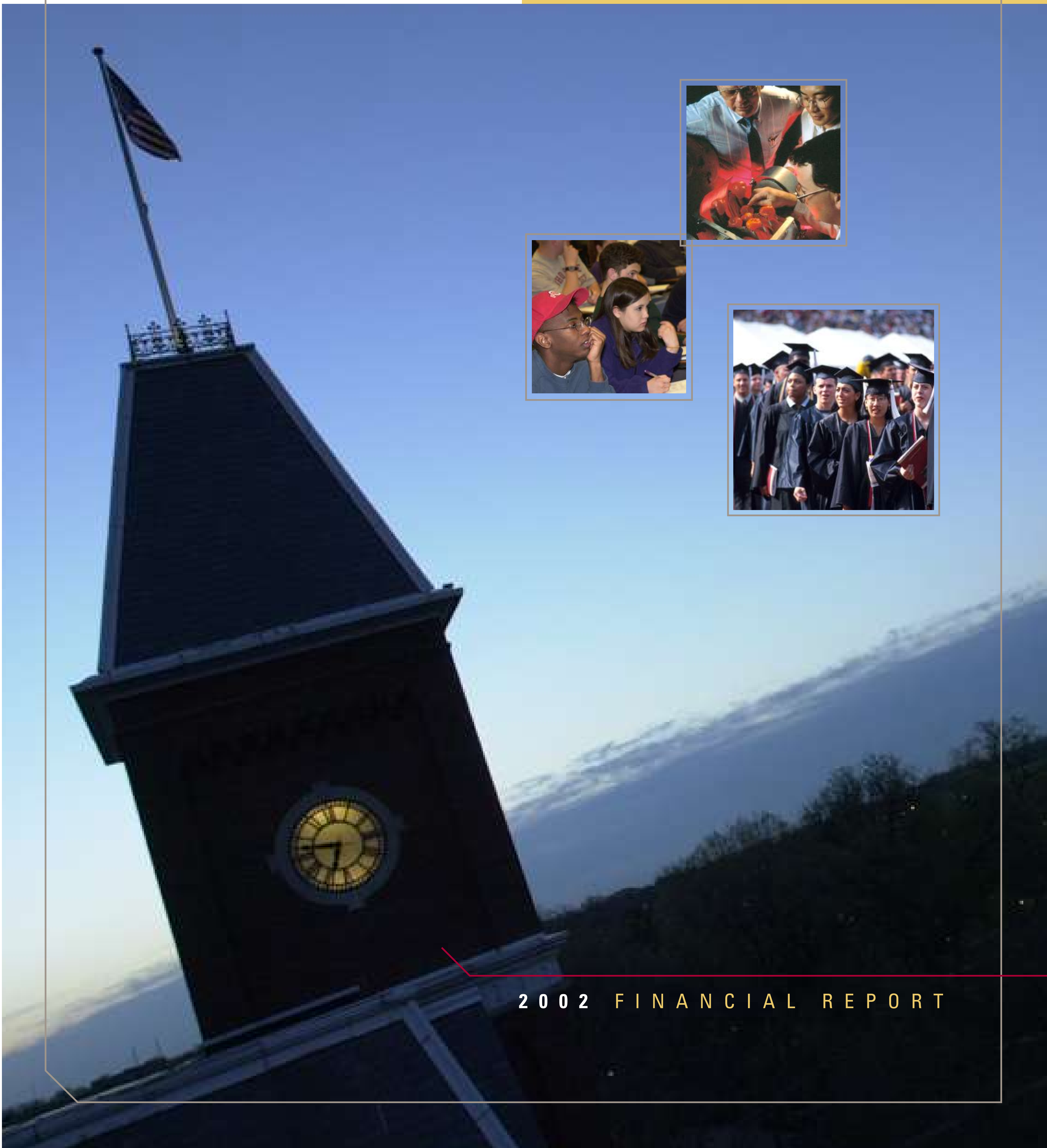
THE OHIO STATE UNIVERSITY



2002 FINANCIAL REPORT

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Letter

We are pleased to present the consolidated financial report for The Ohio State University for the years ended June 30, 2002 and 2001.

