

university of washington

CROSSING



BOUNDARIES

annual report 2003

facts

STUDENTS	2002–2003	1997–1998	1992–1993
Autumn Enrollment			
Undergraduate	31,474	27,780	26,378
Graduate	9,768	8,145	7,880
Professional	1,721	1,662	1,295
TOTAL	42,963	37,587	35,553
Extension ¹	36,203	28,643	28,310
Number of Degrees Awarded			
Bachelor's	8,053	7,065	6,007
Master's	2,735	2,092	1,971
Doctoral	495	478	416
Professional	469	389	377
TOTAL	11,752	10,024	8,771
INSTRUCTIONAL FACULTY	3,490	3,198	3,091
FACULTY AND STAFF²	25,587	21,117	20,804
RESEARCH FUNDING – ALL SOURCES <i>(in thousands of dollars)</i>	\$ 933,000	\$ 557,000	\$ 430,000
SELECTED REVENUES <i>(in thousands of dollars)</i>			
Gifts, Grants, and Contracts	\$ 975,915	\$ 549,756	\$ 431,019
Auxiliary Enterprises ³ and Other Revenues	1,013,253	690,167	413,750
State Appropriations (Operating)	332,518	290,466	277,282
Tuition and Fees ⁴	282,132	217,551	137,916
SELECTED EXPENSES <i>(in thousands of dollars)</i>			
Instruction, Academic Support, and Student Services	\$ 790,088	\$ 498,272	\$ 446,900
Research and Public Service	526,193	368,399	294,524
Auxiliary Enterprises ³	686,780	521,032	292,064
Institutional Support and Physical Plant	254,890	161,715	136,814
CONSOLIDATED ENDOWMENT FUNDS⁵ <i>(in thousands of dollars)</i>	\$1,000,000	\$ 582,000	\$ 242,000
SQUARE FOOTAGE⁶ <i>(in thousands of square feet)</i>	17,100	15,300	13,600

¹ Course registrations

² Full-time equivalents

³ Includes UWMC

⁴ Net of scholarship allowances of \$40,481,000 in 2002–2003

⁵ Stated at fair value

⁶ Gross square footage, all campuses

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BOARD OF REGENTS AND ADMINISTRATIVE OFFICERS **INSIDE BACK COVER**

BOUNDARIES

message from the president

A year ago in this space, I argued two cases: that keeping the University of Washington strong was critical to the future of the state, and that current levels of state support were not adequate to the job. As the 2003 legislative session progressed, it became clear that many legislators agreed with both propositions but felt powerless, with a budget shortfall of more than \$2 billion, to do anything for higher education beyond keeping cuts as small as possible. And indeed, far from gaining ground in the '03 session, the UW slipped farther behind the funding level of its peer universities in other states.

Yet the session was encouraging in two ways. First, we heard wider and stronger public support for the vital role of research universities than ever before—thanks in part, I believe, to our joining voices with Washington State University. Second, the legislature itself showed signs of increasing concern about the prospects of the UW and its sister institutions. Even as they wrestled with the budget gap, legislators created two bipartisan working groups to look closely at public higher education: one to deal with overall master planning, the other to study the idea of “performance contracts” for each institution. At the UW, such a contract might mean agreeing to clear public goals and standards of accountability in exchange for more autonomy and flexibility in meeting those goals. We don't yet know how this idea will

play out in the '04 legislative session. But it is a promising signal that legislators want to engage these issues creatively.

Meanwhile, the University has not been sitting still.

In the spirit of this region, we like to think of ourselves as “the entrepreneurial public university”: a place where initiative, innovation, and agility make new things happen, for the benefit both of students and of the world at large. **Today, doing new things often means crossing old boundaries—between disciplines, between institutions, between parts of the world, between teaching and research** (a boundary always more perceived than real). The year under review here was full of such stories, and we tell a few of them in the opening pages of this report. New ventures that blend biology and engineering show up here, along with interdisciplinary quests for the origins of life and of Western civilization. And the story of veteran law professor Roy Prosterman—whose efforts on behalf of land reform have been changing lives in places like China and India for more than 30 years—is a reminder that UW people have been crossing boundaries for quite a long time.

Clearly, the entrepreneurs here are the faculty and the students they inspire. But the culture and management of the University also matter. The UW enjoys a national

reputation for faculty collegiality and for the relative ease of interdisciplinary work. People who seek that kind of environment come here. **They stay because they find opportunities here to pursue their most compelling ideas.** They find colleagues with other kinds of expertise who want to work with them. They find schools and colleges that see their charge not only as excellence in traditional disciplines, but also as inventing the disciplines of the future. They find a central administration whose priorities, investments, and recruiting actively encourage new, collaborative approaches to teaching, research, and combining the two. All this is true not just in science and technology but also in the arts and humanities and social sciences. Take a look, for example, at the Web site of the Simpson Center for the Humanities (<http://depts.washington.edu/uwch/index.htm>) or the Center for Digital Arts and Experimental Media (<http://www.washington.edu/dxarts/>).

What kinds of rewards accrue to an entrepreneurial university? Some are intangible—the excitement of working with colleagues at new frontiers, the deep satisfaction of guiding students in new directions. But there is also the University’s remarkable success in the national competition for research funds. Formulating new questions and creating interdisciplinary teams to attack them—hallmarks of UW



research—have won the University some extraordinary investments from research agencies, including two of the only three federal Centers of Excellence in Genomic Science. At the same time, the head of the Woodrow Wilson Foundation recently called the University of Washington one of the most influential educational innovators in the nation.

Research dollars and national recognition are good things. But of course the goal, finally, is serving our students and the public. **We cross boundaries, not to chase the new for its own sake, but to prepare students who can make original contributions to society, and to seek knowledge that will improve and illuminate our lives.**

We cross boundaries, that is, to the future.

Lee L. Huntsman



BIOLOGY FOR ENGINEERS 6



BELOW THE SURFACE 8



LAUNCHING THE GEN...



crossing boundaries



HOME ERA 10



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In high school in her native Indonesia, Febe Kusmanto loved math and chemistry. She set her sights on becoming a chemical engineer, came to the Northwest to study, spent two years at North Seattle Community College, and then enrolled in the UW's chemical engineering department.

biology for engineers



“You have to have students who can cross those boundaries.”



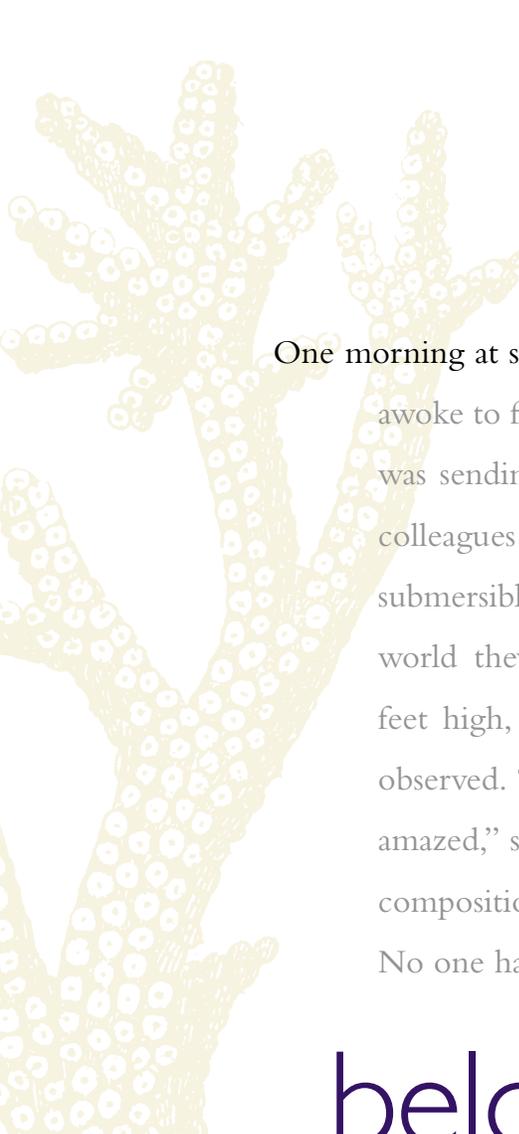
There she discovered something new about engineering: its increasing connections with biology. “If you look in the work area right now,” she says, “it’s almost all related to biology.” So she set herself a new goal: working as a chemical engineer in a biomedical company. And she found a gateway to that career in a class called “Biological Frameworks for Engineers,” conceived and co-taught by Professor Mary Lidstrom.

Designed for students like Febe, the course is a kind of mirror image of Professor Lidstrom’s own career. She began as a microbiologist, trying to learn how bacterial cells work and how to manipulate what they can do. This, she gradually realized, was a kind of engineering problem. “It became clear to me,” she says, “that to take my research where I wanted it to go, I had to have a more quantitative, problem-solving approach. I began working with engineers,

and it opened my eyes to what we biologists could do if we had that expertise.” Today she is a faculty member in both microbiology and chemical engineering, and her research team is working on bacterial strategies for cleaning up hazardous waste at Hanford.

“If you’re going to push forward in truly interdisciplinary research,” says Professor Lidstrom, “you have to have students who can cross those boundaries, who can be translators.” Febe understood: “I needed a connection between chemical engineering and bioengineering,” she says, “and I found it in Mary’s class. We started with basic biology, but we also used equipment that I’d never used before, and we did DNA analysis. It was pretty cool.” Febe is spending her final quarter at the UW as an intern at Boston Scientific in Redmond, doing research on materials for medical devices.

In September 2002, Mary Lidstrom was named a Howard Hughes Medical Institute Professor, one of only 20 nationwide. The Hughes program aims to support creative people who bridge the laboratory and the classroom. Professor Lidstrom is using her Hughes funds to expand “Biological Frameworks for Engineers,” with new gateway classes for other engineering disciplines and guidance on choosing appropriate follow-up courses. “Now,” she says, “we can take this to the next stage—from a class to a career path.”

A stylized, yellow, branching coral-like graphic with small circular patterns, positioned on the left side of the page, partially overlapping the text.

One morning at sea in the mid-Atlantic, marine geologist Debbie Kelley awoke to find that an unmanned vehicle beneath her research ship was sending back pictures of fantastic white spires. She and two colleagues promptly went down to investigate. In Alvin, their tiny submersible sphere, they did the first exploration of an undersea world they dubbed Lost City. The spires, towering up to 180 feet high, turned out to be hydrothermal vents, the tallest ever observed. “When I saw them, I was completely and absolutely amazed,” says Professor Kelley, “in part because of their size and composition, but also because they are so beautiful and delicate. No one had ever found anything like this before.”

below the surface



Part of the fascination of Lost City was its stark contrast with hydrothermal vents discovered earlier in the Pacific. “Black smokers” in the Pacific are powered by undersea volcanoes that spew superheated fluids and sulfide gases. At Lost City, chemical reactions between seawater and old rock produce warm fluids, methane and hydrogen



“At 500 meters,
you cross into darkness.”

