

PACE UNIVERSITY

Financial Statements

June 30, 2004 and 2003

(With Independent Auditors' Report Thereon)



KPMG LLP
345 Park Avenue
New York, NY 10154

Independent Auditors' Report

The Board of Trustees
Pace University:

We have audited the accompanying balance sheets of Pace University as of June 30, 2004 and 2003, and the related statements of changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended. 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 Pace University as of June 30, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

December 6, 2004, except as to notes 6 and 7,
which are as of February 23, 2005.

PACE UNIVERSITY

Balance Sheets

June 30, 2004 and 2003

Assets	2004	2003
Cash and cash equivalents	\$ 1,160,267	2,092,343
Student accounts receivable (net of allowance for doubtful accounts of \$1,479,000 in 2004 and 2003)	7,820,509	6,495,453
Grants and other receivables (note 21)	12,969,836	13,656,129
Prepaid expenses and other assets	6,490,383	5,326,689
Contributions receivable, net (note 4)	8,513,261	2,500,546
Investments (notes 3 and 10)	94,922,494	81,591,626
Student loans receivable (net of allowance for doubtful accounts of \$1,710,000 and \$1,685,000 in 2004 and 2003, respectively)	14,426,225	13,665,103
Funds held by bond trustees (note 7)	11,408,466	11,046,956
Plant assets (notes 5 and 7)	275,777,636	270,411,350
Total assets	<u>\$ 433,489,077</u>	<u>406,786,195</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued liabilities (notes 12 and 14)	\$ 26,565,526	24,382,239
Notes payable (note 6)	44,940,000	43,400,000
Deferred revenues and deposits	8,413,755	6,420,550
Liability under split-interest agreements	889,867	922,418
Long-term debt (notes 7 and 8)	81,718,954	81,874,799
Deferred compensation (note 10)	6,364,883	6,674,675
Deferred rental revenue (note 9)	15,107,142	16,051,338
Accrued postretirement benefit obligation (note 11)	54,249,374	52,495,150
U.S. Government grants refundable	12,636,714	12,228,854
Total liabilities	<u>250,886,215</u>	<u>244,450,023</u>
Net assets:		
Unrestricted	98,913,391	93,574,847
Temporarily restricted (note 15)	35,091,135	22,378,572
Permanently restricted (note 15)	48,598,336	46,382,753
Total net assets	<u>182,602,862</u>	<u>162,336,172</u>
Total liabilities and net assets	<u>\$ 433,489,077</u>	<u>406,786,195</u>

See accompanying notes to financial statements.

PACE UNIVERSITY

Statements of Changes in Unrestricted Net Assets

Years ended June 30, 2004 and 2003

	<u>Operating</u>	<u>Nonoperating</u>	<u>Total</u>	
			<u>2004</u>	<u>2003</u>
Revenues:				
Tuition and fees, net (note 16)	\$ 190,930,915	—	190,930,915	179,520,959
Government grants and contracts	150,000	—	150,000	—
State appropriations	1,261,892	—	1,261,892	1,185,800
Contributions (note 17)	1,253,909	—	1,253,909	700,652
Investment return (note 3)	521,174	883,188	1,404,362	(2,046,354)
Investment return on funds held by bond trustees	—	(166,419)	(166,419)	353,120
Sales and services of auxiliary enterprises	18,728,668	—	18,728,668	17,152,888
Other sources (note 9)	7,686,847	—	7,686,847	6,035,172
Net assets released from restrictions	21,765,699	—	21,765,699	21,546,274
Total revenues	<u>242,299,104</u>	<u>716,769</u>	<u>243,015,873</u>	<u>224,448,511</u>
Expenses (notes 17 and 19):				
Instruction	98,412,105	2,854,572	101,266,677	96,522,679
Research	2,941,836	53,211	2,995,047	2,855,538
Academic support	32,562,771	2,051,625	34,614,396	32,759,013
Student services	29,305,734	1,473,640	30,779,374	29,133,416
Institutional support	41,867,644	1,412,594	43,280,238	40,489,649
Auxiliary enterprises	22,199,569	4,092,554	26,292,123	24,110,078
Total expenses	<u>227,289,659</u>	<u>11,938,196</u>	<u>239,227,855</u>	<u>225,870,373</u>
Losses and related recoveries (note 21):				
Costs and losses related to events of September 11, 2001	—	—	—	(176,927)
Insurance recoveries and FEMA aid	1,550,526	—	1,550,526	4,897,404
Excess insurance recoveries over costs and losses	<u>1,550,526</u>	<u>—</u>	<u>1,550,526</u>	<u>4,720,477</u>
Transfer for repayment of indebtedness	<u>(1,673,000)</u>	<u>1,673,000</u>	<u>—</u>	<u>—</u>
Increase (decrease) in unrestricted net assets	<u>\$ 14,886,971</u>	<u>(9,548,427)</u>	<u>5,338,544</u>	<u>3,298,615</u>

See accompanying notes to financial statements.

