For Jeremy, the return to Omak is deeply satisfying. "I wanted to bring something back to this area," he says. "This is a great job. I'm having a lot of fun."

FINANCIAL HIGHLIGHTS

FUNDING AND OPERATIONS 18

INVESTMENTS 20

DEBT FINANCING 22

CAPITAL BUDGET AND CAMPUS CONSTRUCTION 24

Funding and Operations

• The University has a diversified revenue base. No single source generated more than 31 percent of the total fiscal year 2002 revenues of $2.4 billion.

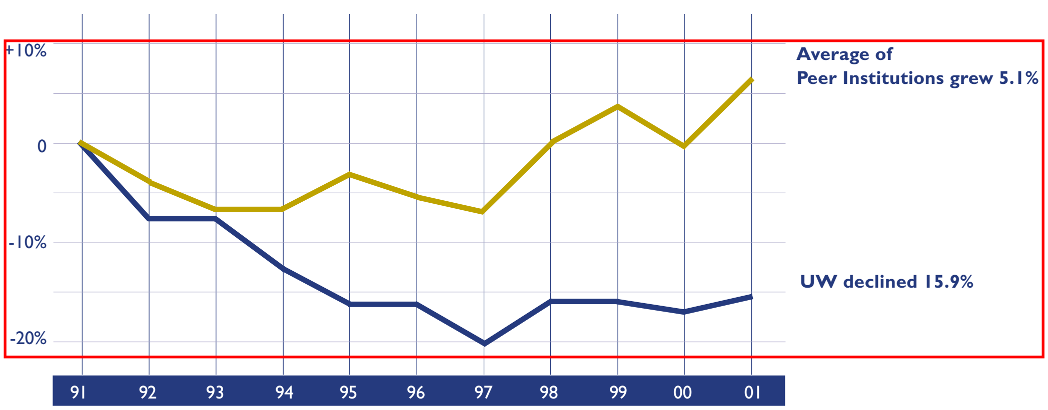
• Grants and contracts (31 percent) generated $722 million of current year revenue, a 12 percent increase over fiscal year 2001. These funds provided the opportunity for graduate and undergraduate students to work with nationally recognized faculty in research, as part of their educational experience.

• Income from gifts totaled $114 million (5 percent). This private support gave the University an added margin of excellence and the flexibility to respond to special opportunities as well as establish various endowments which will provide benefit throughout the future.

• Two primary functions of the University, instruction and research, comprised 42 percent of total operating expenses. These dollars provided instruction to more than 41,000 students and funded 5,200 research awards.

• The University provided students with scholarships and fellowships, including scholarship allowances, that totaled over $80 million (3 percent of operating expenditures).

• State operating appropriations amounted to $352 million or 15% of total revenues. The University heavily relies upon such funding for instructional activities. Although funding has increased slightly year to year, in constant dollars per student, funding has dropped significantly (see the chart below) when compared to peer institutions selected by the state Higher Education Coordination Board.



Change in State Appropriations per Full-Time Student, based on Constant Dollars FISCAL YEARS 1991–2001

Reaching Out in a High Tech World

Every year more of the UW's business is conducted over the Web: students now register for classes, pay their tuition, and receive their grades online; and all information necessary to hire and pay an employee can now be entered online. These changes have streamlined cumbersome processes, created efficiencies, and provided greatly appreciated conveniences for both students and university employees.

These new ways of doing business, however, are presenting challenges for central administrative units. The role of staff is changing as students and employees move to conducting their business independently over the Web. Staff are increasingly being called upon to consult, problem-solve, and train students and other employees to effectively use the new technology.

The University's Financial Management division has developed innovative ways to prepare staff for these new responsibilities. The following examples highlight some of the approaches being used:

Because many staff speak English as a second language, Financial Management provides a tailored course in verbal and written English for its employees who want to improve communication and customer service skills.

Training in critical skills, such as cash management, has been adapted for delivery both via the Web and through in-class discussion. This change has lowered the course fee and enabled employees to advance at their own pace at convenient times, while still providing an opportunity for group discussion and learning.

Free seminars are routinely presented to students on approaches to money management. In addition, other training sessions are offered on how to use the many electronic services which are available to them via the Web.

Investments

• Investment returns provide an important source of revenue for the University's programs. Among the funds invested by the University are endowments, life income trusts and annuities, outright gifts, reserve balances, and excess cash.

• Endowed gifts for current use provide permanent capital and an ongoing stream of current earnings to the University. Programs supported by the endowment include undergraduate scholarships, graduate fellowships, professorships and chairs, and research activities.

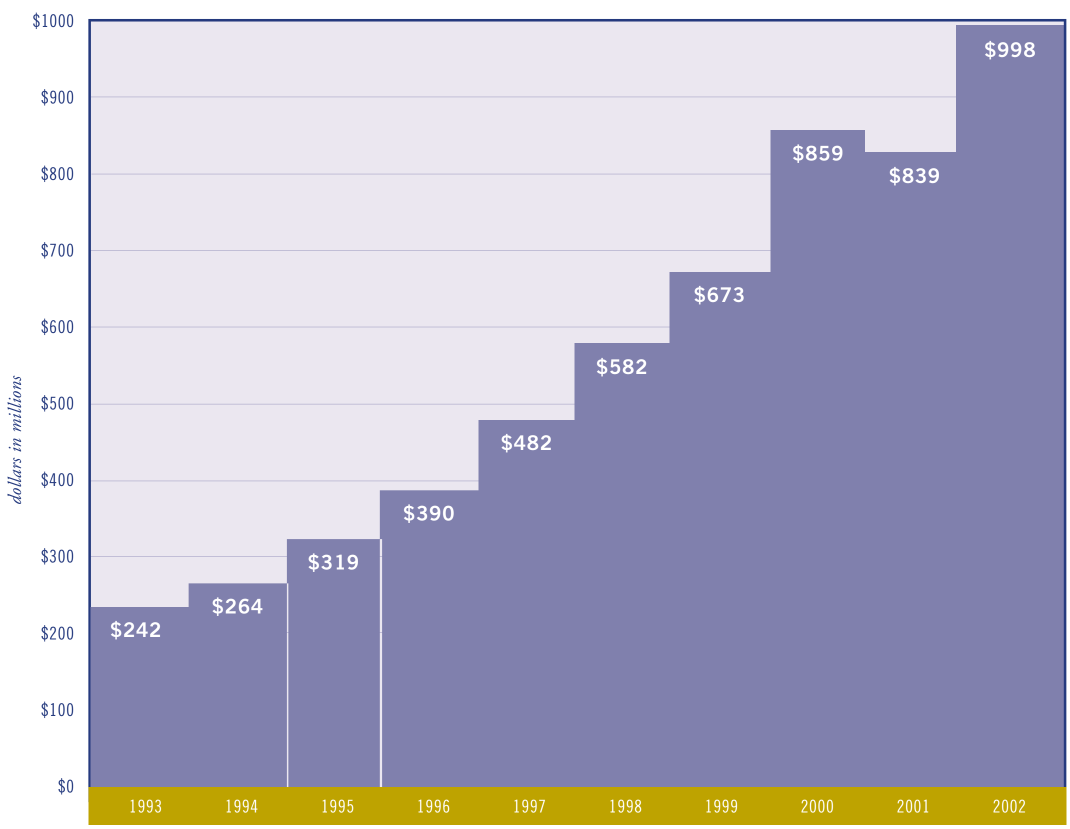
• Most endowments are commingled in the Consolidated Endowment Fund (CEF), a balanced investment fund. As in a mutual fund, each individual endowment maintains a separate identity and owns units in the fund. On June 30, 2002, the fair market value of the CEF was $998 million, representing the investments of 1,715 individual endowments.

• Endowed program support over the last five years totaled $161 million. During that period, the average annual total return on the CEF was 9.6 percent.

• Non-endowed gifts, reserve balances, and cash are commingled for investment purposes although accounted for separately. The fair market value of these investments at the end of the fiscal year was $638 million. The total return has averaged 7.8 percent annually over the last five years.

• During fiscal year 2002, the Board of Regents approved the investment of a portion of the University's operating funds to establish an endowment. The investment of these funds added over $200 million to the CEF.