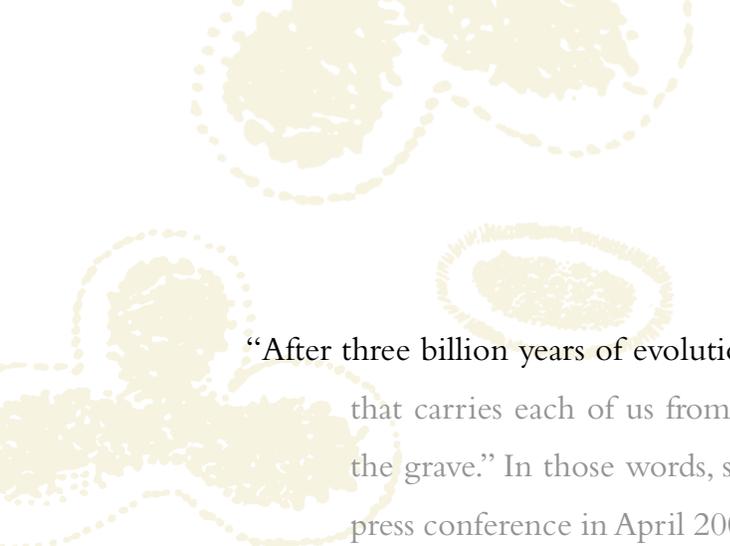
gases, and white limestone towers. Yet both systems support distinct colonies of microorganisms that are independent of sunlight and photosynthesis, once believed to be the basis of all life. Many scientists now speculate that these warm chemical stews in the deep sea fostered the earliest life on earth.

So in spring 2003 Professor Kelley led a multi-faceted research cruise back to Lost City to learn more. “Vents are really complex feedback loops,” says Professor Kelley, “where life is intertwined with geological, tectonic, and biochemical processes. You have to be interdisciplinary to study these systems.”



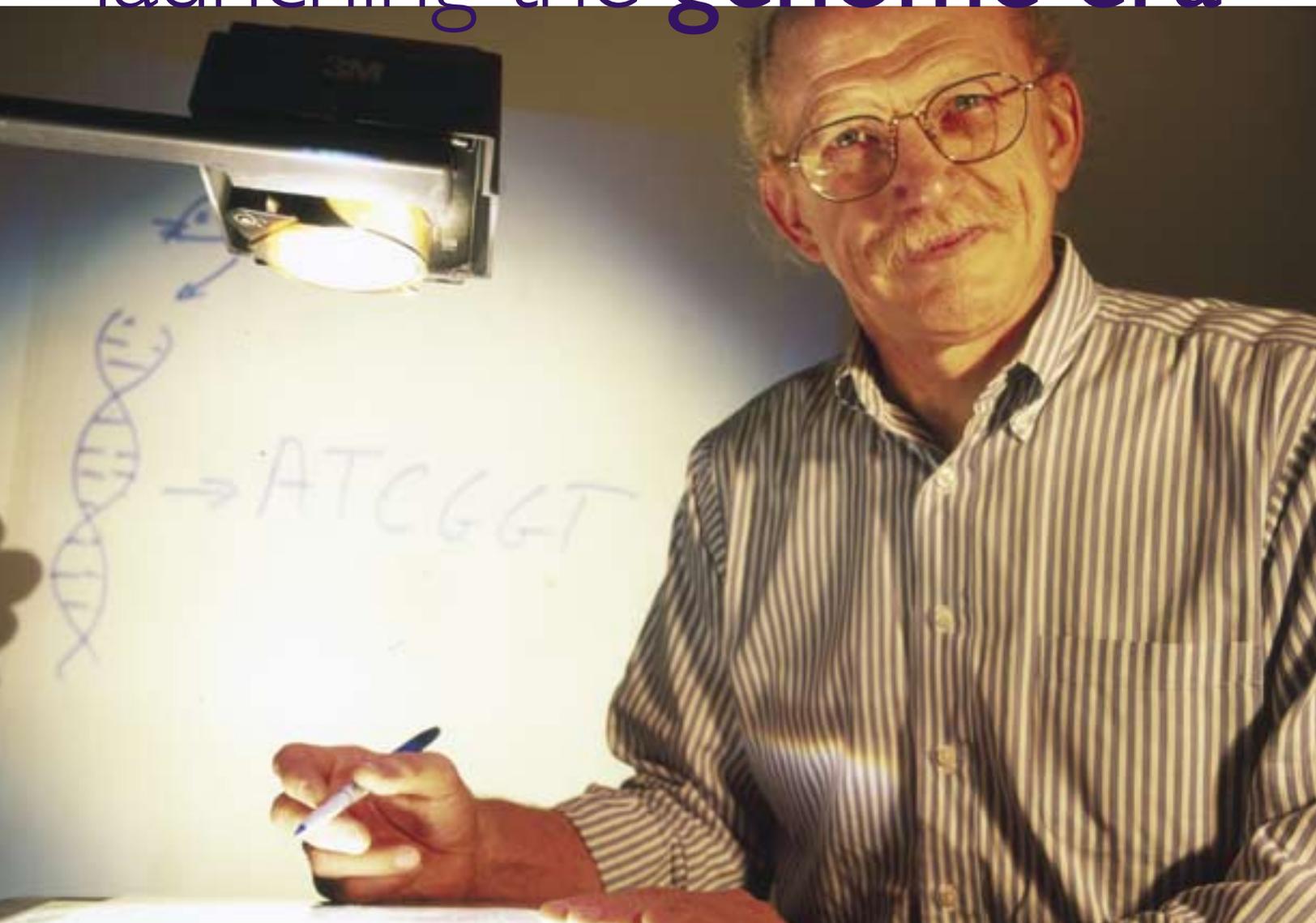
One member of the team was Giora Proskurowski, a UW doctoral student in chemical oceanography. His assignment was to collect and analyze gases dissolved in the warm vent fluids. “One of the biggest challenges and rewards about a cruise,” he says, “is that everybody comes from a different place—a different scientific angle or institution or even country. But we have daily meetings, so by the end you know about everything: the biology, the microbiology, the chemistry, the physics, the geology.”

Giora and his shipmates are still analyzing the samples they brought back. But beneath the sober science of oceanography is the old seagoing spirit of adventure. Giora describes going down in Alvin: “They drop you into the water. At about 500 meters, you cross into darkness. When you hit the ocean bottom, it feels like the Eagle landing on the moon.”

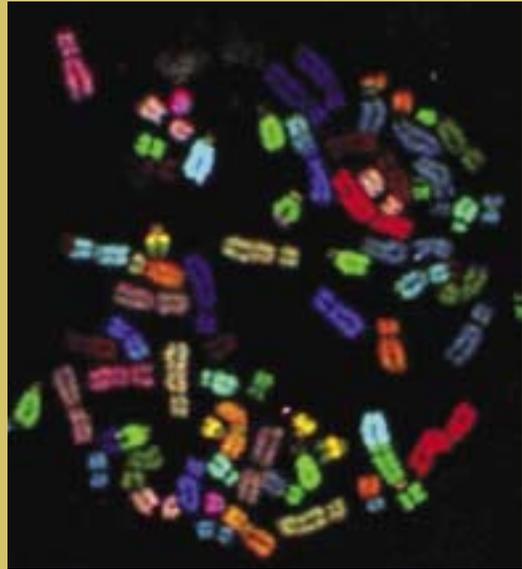


“After three billion years of evolution, we have before us the instruction set that carries each of us from a one-celled egg through adulthood to the grave.” In those words, spoken at a National Institutes of Health press conference in April 2003, Dr. Robert Waterston announced the completed mapping of the human genome. For years, as director of the Genome Sequencing Center at Washington University in Saint Louis, he had been one of the prime architects of the human genome project. Now, however, he was speaking as the new chair of the UW medical school’s Department of Genome Sciences.

launching the genome era



The move to Seattle reunited Bob Waterston with two brilliant former colleagues: UW professors Maynard Olson and Phil Green. Starting from different academic backgrounds (medicine, chemistry, and mathematics), the three had found their separate ways to genomics. “It’s a new field,” says Dr. Waterston. “You have to be able to think across boundaries.” In Saint Louis, the three had collaborated to give the human genome project much of its shape and some of its most important conceptual and computational tools. In 2002, three of the eight Gairdner International Awards for genome-science pioneers went to Waterston, Olson, and Green.

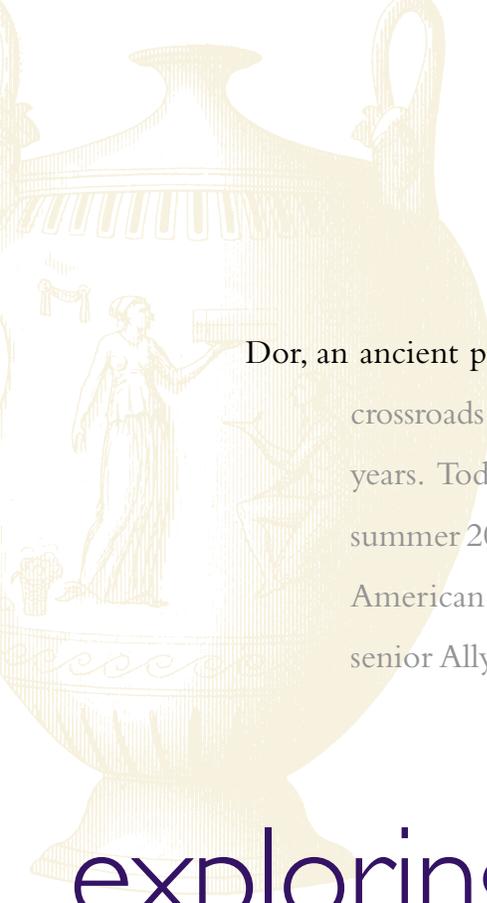


“Now the real work begins.”

Soon after Dr. Waterston’s arrival at the UW, the Bill and Melinda Gates Foundation announced a major gift for a new research building to house both genome sciences and bioengineering. For the Gateses, the growing cross-fertilization of biology and technology looks to be the best hope for meeting the vast challenges of global health.

“Now the real work begins,” said Dr. Waterston at the groundbreaking for the new building. “We have to learn how to use the genomic instruction book to understand and treat disease.” He is very clear about the time, patience, and ingenuity that will be required to do this. “The time frame is hard,” he says. “Each disease has its own pace.” He takes pains not to promise instant cures for cancer or malaria or the ills of aging.

But he is also clear that medicine has crossed over into new territory. “This is the beginning of the genome era,” he says. “We are trying to gain a molecular understanding of human physiology and disease, and with genomics we can begin to understand individual human variation. This is unheard of. The implications of what we are doing are profound, and the potential is enormous. The therapies will come.”



Dor, an ancient port city just south of modern Haifa, Israel, was a major crossroads of classical and Near Eastern cultures for two thousand years. Today it is a crossroads of international archaeology. In summer 2003, the site was host to scholars and scientists from several American and Israeli institutions—and to one undergraduate, UW senior Allyssa Lamb.

exploring ancient **crossroads**



Sarah Stroup, a classics professor and co-director of the Tel Dor excavations, brought Allyssa along as a research assistant. “She has a real breadth of interests,” says Professor Stroup, who had taught Allyssa both on campus and at the UW’s Rome Center. “I wanted to show her various aspects of archaeology.” So Allyssa divided her time between digging in a Bronze Age trench, doing computer analysis of the multiple levels of the site, and helping Berkeley art historian Andrew Stewart catalogue fragments of Greek pottery. “It was fascinating,” says Allyssa, “and a lot of fun.” Says a proud Professor Stroup, “She was a real trouper, easily holding her own with the graduate students. Everyone was very impressed.”