Fiscal year 2002 marks the beginning of a new era for financial reporting at Ohio State. In coordination with the State of Ohio, the university has implemented a new financial reporting model, which replaces multi-column fund accounting statements provided in prior years with a single-column "business type activity" format. A new Management's Discussion and Analysis (MD&A) section, which precedes the financial statements, provides additional details on the various accounting changes in 2002, along with an objective, easily readable analysis of the university's financial activities. Although institutions were required to present only a single year of financial results in the year of implementation, Ohio State chose to restate its fiscal year 2001 results to facilitate comparisons between fiscal years. We hope this additional information and the new format help you to better understand the university's finances.

The accompanying financial reports indicate that The Ohio State University's financial health remains sound, despite flat or declining levels of state support and recent investment losses related to declines in the equity markets. Total expendable net assets (equity) increased $129 million, to $875 million at June 30, 2002. Total plant debt—in the form of commercial paper, bonds, notes, and capital lease obligations—increased $168 million, to $581 million at June 30, 2002. In addition, we are seeing positive trends in university enrollments and in freshman retention rates. Overall, the university is becoming less dependent on state support, is fostering a more entrepreneurial culture, and is redirecting resources to areas of greatest student demand and academic promise through a restructured budgeting process.

Fiscal year 2002 also saw a change in the university's leadership. On June 30, President William E. Kirwan left Ohio State to become the chancellor of the University of Maryland System. On October 1, 2002, he was succeeded by Karen A. Holbrook, who came to Ohio State from the University of Georgia. Edward H. Jennings, Ohio State's president from 1981 to 1990, provided interim leadership to the university during this period of transition. We look forward to working with Dr. Holbrook and the rest of the university community as we continue to move Ohio State towards a top-tier ranking among the nation's public institutions.

We encourage you to read the MD&A, the new statements, and the notes, and we welcome your interest in this great university. Go Bucks!

Very truly yours,

William J. Shkurti
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Independent Auditors' Report

To the Board of Directors of
The Ohio State University
Columbus, Ohio

We have audited the accompanying consolidated statements of net assets of The Ohio State University ("The University"), a component unit of the State of Ohio, as of June 30, 2002 and 2001, and the related consolidated statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of The Ohio State University as of June 30, 2002 and 2001, and their changes in net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, the University has implemented a new financial reporting model as required by the provisions of the Governmental Accounting Standards Board ("GASB") Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities;* Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments: Omnibus;* and Statement No. 38, *Certain Financial Statement Note Disclosures* as of and for the year ended June 30, 2002.

The Management's Discussion and Analysis (MD&A) on pages 3 through 13 is not a required part of the basic financial statements, but is supplementary information required by GASB. This supplementary information is the responsibility of the University's management. 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 such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 12, 2002, on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

DELOITTE & TOUCHE LLP
November 12, 2002

Deloitte
Touche
Tohmatsu

About the New Financial Statements

Fiscal year 2002 marks the beginning of a new era for financial reporting at The Ohio State University. Along with the State of Ohio, the university has implemented a new governmental financial reporting model, which is set forth in Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. Under these new accounting standards, Ohio State is presenting its financial reports in a single-column "business type activity" format, a significant departure from the multi-column fund accounting statements provided in prior years. GASB Statement No. 35 defines business type activities as those financed in whole or in part by fees charged to external parties for goods and services. Most public colleges and universities have elected to use the business type activity format.

In addition to this MD&A section, the new financial report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Other Changes in Net Assets; a Statement of Cash Flows; and Notes to the Financial Statements.