GROWTH OF CONSOLIDATED ENDOWMENT FUND: 1993–2002



Pancreatic Cancer

For many years, people diagnosed with pancreatic cancer have faced overwhelming odds. Of the 29,000 Americans who will be diagnosed with pancreatic cancer this year, 28,900 will die within a year of diagnosis. Scientific advances have remained elusive. Though pancreatic cancer is the fourth leading cause of cancer death in the United States, it receives substantially less research funding than most other cancers. This year, however, an important discovery and a generous gift have opened the door for UW investigators to explore promising new leads that may provide the first glimmer of a brighter day.

In 2002, UW gastroenterologist and researcher Dr. Teresa Brentnall directed a study that resulted in the identification of a genetic defect linked to pancreatic cancer. “The cancer is asymptomatic, strikes later in life, and is rapidly lethal,” says Brentnall. Finding this gene will help investigators understand how the disease develops and ultimately may lead to advancements in preventing, detecting, and treating this deadly malignancy.

For more than seven years, Brentnall has been working with an extended family with a very high rate of inherited pancreatic cancer. The family has provided a powerful tool for isolating the gene and identifying early precancerous changes within the pancreas. And, this year, Charles “Gene” and Mary Ann Walters made a multi-million dollar investment to help establish the Walters Center for Pancreatic Research. Their gift jump-starts new studies and creates a research endowment that makes it possible to carry this important work far into the future.

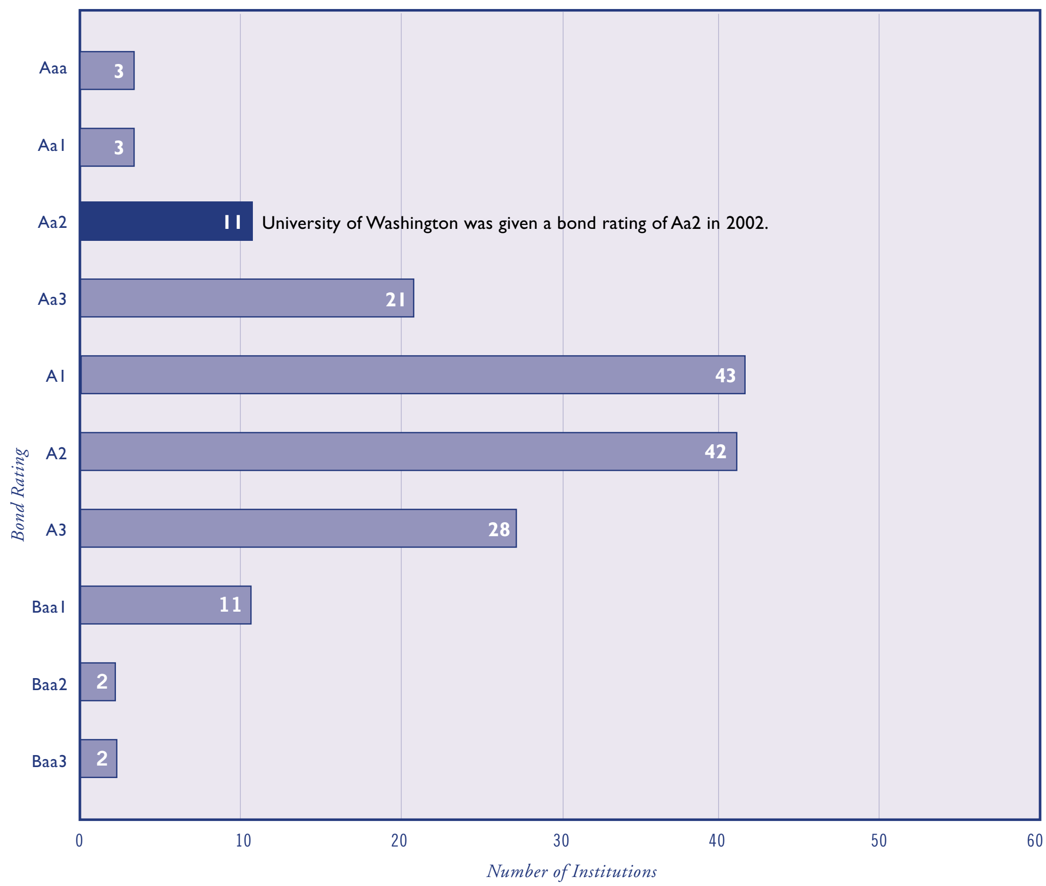
Debt Financing

- The University takes seriously its role of financial stewardship and works hard to manage its financial resources effectively. Continued high debt ratings are important indicators of the University's success in this area.

- Strong ratings carry substantial advantages for the UW: continued and better access to capital markets when the University issues debt, lower interest rates on bonds, and the ability to negotiate favorable bond terms.

- The University has received ratings upgrades from the major rating agencies, Standard & Poor's and Moody's, in 1997, 1998, and 2000. The nation's premier credit agencies continue to recognize the University's strong stewardship of financial resources and prudent use of debt to finance capital projects.

MOODY'S 2002 PUBLIC COLLEGE AND UNIVERSITY RATINGS



Husky Den at the HUB—Open for Business

Husky Den—the biggest campus food service outlet with the largest customer count and highest sales volume—was given a major renovation and reopened in January 2002. The emphasis shifted from behind-the-scenes food preparation to predominantly "display cooking" in themed kiosks where a wide assortment of food is prepared in front of customers.

Financing the improvements created several challenges. While Retail and Remote Food Services, a self-sustaining division of Housing and Food Services that operates Husky Den, is strong financially, it did not have the ability to directly issue debt. Instead, the University partnered with the State Treasurer's Office to issue lease-backed Certificates of Participation (COP's). As a result, the University was able to take advantage of the State's credit rating to secure low interest rates and flexible financing terms. The COP's were sold in June of 2001 and the newly remodeled facility opened for business the following January.

Since its opening, the Husky Den has exceeded its sales expectations, and the campus community appreciates the high-quality offerings and inviting layout. The lower interest costs from the State COP's helped Housing and Food Services provide its customers with an excellent value.

Capital Budget and Campus Construction

Generations of Washington residents have made significant investments and sacrifices to create the magnificent campus facilities that support a world-class education for students at the University of Washington. During 2001-2002 the University established a long-term goal of focusing state capital funds on restoring the core campus facilities at the Seattle campus. Under this plan, state funds will be targeted to major building renovations and infrastructure improvements, while research facilities and access-expansion projects will be added using alternative funding mechanisms.

During 2001-2002 a number of major projects were under way.

UW TACOMA

Development of new science and classroom facilities at the University of Washington Tacoma campus was completed during 2002. Further expansion was approved, including the renovation of five historic buildings to accommodate an additional 600 students and staff.

PAUL G. ALLEN CENTER FOR COMPUTER SCIENCE AND ENGINEERING

This new facility will house computer research and teaching laboratories, faculty and staff offices, and associated support space. The 160,000-gross-square-foot building was "topped out" on October 11, 2002, and is scheduled for completion in the summer of 2003. This state-of-the-art facility will support the growing needs of the computer science engineering program.

WILLIAM H. GATES HALL

The new home of the University of Washington School of Law passed the mid-point of construction during 2002 and is on schedule to open its doors in the fall of 2003. This 196,000-gross-square-foot facility will house faculty and staff offices, classrooms, law clinics, seminar rooms, mock court rooms, and the UW Law Library.

INFRASTRUCTURE PROJECTS

Several important projects directly related to the restoration and improvement of the campus infrastructure were undertaken during 2002. These included the first phase of the Emergency Power System Expansion Project, which will increase the campus capacity to provide emergency power. This Phase I work will enable the connection of approximately 60 additional buildings to the Seattle campus emergency power system.

UW SURGERY PAVILION

Construction of this new 160,000-gross-square-foot facility will be completed in late summer 2003, creating a new "short-stay" surgery and diagnostic center. The Surgery Pavilion will provide state-of-the-art surgical and clinical service facilities that will accommodate the changing needs in medical care delivery and outpatient services.

This is the first major addition to the hospital since 1986. The Surgery Pavilion is constructed over an underground 280-stall garage intended primarily for patients, visitors, and medical staff.


Suzzallo Library Renovation

A $47-million renovation of the Suzzallo Library was completed in the summer of 2002, restoring the "soul of the University" to its original glory. This project included extensive seismic, life-safety, electrical, and mechanical upgrades to preserve the facility for future generations.