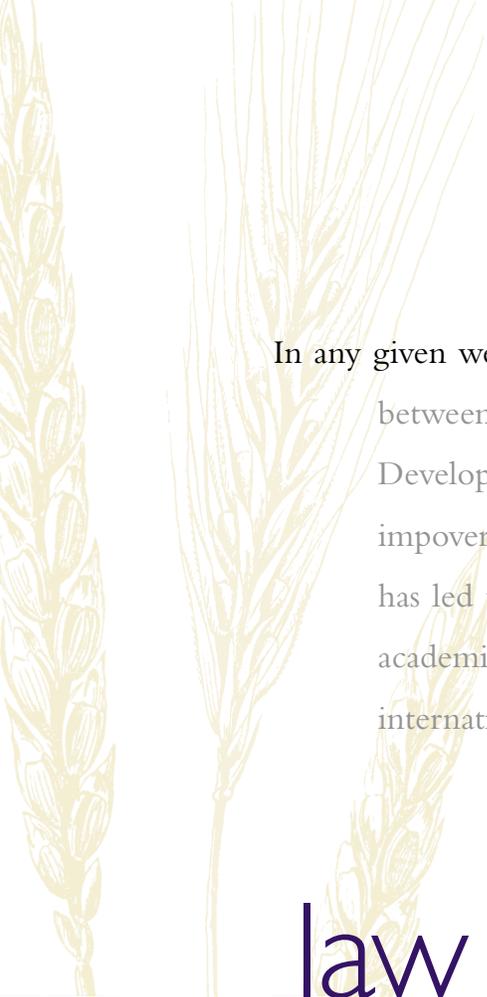


The archaeologists were not the first people to be impressed by Allyssa. Since arriving at the UW from Bothell High School, she has learned Greek, Latin, Hebrew, and hieroglyphics. (“Once in a while,” she admits, “I find myself thinking in the wrong language.”) She has mastered the history and literature required by two demanding majors: classics, and Biblical and ancient Near Eastern studies. She has spent a quarter in Rome, studying ancient Roman culture and the “slightly mind-bending” historical layers of the city. She is a multiple winner of classics and humanities scholarships.

Behind her double major and many languages is Allyssa’s drive to understand the cross-fertilization of ancient peoples—and its legacy to the modern world. “That’s why I’m so interested in the Hellenistic period, which was the heyday of Dor,” she says. “It was cosmopolitan; different peoples were talking to each other. Sometimes you can’t tell where an idea or art form came from—even things we think of as basic to Western civilization. That gray area is very interesting to me.”

“Once in a while,
I find myself
thinking in the
wrong language.”

In November 2003, Allyssa got exciting news: she will spend her next two years as a Rhodes Scholar at Oxford University. There she will study Hellenistic Egypt and its blending of Greek and Egyptian cultures. “She’s chosen a very, very challenging topic,” says Professor Stroup. “But she’s well cut out for doing this. I think her strength is in her ability to cross over.”



In any given week, law professor Roy Prosterman might divide his time between a seminar room on campus, his office at the Rural Development Institute (RDI) in downtown Seattle, and an impoverished village somewhere in the developing world. He has led this kind of life for more than 30 years, quietly blending academic law with astonishingly effective activism in the cause of international land reform.

law for the **landless**



“It’s hard to draw the boundary,” he says. “I’m teaching in the same field—development law—as RDI’s work. All the fieldwork I do for RDI is grist for the mill for my seminar, Legal Problems of Economic Development.” And on the RDI staff, all but two of the nine lawyers have UW law degrees; several started as RDI research assistants while they were still in law school.

Professor Prosterman arrived at the UW in 1965, haunted by the poverty he had seen in Puerto Rico and Liberia as a young lawyer. One of his first students showed him an article on land reform in Latin America. Convinced by the cause, but not by the coercive and collectivized version of it in the article, Professor Prosterman wrote about his own democratic vision of land reform. Large landowners would be compensated, as in the law of eminent domain; farmers would take title to the land as individuals, able to farm as they wished.

From this initial vision has flowed Professor Prosterman’s life work. In the early ’70s, working with the US Agency for International Development, he put his model of land reform to the test in South Vietnam. A million landless families received title to land—and where the land reform was implemented, rice production rose by 30 percent per acre and Viet Cong recruitment fell by 80 percent. In 1981 Professor Prosterman founded RDI, and today he can point to more than 120 million poor families in 37 countries who have gained secure tenure rights to the land they farm, thanks to the work of RDI’s dedicated little band of lawyers. In April 2003, Professor Prosterman received a Gleitsman Foundation International Activist Award.



120 million poor families have gained rights to the land they farm.

The benefits of land reform, Professor Prosterman believes, extend far beyond individual farmers. “Desperately poor landless families,” he says, “are prey to siren songs. In Pakistan, they often turn their sons over to radical madrassas, with enormous potential for instability and deep mischief.” Right now, he says, Pakistan may be too dangerous for direct RDI fieldwork—but somehow he’ll find a way to get involved.

financial hi li



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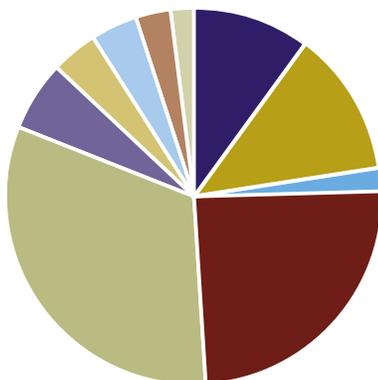
CAPITAL BUDGET AND CAMPUS CONSTRUCTION **24**



Funding and Operations

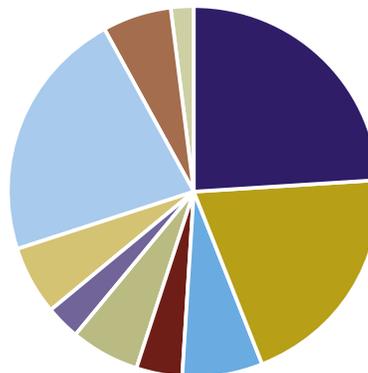
- The University has a diversified revenue base. No single source generated more than 32 percent of the total fiscal year 2003 revenues of \$2.7 billion.
- State operating appropriations were \$341 million, or 13 percent of total revenues. This includes \$8 million of state funding classified as Other Medical Center Revenues on the Statements of Revenues, Expenses, and Changes in Net Assets. The University relies heavily on such funding for instructional activities.
- Grants and contracts (32 percent) generated \$843 million of current year revenue, a 17 percent increase over fiscal year 2002. 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 \$170 million (6 percent), including a single gift of \$70 million. 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 44 percent of total operating expenses. These dollars provided instruction to more than 42,000 students and funded 5,200 research awards.
- The University provided students with scholarships and fellowships, including scholarship allowances of \$40 million, that totaled over \$79 million (3 percent of operating expenditures).

Sources of Funds

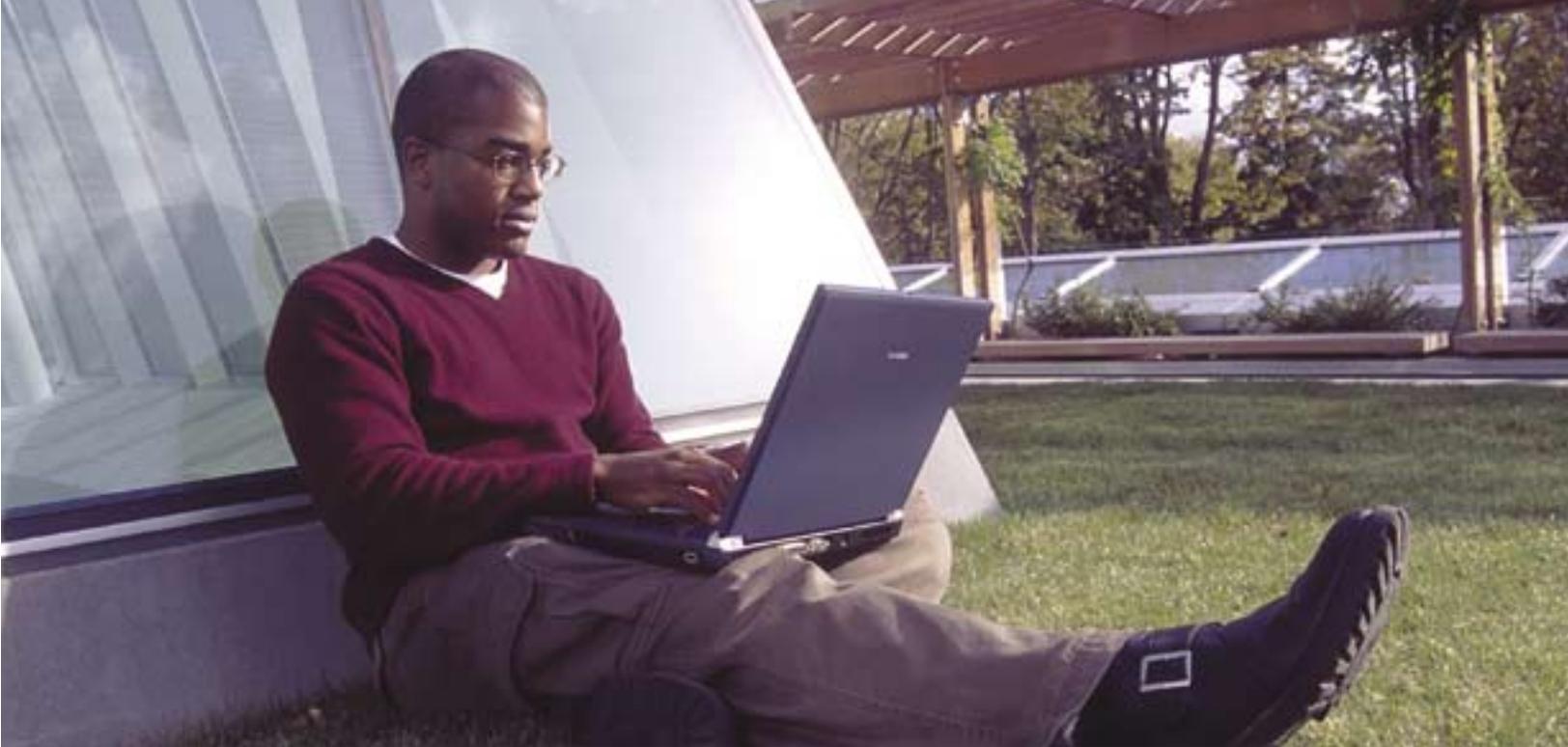


- 10% TUITION
- 13% STATE FUNDING FOR OPERATIONS
- 2% STATE FUNDING FOR CAPITAL EXPENDITURES
- 24% PATIENT REVENUE
- 32% GRANTS AND CONTRACTS
- 6% GIFTS
- 4% AUXILIARY
- 4% SALES AND SERVICES OF EDUCATIONAL DEPTS.
- 3% INVESTMENT INCOME
- 2% OTHER

Uses of Funds



- 24% INSTRUCTION
- 20% RESEARCH
- 7% ACADEMIC SUPPORT
- 4% INSTITUTIONAL SUPPORT
- 6% OPERATION AND PLANT MAINTENANCE
- 3% SCHOLARSHIPS AND FELLOWSHIPS (INCLUDING SCHOLARSHIP ALLOWANCES)
- 6% AUXILIARY ENTERPRISES
- 22% MEDICAL RELATED
- 6% DEPRECIATION
- 2% OTHER