The **Statement of Net Assets** is the university's balance sheet. It reflects the total assets, liabilities, and net assets (equity) of the university as of June 30, 2002, with comparative information as of June 30, 2001. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Investment assets are carried at market value. Capital assets, which include the university's land, buildings, improvements, and equipment, are shown net of accumulated depreciation. Net assets are grouped in the following categories:

- Invested in capital assets, net of related debt
- Restricted – Nonexpendable (endowment and annuity funds)
- Restricted – Expendable (primarily current restricted and quasi-endowment funds)
- Unrestricted

The **Statement of Revenues, Expenses, and Other Changes in Net Assets** is the university's income statement. It details how net assets have increased (or decreased) during the year ended June 30, 2002, with comparative information for fiscal year 2001. Tuition revenue is now shown net of scholarship allowances, depreciation is provided for capital assets, and there are required subtotals for net operating income (loss) and net income (loss) before capital contributions and additions to permanent endowments.

It should be noted that the required subtotal for net operating income or loss will generally reflect a "loss" for state-supported colleges and universities. This is primarily due to the way operating and non-operating items are defined under GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Govermental Entities That Use Proprietary Fund Accounting*. Operating expenses include virtually all university expenses, except for interest on long-term debt. Operating revenues, however, exclude certain significant revenue streams that Ohio State and other public institutions have traditionally relied

I. Summary Statement of Net Assets

(in thousands)

	2002	2001
Cash and current investments	$759,536	$502,800
Current receivables, inventories and prepaid expenses	342,165	350,822
Total current assets	1,101,701	853,622
Restricted cash and cash equivalents	24,343	22,867
Noncurrent notes and pledges receivable	107,069	99,367
Endowments and other long-term investments	1,011,568	1,159,097
Capital assets, net of accumulated depreciation	1,762,814	1,698,010
Total noncurrent assets	2,905,794	2,979,341
Total assets	$4,007,495	$3,832,963
Accounts payable and accrued expenses	$260,501	$207,257
Deferred revenues and deposits	135,550	115,471
Commercial paper and current portion of bonds, notes and lease obligations	285,072	262,638
Other current liabilities	13,900	13,059
Total current liabilities	695,023	598,425
Noncurrent portion of bonds, notes and lease obligations	296,034	149,999
Other noncurrent liabilities	208,659	206,741
Total noncurrent liabilities	504,693	356,740
Total liabilities	$1,199,716	$955,165
Invested in capital assets, net of related debt	$1,181,708	$1,285,373
Restricted – nonexpendable net assets	751,317	846,939
Restricted – expendable net assets	457,521	495,021
Unrestricted net assets	417,233	250,465
Total net assets	$2,807,779	$2,877,798

I University **cash and current investment balances** increased $257 million, primarily due to the issuance of $228 million in new bonds and a $122 million reduction in capital spending in 2002. The Statement of Cash Flows, which is discussed in more detail below, provides additional details on sources and uses of university cash.

The market value of the university's **endowment and other long-term investments** decreased $148 million, to $1.01 billion at June 30, 2002, due to economic and financial market conditions, primarily in the equity markets, that negatively affected the returns of the Endowment Fund. The Endowment Fund operates with a long-term investment goal of preserving the purchasing power of the principal in a diversified portfolio.

Capital assets, which include the university's land, buildings, improvements, equipment, and library books, grew $65 million, to approximately $1.76 billion at June 30, 2002. The university depreciates its capital assets on a straight-line basis, using estimated useful lives ranging from five years (for computer equipment) to 100 years (for certain building components such as foundations).

During fiscal year 2002, the university completed several significant construction projects, including:

- *Jesse Owens Memorial Stadium* – an $11 million track & field and soccer facility and new home of the Jesse Owens track, which was relocated as part of the Ohio Stadium renovation
- *Veterinary Medicine Administration Building* – a $26 million facility that replaces sections of Sisson Hall built in 1957 and 1959; the new facility houses laboratories, classrooms, and offices for the College of Veterinary Medicine
- *The Blackwell Inn at Fisher College* (**A**) (executive residence) – a first-class hotel and banquet facility, which cost approximately $25 million, serving executives attending executive education programs at the Fisher College of Business (opened June 2002)