Beginning in 1925 with the historic West Wing, the Suzzallo Library was built in several phases. New wings were added in 1935, 1948, and 1963, allowing the library to expand to house the growing University of Washington collections, and to meet the needs of the increasing UW enrollments. The western side of the library, with its eleven monumental glass windows framed by Gothic-inspired statues and arches, houses the most voluminous library reading room in the nation. This part of the building is considered one of the finest examples of Collegiate Gothic architecture anywhere.

About ninety-five percent of the budget was spent on seismic upgrades, building-code compliance, and life-safety work, and about five percent on general remodeling. The renovation project preserved and restored the original exterior and interior architectural features while concealing much of the seismic work behind walls, ceilings, and columns. Thoughtful care and handling of several interior wall murals has preserved these historic depictions of the exploration of the West.

With the official reopening of the renovated Suzzallo Library in September 2002, this cherished icon of the University of Washington is preserved for future generations.

FINANCIAL STATEMENTS
AND REQUIRED SUPPLEMENTAL INFORMATION

MANAGEMENT'S DISCUSSION AND ANALYSIS 28
INDEPENDENT AUDITORS' REPORT 33
BALANCE SHEET 34
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS 35
STATEMENT OF CASH FLOWS 36
NOTES TO FINANCIAL STATEMENTS 38

Management's Discussion and Analysis

The following discussion and analysis provides an overview of the financial position and activities of the University of Washington ("the University") for the year ended June 30, 2002. This discussion has been prepared by management and should be read in conjunction with the financial statements and accompanying notes which follow this section.

The financial statements of the University for fiscal year 2002 have been prepared in accordance with Governmental 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,* No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus (an amendment of GASB Statements No. 21 and No. 34)*, and No. 38, *Certain Financial Statement Note Disclosures.*

Since this is the year of transition to the new GASB reporting model, the focus is primarily on the current year. Additional comparative data will be presented in subsequent years.

In accordance with the new requirements, the University's financial report includes three financial statements: the Balance Sheet, the Statement of Revenues, Expenses and Changes in Net Assets (SRECNA), and the Statement of Cash Flows.

Significant changes resulting from the new reporting model include:

- Combined Format: The statements present combined totals for the University as a whole; previously, amounts were presented by individual fund group.
- On the Balance Sheet, assets and liabilities are now classified as current or noncurrent.
- Revenues and expenses are categorized as operating or non-operating; in prior years, operating income, or loss, was not presented.
- Revenues are reported net of discounts and allowances. For example, tuition revenue is now reported net of scholarship allowances, previously reported as scholarship expenses.
- An allowance for accumulated depreciation is now reported on the Balance Sheet, and depreciation expense for the current year is now included in the SRECNA. Under the previous reporting standards, depreciation was not reported in the Financial Statements.
- Deferred Giving: A liability is now established at the time the University receives funds with an agreement whereby payments are due to another party. This liability represents the present value of the expected future distributions to be made.

FINANCIAL RESULTS

Financial Health

Net Assets

The University reports its "equity" in the following categories:

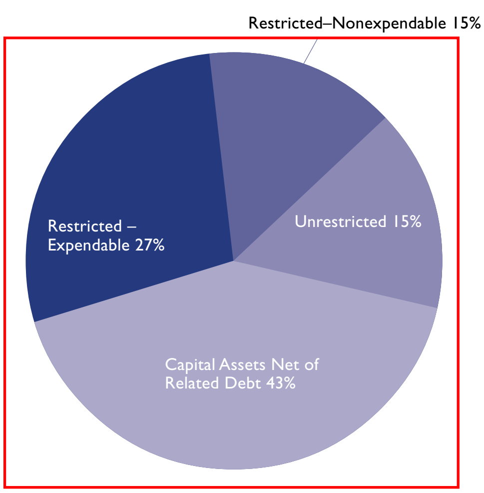
- *Invested in Capital Assets, net of related debt* - the University's total investment in property, plant, equipment, and infrastructure, net of accumulated depreciation and outstanding debt obligations related to those capital assets;

- *Restricted Net Assets:*
    - *Nonexpendable* - consists of funds on which the donor or other external party has imposed the restriction that the corpus is not available for expenditures but for investment purposes only;
    - *Expendable* - resources which the University is legally or contractually obligated to spend in accordance with restrictions placed by donors or other external parties that have placed time or purpose restrictions on the use of the asset;
- *Unrestricted Net Assets* - all other funds available to the institution for the general and educational purposes of the University.

The graph below shows the composition of the University's net assets. Unrestricted assets are often internally designated for specific purposes.

Within each category, the University has experienced growth in the past two years with the exception of the unrestricted category which suffered a slight decrease.

Net Assets



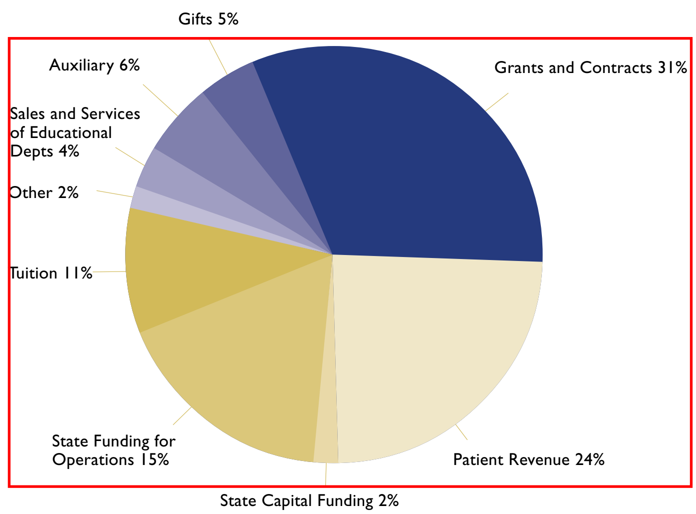
Unrestricted net assets decreased primarily because the University's tuition and state appropriation revenues lagged behind its non-grant funded operations. In addition, the market value of unrestricted investments decreased.

Despite the recent decline in unrestricted net assets, the University maintains overall financial strength. The primary reserve ratio (as defined by Moody's) measures this strength. Today the University has enough expendable resources from various sources to fund operations for more than seven months. The University will continue to monitor this ratio in the future and benchmark itself against the Moody's peer group as schools and Moody's adapt to the new GASB reporting model.

Revenues for Education and Research

Diversified Revenue Sources

The University has a diversified revenue base. No single source generated more than 31% of the total fiscal 2002 revenues of $2.4 billion. (See figure below).



Grant Revenue

The largest component of revenues has been federal grant and contract revenue, and this revenue has increased approximately 12% over the past year. The University's dollar awards of federal grants and contracts are more than any other public institution in the country, and federal grants and contracts are its largest source of revenues and cash flows. This revenue is earned only as direct expenditures are made; therefore, there is little effect to the University's operating margin as a result of this direct expense reimbursement (i.e., salaries or purchases of goods and services). Indirect cost recovery reimburses the university for necessary facility and administrative expenses incurred to support grants and contracts. The current indirect cost recovery averages 30 cents per direct expenditure dollar on federal grants and contracts.

The remaining grant and contract revenues from all other sources have increased approximately 10% since last year, and their impact on the University's operating margin is similar to that of federal grants and contracts.

Primary Non-Grant Funding Sources

The University relies primarily on student tuition and fees and state appropriations as revenue sources to back its non-grant funded core operating expenses. Tuition revenue has been increasing slightly over the last three years for two reasons; tuition rates increased an average of 5% annually, and more students enrolled in the Bothell and Tacoma campuses and Distance Learning Program.

Non-capital state appropriations, although considered nonoperating revenue under GASB 35 standards and reflected in the nonoperating section of the SRECNA, are used solely for operating purposes. State appropriations for operating purposes have increased approximately $10 million or 3% since fiscal year 2001. However, these increases have not kept pace with the increase in functions that are heavily reliant upon tuition and state appropriations (instruction, academic support, and student services). In the current year, these two revenue sources covered only 83% of those functions' expenses.

Patient Revenues

Patient revenues increased slightly over the prior year. Revenues increased due to both volume and price increases during the year. Volume increases were primarily in transplant, oncology and other tertiary care service areas.