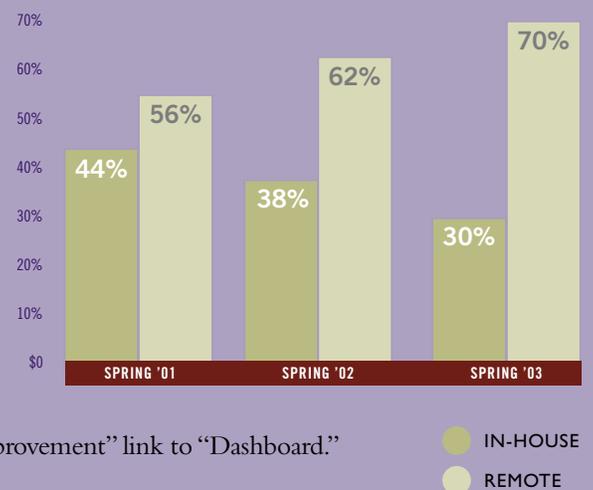
Developing Performance Measures

To help campus customers achieve what's important to them, the University's Financial Management division closely monitors its performance in delivering financial services. To do this, Financial Management adapted the balanced scorecard approach widely used in businesses across the country. The scorecard, or dashboard, gives managers a fast but comprehensive view of financial measures that help Financial Management be a good steward of University resources. In addition, dashboard measures evaluate customer satisfaction, internal business efficiency, and the division's ability as an organization to learn and grow. To see the Financial Management Dashboard, go to <http://www.washington.edu/admin/finmgmt> and follow the "Quality Improvement" link to "Dashboard."

By regularly reviewing and acting on key measures, Financial Management has been able to significantly improve important financial processes for campus. For example:

- In spring quarter 2003, 70 percent of student fiscal services (SFS) were delivered through remote access (e.g., web payments, direct deposit and credit cards) compared to 56 percent in 2001. Students benefit from this increase in remote access options as they can do their transactions at any time that suits their schedules. The reduction of in-person visits to the SFS office also allows the staff more time with students who need more personalized service.
- Over 90 percent of all travel expense vouchers are now paid within 5 days of receipt in the Travel Office. This is a significant improvement over the 16 percent payment timeliness four years ago.
- The Payroll Office has reduced the number of special checks, those manually produced outside the normal payment cycle, by 50 percent. Improvements like this in operational efficiency allow Payroll to meet the urgent needs of employees and still deliver timely service, despite a recent reduction in payroll staff.

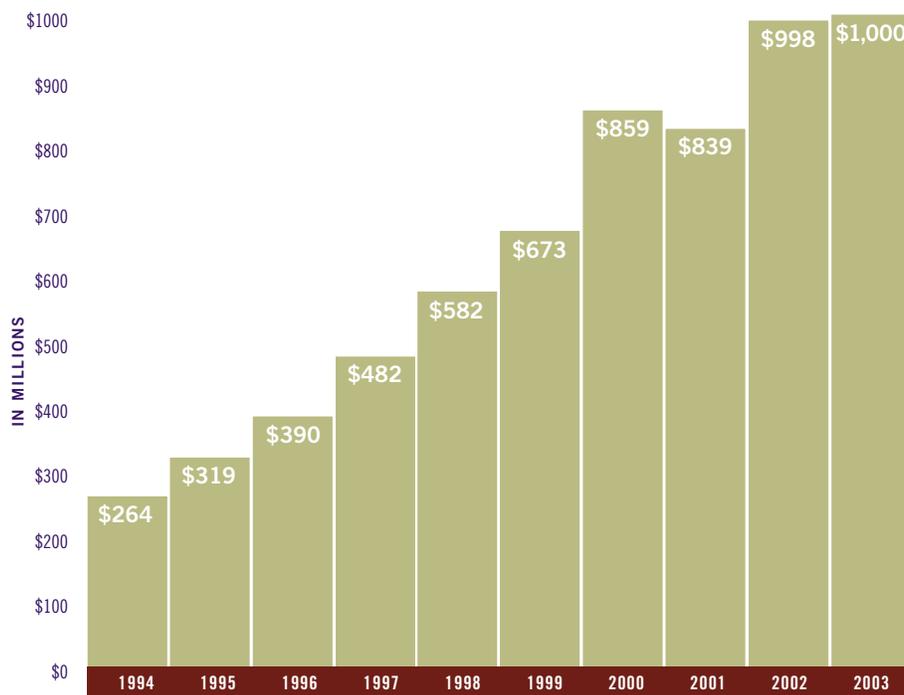
Student Fiscal Services,
Service Delivery In-House vs. Remote



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, 2003, the fair market value of the CEF was \$1 billion, representing the investments of 1,801 individual endowments.
- Endowed program support over the last five years totaled \$198 million. During that period, the average annual total return on the CEF was 5.7 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 \$762 million. The total return has averaged 7.2 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: 1994-2003





Marsh Endowed Fellowship in Music

Just a few short months ago, Elizabeth Ferlic was in Boston working long hours at a job she didn't enjoy and unsure what the future would bring. Now, thanks to the generous contributions of two dedicated friends of the University, the first year doctoral student is studying ethnomusicology at the University of Washington and contemplating a whole new array of creative opportunities.

"There are times I feel so thankful that I can be in school," says Ferlic, the first-ever recipient of the Louis G. and Patti A. Marsh Endowed Fellowship in Music. The endowment was established by the Marshes in honor of their deep ties to the University, their passion for music, and their faith in the vision of School of Music Director Robin McCabe.

Pursuing a doctoral degree will allow Ferlic—who already has earned undergraduate degrees in music composition and psychology—opportunities to explore the use of music as a tool to help others. She cites an interest in music therapy as a possible focus, though she says the program's emphasis on field work also will allow her to continue research in Afro-Cuban music and tradition, an area in which she developed a keen interest during previous studies in Cuba.

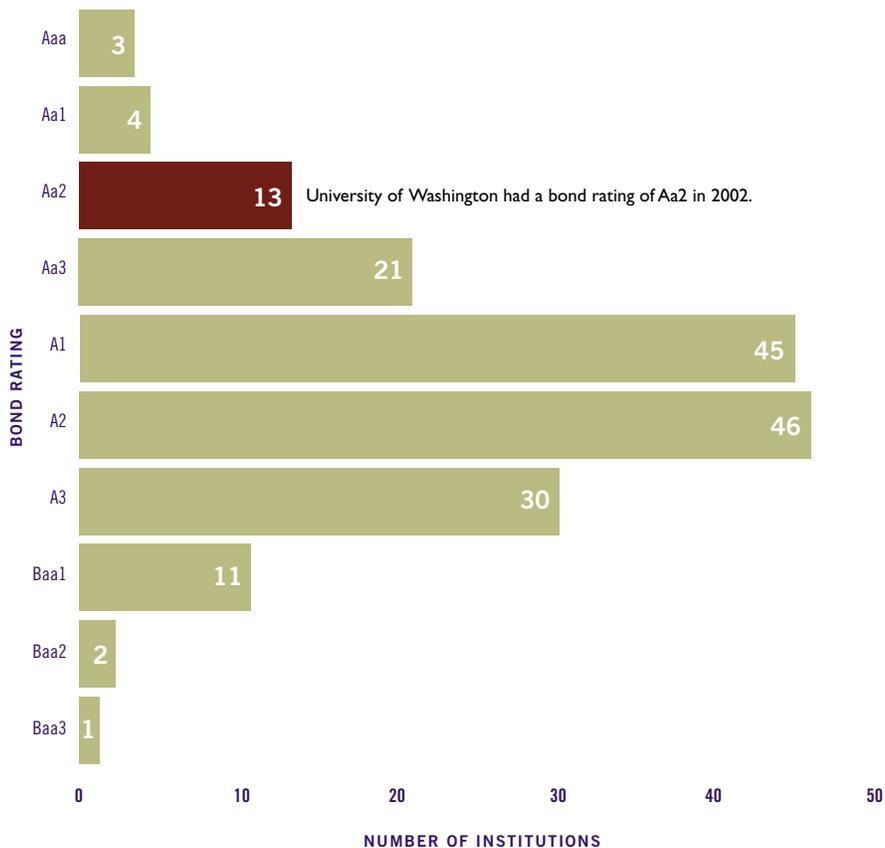
The program's interdisciplinary approach to teaching and learning earns high marks from Ferlic, and she relishes the opportunity to work with visiting scholars from far-flung cultures. Such learning environments require her to stretch her own perspectives—and vocal cords. Of a voice class she's taking this fall from visiting Iranian artist Hossein Omoumi, she says, "I've been singing my whole life, but the way he describes singing is to imagine that you're laughing. It's quite foreign to me, but it's pretty cool."

The Marshes' generosity, which proved critical to Ferlic's decision to attend the UW, has given her the means to pursue these new experiences, as well as a nudge in a new direction. "In a way, I saw it as encouragement not only from the University of Washington community, but from the field of ethnomusicology," she says. "It's reassurance that I'm going in the right direction in my life. Getting this financial support is extremely affirming to me."

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





New Borrowing Authority Leads to New Facilities

For many years, the UW has been able to issue local bonds to support auxiliary capital projects. Bonds for these purposes have funded residence halls, parking garages and student facilities. Until now, this authority was not extended to the research enterprise. New legislation passed in the 2002 session broadened the UW's local borrowing authority to include research buildings.

Under this new borrowing authority granted by the state legislature, UW is now able to issue bonds and sign financing contracts for research projects without prior approval. This authority will speed up project completion and increase the certainty of project funding. This increased certainty will also assist in securing the commitment of other funds from donors and granting agencies.

The Genome Sciences and Blue Flame buildings will be the first to take advantage of this new authority. The financing lease for a School of Medicine research building at South Lake Union was signed in August, 2003. Revenue bonds for Genome Sciences will be issued in 2004. The overall strength of the UW's research enterprise and the incremental indirect cost that will be generated by these new facilities assure that each transaction will be completed with the best possible terms.

Capital Budget and Campus Construction

The Paul G. Allen Center

The new Paul G. Allen Center for Computer Science & Engineering will enable the UW to accommodate the growing interest in Computer Science and Engineering (CSE) and contribute to the UW's firmly staying in the top tier of the CSE field. Attaching it to the existing Electrical Engineering building by means of a common atrium will enhance opportunities for collaboration between students and faculty of the two departments.

This facility added 160,000 gross square feet for computer research and teaching laboratories, faculty and staff offices, support space and computer laboratories. The center has numerous high tech features such as building-wide wireless access, super-fast network connections, interactive white boards, and conference rooms fully wired with state-of-the-art audio-visual equipment.

Throughout the building the architectural emphasis has been on people. Natural light and comfortable surroundings are designed throughout the building. Breakout areas have floor to ceiling whiteboards. Common areas foster informal meetings to discuss ideas and socialize. Additionally, the building includes open space, common space and an open-air deck on the sixth floor with a panoramic view east overlooking Husky Stadium, Lake Washington and the Cascade mountains.

The facility was predominantly funded by private donations from over 250 donors who contributed approximately \$40 million. An additional \$26 million in UW funds and \$10 million in state funds completed the funding package.



