

UNIVERSITY OF SOUTH CAROLINA

Financial Statements and Schedules

June 30, 2005

(With Independent Auditors' Report Thereon)

Independent Auditors' Report

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying statement of net assets of the business-type activities and the blended and discretely presented component units of the University of South Carolina (the University), a department of the State of South Carolina, as of June 30, 2005, and the related statements of revenues, expenses and changes in net assets and cash flows, where applicable, thereof for the year then ended, which collectively comprise the University's basic financial statements. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the University of South Carolina School of Medicine Educational Trust and Clinical Faculty Practice Plan (the Trust); the University of South Carolina Research Foundation; the University of South Carolina Research Campus Foundation; the University of South Carolina Development Foundation; the University of South Carolina Educational Foundation; the University of South Carolina Business Partnership Foundation; the Greater University of South Carolina Alumni Association; the Carolina Piedmont Foundation Inc.; the Educational Foundation of the University of South Carolina – Lancaster, Inc.; and the Aiken Student Housing Foundation (collectively referred to as Foundations). Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the Trust and Foundations, are based on the reports of other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

As discussed in note 1, the financial statements of the University are intended to present the financial position, change in financial position and, where applicable, the cash flows, of only that portion of the business-type activities, and blended and discretely presented component units of the State of South Carolina that is attributable to the transactions of the University. They do not purport to, and do not, present fairly the financial position of the State of South Carolina as of June 30, 2005, the changes in its financial position or where applicable, its cash

flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, and the blended and discretely presented component units as of June 30, 2005, and the respective changes in financial position and, where applicable, cash flows of the University of South Carolina, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 30, 2005 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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.

The management's discussion and analysis on accompanying pages 3 thru 6 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 and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the University's basic financial statements. The supplementary information included in the accompanying schedules of non-capital appropriations, capital improvement bond proceeds and statement of activities are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

September 30, 2005

UNIVERSITY OF SOUTH CAROLINA – Management’s Discussion and Analysis (Unaudited)

Overview of the Financial Statements and Financial Analysis

The University of South Carolina is pleased to present its financial statements for fiscal year 2005. While audited financial statements for fiscal year 2004 are not presented with this report, condensed operations and financial position data will be presented in this section in order to illustrate certain increases and decreases. However, the emphasis of discussions about these statements will be on current year data. In addition, this discussion will focus on operations and financial position of the primary institution – the University of South Carolina – and will not include its blended component unit – the University of South Carolina School of Medicine Educational Trust and Clinical Faculty Practice Plan. Neither will this discussion include the discretely presented component units – the University of South Carolina’s Research Foundation, Development Foundation, Educational Foundation, Business Partnership Foundation, Alumni Association, Research Campus Foundation, the Carolina Piedmont Foundation, the Lancaster County Foundation, and the Aiken Housing Foundation.

This report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB) in Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis – for State and Local Governments* and Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Colleges and Universities*. The financial statements presented focus on the financial condition of the University, the results of operations, and cash flows of the University as a whole.

There are three financial statements presented: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and, the Statement of Cash Flows. These statements present financial information in a format similar to that used by private corporations. The University’s net assets (the difference between assets and liabilities) are one indicator of the improvement or erosion of the University’s financial health when considered with non-financial facts such as enrollment levels and the condition of the facilities.

This discussion and analysis of the University’s financial statements provides an overview of its financial activities for the year.

Summary of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The Statement of Net Assets is a point of time financial statement. The purpose of the Statement of Net Assets is to present to the readers of the financial statements a fiscal snapshot of the University. The Statement of Net Assets presents end-of-year data concerning Assets (property that we own and what we are owed by others), Liabilities (what we owe to others and have collected from others before we have provided the service), and Net Assets (Assets minus Liabilities). It is prepared under the accrual basis of accounting, where revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service to us, regardless of when cash is exchanged.

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the institution. They are also able to determine how much the institution owes vendors, investors, and lending institutions. Finally, the Statement of Net Assets provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the institution.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the institution’s equity in property, plant, and equipment owned by the institution. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. Restricted nonexpendable net assets consist solely of the University’s permanent endowment funds and are only available for investment purposes. Expendable restricted net assets are available for expenditure by the institution but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted assets are available to the institution for any lawful purpose of the institution.