Other Sources of Revenue

Fiscal 2002 marked another difficult year in equity markets. The Consolidated Endowment Fund was down 3.2%, ending the year at $998 million. During a year when the S&P 500 dropped 18.0% and the NASDAQ, 32.3%, active management and a diversified asset allocation helped the CEF perform comparatively well. Over the past three, five and ten year periods, the CEF's performance ranks in the top quartile relative to other college and university endowments in the National Association of College and University Business Officers (NACUBO) universe.

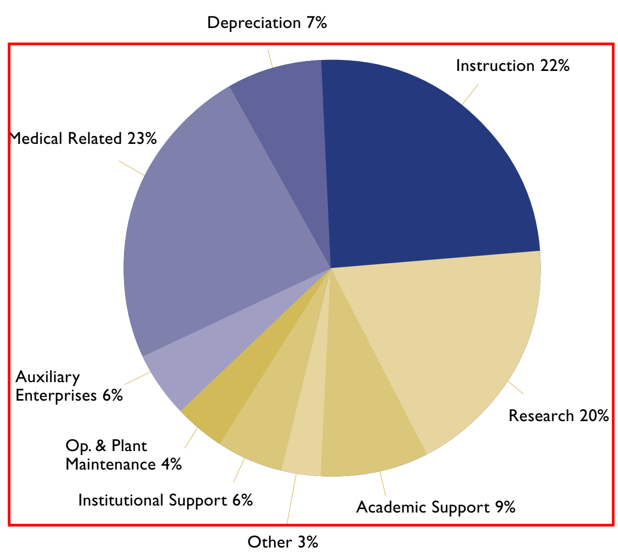
The Invested Funds (IF) or operating monies of the University returned 5.1%, ending the fiscal year with a market value of $638 million.

Auxiliary, or self-supporting operations such as the sports programs, parking services, and housing and food services have remained fairly consistent year to year with slight growth in revenues.

Despite a difficult market, the University's gift income (which includes operating and capital gifts and gifts to permanent endowments) reached $114 million, or roughly 5% of total revenues. Gifts are used to support a variety of purposes, including capital improvements, scholarships, and endowments for various academic and research chairs.

Expenses

Two primary functions of the University, instruction and research, comprised 42% of the total operating expenses.



The University continues to experience increases in its operating expenses. Overall, salaries and benefits have increased over $100 million over the past year. However, a significant portion of this compensation is grant and contract-related and therefore, fully supported by the related grant. The University has also experienced increases in supplies and materials ($23 million) and utilities ($2 million). These increases have been partially mitigated by decreases in purchased services ($14 million) and other expenses ($8 million).

Interest expense has increased only slightly despite an increase in debt levels. This is due to the favorable interest rate environment and recent refundings of older, higher rate debt.

The net result of the revenues and expenses is the operating margin. The current year margin (as defined by Moody's) is -1.6% which reflects the lack of state funding and a difficult stock market.

Capital Improvements and Related Debt

The low interest rate environment during fiscal years 2001 and 2002 enabled the University to borrow and lease at favorable rates to finance facilities and equipment for research and auxiliary enterprises and to refund outstanding bonds. Total long-term bonds associated with capital assets increased to $439 million at June 30, 2002.

Over $30 million in bonds at 5% were issued during the current year for construction of the University's new law school. $28 million of 5% bonds were issued for hospital-related construction. In order to fund Housing and Food Services dorm refurbishings, $13 million of 4% - 5% revenue bonds were issued.

Obligations under capital leases amount to $68 million on June 30, 2002. Leases related to a new research facility were the primary reason for the net increase of $12 million over the prior year.

The total resources to debt ratio shows that the University has been more active in the issuance of debt for financing capital projects in the current year. The current year ratio is 3.7.

Economic Factors That Will Affect the Future

The University's funding comes primarily from three general functions: research (grants and contracts), auxiliary (patient service revenues, sports, etc.), and instructional (state appropriations and tuition and fees).

The University's research funding has increased approximately 10% each year over the past three years. Based upon the various research awards currently in the pipeline, this revenue should continue to increase over the next year. In addition, demand for auxiliary services currently remains strong.

The health of the instructional function of the University is closely tied to that of the state of Washington, both in terms of the funding from the state as well as the state's authorization to adjust tuition rates. State appropriations (operational and capital) comprise 17% of total revenues for fiscal year 2002. The state economy has slowed, resulting in lower state revenues.

The University has temporarily received increased flexibility to set tuition rates and there continues to be strong demand for services from both residents and non-residents.

KPMG

INDEPENDENT AUDITORS' REPORT

The Board of Regents
University of Washington:

We have audited the accompanying basic financial statements of the University of Washington, an agency of the State of Washington, as of and for the year ended June 30, 2002, as listed in the table of contents. 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. 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 the University of Washington, as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, as of July 1, 2001, the University has implemented a new financial reporting model, as required by the provisions of Governmental 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 Statements No. 35, *Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities*, No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus (an amendment of GASB Statements No. 21 and No. 34)*, and No. 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis on pages 28 through 31 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Seattle, Washington
November 8, 2002

UNIVERSITY OF WASHINGTON

Balance Sheet

June 30, 2002

ASSETS		
CURRENT ASSETS:		
CASH AND CASH EQUIVALENTS (NOTE 2)	$	25,038
COLLATERAL FROM SECURITIES LENDING (NOTE 6)		251,272
SHORT-TERM INVESTMENTS (NOTE 6)		252,750
ACCOUNTS RECEIVABLE, (NET OF $ 69,801 ALLOWANCE) (NOTE 5)		339,939
INVENTORIES		21,412
OTHER ASSETS		31,873
TOTAL CURRENT ASSETS		922,284
NONCURRENT ASSETS:		
DEPOSIT WITH STATE OF WASHINGTON (NOTE 3)		69,355
LONG-TERM INVESTMENTS (NOTE 6)		1,643,251
METRO TRACT (NOTE 7)		109,911
STUDENT LOANS RECEIVABLE, (NET OF $6,083 ALLOWANCE) (NOTE 4)		58,893
CAPITAL ASSETS (NET OF $ 1,401,641 ACCUMULATED DEPRECIATION) (NOTE 8)		1,842,174
TOTAL NONCURRENT ASSETS		3,723,584
TOTAL ASSETS	**$**	**4,645,868**
LIABILITIES		
CURRENT LIABILITIES:		
ACCOUNTS PAYABLE	$	214,212
ACCRUED LIABILITIES		110,175
PAYABLES: SECURITIES LENDING TRANSACTIONS (NOTE 6)		251,272
DEFERRED REVENUE		105,835
FUNDS HELD FOR OTHERS		4,960
LONG-TERM LIABILITIES-CURRENT PORTION (NOTES 9, 10, AND 11)		37,354
TOTAL CURRENT LIABILITIES		723,808
NONCURRENT LIABILITIES:		
DEFERRED REVENUE		5,660
U.S. GOVERNMENT GRANTS REFUNDABLE		46,456
LONG-TERM LIABILITIES, NET OF CURRENT PORTION (NOTES 9, 10, AND 11)		562,581
TOTAL NONCURRENT LIABILITIES		614,697
TOTAL LIABILITIES		1,338,505
NET ASSETS		
INVESTED IN CAPITAL ASSETS, NET OF RELATED DEBT		1,410,112
RESTRICTED FOR:		
NONEXPENDABLE-SCHOLARSHIPS, RESEARCH AND DEPARTMENT USES		486,768
EXPENDABLE-		
SCHOLARSHIPS, RESEARCH AND DEPARTMENT USES		871,006
OTHER		28,499
UNRESTRICTED		510,978
TOTAL NET ASSETS		3,307,363
TOTAL LIABILITIES AND NET ASSETS	**$**	**4,645,868**