William H. Gates Hall

The new William H. Gates Hall opened this fall with over 196,000 gross square feet of space for the Law School and Law Library to meet growing educational, technical, and physical demands that have outgrown Condon Hall, the former Law School facility, built in the early 1970s.

The new facility provides state-of-the-art technology and greatly improves accessibility to the Law Library, a valuable resource for students, faculty, and the general public. The architecture of the facility is an impressive blend of modern design and functionality.

In the Law Library faculty members and students engage in numerous law reform efforts and research on a wide range of issues such as health care delivery, environmental law, international development, and intellectual property.

This new facility serves more than instructional purposes for law students. The “mock” courtrooms provide realistic surroundings for law students to experience simulated legal proceedings. The classrooms, “interview” rooms, laboratory areas, and library feature current audio-visual and computer technology. These state-of-the-art features will enable the students, clinical staff and faculty to deploy modern case management software and legal research.

William H. Gates III, Microsoft co-founder, and his wife, Melinda, provided \$12 million of the \$34 million in private donations for the new facility, which is named for his father, UW Regent William H. Gates II. UW and local funds will complete funding for the facility, estimated to cost \$80 million in total.



financial statements and required supplemental information



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Management's Discussion and Analysis

The following discussion and analysis provides an overview of the financial position and activities of the University of Washington ("University") for the years ended June 30, 2003 and 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.

Using the Financial Statements

The University's financial reports include the Balance Sheets, the Statements of Revenues, Expenses, and Changes in Net Assets, and the Statements of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) principles, which establish standards for external financial reporting for public colleges and universities. Current GASB standards require that financial statements be presented on a consolidated basis in order to focus on the University as a whole.

Financial Health

BALANCE SHEETS

The Balance Sheets present the financial condition of the University at the end of the last two fiscal years and report all assets and liabilities of the University. A summarized comparison of the University's assets, liabilities and net assets as of June 30, 2003 and 2002, follows:

	2003	2002
	(in millions)	
Current assets	\$ 1,062	\$ 839
Noncurrent assets:		
Capital assets, net	2,024	1,842
Other	1,962	1,965
Total assets	5,048	4,646
Current liabilities	886	721
Noncurrent liabilities	619	618
Total liabilities	1,505	1,339
Net assets	\$ 3,543	\$ 3,307

Current assets consist primarily of cash, short-term investments, securities lending collateral and accounts receivable. Total current assets increased by \$223 million, to \$1,062 million at June 30, 2003. The June 30, 2002 balance of \$839 million decreased \$52 million from the prior year. The excess of current assets over current liabilities of \$176 million in 2003 demonstrates the University's ability to meet its short-term obligations.

The difference between total assets and total liabilities—net assets, or "equity"—is one indicator of the current financial condition of the University. The change in net assets measures whether the overall financial condition has improved or deteriorated during the year.

The University reports its "equity" in four categories:

- **Invested in Capital Assets, Net of Related Debt** is 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:**
 - **Expendable** are resources which the University is legally or contractually obligated to spend in accordance with restrictions placed by donors and/or external parties
 - **Nonexpendable** consists of funds in which the donor or external party has imposed the restriction that the corpus is not available for expenditures but for investment purposes only
- **Unrestricted Net Assets** are all other funds available to the institution for the general and educational obligations to meet current expenses for any purpose. Unrestricted assets are often internally designated for specific purposes.

The University's net assets at June 30, 2003 and 2002 are summarized as follows:

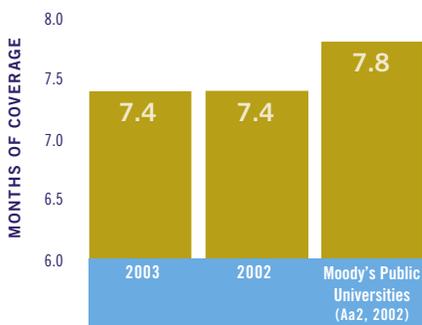
	2003	2002
	(in millions)	
Invested in capital assets, net of related debt	\$ 1,534	\$ 1,406
Restricted:		
Nonexpendable	498	477
Expendable	910	874
Unrestricted	601	550
Total net assets	\$ 3,543	\$ 3,307

The \$128 million, or 9% increase in the net investment in capital assets shows that the University continues to invest heavily in its buildings and plant. Restricted net assets grew \$57 million, or 4% as a result of increases in gift revenue and earnings on endowments. The Unrestricted Net Asset growth of \$51 million, or 9%, was due to increases in tuition, unrestricted investment income, patient revenues, indirect cost recoveries and the result of conservative spending for operating activities.

The ratio of expendable financial resources to operations (as defined by Moody's) measures the strength of Net Assets. This ratio, illustrated in the chart below, shows that as of June 30, 2003, and 2002, the University had enough expendable resources from various sources to fund operations for more than seven months.

All ratios are compared to Moody's peer group average of Public Universities in the Aa2 bond rating category.

Expendable Financial Resources to Operations (months)¹



Endowment and Other Investments

Equity markets ended two consecutive years (fiscal 2001 and 2002) of double-digit negative returns and registered a 0.3% gain in fiscal year 2003, as measured by the Standard and Poor's 500. The Consolidated Endowment Fund (CEF) returned 1.6%, ending the year at \$1 billion, compared to a return of -3.2% in the prior year. Over the past ten years, the CEF averaged a 10.6% return, which places it in the top quartile of the Cambridge Associates College and University peer group.

1.0
0.5
0

¹ The sum of Unrestricted Net Assets and Restricted Expendable Net Assets, divided by Total Operating Expenses (Operating Expenses plus interest expense). The result is multiplied by 12 to arrive at months of coverage.
² The sum of Unrestricted Net Assets and Restricted Expendable Net Assets, divided by total capital leases, bonds and notes payable outstanding.

The Invested Funds (IF), or operating monies of the University, returned 7.5% for fiscal year 2003 and 5.1% in 2002, ending the 2003 fiscal year with a market value of \$762 million.

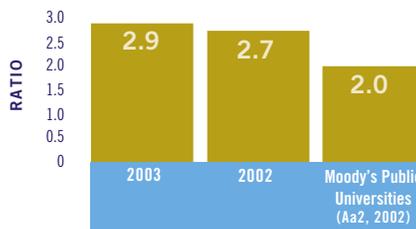
Capital Improvements and Related Debt

Total long-term debt associated with capital assets decreased slightly during 2003, as there were no significant issuances in the current year. The largest new debt issue in the current year was for \$10 million at 4.6% to complete construction of the William H. Gates Hall (which houses the UW Law School) and the UWMC (University of Washington Medical Center) Surgery Pavilion. In fiscal 2002, the University was able to take advantage of the low interest rate environment in order to borrow and lease at favorable rates to finance facilities and equipment. As a result, in 2002, long-term debt increased by \$139 million, an increase of \$56 million. This debt was issued primarily to finance capital additions to Housing and Dining, and to the UWMC's Surgery Pavilion.

Obligations under capital leases amounted to \$70 million on June 30, 2003, compared to \$68 million in 2002. The net increase in 2003 from the previous year is due to additional capital leases for tenant improvements at Sand Point. In the 2002 fiscal year, capital leases increased by \$12 million, primarily for financing a new research facility.

The expendable financial resources to debt ratio (as defined by Moody's) shows that the University has sufficient resources to cover its long-term debt obligations. The graph below shows a slight improvement of the current year's ratio over the prior year.

Expendable Financial Resources to Direct Debt²



STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. In accordance with GASB reporting principles, revenues and expenses are classified as operating, nonoperating or other. A condensed comparison of the University's revenues, expenses and changes in net assets for the years ended June 30, 2003 and 2002 follows:

	2003	2002
	(in millions)	
Operating revenues	\$ 2,050	\$ 1,795
Operating expenses	2,447	2,272
Operating loss	(397)	(477)
Nonoperating revenues, net of expense	527	444
Other revenues	106	83
Increase (decrease) in net assets	236	50
Net assets, beginning of year	3,307	3,257
Net assets, end of year	\$ 3,543	\$ 3,307

The University's Net Assets increased by \$236 million in fiscal year 2003. Operating revenues increased 14%, while the growth in operating expenses was held down to 8% as a result of prudent budgeting and conservative spending. This compares to an operating revenue increase of \$130 million, or 8% in the prior year and increases in operating expenses in 2002 of \$124 million, or 6%. Nonoperating revenues and other revenues also grew by \$106 million in 2003 from the previous year, compared to a decrease of \$9 million in the prior year.

The University has a diversified revenue base. No single source generated more than 32% of the total fiscal 2003 revenues of \$2.7 billion. The following table summarizes revenues from all sources:

	2003	2002
	(in millions)	
Tuition	\$ 282	\$ 250
Patient Services	636	562
Grants and Contracts	843	722
Sales and Services of Educational Departments	116	98
Auxiliary	114	110
State Funding for Operations	333	344
Gifts	170	116
Investment income	88	38
State Funding for Capital Projects	61	42
Other	60	63
Total revenue – all sources	\$ 2,703	\$ 2,345

Grant Revenue

The largest component of revenues is grants and contracts. This revenue has increased 17% in the current year, compared to an 12% increase in the prior year. The University receives more dollar awards of federal grants and contracts than any other public institution in the country. This revenue is recorded only when direct expenditures (such as researchers' compensation or purchases of goods and services) are made; therefore, there is little effect to the University's operating margin as a result of this direct expense reimbursement process.

Facility and administrative expenses necessary to support grants and contracts are reimbursed by an indirect cost recovery. The current federal indirect cost recovery is approximately 28 cents on every direct expenditure dollar on these grants and contracts.

Primary Non-Grant Funding Sources

The University relies primarily on student tuition and fees and state appropriations as revenue sources to fund its non-grant funded core operating expenses. Tuition revenue has continued to grow, increasing from \$250 million in fiscal year 2002 to \$282 million in the 2003 fiscal year, an increase of 13%. The increase in the current year was due primarily to overall increases in tuition rates. The University has flexibility in its ability to set non-undergraduate resident tuition rates in order to compensate for any shortfall in state funding.

State appropriations are considered nonoperating revenue under GASB 35 standards and reflected in the nonoperating section of the income statement; however, they are used solely for operating purposes. State appropriations for operating purposes have decreased approximately \$11 million, or 3% from fiscal year 2002, compared to an increase of \$11 million in the prior year.

Patient Services

Revenues from patient services increased \$74 million, or 13%, from \$562 million in 2002 to \$636 million in 2003. In 2002, patient revenues increased 5% over the previous year. Revenues increased due to patient volume and price increases during both years. Volume increases were primarily in transplant, oncology and other tertiary care service areas.

Other Sources of Revenue

Revenues from Auxiliary, or self-supporting operations such as the sports programs, parking services, and housing and food services, have remained fairly constant during the last two fiscal years.

Despite a difficult market, the University's gift income (which includes operating and capital gifts and gifts to permanent endowments) reached \$170 million, or about 6% of total revenues, compared to \$116 million in 2002. The gift revenue in fiscal 2003 represents an increase of 47% from the previous year. The increase was driven primarily by a single gift of \$70 million. Gifts in 2002 increased by \$4 million over the previous year—a 4% growth. Gifts are used to support a variety of purposes including capital improvements, scholarships, instruction and endowments for various academic and research chairs.