Major projects currently underway or in advanced planning stages include:

- *Knowlton School of Architecture* – construction is underway on a new $33 million home for the university's Architecture, City and Regional Planning, and Landscape Architecture programs, to be located adjacent to Tuttle Park Place, across from the Fisher College of Business.
- *Physical Sciences Research Building* (**B**) – construction is underway on a new $53 million home for the university's Department of Physics. The building will be on the site of the old Welding Engineering building, which was demolished in fiscal year 2002.
- *Stanley J. Aronoff Laboratory (Life Sciences Research Building)* – work is underway on a $27 million project to provide approximately 123,000 square feet of new laboratory and office space for the university's Zoology, Entomology, and Plant Biology departments. The new building will be located between the Botany and Zoology Building and the 12th Avenue Parking Garage.
- *Ross Heart Hospital* (**C**) – planning is underway to construct an $82 million heart hospital on the current site of the Rhodes Hall auditorium. This facility will include inpatient services, outpatient services, clinical and administrative support staff areas, and cardiac rehabilitation services.
- *Student housing* – various projects are underway to renovate or add new student housing space, both on Ohio State's main campus and on the regional campuses. Chief among these is a $29 million Graduate and Professional Student Housing complex, which is being constructed in stages in the South Campus area on Neil Avenue.
- *New recreation center* – planning is underway to replace Larkins Hall with a new 604,800-square-foot recreation center, to be constructed in two phases. The $140 million facility will house a 50

Net Assets. **Refundable advances for Federal Perkins loans** represent the accumulated federal capital contributions to the university's Perkins loan program. These amounts—which would be refundable to the federal government if the university were to terminate its participation in the program—were formerly reported as Loan Fund equity (net assets) in the university's financial reports. Refundable advances for Federal Perkins loans totaled approximately $35 million at June 30, 2002 and 2001.

The second new liability category arises from the State of Ohio's GASB 34/35 implementation. Under the state's workers' compensation program, Public Employer State Agencies, including state universities and university hospitals, pay workers' compensation premiums into the State Insurance Fund on a pay-as-you-go basis. The Bureau of Workers' Compensation determines a rate for each governmental agency that will generate premium collections equal to the losses anticipated to be paid in the coming year. As part of the GASB 34/35 implementation, the State of Ohio has allocated the **unfunded workers' compensation liabilities** for Public Employer State Agencies to the individual agencies and instructed state-assisted colleges and universities to incorporate these allocated liabilities in their financial reports. Accordingly, the university's Statement of Net Assets reflects unfunded workers' compensation liabilities of $53 million and $57 million at June 30, 2002 and 2001, respectively.

II. Summary of Revenues, Expenses, and Other Changes in Net Assets

(in thousands)

	2002	2001
Operating Revenues:		
Tuition and fees, net	$ 341,371	$ 313,716
Grants and contracts	425,012	417,004
Auxiliary enterprises sales and services, net	129,521	138,893
OSU Health System sales and services, net	711,753	604,322
Departmental sales and other operating revenues	85,619	81,577
Total operating revenues	1,693,276	1,555,512
Operating Expenses:		
Educational and general	1,286,403	1,252,480
Auxiliary enterprises	148,489	148,194
OSU Health System	701,310	612,062
Depreciation	147,775	152,795
Total operating expenses	2,283,977	2,165,531
Net operating income (loss)	(590,701)	(610,019)
Non-operating revenues (expenses):		
State share of instruction and line-item appropriations	446,115	467,907
Gifts – current use	69,123	129,203
Net investment income (loss)	(112,142)	(164,846)
Other non-operating revenues (expense)	13,898	382
Income (loss) before other revenues, expenses, gains or losses	(173,707)	(177,373)
State capital appropriations	50,342	47,331
Private capital gifts	20,917	29,870
Additions to permanent endowments	32,429	60,463
Increase (decrease) in net assets	(70,019)	(39,709)
Net assets – beginning of year	2,877,798	2,917,507
Net assets – end of year	$2,807,779	$2,877,798

II Net **tuition and fees** increased $28 million, to $341 million in fiscal year 2002. This nine percent increase is consistent with 2002 increases in tuition rates, which went up nine percent for in-state undergraduates.