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Summary of Net Assets				
	<u>2005</u>	<u>2004</u>	<u>Increase/ Decrease</u>	<u>Percent Change</u>
Assets				
Current Assets	\$ 255,201,854	\$ 226,444,887	\$ 28,756,967	12.70%
Capital Assets, Net	705,636,521	663,449,011	42,187,510	6.36%
Other Assets	<u>53,992,973</u>	<u>50,272,146</u>	<u>3,720,827</u>	7.40%
Total Assets	<u>1,014,831,348</u>	<u>940,166,044</u>	<u>74,665,304</u>	7.94%
Liabilities				
Current Liabilities	88,705,901	113,231,208	(24,525,307)	(21.66%)
Noncurrent Liabilities	<u>267,436,281</u>	<u>185,083,489</u>	<u>82,352,792</u>	44.49%
Total Liabilities	<u>356,142,182</u>	<u>298,314,697</u>	<u>57,827,485</u>	19.38%
Net Assets				
Invested in capital assets, net of related debt	452,227,107	459,928,243	(7,701,136)	(1.67%)
Restricted - nonexpendable	14,867,303	11,895,005	2,972,298	24.99%
Restricted - expendable	43,718,637	26,197,579	17,521,058	66.88%
Unrestricted	<u>147,876,119</u>	<u>143,830,520</u>	<u>4,045,599</u>	2.81%
Total Net Assets	<u>\$ 658,689,166</u>	<u>\$ 641,851,347</u>	<u>\$ 16,837,819</u>	2.62%

- Total Assets of the University increased by \$74.7 million. Capital assets increased \$42.2 million, primarily due to major building projects completed and in progress. Total cash and cash equivalents increased \$35.1 million, driven by the increase in unrestricted net assets and restricted expendable net assets for capital projects.
- The decrease in Current Liabilities is attributable to a significant decrease in short term debt that was converted to long term debt.
- The \$82.4 million increase in Noncurrent Liabilities is attributable to issuance of long term bonds and notes payable and the conversion of short term debt to long term.
- Net Assets of the University increased during the year by \$16.8 million. The increase is driven largely by a \$17.5 million increase in restricted expendable net assets for capital projects due to unexpended bond and note proceeds.

Summary of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or non-operating. A public University’s dependency on state aid and gifts will result in operating deficits. The GASB requires state appropriations and gifts to be classified as non-operating revenues. The utilization of long-lived assets, referred to as Capital Assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

Changes in total net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses and Changes in Net Assets. The purpose of the statement is to present the revenues received by the institution, both operating and non-operating, and the expenses paid by the institution, operating and non-operating, and any other revenues, expenses, gains and losses received or spent by the institution.

**UNIVERSITY OF SOUTH CAROLINA – Management’s Discussion and Analysis
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Operating revenues are received for providing goods and services to the various customers and constituencies of the institution. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the institution. Non-operating revenues are revenues received for which goods and services are not

provided. State capital appropriations and capital grants and gifts are considered neither operating nor non-operating revenues and are reported after “Income before other revenues, expenses, gains or losses”.

Summary of Revenues, Expenses and Changes in Net Assets	<u>2005</u>	<u>2004</u>	<u>Increase/ Decrease</u>	<u>Percent Change</u>
Operating Revenues:				
Student tuition and fees	\$ 278,985,272	\$ 247,648,642	\$ 31,336,630	12.65%
Less scholarship allowance	(64,570,445)	(56,781,483)	(7,788,962)	13.72%
Federal grants and contracts	128,690,344	122,815,472	5,874,872	4.78%
State grants and contracts	59,456,363	54,292,147	5,164,216	9.51%
Local grants and contracts	701,791	920,173	(218,382)	(23.73%)
Nongovernmental grants and contracts	19,323,916	19,756,796	(432,880)	(2.19%)
Sales and services of educational and other activities	17,056,818	15,788,221	1,268,597	8.04%
Sales and services of auxiliary enterprises	76,640,024	75,347,079	1,292,945	1.72%
Less scholarship allowance	(2,573,218)	(2,598,803)	25,585	(0.98%)
Interest collected on student loans	282,689	298,210	(15,521)	(5.20%)
Other fees	5,743,772	5,948,183	(204,411)	(3.44%)
Other operating revenues	<u>3,063,506</u>	<u>3,012,848</u>	<u>50,658</u>	1.68%
Total operating revenues	<u>522,800,832</u>	<u>486,447,485</u>	<u>36,353,347</u>	7.47%
Operating Expenses:				
Compensation and employee benefits	461,706,311	428,645,703	33,060,608	7.71%
Services and supplies	171,563,779	147,573,608	23,990,171	16.26%
Utilities	23,073,722	20,455,611	2,618,111	12.80%
Scholarships and fellowships	47,587,874	45,211,409	2,376,465	5.26%
Depreciation expense	<u>33,096,525</u>	<u>32,732,245</u>	<u>364,280</u>	1.11%
Total operating expenses	<u>737,028,211</u>	<u>674,618,576</u>	<u>62,409,635</u>	9.25%
Operating loss	(214,227,379)	(188,171,091)	(26,056,288)	13.85%
Non-operating revenues (expenses)	<u>215,310,417</u>	<u>209,079,818</u>	<u>6,230,599</u>	2.98%
Income before other revenues, expenses, and transfers	1,083,038	20,908,727	(19,825,689)	(94.82%)
Other revenues, expenses, and transfers	<u>15,754,781</u>	<u>5,874,743</u>	<u>9,880,038</u>	168.18%
Increase in net assets	16,837,819	26,783,470	(9,945,651)	(37.13%)
Net assets at beginning of year	<u>641,851,347</u>	<u>615,067,877</u>	<u>26,783,470</u>	4.35%
Net assets at end of year	<u>\$ 658,689,166</u>	<u>\$ 641,851,347</u>	<u>\$ 16,837,819</u>	2.62%