Expenses

A comparative summary of the University's expenses by functional classification for the years ended June 30, 2003 and 2002 is as follows:

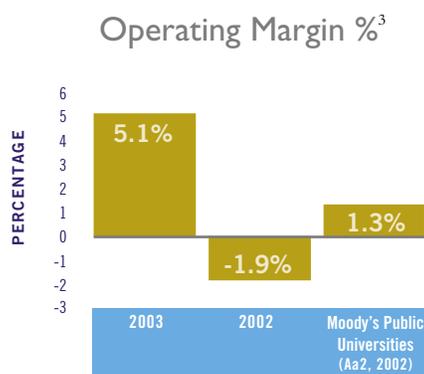
	2003	2002
	(in millions)	
Operating expenses:		
Instruction	\$ 598	\$ 558
Research	505	420
Public Service	21	20
Academic support	167	189
Student services	25	24
Institutional support	99	90
Operations and maintenance of plant	156	141
Scholarships and fellowships	39	45
Auxiliary enterprises	140	133
Medical related	547	497
Depreciation	150	155
Total operating expense	2,447	2,272
Interest expense	20	22
Total expenses	\$ 2,467	\$ 2,294

The University's operating expenses continue to increase. However, as a result of prudent management and conservative spending, the increase in operating expenses was held down to 8% in 2003, compared to a 14% increase in operating revenues. Consistent with the overall growth in operations on the revenue side, the greatest increase in expenses was

\$85 million, or 20%, for research expenses, followed by a \$50 million, or 10% increase in medical-related expenses.

Salaries and benefits increased approximately 7% each year over the last two years. Supplies, materials, and services increased a total of \$85 million, or 17% in 2003, as opposed to minimal changes in the prior year.

The net result of revenues and expense activity is measured by the operating margin (as defined by Moody's). The current year margin is a positive 5.1%, an improvement over the prior year's margin of -1.9%.



Economic Factors That Will Affect the Future

The University's funding comes primarily from four general sources: research grants and contracts (mainly from auxiliary enterprises (including patient services), state appropriations, and tuition and fees.

The ability to fund the instructional function of the University continues to be under pressure because of decreasing state funding. However, the ability to increase some tuition rates, along with continued strong demand for instruction, offsets much of that pressure.

The University's research awards have increased approximately 10% each year over the past three years. Based upon the various research awards currently in the pipeline, research revenue should continue to increase over the next year, although not as significantly as in prior years. Also, revenue from auxiliary activities currently remains strong.

³ Operating loss, (including interest expense, operating appropriations, investment income and non-permanent endowment gifts), divided by operating revenue (less scholarship expenses and including operating appropriations, investment income and non-permanent endowment gifts).





INDEPENDENT AUDITORS' REPORT

The Board of Regents
University of Washington:

We have audited the accompanying financial statements of the University of Washington, an agency of the State of Washington, as of and for the years ended June 30, 2003 and 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 audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Washington 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.

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 7, 2003

UNIVERSITY OF WASHINGTON

Balance Sheets

	<i>June 30,</i>	
ASSETS	2003	2002
CURRENT ASSETS:		
CASH AND CASH EQUIVALENTS (NOTE 2)	\$ 22,073	\$ 25,038
COLLATERAL FROM SECURITIES LENDING (NOTE 6)	357,087	251,272
SHORT-TERM INVESTMENTS (NOTE 6)	239,208	168,966
ACCOUNTS RECEIVABLE (NET OF \$59,996 AND \$69,801 ALLOWANCE) (NOTE 5)	389,078	339,939
INVENTORIES	21,282	21,412
OTHER ASSETS	32,857	31,873
TOTAL CURRENT ASSETS	1,061,585	838,500
NONCURRENT ASSETS:		
DEPOSIT WITH STATE OF WASHINGTON (NOTE 3)	44,741	69,355
LONG-TERM INVESTMENTS (NOTE 6)	1,742,095	1,727,035
METROPOLITAN TRACT (NOTE 7)	115,435	109,911
STUDENT LOANS RECEIVABLE (NET OF \$7,988 AND \$6,083 ALLOWANCE) (NOTE 4)	59,886	58,893
CAPITAL ASSETS (NET OF \$1,487,492 AND \$1,401,641 ACCUMULATED DEPRECIATION) (NOTE 8)	2,024,137	1,842,174
TOTAL NONCURRENT ASSETS	3,986,294	3,807,368
TOTAL ASSETS	\$ 5,047,879	\$ 4,645,868
LIABILITIES		
CURRENT LIABILITIES:		
ACCOUNTS PAYABLE	\$ 86,752	\$ 68,582
ACCRUED LIABILITIES	284,689	255,805
PAYABLES: SECURITIES LENDING TRANSACTIONS (NOTE 6)	357,087	251,272
DEFERRED REVENUE	114,847	105,835
FUNDS HELD FOR OTHERS	9,426	4,960
LONG-TERM LIABILITIES-CURRENT PORTION (NOTES 9, 10, AND 11)	33,249	33,859
TOTAL CURRENT LIABILITIES	886,050	720,313
NONCURRENT LIABILITIES:		
DEFERRED REVENUE	5,005	5,660
U.S. GOVERNMENT GRANTS REFUNDABLE (NOTE 4)	48,759	46,456
LONG-TERM LIABILITIES, NET OF CURRENT PORTION (NOTES 9, 10, AND 11)	564,965	566,076
TOTAL NONCURRENT LIABILITIES	618,729	618,192
TOTAL LIABILITIES	1,504,779	1,338,505
NET ASSETS		
INVESTED IN CAPITAL ASSETS, NET OF RELATED DEBT	1,533,750	1,406,152
RESTRICTED FOR:		
NONEXPENDABLE – SCHOLARSHIPS, RESEARCH AND DEPARTMENT USES	497,964	476,897
EXPENDABLE-SCHOLARSHIPS, RESEARCH AND DEPARTMENT USES	909,806	874,406
UNRESTRICTED	601,580	549,908
TOTAL NET ASSETS	3,543,100	3,307,363
TOTAL LIABILITIES AND NET ASSETS	\$ 5,047,879	\$ 4,645,868

See accompanying Notes to the Financial Statements

Dollars in thousands

UNIVERSITY OF WASHINGTON

Statements of Revenues, Expenses, and Changes in Net Assets

	<i>For the Year Ended June 30,</i>	
	2003	2002
REVENUES		
OPERATING REVENUES:		
STUDENT TUITION AND FEES (NET OF SCHOLARSHIP ALLOWANCES OF \$38,848 AND \$34,220)	\$ 282,132	\$ 249,861
PATIENT SERVICES (NET OF CHARITY CARE AND UNCOLLECTIBLE ACCOUNTS OF \$20,940 AND \$18,432)	636,290	561,557
FEDERAL GRANTS AND CONTRACTS	702,226	596,593
STATE AND LOCAL GRANTS AND CONTRACTS	46,089	42,166
NONGOVERNMENTAL GRANTS AND CONTRACTS	94,580	82,970
SALES AND SERVICES OF EDUCATIONAL DEPARTMENTS	115,559	98,117
AUXILIARY ENTERPRISES:		
HOUSING AND FOOD SERVICES	42,338	43,237
PARKING SERVICES	7,282	6,856
SPORTS PROGRAMS (NET OF SCHOLARSHIP ALLOWANCES OF \$1,633 AND \$1,468)	37,126	30,208
OTHER AUXILIARY ENTERPRISES	27,340	29,459
OTHER MEDICAL CENTER REVENUES	31,568	28,242
OTHER OPERATING REVENUES	27,793	26,117
TOTAL OPERATING REVENUES	2,050,323	1,795,383
EXPENSES		
OPERATING EXPENSES:		
SALARIES	1,241,101	1,184,223
BENEFITS	311,250	270,912
SCHOLARSHIPS AND FELLOWSHIPS	38,632	44,335
UTILITIES	39,756	39,249
SUPPLIES AND MATERIALS	272,042	240,852
PURCHASED SERVICES	310,890	257,366
DEPRECIATION	150,377	154,616
OTHER	82,911	80,567
TOTAL OPERATING EXPENSES	2,446,959	2,272,120
OPERATING LOSS	(396,636)	(476,737)
NONOPERATING REVENUES (EXPENSES)		
STATE APPROPRIATIONS	332,518	343,656
GIFTS	125,401	76,135
INVESTMENT INCOME (NET OF INVESTMENT EXPENSE OF \$6,937 AND \$8,505)	87,957	37,770
INTEREST ON CAPITAL ASSET-RELATED DEBT	(20,067)	(22,240)
OTHER NONOPERATING REVENUES, NET	574	8,555
NET NONOPERATING REVENUES	526,383	443,876
GAIN (LOSS) BEFORE OTHER REVENUES, EXPENSES, GAINS, OR LOSSES	129,747	(32,861)
CAPITAL APPROPRIATIONS	61,389	42,254
CAPITAL GRANTS AND GIFTS	12,418	8,156
GIFTS TO PERMANENT ENDOWMENTS	32,183	32,142
TOTAL OTHER REVENUE	105,990	82,552
INCREASE IN NET ASSETS	235,737	49,691
NET ASSETS		
NET ASSETS-BEGINNING OF YEAR	3,307,363	3,257,672
NET ASSETS-END OF YEAR	\$ 3,543,100	\$ 3,307,363