See accompanying Notes to the Financial Statements

Dollars in thousands

UNIVERSITY OF WASHINGTON

Statement of Revenues, Expenses, and Changes in Net Assets

For the Year Ended June 30, 2002

REVENUES		
OPERATING REVENUES:		
STUDENT TUITION AND FEES (NET OF SCHOLARSHIP ALLOWANCES OF $34,220)	$	249,861
PATIENT SERVICES (NET OF CHARITY CARE OF $8,697)		559,034
FEDERAL GRANTS AND CONTRACTS		596,593
STATE AND LOCAL GRANTS AND CONTRACTS		42,166
NONGOVERNMENTAL GRANTS AND CONTRACTS		82,970
SALES AND SERVICES OF EDUCATIONAL DEPARTMENTS		88,172
AUXILIARY ENTERPRISES:		
HOUSING AND FOOD SERVICES		46,661
PARKING SERVICES		8,792
SPORTS PROGRAMS (NET OF SCHOLARSHIP ALLOWANCES OF $1,468)		31,811
OTHER AUXILIARY ENTERPRISES		48,798
OTHER MEDICAL CENTER REVENUES		28,589
OTHER OPERATING REVENUES		30,344
TOTAL OPERATING REVENUES		1,813,791
EXPENSES		
OPERATING EXPENSES:		
SALARIES		1,184,223
BENEFITS		270,912
SCHOLARSHIPS AND FELLOWSHIPS		44,335
UTILITIES		39,249
SUPPLIES AND MATERIALS		240,883
PURCHASED SERVICES		268,357
DEPRECIATION		154,616
OTHER		87,953
TOTAL OPERATING EXPENSES		2,290,528
OPERATING LOSS		(476,737)
NONOPERATING REVENUES (EXPENSES)		
STATE APPROPRIATIONS		343,656
GIFTS		82,110
INVESTMENT INCOME (NET OF INVESTMENT EXPENSE OF $8,505)		37,512
INTEREST ON CAPITAL ASSET-RELATED DEBT		(22,240)
OTHER NONOPERATING REVENUES		2,838
NET NONOPERATING REVENUES		443,876
LOSS BEFORE OTHER REVENUES, EXPENSES, GAINS, OR LOSSES		(32,861)
CAPITAL APPROPRIATIONS		42,254
CAPITAL GRANTS AND GIFTS		8,156
GIFTS TO PERMANENT ENDOWMENTS		32,142
TOTAL OTHER REVENUE		82,552
INCREASE IN NET ASSETS		49,691
NET ASSETS		
NET ASSETS-BEGINNING OF YEAR		3,257,672
NET ASSETS-END OF YEAR	**$**	**3,307,363**

See accompanying Notes to the Financial Statements

Dollars in thousands

UNIVERSITY OF WASHINGTON

Statement of Cash Flows

For the Year Ended June 30, 2002

CASH FLOWS FROM OPERATING ACTIVITIES:		
STUDENT TUITION AND FEES	$	217,999
PATIENT SERVICES		565,681
GRANTS AND CONTRACTS		725,640
PAYMENTS TO SUPPLIERS		(257,229)
PAYMENTS FOR UTILITIES		(40,406)
PURCHASED SERVICES		(268,357)
OTHER OPERATING DISBURSEMENTS		(87,954)
PAYMENTS TO EMPLOYEES		(1,185,340)
PAYMENTS FOR BENEFITS		(237,769)
PAYMENTS FOR SCHOLARSHIPS AND FELLOWSHIPS		(44,335)
LOANS ISSUED TO STUDENTS		(21,472)
COLLECTION OF LOANS TO STUDENTS		20,859
SALES AND SERVICES OF THE MEDICAL CENTER		28,588
AUXILIARY ENTERPRISE RECEIPTS		137,902
SALES AND SERVICES OF EDUCATIONAL DEPARTMENTS		83,417
OTHER RECEIPTS		32,420
NET CASH USED BY OPERATING ACTIVITIES		(330,356)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
STATE APPROPRIATIONS		350,600
GIFTS, EXCLUDING PERMANENT ENDOWMENT AND CAPITAL		82,110
ADDITIONS TO PERMANENT ENDOWMENTS		32,142
DIRECT LENDING RECEIPTS		111,882
DIRECT LENDING DISBURSEMENTS		(109,467)
RECEIPTS FROM OUTSIDE AFFILIATED AGENCIES		295,939
DISBURSEMENTS TO OUTSIDE AFFILIATED AGENCIES		(303,377)
OTHER		2,898
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES		462,727
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
PROCEEDS FROM CAPITAL DEBT		128,818
CAPITAL APPROPRIATIONS		37,287
CAPITAL GRANTS AND GIFTS RECEIVED		8,156
PURCHASES OF CAPITAL ASSETS		(257,348)
PRINCIPAL PAID ON CAPITAL DEBT AND LEASES		(48,030)
INTEREST PAID ON CAPITAL DEBT AND LEASES		(21,148)
OTHER		(7,675)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES		(159,940)

See accompanying Notes to the Financial Statements

Dollars in thousands

CASH FLOWS FROM INVESTING ACTIVITIES:		
PROCEEDS FROM SALES OF INVESTMENTS		2,689,134
PURCHASES OF INVESTMENTS		(2,733,127)
INVESTMENT INCOME		72,695
NET CASH PROVIDED BY INVESTING ACTIVITIES		28,702
NET INCREASE IN CASH AND CASH EQUIVALENTS		1,133
CASH AND CASH EQUIVALENTS - BEGINNING OF THE YEAR		23,905
CASH AND CASH EQUIVALENTS - END OF THE YEAR	$	**25,038**

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES:		
OPERATING LOSS	$	(476,737)
ADJUSTMENTS TO RECONCILE OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES:		
DEPRECIATION EXPENSE		154,616
LOSS ON DISPOSAL OF FIXED ASSETS		3,505
CHANGES IN ASSETS AND LIABILITIES:		
RECEIVABLES		(1,818)
INVENTORIES		(1,180)
OTHER ASSETS		4,162
ACCOUNTS PAYABLE		(13,014)
DEFERRED REVENUE		4,196
OTHER LONG-TERM LIABILITIES		(4,976)
U.S. GOVERNMENTAL GRANTS REFUNDABLE		1,504
LOANS TO STUDENTS		(614)
NET CASH USED BY OPERATING ACTIVITIES	$	**(330,356)**

NOTE 1:

Summary of Significant Accounting Policies

Financial Reporting Entity

The University of Washington (University), an agency of the state of Washington, is governed by a ten-member Board of Regents, appointed by the Governor and confirmed by the state senate.

The financial statements include the individual schools, colleges, and departments of the University, the University of Washington Medical Center, and certain affiliated operations determined to be a part of the University's financial reporting entity. Affiliated organizations are evaluated for inclusion in the reporting entity as component units based on the significance of their relationship with the University.

The University of Washington Alumni Association, University of Washington Physicians, and University of Washington Physicians Network are included in the reporting entity as blended component units. These legally separate entities are included in the University's financial reporting entity because of the nature of their relationship to the University. Financial information for these affiliated organizations may be obtained from their respective administrative offices.

Basis of Accounting

The financial statements of the University for the year ended June 30, 2002 have been prepared in accordance with Governmental 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*, No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus (an amendment of GASB Statements No. 21 and No. 34)*, and No. 38, *Certain Financial Statement Note Disclosures*. The University is reporting as a special purpose government engaged in business type activities (BTA). In accordance with BTA reporting, the University presents a management's discussion and analysis, a balance sheet, a statement of revenues, expenses, and changes in net assets, a statement of cash flows, and notes to the financial statements. The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. The University reports capital assets net of accumulated depreciation, and reports depreciation expense in the Statement of Revenues, Expenses, and Changes in Net Assets. Prior to the year ended June 30, 2002, depreciation was not included in the financial statements.

Other Accounting Policies

Investments. Investments other than real estate or miscellaneous investments are stated at fair value. Real estate and miscellaneous investments are stated at cost or, in the case of gifts, at fair values at the date of donation. Limited partnership investments are valued based upon the valuations provided by the respective general partners. Securities are valued at the last sale price on the last business day of the fiscal year, as quoted on a recognized exchange or an industry standard pricing service. Securities for which no sale was reported as of the close of the last day of business of the fiscal year are valued at the quoted market price of a dealer who regularly trades in the security being valued. Investments under long-term strategies are considered noncurrent. Short-term investments consist primarily of cash equivalents and fixed income funds.

Securities Lending Transactions. Cash collateral received from borrowers through securities lending transactions is recorded as an asset with an offsetting liability.