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The Summary of Revenues, Expenses and Changes in Net Assets reflects a positive year with an increase in Net Assets at the end of the year. Some highlights of the information presented on this Summary are as follows:

- A net \$23.5 million increase in student tuition and fees, a \$10.4 million increase in grant and contract revenues, and a \$2.6 million increase in sales and service were largely responsible for the overall \$36.4 million increase in Operating Revenues. The increase in student tuition and fees is a result of a minor increase in enrollment and a 11 percent tuition increase. The tuition increase was necessary due to no significant increase in State appropriations and to still allow the University to meet its mission goals. The increase in grant and contract revenues are mainly attributable to increased federal and state student grants and research grants and contracts.
- Operating expenses increased \$62.4 million or 9.25 percent. The largest increases occurred in compensation and employee benefits, utilities and services and supplies. Utilities increased due to rate increases and the addition of major capital buildings. Compensation and employee benefits and services and supplies increased because of the increase in grant and contract obligations and research activities.
- The \$6.2 million increase in Non-operating revenues and expenses was primarily attributable to an increase in private gift revenues.
- State capital appropriations and other capital grants and gifts increased approximately \$7.5 million and additions to permanent endowments increased \$2.3 million.

Statement of Cash Flows

The final statement presented is the Statement of Cash Flows. The Statement of Cash Flows presents detailed information about the cash activity of the institution during the year. The statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by the operating activities of the institution. The second section reflects cash flows from non-capital financing activities. This section reflects the cash received and

spent for non-operating, non-investing, and non-capital financing purposes. The third section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The fourth section reflects the cash flows from investing activities and shows the purchases, proceeds, and interest received from investing activities. The fifth section reconciles the net cash used to the operating income or loss reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

Capital Asset and Debt Administration

The University placed into service a 500 bed student housing facility in the fall of 2004 and Phase I of an Energy Performance Contract began with the facility improvement measures in the areas of lighting, water, steam and mechanical controls. In the spring of 2006, two projects are scheduled to be completed. The addition to a parking garage will provide 900-1000 new parking spaces and the completion of a new 88,000 square foot building for the School of Public Health will house laboratories, computer based research facilities and smart classrooms. The University’s indebtedness consists of bonds payable of \$194,914,101, bond anticipation notes of \$9,345,000 and notes payable of \$49,150,312. During the current year, \$12,400,000 bonds were issued to fund the construction of a new parking garage and \$30,900,000 were issued to refinance a portion of the remaining balance of a bond anticipation note. There were also \$48,251,445 notes payable issued for an energy retrofitting project and several equipment acquisitions.

Economic Outlook

The economic position of the University is somewhat tied to that of the State of South Carolina. The state closed fiscal year 2005 with a funds surplus for the second time in two years. Higher Education funding from the state for fiscal year 2006 has increased approximately 5% over the 2005 funding level.

The University’s overall financial position remains strong. Even with no significant increase in state appropriations, the University managed an increase in unrestricted net assets. The University was aware of state appropriation fund levels at the time fees were established and has anticipated the minor increase in the level of funding.

**UNIVERSITY OF SOUTH CAROLINA – Management’s Discussion and Analysis
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Complete financial statements for the University can be obtained from the Office of the Controller, 1600 Hampton Street, 6th floor, Columbia, SC 29208.