Grant and contract revenues increased $8 million, to $425 million in fiscal year 2002, due to increases in federal grants and contracts. Federal research awards administered by The Ohio State University Research Foundation increased $14 million. The university also received increased funding from federal student aid programs, including Pell Grants (up $4 million) and the Federal Workstudy Program (up $2 million). These increases were partially offset by declines in state grants and contracts and private grants and contracts.

Fiscal year 2002 saw limited growth in total **educational and general expenses**. Total E&G expenses increased less than three percent, to $1.29 billion. Additional details are provided below.

Educational and General Expenses

(in thousands)

	2002	2001
Instruction and departmental research	$ 540,454	$ 521,503
Separately budgeted research	272,504	246,754
Public service	113,516	103,342
Academic support	83,990	85,834
Student services	58,097	57,105
Institutional support	102,531	116,927
Operation and maintenance of plant	77,927	84,346
Scholarships and fellowships	37,384	36,669
Total	$1,286,403	$1,252,480

Total **instructional and departmental research expenses** increased less than four percent in 2002, primarily due to the minimal salary increases (averaging less than one percent) provided to faculty and staff in response to the state budget reductions. Most of the increase relates to higher employee benefit charges and increases in restricted expenses in the Colleges of Medicine, Business, and Math & Physical Sciences. **Separately budgeted research expenses** increased $26 million, or 10 percent, reflecting the growth in federal sponsored research volume and increases in research fee authorizations provided to graduate assistants. **Institutional support** decreased $14 million, or 12 percent, primarily due to reductions in central charges for self-insured employee health plans (increased health benefit costs in 2002 were distributed to other E&G categories, auxiliaries, and the OSU Health System via increases in the composite benefit rates charged to university departments).

Current-use gifts to the university decreased $60 million, to $69 million in 2002, primarily due to the one-time recognition of $68 million in gift pledges receivable in 2001, as result of the adoption of GASB Statement No. 33, *Accounting and Reporting for Nonexchange Transactions*. Excluding the effects of this accounting change and similar 2002 accruals, actual receipts of current-use gifts increased $2 million.

Additions to permanent endowments decreased $28 million, to $32 million in 2002. A total of 168 new named endowments were established in 2002, including 16 new chairs or professorships, 80 new scholarship funds, and 74 new funds supporting programs throughout the university. The amount of private gifts to the endowment has averaged $38 million per year during the past five years (excluding a single $30.3 million gift in 2001). Gifts to the endowment are expected to continue in the $30–$40 million per year range.

Private capital gifts, which are restricted for the purchase or construction of capital assets, decreased $9 million, to $21 million in 2002. Major capital gift commitments in 2002 included $5.0 million pledge for the Thompson Library renovation, $4.5 million for the 4-H Center and $4.5 million for Newark Campus. Given the number of capital projects for which private gifts are being sought and projected given to existing projects, a steady state or slight increase in giving for these purposes is expected.

Revenues and expenses of the OSU Health System showed continued improvement. Health System sales and service revenues increased $107 million, or 18 percent, in 2002, primarily due to increased patient volumes across the Health System, as well as rate increases for certain services. Expenses (excluding depreciation, interest, and interfund transfers) increased $89 million due to higher patient volumes, increased utilization of contract nurses, increased cost of employee benefits, and general inflation.

Continuing declines in the equity markets resulted in a **net investment loss** of $112 million in 2002. Net depreciation in the fair market value of university investments totaling $157 million was partially offset by interest and dividends of $45 million.

III The university's Statement of Cash Flows reflects relatively stable cash flows for operating and noncapital financing activities. Total cash provided by these activities increased slightly, from $179 million in 2001 to $182 million in 2002. The overall increase in university cash balances in 2002 is primarily due to the issuance of new plant debt and reductions in capital expenditures.