Inventories. Inventories are carried at the lower of cost or market value. Consumable inventories, consisting of expendable materials and supplies held for consumption, are generally valued using the weighted average method. Merchandise inventories are generally valued using the first-in, first-out method.

Capital Assets. Land, buildings, equipment, and library books are stated at cost or, if acquired by gift, at fair market value at the date of the gift. Additions, replacements, major repairs, and renovations are capitalized. Accumulated depreciation of capital assets including capital leases as of June 30, 2001, and depreciation expense for fiscal year 2002 have been recorded in the financial statements.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 50 years for building components, 20 to 50 years for infrastructure and land improvements, 15 years for library books, and 5 to 7 years for equipment.

During the year, $4,147,000 of construction-related interest was capitalized.

Deferred Revenues. Deferred revenues occur when funds have been collected in advance of an event, such as advance ticket sales, summer quarter tuition, and unspent cash advances on certain grants.

Deferred Giving - Split-Interest Agreements. Under these agreements, donors make initial gifts to trusts or directly to the University. The University has beneficial interests but is not the sole beneficiary. The University records an asset related to these agreements at fair market value at year end. The University also records a liability related to the split-interest agreements equal to the present value of expected future distributions; the discount rates applied range from 6.5% to 8.0%.

Compensated Absences. University employees accrue annual leave at rates based on length of service and sick leave at the rate of one day per month. Compensated absences accrued as of June 30, 2002, were $38,984,000 for annual leave, included in accrued liabilities, and $13,636,000 for sick leave, included in long-term liabilities.

Tuition and Fees. Tuition and fees are presented net of scholarship allowances applied to students' accounts, while student aid paid directly to students is presented as scholarship and fellowship expenses.

State Appropriations. The state of Washington appropriates funds to the University on both an annual and biennial basis. These revenues are reported as nonoperating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets. The University of Washington Medical Center received $8,480,000 in operating-specific state appropriations during the current year, which are reflected in other medical center revenue in the Statement of Revenues, Expenses and Changes in Net Assets.

Operating Activities. The University's policy for defining operating activities as reported in the Statement of Revenues, Expenses, and Changes in Net Assets is to include those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. As prescribed by GASB 35, certain significant revenue streams relied upon for operations are recorded as nonoperating revenues, including state appropriations, gifts and investment income.

Net Assets. The University's net assets are classified as follows:

Invested in capital assets, net of related debt: The University's investments in capital assets, less accumulated depreciation, net of outstanding debt obligations related to capital assets;

Restricted net assets - nonexpendable: Net assets subject to externally-imposed requirements that they be maintained permanently by the University, including permanent endowment funds;

Restricted net assets - expendable: Net assets which the University is obligated to spend in accordance with restrictions imposed by external parties;

Unrestricted net assets: Net assets not subject to externally imposed restrictions, but which may be designated for specific purposes by management, or the Board of Regents.

Tax Exemption. The University is a tax-exempt organization under the provisions of Section 115 of the Internal Revenue Code and is exempt from federal income taxes on related income.

NOTE 2:

Cash

Cash includes bank demand deposits, cash held by fiscal agents, $6,855,000 cash held with escrow agents, and petty cash. Most cash, except for cash held at the University, is covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). At June 30, 2002, bank balances of $1,435,000 were insured by the FDIC and balances of $16,808,000 were collateralized under the PDPC.

NOTE 3:

Deposit with State of Washington

State law requires the University to deposit certain funds with the state treasurer, who holds and invests the funds. The deposits include: amounts held for the University's permanent land grant funds, the University of Washington building fee, and certain general obligation bonds reserve funds. The fair value of these funds approximates the carrying value.

NOTE 4:

Student Loans

Net student loans of $58,893,000 at June 30, 2002, consist of $49,697,000 from federal programs and $9,196,000 from University programs. Interest income from student loans for the year ended June 30, 2002, was $1,466,000. Student loans are made primarily to individuals who reside in the state of Washington. The loans are unsecured and are expected to be repaid from earnings of individual borrowers.

NOTE 5:

Accounts Receivable

The major components of accounts receivable at June 30, 2002, were:

	Dollars in thousands
PATIENT SERVICES	$ 192,737
GRANTS AND CONTRACTS	101,368
PENDING INVESTMENT SALES	45,463
SALES AND SERVICES	13,964
TUITION	17,546
STATE APPROPRIATIONS-CAPITAL	1,817
STATE APPROPRIATIONS–NON-CAPITAL	5,554
OTHER	31,291
TOTAL	**409,740**
LESS ALLOWANCE FOR DOUBTFUL ACCOUNTS	69,801
ACCOUNTS RECEIVABLE, NET	**$ 339,939**

NOTE 6:

Investments

Investments - General

The Board of Regents of the University of Washington is responsible for the management of the University's investments. In 2001, the Board established the University of Washington Investment Committee (UWINCO), comprised of Board members and investment professionals. The Board establishes investment policy and UWINCO approves the appointment of investment managers and conducts quarterly reviews of investment performance. The Board of Regents' policies are carried out by the Treasurer, Board of Regents and UWINCO.

Categorized investments are insured, registered, or held by the University's custodial bank as an agent for the University. Investments that are not categorized include lent securities, mutual funds, venture capital, private equity, bankruptcy, mortgages, real estate, and miscellaneous investments.

The University's investments include certain derivative instruments and structured notes that derive their value from a security, asset, or index. Such investments are governed by the University's Investment Policies and Guidelines, which effectively constrain their use by establishing (a) duration parameters which limit price sensitivity to interest rate fluctuations (market risk), (b) minimum quality ratings at both the security and portfolio level, and (c) a market index as a performance benchmark.

The University's investment portfolio includes certain foreign denominated securities. To reduce the exposure to foreign currency fluctuations inherent in such investments, the University enters into foreign currency forward contracts, futures contracts, and options. Under the University's Investment Policies and Guidelines, such instruments are not permitted for speculative use or to create leverage. The guidelines also specify counterparty exposure limits and credit screens to reduce credit risk.

At June 30, 2002, the University had net outstanding forward commitments to sell foreign currency with a total fair value of $45,891,000, which equals 2.4% of the

TABLE 1

UNIVERSITY INVESTMENTS AND COLLATERAL FROM SECURITIES LENDING

Investment Type	Carrying Value
CASH EQUIVALENTS	$ 99,051
DOMESTIC FIXED INCOME	503,700
DOMESTIC FIXED INCOME – LOANED	287,213
FOREIGN FIXED INCOME	57,361
FOREIGN FIXED INCOME – LOANED	8,291
DOMESTIC EQUITY	499,264
DOMESTIC EQUITY – LOANED	35,972
FOREIGN EQUITY	122,234
FOREIGN EQUITY – LOANED	12,129
VENTURE CAPITAL	186,551
PRIVATE EQUITY	34,052
BANKRUPTCY	37,580
MORTGAGES	6,351
REAL ESTATE	4,926
MISCELLANEOUS	1,326
TOTAL INVESTMENTS	1,896,001
SHORT-TERM COLLATERAL FROM SECURITIES LENDING	251,272
TOTAL INVESTMENTS AND COLLATERAL	**$ 2,147,273**

Dollars in thousands

total portfolio. Unrealized and realized gains or losses are reported in the Statement of Revenues, Expenses, and Changes in Net Assets and are netted with the hedged securities in Table 1.

Investment Pools

The University combines most short-term cash balances into the Invested Funds pool. At June 30, 2002, the Invested Funds pool totaled $638,373,000. By University policy, departments participating in the Invested Funds pool receive one of three rates of return based on the realized yield of the portfolio. Long-term deposits received 6.3% for fiscal year 2002. Operating and plant fund balances of self-sustaining units received 5.7%. Gift and royalty accounts received 3.0%. The difference between the actual earnings of the Invested Funds pool and the stated rates is used to support activities benefiting all University departments.

The composition of the carrying amounts of investments by type at June 30, 2002, is listed in Table 1.

Net depreciation in the fair value of investments includes both realized and unrealized gains and losses on investments.

During the year ended June 30, 2002, the University realized a net loss of $15,904,000 from the sale of investments. The calculation of realized gains and losses is independent of the net appreciation of the fair value of investments. Realized gains and losses on investments that have been held in more than one fiscal year and sold in the current year include the net appreciation (depreciation) of these investments reported in the prior year. The net depreciation in the fair value of investments during the year ended June 30, 2002, was $69,065,000.