See accompanying Notes to the Financial Statements

Dollars in thousands

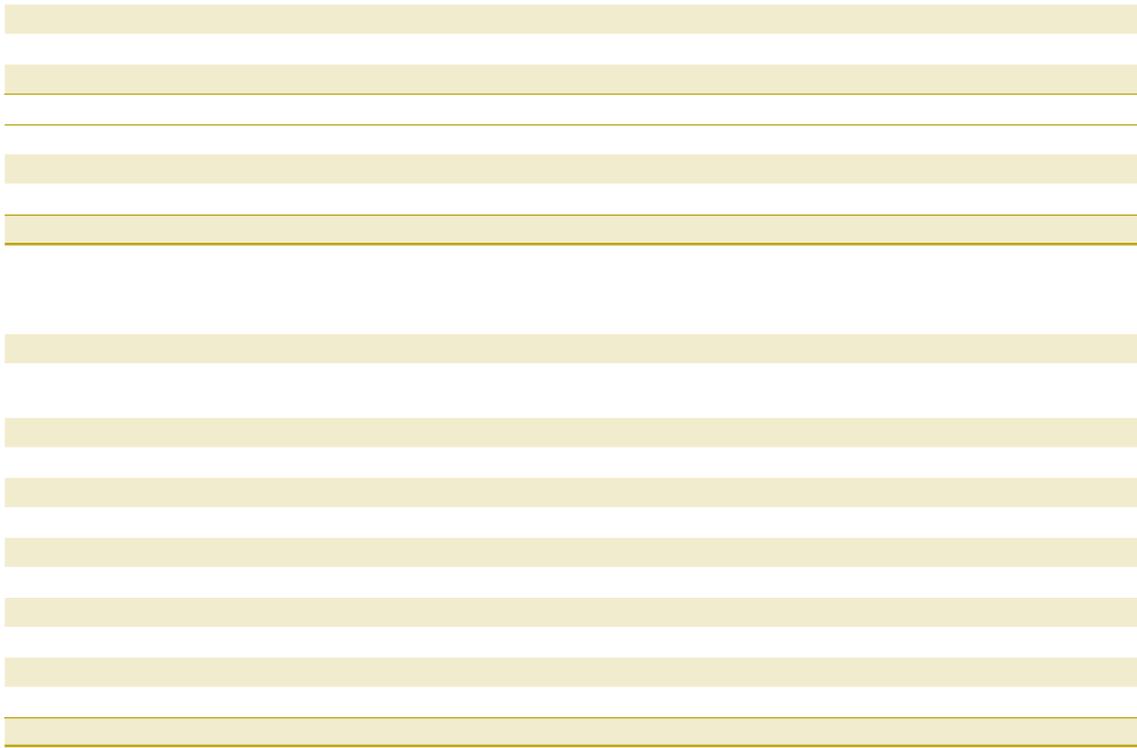
UNIVERSITY OF WASHINGTON

Statements of Cash Flows

	<i>For the Year Ended June 30,</i>	
	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
STUDENT TUITION AND FEES	\$ 282,224	\$ 217,999
PATIENT SERVICES	638,031	566,085
GRANTS AND CONTRACTS	825,347	725,640
PAYMENTS TO SUPPLIERS	(257,193)	(257,198)
PAYMENTS FOR UTILITIES	(39,490)	(40,406)
PURCHASED SERVICES	(310,890)	(257,366)
OTHER OPERATING DISBURSEMENTS	(82,912)	(87,954)
PAYMENTS TO EMPLOYEES	(1,236,621)	(1,185,340)
PAYMENTS FOR BENEFITS	(310,673)	(237,769)
PAYMENTS FOR SCHOLARSHIPS AND FELLOWSHIPS	(38,632)	(44,335)
LOANS ISSUED TO STUDENTS	(29,278)	(21,472)
COLLECTION OF LOANS TO STUDENTS	25,980	20,859
SALES AND SERVICES OF THE MEDICAL CENTER	31,569	28,588
AUXILIARY ENTERPRISE RECEIPTS	115,298	111,598
SALES AND SERVICES OF EDUCATIONAL DEPARTMENTS	121,763	93,362
OTHER RECEIPTS	16,525	37,353
NET CASH USED BY OPERATING ACTIVITIES	(248,952)	(330,356)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
STATE APPROPRIATIONS	337,231	350,600
GIFTS, EXCLUDING PERMANENT ENDOWMENT AND CAPITAL	125,401	76,134
ADDITIONS TO PERMANENT ENDOWMENTS	32,183	32,142
DIRECT LENDING RECEIPTS	121,645	111,882
DIRECT LENDING DISBURSEMENTS	(121,202)	(109,467)
RECEIPTS FROM OUTSIDE AFFILIATED AGENCIES	347,623	295,939
DISBURSEMENTS TO OUTSIDE AFFILIATED AGENCIES	(342,050)	(303,377)
OTHER	572	8,874
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	501,403	462,727
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
PROCEEDS FROM CAPITAL DEBT	65,005	128,818
CAPITAL APPROPRIATIONS	62,759	37,287
CAPITAL GRANTS AND GIFTS RECEIVED	12,418	8,156
PURCHASES OF CAPITAL ASSETS	(316,859)	(253,201)
PRINCIPAL PAID ON CAPITAL DEBT AND LEASES	(42,152)	(48,030)
INTEREST PAID ON CAPITAL DEBT AND LEASES	(27,567)	(25,295)
OTHER	4,377	(7,675)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(242,019)	(159,940)

See accompanying Notes to the Financial Statements

Dollars in thousands



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, Portage Bay Insurance (a wholly owned subsidiary of the University) 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 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, balance sheets, statements of revenues, expenses, and changes in net assets, statements 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.

Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All intra-agency transactions have been eliminated. The University has elected not to apply any FASB pronouncements after November 30, 1989. The University reports capital assets net of accumulated depreciation, and reports depreciation expense in the Statement of Revenues, Expenses, and Changes in Net Assets.

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.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 50 years for build-

ing components, 20 to 50 years for infrastructure and land improvements, 15 years for library books, and 5 to 7 years for equipment.

Capitalized construction-related interest was \$7,354,000 and \$4,147,000 during 2003 and 2002, respectively.

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 6.3% to 8.0%.

Compensated Absences. University employees accrue annual leave at rates based on length of service, and for sick leave at the rate of one day per month. Annual leave accrued as of June 30, 2003 and 2002, was \$40,675,000 and \$38,984,000, respectively, included in accrued liabilities. Sick leave accrued as of June 30, 2003 and 2002, was \$14,324,000 and \$13,636,000, respectively, 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 annual and biennial bases. These revenues are reported as nonoperating revenues in the Statements of Revenues, Expenses, and Changes in Net Assets. The University of Washington Medical Center received \$8,308,000 and \$8,480,000 in operating state appropriations in 2003 and 2002, respectively. These amounts are included in other medical center revenue in the Statements of Revenues, Expenses, and Changes in Net Assets.

Operating Activities. The University's policy for reporting operating activities in the Statements of Revenues, Expenses, and Changes in Net Assets is to include activities

that generally result from exchange transactions. Examples of exchange transactions are payments received or made for an exchange of goods or services. Certain other significant revenue streams used for operations, such as state appropriations, gifts and investment income are recorded as nonoperating revenues, as prescribed by GASB 35.

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 income related to the University's mission.

Related Party. During the year ended June 30, 2003, the University received \$70,000,000 as a gift from a foundation related to a member of the Board of Regents.

Reclassifications. Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements.

NOTE 2:

Cash and Cash Equivalents

Cash includes bank demand deposits, cash held by fiscal agents, \$11,292,000 and \$6,855,000 of cash held with escrow agents in 2003 and 2002, respectively, 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, 2003 and 2002, bank balances of \$1,040,000 and \$1,435,000, respectively, were insured by the FDIC and balances of \$20,255,000 and \$16,808,000, respectively, 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 Receivable

Net student loans of \$59,886,000 and \$58,893,000 at June 30, 2003 and 2002, respectively, consist of \$48,759,000 and \$49,697,000 from federal programs and \$11,127,000 and \$9,196,000 from University programs. Interest income from student loans for the years ended June 30, 2003 and 2002, was \$1,302,000 and \$1,466,000, respectively. Loans are made primarily to students who reside in the state of Washington. The loans are unsecured and are expected to be repaid from earnings of the borrowers.

NOTE 5:

Accounts Receivable

The major components of accounts receivable were:

	<i>(Dollars in thousands)</i>	
	2003	2002
PATIENT SERVICES	\$ 181,996	\$ 192,737
GRANTS AND CONTRACTS	124,721	101,368
PENDING INVESTMENT SALES	68,381	45,463
SALES AND SERVICES	7,772	13,964
TUITION	18,677	17,546
STATE APPROPRIATIONS – CAPITAL AND NONCAPITAL	1,288	7,371
OTHER	46,239	31,291
TOTAL	449,074	409,740
LESS ALLOWANCE FOR DOUBTFUL ACCOUNTS	(59,996)	(69,801)
ACCOUNTS RECEIVABLE, NET	\$ 389,078	\$ 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 of the Board of Regents and UWINCO.

The majority of the University's investments are insured, registered, and held by the University's custodial bank as an agent for the University. Investments not held by the custodian include lent securities, mutual funds, venture capital, private equity, opportunistic, marketable alternatives, 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

NOTES TO FINANCIAL STATEMENTS

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, 2003 and 2002, the University had net outstanding forward commitments to sell foreign currency with a total fair value of \$28,249,000 and \$45,891,000, respectively, which equals 1.4% and 2.4% of the total portfolio. Unrealized and realized gains and losses are reported in the Statements of Revenues, Expenses, and Changes in Net Assets and are netted with the hedged securities in the table.

Investment Pools

The University combines most short-term cash balances into the Invested Funds Pool. At June 30, 2003, the Invested Funds Pool totaled \$762,391,000, compared to \$638,373,000 at June 30, 2002. By University policy, departments with qualifying funds 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 years 2003 and 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 calculated distributions is used to support activities benefiting all University departments.

The composition of the carrying amounts of investments by type at June 30, 2003 and 2002, are listed in the table.

Net appreciation (depreciation) in the fair value of investments includes both realized and unrealized gains and losses on investments. During the years ended June 30, 2003 and 2002, the University realized net losses of \$20,055,000 and \$15,904,000, respectively, 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 appreciation (depreciation) in the fair value of investments during the years ended June 30, 2003 and 2002, was \$17,572,000 and (\$69,065,000), respectively.

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.

The University records its permanent endowments at the lower of original value or current market value in the Restricted Nonexpendable Net Assets category. Of the total \$603,000,000 and \$592,000,000 permanent endowment funds (at market value) as of June 30, 2003 and 2002, the aggregate amount of the deficiencies for all funds for which the fair value of the assets

is less than the original gifts is \$14,993,000 and \$9,871,000 at June 30, 2003 and 2002, respectively.

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 \$48,000,000 at June 30, 2003 compared to \$49,000,000 at June 30, 2002. Income received from these trusts was \$2,194,000 for the year ended June 30, 2003 and \$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. The University's custodian lends securities for collateral in the form of cash or other securities, with the simultaneous agreement to return the collateral for the same securities in the future. 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 had no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University.

UNIVERSITY INVESTMENTS AND COLLATERAL FROM SECURITIES LENDING

Investment Type	<i>(Dollars in thousands)</i> Carrying Value	
	2003	2002
CASH EQUIVALENTS	\$ 93,065	\$ 99,051
DOMESTIC FIXED INCOME	465,162	503,700
DOMESTIC FIXED INCOME – LOANED	431,398	287,213
FOREIGN FIXED INCOME	35,349	57,361
FOREIGN FIXED INCOME – LOANED	2,742	8,291
DOMESTIC EQUITY	382,306	477,012
DOMESTIC EQUITY – LOANED	40,322	35,972
FOREIGN EQUITY	186,628	95,286
FOREIGN EQUITY – LOANED	18,216	12,129
VENTURE CAPITAL	55,077	70,119
BUYOUT	47,133	34,052
OPPORTUNISTIC	46,033	37,580
MARKETABLE ALTERNATIVES	170,520	171,983
REAL ESTATE	3,024	4,926
MISCELLANEOUS	4,328	1,326
TOTAL INVESTMENTS	1,981,303	1,896,001
SHORT-TERM COLLATERAL FROM SECURITIES LENDING	357,087	251,272
TOTAL INVESTMENTS AND COLLATERAL	\$ 2,338,390	\$ 2,147,273

NOTES TO FINANCIAL STATEMENTS

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 74 days. Cash collateral is invested in a short-term investment pool which had an average weighted maturity of 38 days as of June 30, 2003. 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 these loaned securities. The University cannot sell

or pledge non-cash collateral unless the borrower defaults.

Securities on loan at June 30, 2003 and 2002, totaled \$492,678,000 and \$343,605,000, respectively, and are listed by investment type in the table. The securities lending program resulted in net revenues of \$676,000 for the year ended June 30, 2003 and \$801,000 for the year ended June 30, 2002.