III. University Cash Flows Summary

(in thousands)

	2002	2001
Net cash flows from operating activities	$(362,206)	$(414,076)
Net cash flows from noncapital financing activities	544,453	593,381
Capital appropriations and gifts for capital projects	67,175	78,341
Proceeds from issuance of bonds and notes payable	264,464	114,000
Payments for purchase and construction of capital assets	(163,249)	(284,786)
Principal and interest payments on capital debt	(129,757)	(113,492)
Net cash flows from investing activities	51,127	55,377
Net increase (decrease) in cash	$ 272,007	$ 28,745

Economic Factors That Will Affect the Future

The recent decreases in state support highlight two long-term trends:

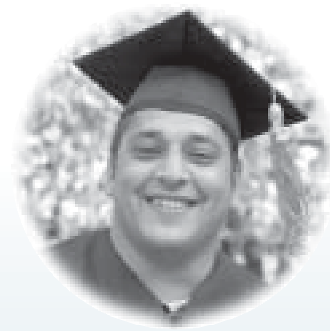
- ***Ohio State is becoming less dependent on state support.*** Ten years ago, the university received $1.11 in state instructional subsidy for each $1 of tuition and fees charged to students. By 2002, that ratio had dropped to $0.85 for each $1 of tuition. This trend will accelerate in 2003, with the implementation of two-tiered tuition rates for new and continuing students. Undergraduate tuition—which increased

- ***Strengthen significantly the quality of the academic experience for undergraduates.*** New initiatives in this area have provided funding for smaller classes; more openings in high-demand courses; expanded academic and career advising services; improved classroom teaching and development programs for faculty and graduate associates; and expanded living/learning options for student housing. In addition, the university's budget restructuring process will direct future increases in general funds budgets to those disciplines and programs with the greatest student demand.
- ***Establish Ohio State as a leader in biomedical research.*** The university plans to build a 422,000 square-foot Biomedical Research Tower. This ten-story tower, which is projected to open in late 2006, will nearly double the space devoted to biomedical research at the university. The $120 million facility will be financed largely with bonds, to be repaid from facilities and administrative cost recoveries on research grants and other sources generated by the College of Medicine and Public Health.
- ***Create a state and national resource for understanding and resolving issues of race and ethnicity that continue to divide the nation.*** Ohio State has founded the William E. Kirwan Institute for the Study of Race and Ethnicity in the Americas. Named after the university's outgoing president, who left Ohio State July 1 to become chancellor of the University of Maryland System, the institute will receive over $1 million in annual institutional funding and is expected to stimulate considerable new grant activity.

The OSU Health System is expecting to continue its growth during fiscal year 2003. This growth includes an increase of 4,000 admissions. Also, the number of outpatient and clinic visits is expected to increase by 40,000 or 5.2 percent. The operating revenues and expenses are expected to increase by over $100 million respectively during 2003 as a result of these increased activities. The Health System continues to implement management initiatives aimed at better utilization of its human and capital resources to improve patient care and financial viability.

The OSU Health System as part of the Medical Center is supporting the development of research resulting in leading edge clinical services while fulfilling its teaching mission. These efforts are particularly focused on Cardiology and Oncology Services during 2003. The Health System is currently building a Heart Hospital, which will open during 2004, while extending services into communities throughout Ohio. It continues to expand its oncology services throughout the Columbus metropolitan area and state, with the expectation that the James Cancer Hospital has become the provider of choice. The Medical Center will continue to develop services that support its pursuit of becoming a leading research, educational, and patient care provider in the United States.

Despite the resource challenges faced by the university over the past year, university management believes that Ohio State will maintain its sound financial position and is positioned to continue its progress towards a top-tier ranking among the nation's public institutions.



The focal point for the university's budgeting and spending priorities is the Academic Plan, which was adopted in 2000.