The majority of the endowed funds are invested in a pooled fund called the Consolidated Endowment Fund (CEF). Individual endowments subscribe to or dispose of units in the pool on the basis of a per unit valuation of the CEF at fair value on the last business day of the calendar quarter. Income is distributed based on the number of units held. The CEF income distribution is 5% of the average fair value of the CEF for the previous three years. RCW 24.44.050 of the Washington State Code allows for the spending of appreciation in the CEF.

Funds in irrevocable trusts managed by trustees other than the University are not reported in the financial statements. The fair value of these funds was approximately $49,000,000 at June 30, 2002. Income received from these trusts was $1,832,000 for the year ended June 30, 2002.

Securities Lending

The University's investment policies permit it to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The University's custodian lends securities of the type on loan at year-end for collateral in the form of cash or other securities. U.S. securities are loaned and secured by collateral valued at 102% of the fair value of the securities plus any accrued interest. Non-U.S. securities are loaned and secured by collateral valued at 105% of the fair value of the securities plus any accrued interest. 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. The contract with the custodian requires it to indemnify the University if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the University for income distributions by the securities' issuers while the securities are on loan.

Either the University or the borrower can terminate all securities loans on demand, although the average term of overall loans is 91 days. Cash collateral is invested in a short-term investment pool which had an average weighted maturity of 30 days as of June 30, 2002. The relationship between the maturities of the investment pool and the University's loans is affected by the maturities of the securities loaned by other entities that use the custodian's pool. The University cannot determine the maturities of those loaned securities. Non-cash collateral cannot be pledged or sold unless the borrower defaults.

Securities on loan at June 30, 2002, totaled $343,605,000 and are listed by investment type in Table 1. The securities lending program resulted in net revenues of $801,000 for the year ended June 30, 2002.

NOTE 7:

Metropolitan Tract

The Metropolitan Tract, ten acres in downtown Seattle, is developed and managed by UNICO Properties, Inc. (UNICO) and a joint venture partnership of Four Seasons Hotels, Ltd. and The Urban Investment and Development Company in accordance with leases with the University. The UNICO lease provides that the University reimburse UNICO from Tract rental income for its advances for approved additions and modernization.

The balance at June 30, 2002, represents operating assets, net of liabilities; and land, buildings, and improvements stated at appraised value as of November 1, 1954, plus all subsequent capital additions and improvements at cost, less buildings retired or demolished and accumulated depreciation of $72,840,000.

NOTE 8:

Capital Assets

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

CAPITAL ASSETS

	Beginning Balance	Additions/ Transfers	Retirements	Ending Balance
LAND	$ 55,091	1,535	-	56,626
INFRASTRUCTURE	158,918	-	-	158,918
INFRASTRUCTURE - CONSTRUCTION IN PROGRESS	959	3,033	-	3,992
BUILDINGS	1,757,381	43,274	-	1,800,655
BUILDINGS - CONSTRUCTION IN PROGRESS	178,140	122,530	-	300,670
FURNITURE, FIXTURES, AND EQUIPMENT	685,684	84,396	35,240	734,840
LIBRARY MATERIALS	172,115	12,503	913	183,705
CAPITALIZED COLLECTIONS	4,409	-	-	4,409
TOTAL	3,012,697	267,271	36,153	3,243,815
LESS ACCUMULATED DEPRECIATION:				
INFRASTRUCTURE	41,766	4,906	-	46,672
BUILDINGS	650,023	54,791	-	704,814
FURNITURE, FIXTURES, AND EQUIPMENT	485,003	85,996	32,088	538,911
LIBRARY MATERIALS	102,881	8,923	560	111,244
TOTAL ACCUMULATED DEPRECIATION	1,279,673	154,616	32,648	1,401,641
CAPITAL ASSETS, NET	$ 1,733,024	112,655	3,505	1,842,174

Dollars in thousands

NOTE 9

Long-term Liabilities

Long-term liability activity for the year ended June 30, 2002 is summarized as follows:

LONG-TERM LIABILITIES

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
LEASES AND BONDS PAYABLE:					
CAPITAL LEASE OBLIGATIONS	$ 55,926	19,392	7,080	68,238	9,698
GENERAL OBLIGATION BONDS PAYABLE	249,140	57,765	12,736	294,169	10,948
REVENUE BONDS PAYABLE	134,335	38,775	27,875	145,235	5,020
TOTAL LEASES AND BONDS PAYABLE	439,401	115,932	47,691	507,642	25,666
OTHER LIABILITIES:					
NOTES PAYABLE - CAPITAL ASSET RELATED	3,360	-	339	3,021	403
NOTES PAYABLE - OTHER	2,775	10,000	-	12,775	-
ANNUITY AND LIFE INCOME PAYABLE	158	-	3	155	-
CHARITABLE AND DEFERRED GIFT ANNUITY LIABILITY	32,163		1,897	30,266	-
SICK LEAVE	12,498	3,687	2,549	13,636	2,439
SELF-INSURANCE	36,653	8,806	13,019	32,440	8,846
TOTAL OTHER LIABILITIES	87,607	22,493	17,807	92,293	11,688
TOTAL LONG-TERM LIABILITIES	$ 527,008	138,425	65,498	599,935	37,354

Dollars in thousands

NOTE 10:

Leases

Capital Leases

The University has certain lease agreements in effect that are considered capital leases. As of June 30, 2002, the University had recorded buildings in the amount of $48,737,000 and equipment in the amount of $22,361,000, related to capitalized leases.

Future minimum lease payments under capital leases, and the present value of the net minimum lease payments, as of June 30, 2002, are as follows:

Year	*Dollars in thousands*
2003	$ 9,698
2004	9,608
2005	9,474
2006	9,225
2007	8,802
2008-2012	27,784
2013-2017	9,763
2018-2022	8,008
TOTAL MINIMUM LEASE PAYMENTS	92,362
LESS AMOUNTS REPRESENTING INTEREST	24,124
OBLIGATION UNDER CAPITAL LEASES	**$ 68,238**

Operating Leases

The University has certain lease agreements in effect that are considered operating leases, primarily for leased building space. During the year ended June 30, 2002, the University recorded expenses of $18,858,000 for these leases.

Future lease payments under these leases as of June 30, 2002, are as follows:

Year	*Dollars in thousands*
2003	$ 16,779
2004	14,802
2005	13,172
2006	10,656
2007	5,896
2008-2012	19,763
2013-2017	9,755
2018-2022	1,391
2023-2027	1,391
2028-2032	300
TOTAL MINIMUM LEASE PAYMENTS	**$ 93,905**

NOTE 11:

Bonds And Notes Payable

The bonds and notes payable at June 30, 2002, consist of State of Washington General Obligation and Refunding Bonds, University Revenue and Facilities Bonds, and Notes Payable. These obligations have fixed interest rates ranging from 3.25% to 9.00%, except for debt totaling $2,775,000 with variable rates.

State law requires that the University reimburse the state for debt service payments relating to its portion of the State of Washington General Obligation and Refunding Bonds from Medical Center patient revenues, tuition, timber sales, and other revenues. The University has pledged the net revenues from the Housing and Dining System, the Intercollegiate Athletics Department, the Parking System, and a portion of special student fees to retire the related revenue and facilities bonds.

On April 1, 2002, $4,940,000 of Housing and Dining System Revenue Bonds with an average interest rate of 6.99% were refunded. The refunding bonds have a maturity value of $5,130,000, and are part of the $18,920,000 Housing and Dining System Revenue and Refunding Bonds, series 2002 with an average interest rate of 5.13% on the refunding portion. The refunding of the bonds decreased the University's total debt service payments to be made over the next 21 years by $1,377,000.