NOTE 7

Metropolitan Tract

The Metropolitan Tract, located in downtown Seattle, is comprised of approximately 11 acres of developed property, including office space, retail space, parking, and a luxury hotel. This land was the original site of the University from 1861 until 1895 when the University moved to its present location. Since the early 1900s, the Metropolitan Tract has been leased by the University to entities responsible for developing and operating

the property. On July 18, 1953, the Board of Regents of the University and the entity now known as Unico Properties, Inc. entered into a lease agreement for office, retail, and parking facilities, which will expire in 2014. On January 19, 1980, the Board of Regents of the University entered into a lease with the Urban/Four Seasons Hotel Venture for the Olympic Hotel property, which will expire in 2040. The hotel was operated as the Four Seasons Olympic Hotel until July 31, 2003. On August 1, 2003, the remaining lease

term was assigned to LHCS Hotel Holding (2002) LLC. The hotel was renamed the Fairmont Olympic Hotel and is now managed by Fairmont Hotels & Resorts.

The balances as of June 30, 2003 and 2002, represent 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 \$77,129,000 and \$72,840,000, respectively.

NOTE 8:

Capital Assets

Capital asset activity for the two year period ended June 30, 2003 is summarized as follows:

CAPITAL ASSETS (Dollars in thousands)							
	Balance at June 30, 2001	Additions/ Transfers	Retirements	Balance at June 30, 2002	Additions/ Transfers	Retirements	Balance at June 30, 2003
LAND	\$ 55,091	\$ 1,535	\$ -	\$ 56,626	\$ -	\$ -	\$ 56,626
INFRASTRUCTURE	158,918	-	-	158,918	1,066	-	159,984
INFRASTRUCTURE – CONSTRUCTION IN PROGRESS	959	3,033	-	3,992	6,408	-	10,400
BUILDINGS	1,757,381	43,274	-	1,800,655	150,883	5,566	1,945,972
BUILDINGS – CONSTRUCTION IN PROGRESS	178,140	122,530	-	300,670	80,698	-	381,368
FURNITURE, FIXTURES, AND EQUIPMENT	685,684	84,396	35,240	734,840	86,806	63,036	758,610
LIBRARY MATERIALS	172,115	12,503	913	183,705	11,531	976	194,260
CAPITALIZED COLLECTIONS	4,409	-	-	4,409	-	-	4,409
TOTAL	3,012,697	267,271	36,153	3,243,815	337,392	69,578	3,511,629
LESS ACCUMULATED DEPRECIATION:							
INFRASTRUCTURE	41,766	4,906	-	46,672	3,732	-	50,404
BUILDINGS	650,023	54,791	-	704,814	55,152	4,315	755,651
FURNITURE, FIXTURES, AND EQUIPMENT	485,003	85,996	32,088	538,911	82,182	59,605	561,488
LIBRARY MATERIALS	102,881	8,923	560	111,244	9,311	606	119,949
TOTAL ACCUMULATED DEPRECIATION	1,279,673	154,616	32,648	1,401,641	150,377	64,526	1,487,492
CAPITAL ASSETS, NET	\$ 1,733,024	\$ 112,655	\$ 3,505	\$ 1,842,174	\$ 187,015	\$ 5,052	\$ 2,024,137

NOTES TO FINANCIAL STATEMENTS

NOTE 9:

Long-Term Liabilities:

Long-term liability activity for the two year period ending June 30, 2003 is summarized as follows:

LONG-TERM LIABILITIES (Dollars in thousands)									
	Balance at June 30, 2001	Additions	Reductions	Balance at June 30, 2002	Additions	Reductions	Balance at June 30, 2003	Current Portion 2002	Current Portion 2003
LEASES AND BONDS PAYABLE:									
CAPITAL LEASE OBLIGATIONS	\$ 55,926	\$ 19,392	\$ 7,080	\$ 68,238	\$ 10,312	\$ 8,796	\$ 69,754	\$ 6,203	\$ 7,222
GENERAL OBLIGATION BONDS	249,140	57,765	12,736	294,169	27,805	27,933	294,041	10,948	11,466
REVENUE BONDS PAYABLE	134,335	38,775	27,875	145,235	-	5,020	140,215	5,020	5,050
TOTAL LEASES AND BONDS	439,401	115,932	47,691	507,642	38,117	41,749	504,010	22,171	23,738
OTHER LIABILITIES:									
NOTES PAYABLE – CAPITAL ASSET	3,360	-	339	3,021	-	403	2,618	403	424
NOTES PAYABLE – OTHER	2,775	10,000	-	12,775	-	-	12,775	-	-
ANNUITY AND LIFE INCOME	158	-	3	155	-	2	153	-	-
CHARITABLE AND DEFERRED GIFT ANNUITIES	32,163	-	1,897	30,266	-	1,004	29,262	-	-
SICK LEAVE	12,498	3,687	2,549	13,636	1,445	757	14,324	2,439	787
SELF-INSURANCE	36,653	8,806	13,019	32,440	7,080	4,448	35,072	8,846	8,300
TOTAL OTHER LIABILITIES	87,607	22,493	17,807	92,293	8,525	6,614	94,204	11,688	9,511
TOTAL LONG-TERM LIABILITIES	\$ 527,008	\$ 138,425	\$ 65,498	\$ 599,935	\$ 46,642	\$ 48,363	\$ 598,214	\$ 33,859	\$ 33,249

NOTE 10:

Leases

Capital Leases

The University has certain lease agreements in effect that are considered capital leases. As of June 30, 2003 and 2002, the University had recorded buildings in the amount of \$55,777,000 and \$48,737,000, and equipment in the amount of \$23,033,000 and \$22,361,000, respectively, 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, 2003, are as follows:

Year	(Dollars in thousands)
2004	\$ 10,605
2005	10,616
2006	10,320
2007	9,015
2008	7,788
2009-2013	24,554
2014-2018	11,100
2019-2023	8,893
2024-2028	261
TOTAL MINIMUM LEASE PAYMENTS	93,152
LESS: AMOUNTS REPRESENTING INTEREST	(23,398)
OBLIGATIONS UNDER CAPITAL LEASES	\$ 69,754

Operating Leases

The University has certain lease agreements in effect that are considered operating leases, primarily for leased building space. During the years ended June 30, 2003 and 2002, the University recorded expenses of \$29,066,000 and \$27,285,000, respectively, for these leases.

Future payments under these leases as of June 30, 2003, are as follows:

Year	(Dollars in thousands)
2004	\$ 25,128
2005	23,375
2006	20,071
2007	13,191
2008	10,635
2009-2013	46,813
2014-2018	12,115
2019-2023	2,214
2024-2028	2,236
TOTAL MINIMUM LEASE PAYMENTS	\$ 155,778

NOTE 11:

Bonds and Notes Payable

The bonds and notes payable at June 30, 2003, 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 2.00% to 9.00%, except for debt totaling \$2,775,000, which has variable rates.

Debt service requirements at June 30, 2003 were as follows:

BONDS AND NOTES PAYABLE (Dollars in thousands)						
Year	STATE OF WASHINGTON GENERAL OBLIGATION		REVENUE BONDS		NOTES PAYABLE	
	Principal	Interest	Principal	Interest	Principal	Interest
2004	\$ 11,466	\$ 14,954	\$ 5,050	\$ 7,329	\$ 424	\$ 125
2005	11,763	14,396	5,320	7,102	445	103
2006	11,933	13,855	5,000	6,859	10,469	80
2007	12,239	13,301	5,285	6,614	1,868	56
2008	13,010	12,677	5,600	6,348	1,918	30
2009–2013	63,260	53,552	33,705	26,993	269	5
2014–2018	80,155	34,807	29,935	17,589	-	-
2019–2023	58,470	16,126	23,795	10,856	-	-
2024–2028	31,745	2,787	16,715	5,658	-	-
2029–2032	-	-	9,810	937	-	-
TOTAL	\$ 294,041	\$ 176,455	\$ 140,215	\$ 96,285	\$ 15,393	\$ 399

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.

Refunding Activity

On May 27, 2003, \$8,990,000 of Education Bonds, Series R95A (1994-A-UW) with an average interest rate of 5.696% were partially refunded. The refunding bonds have a maturity of \$9,170,000, Series R2003C (R95A (1994-A-UW)) with an average interest rate of 3.684%. The refunding of the bonds decreased the University’s total debt service payments to be made over the next 9 years by \$809,000. The refunding resulted in an economic gain (difference between the present values of debt service payments on the old and new debt) of \$758,000.

On May 7, 2003, \$7,995,000 of Education Bonds, Series R95A (1994-HE-UW) with an average interest rate of 5.065% were partially refunded. The refunding bonds have a maturity of \$8,155,000, Series R2003C (R95A

(1994-HE-UW)) with an average interest rate of 3.276%. The refunding of the bonds decreased the University’s total debt service payments to be made over the next 9 years by \$719,000. The refunding resulted in an economic gain of \$674,000.

On April 1, 2002, \$4,940,000 of Housing and Dining System Revenue Bonds with an average interest rate of 6.99% were refunded through the issuance of a \$5,130,000 portion of \$18,920,000 Housing and Dining System Revenue and Refunding Bonds, series 2002 with an average interest rate of 5.017% 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. The refunding resulted in an economic gain 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 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 of \$890,000.

NOTE 12:

Operating Expenses by Function

Operating expenses by functional classification for the year ended June 30, 2003 and 2002 are summarized as follows:

Operating Expenses:	(Dollars in thousands)	
	2003	2002
INSTRUCTION	\$ 598,038	\$ 558,091
RESEARCH	504,883	419,941
PUBLIC SERVICE	21,310	20,362
ACADEMIC SUPPORT	167,371	189,064
STUDENT SERVICES	24,678	23,842
INSTITUTIONAL SUPPORT	98,802	90,087
OPERATION AND MAINTENANCE OF PLANT	156,088	140,629
SCHOLARSHIPS AND FELLOWSHIPS	38,632	44,771
AUXILIARY ENTERPRISES	140,158	133,132
MEDICAL RELATED	546,622	497,585
DEPRECIATION	150,377	154,616
TOTAL OPERATING EXPENSES	\$ 2,446,959	\$ 2,272,120

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 48380, Olympia, Washington 98504-8380, or visiting <http://www.drs.wa.gov/agency/annualreport/index.htm>

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 was 0.65% at both June 30, 2003 and 2002. PERS 3 members can choose contributions ranging from 5% to 15% of salary, based on the age of the member. The defined contribution benefit for PERS 3 will depend on the member's contributions, the investment earnings on those contributions,

and if an annuity is taken, the age at which the member receives payment. The contribution rate for the University at June 30, 2003 and 2002, for each of PERS Plans 1, 2, and 3 was 1.32% and 1.33%, respectively.

The University's contributions to PERS for the years ended June 30, 2003, 2002, and 2001 were \$7,969,000, \$11,441,000, and \$23,799,000, respectively, which were equal to the required contributions for each year.

University of Washington Retirement 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 the University of

Washington Board of Regents to establish and amend benefit provisions.

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, 2003 were each \$48,640,000 compared to \$43,302,000 for the year ended June 30, 2002.

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, 2003 and 2002, were \$297,674,000 and \$354,840,000, respectively. 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 is used for 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 continuing its federal civil investigation of 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 at 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 resulting from 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, 2003, 2002, and 2001 are noted below.

	(Dollars in thousands)	2003	2002	2001
RESERVE AT BEGINNING OF FISCAL YEAR	\$	32,440	\$ 36,653	\$ 31,704
INCURRED CLAIMS AND CHANGES IN ESTIMATES		7,080	8,806	10,852
CLAIM PAYMENTS		(4,448)	(13,019)	(5,903)
RESERVE AT END OF FISCAL YEAR	\$	35,072	\$ 32,440	\$ 36,653

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