Debt service requirements at June 30, 2002 were as follows:

BONDS AND NOTES PAYABLE

Year	STATE OF WASHINGTON GENERAL OBLIGATION		REVENUE BONDS		NOTES PAYABLE	
	Principal	Interest	Principal	Interest	Principal	Interest
2003	$ 10,948	15,428	5,020	7,562	403	146
2004	10,951	14,858	5,050	7,327	424	125
2005	11,333	14,230	5,320	7,102	446	103
2006	11,553	13,646	5,000	6,859	10,469	80
2007	11,919	13,036	5,285	6,614	1,868	56
2008-2012	61,239	55,051	31,710	28,663	2,341	36
2013-2017	78,055	37,220	32,940	19,314	-	-
2018-2022	58,430	17,949	25,560	12,157	-	-
2023-2027	39,741	4,221	15,815	6,562	-	-
2028-2032	-	-	13,535	1,687	-	-
TOTAL	**$294,169**	**185,639**	**145,235**	**103,847**	**15,951**	**546**

Dollars in thousands

The refunding resulted in an economic gain (difference between the present values of the debt service payments on the old and new debt) of $845,000.

On October 1, 2001, $19,320,000 of University of Washington Alumni Association Lease Revenue Bonds of 1994 with an average interest rate of 6.089 % were refunded, through the issuance of $19,855,000 of University of Washington Alumni Association Lease Refunding Bonds of 2001 with an average interest rate of 5.08%. The net proceeds of the refunding issue were used to purchase U.S. Government securities, which were deposited in irrevocable trusts with escrow agents to provide for all future debt service payments on the refunded bonds. As a result, the bonds are defeased and the liability for those bonds and the assets of the trusts have been removed from the Financial Statements. The refunding of the bonds decreased the University's total debt service payments to be made over the next 14 years by $1,147,000. The refunding resulted in an economic gain (difference between the present values of the debt service payments on the old and new debt) of $890,000.

NOTE 12:

Operating Expenses By Function

Operating expenses by functional classification for the year ended June 30, 2002 are summarized as follows:

Operating Expenses:	*Dollars in thousands*
EDUCATIONAL AND GENERAL:	
INSTRUCTION	$ 496,198
RESEARCH	463,218
PUBLIC SERVICE	8,463
ACADEMIC SUPPORT	209,506
STUDENT SERVICES	22,797
INSTITUTIONAL SUPPORT	143,937
OPERATION AND MAINTENANCE OF PLANT	95,860
SCHOLARSHIPS AND FELLOWSHIPS	44,335
AUXILIARY ENTERPRISES	141,692
MEDICAL RELATED	509,906
DEPRECIATION	154,616
TOTAL OPERATING EXPENSES	**$ 2,290,528**

NOTE 13:

Pension Plans

The University offers two contributory plans: the Washington State Public Employees Retirement System (PERS) plan, a defined benefit retirement plan; and the University of Washington Retirement Plan (UWRP), a defined contribution plan with supplemental payment, when required.

Public Employees Retirement System

Plan Description. The University of Washington contributes to PERS, a cost-sharing multiple-employer defined benefit pension plan administered by the State of Washington Department of Retirement Systems. PERS Plan 1 provides retirement and disability benefits, and minimum benefit increases beginning at age 66, to eligible non-academic plan members hired prior to October 1, 1977. PERS Plans 2 and 3 provide retirement and disability benefits, and a cost-of-living allowance, to eligible non-academic plan members hired on or after October 1, 1977. In addition, PERS Plan 3 has a defined contribution component, which is fully funded by employee contributions. The authority to establish and amend benefit provisions resides with the legislature. The Washington State Public Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for PERS. The report may be obtained by writing to the Department of Retirement Systems, P.O. Box 48386, Olympia, Washington 98504-8380.

Funding Policy. The Office of the State Actuary, using funding methods prescribed by statute, determines actuarially required contribution rates for PERS. Plan 1 members are required to contribute 6% of their annual covered salary. Contributions for Plan 2 members are determined by the aggregate method and may vary over time. The contribution rate for Plan 2 employees at June 30, 2002, was 0.65%. The contribution rate for the University at June 30, 2002, for each of PERS Plans 1, 2, and 3 was 1.33%.

The University's contributions to PERS for the years ended June 30, 2002, 2001, and 2000 were $11,441,000, $23,799,000, and $21,864,000, respectively, equal to the required contributions for each year.

University of Washington Retirement Plan

Plan Description. Faculty, librarians, professional staff, and certain other salaried employees are eligible to participate in the University of Washington Retirement Plan, a defined contribution plan administered by the University. Contributions to the Plan are invested in annuity contracts or mutual fund accounts offered by one or more fund sponsors. Employees have at all times a 100% vested interest in their accumulations.

Benefits from fund sponsors are available upon separation or retirement at the member's option. RCW 28.B.10.400 et. seq. assigns the authority to establish and amend benefit provisions to the University of Washington Board of Regents.

The Plan has a supplemental payment component which guarantees a minimum retirement benefit based upon a one-time calculation at each employee's retirement date. The University makes direct payments to qualifying retirees when the retirement benefits provided by the fund sponsors do not meet the benefit goals.

Funding Policy. Employee contribution rates, based on age, are 5%, 7.5%, or 10% of salary. The University matches the contributions of employees. Within parameters established by the legislature, contribution requirements may be established or amended by the University of Washington Board of Regents. Employee and employer contributions for the year ended June 30, 2002, were $43,302,000 each.

The supplemental payment component of the University of Washington Retirement Plan is financed on a pay-as-you-go basis. Annual payments are not significant.

NOTE 14:

Commitments and Contingencies

Authorized expenditures for construction projects unexpended as of June 30, 2002, were $354,840,000. These expenditures will be funded from local funds and State appropriations.

Substantial amounts are received and expended by the University under federal and state grants and contracts. This funding relates to research, student aid, Medical Center operations, and other programs, and is subject to audit by governmental granting agencies. Certain grant and contract costs billed to the federal government are subject to audit under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* University management believes that any liabilities arising from subsequent audits will not have a material effect on the University's financial statements.

The Office of the United States Attorney for the Western District of Washington is investigating the University of Washington Physicians (UWP), an affiliated organization, under the laws and regulations relating to physician billing for services provided to beneficiaries of federally-funded health care programs. As part of this investigation, the government has asked for a broad range of information from UWP and related institutions, including the University of Washington Medical Center. At this time, the University and its counsel are unable to provide any meaningful assessment of the risk to the University associated with this investigation.

The University is exposed to risk of loss related to tort liability, injuries to employees, and loss of property. The University purchases insurance protection for workers' compensation as well as marine, aviation, and certain other risks. The University also purchases insurance protection for loss of property involving self-sustaining units, bond-financed buildings, and where otherwise required by contract; otherwise, the risk of property loss is retained, unfunded. For professional, general, employment, and automobile liability, the University maintains a program of self-insurance reserves and excess insurance coverage.

The self-insurance reserve represents the estimated ultimate cost of settling claims relating to events that have occurred on or before the balance sheet date. The reserve includes the amount that will be required for future payments of claims that have been reported and claims related to events that have occurred but not been reported. The self-insurance reserve is estimated through an actuarial calculation using individual case-basis valuations and statistical analyses. Although considerable variability is inherent in such estimates, management believes that the self-insurance reserve is adequate. Changes in the self-insurance reserve for the years ended June 30, 2001 and 2002 are noted below.

	2001	**2002**
RESERVE AT BEGINNING OF FISCAL YEAR	$ 31,704	$ 36,653
INCURRED CLAIMS AND CHANGES IN ESTIMATES	10,852	8,806
CLAIM PAYMENTS	(5,903)	(13,019)
RESERVE AT END OF FISCAL YEAR	**$ 36,653**	**$ 32,440**

Dollars in thousands

This publication was prepared by University Relations and Financial Management. Published December 2002.

Additional copies of this report are available from:

University of Washington
Financial Accounting
3917 University Way NE
Box 351120
Seattle, WA 98195-1120
206-543-8414

PHOTOGRAPHY

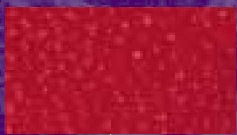
Al Camp, Mel Curtis, Dan Lamont, Susie Fitzhugh, Mary Levin, Robert Pisano, Kathy Sauber

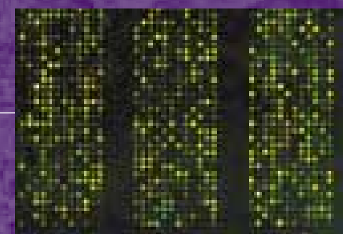
LAYOUT, PRODUCTION, AND PRINT COORDINATION

UW Publications Services

VISIT OUR WEBSITE

www.washington.edu





UNIVERSITY OF WASHINGTON