PACE UNIVERSITY
 Statements of Changes in Net Assets
 Years ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Increase in unrestricted net assets	\$ 5,338,544	3,298,615
Changes in temporarily restricted net assets:		
Government grants and contracts	8,160,311	8,447,063
Private gifts and grants (note 17)	14,717,508	9,304,640
Investment return (note 3)	11,607,671	4,312,298
Change in value of split-interest agreements	(7,228)	2,550
Net assets released from restrictions	<u>(21,765,699)</u>	<u>(21,546,274)</u>
Increase in temporarily restricted net assets	<u>12,712,563</u>	<u>520,277</u>
Changes in permanently restricted net assets:		
Contributions (note 17)	2,055,781	601,050
Investment return (note 3)	28,449	46,761
Change in value of split-interest agreements	130,478	29,429
Interest on student loans, net	<u>875</u>	<u>5,769</u>
Increase in permanently restricted net assets	<u>2,215,583</u>	<u>683,009</u>
Increase in net assets	20,266,690	4,501,901
Net assets at beginning of year	<u>162,336,172</u>	<u>157,834,271</u>
Net assets at end of year	<u>\$ 182,602,862</u>	<u>162,336,172</u>

See accompanying notes to financial statements.

PACE UNIVERSITY

Statements of Cash Flows

Years ended June 30, 2004 and 2003

	2004	2003
Cash flows from operating activities:		
Increase in net assets	\$ 20,266,690	4,501,901
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Net appreciation in fair value of investments	(11,560,856)	(1,061,201)
Change in value of split-interest agreements	(123,250)	(31,979)
Deferred rental revenue	(944,196)	(157,366)
Depreciation	11,908,394	9,959,719
Amortization	135,574	135,574
Write-off of fixed assets	26,585	187,668
Revenues and losses restricted for permanent investment	(2,085,105)	(653,580)
Increase in student accounts receivable	(1,325,056)	(279,738)
Decrease in government grants and other receivables	686,293	2,779,385
(Increase) decrease in prepaid expenses and other assets	(1,281,226)	515,745
Increase in contributions receivable	(4,548,606)	(101,970)
Increase (decrease) in accounts payable and accrued liabilities	2,183,287	(1,838,778)
Increase in deferred revenues and deposits	1,993,205	1,968,858
Increase in accrued postretirement benefit obligation	1,754,224	2,752,364
Increase in U.S. Government grants refundable	407,860	328,192
Net cash provided by operating activities	17,493,817	19,004,794
Cash flows from investing activities:		
(Increase) decrease in student loans receivable	(761,122)	87,352
Decrease in deferred compensation	(309,792)	(1,467,860)
Purchase of plant assets	(17,301,265)	(25,743,075)
Purchase of investments	(167,007,209)	(18,068,372)
Proceeds from sale of investments	165,237,197	19,351,487
Net cash used in investing activities	(20,142,191)	(25,840,468)
Cash flows from financing activities:		
Revenues and losses from contributions restricted for permanent investment	2,085,105	653,580
(Increase) decrease in contributions receivable restricted for permanent investment	(1,464,109)	322,090
Decrease in liabilities under split-interest agreements, net	90,699	40,102
Increase in notes payable	73,740,000	63,500,000
Repayment of notes payable	(72,200,000)	(55,100,000)
Proceeds from long-term notes payable	2,000,000	—
Repayment of indebtedness	(2,173,887)	(1,585,000)
(Increase) decrease in funds held by bond trustees	(361,510)	851,432
Net cash provided by financing activities	1,716,298	8,682,204
Net (decrease) increase in cash and cash equivalents	(932,076)	1,846,530
Cash and cash equivalents at beginning of year	2,092,343	245,813
Cash and cash equivalents at end of year	\$ 1,160,267	2,092,343
Supplemental disclosure:		
Interest paid	\$ 5,435,255	5,161,541
Building received in exchange for use of land	—	16,208,704

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2004 and 2003

(1) Nature of Operations

Pace University (the University) is an independent, coeducational, nonsectarian, not-for-profit institution of higher education with campuses in New York City and Westchester County. The University was founded in 1906 and was granted college status in 1948 by the New York State Board of Regents. It is exempt from Federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

The University considers teaching and learning its highest priorities. The University's commitment to the individual needs of students is at the heart of its mission. Offering access and opportunity to qualified men and women, the University embraces persons of diverse talents, interests, experiences, and origins who have the will to learn and the desire to participate in University life. The University offers a wide range of academic and professional programs at the graduate and undergraduate levels in six colleges and schools. The University is accredited by major accrediting entities.

(2) Summary of Significant Accounting Policies

The significant accounting policies followed by the University are described below:

(a) *Basis of Presentation*

The University's financial statements are prepared on the accrual basis of accounting in accordance with standards established by the Financial Accounting Standards Board for external financial reporting by not-for-profit organizations. Accordingly, net assets of the University and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets that are not subject to donor-imposed restrictions.

Temporarily restricted net assets – Net assets subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed restrictions that stipulate that they be maintained permanently by the University, but permit the University to expend part or all of the income derived therefrom.

Revenues and gains and losses on investments and other assets are reported as changes in unrestricted net assets unless limited by explicit donor-imposed restrictions or by law. Expenses are reported as decreases in unrestricted net assets. Expiration of temporary restrictions on net assets is reported as net assets released from restrictions.

(b) *Contributions*

Contributions, including unconditional promises to give (pledges), are reported as revenues in the period received or pledged. Contributions with purpose or time restrictions are reported as increases in temporarily restricted net assets and are reclassified to unrestricted net assets when the purpose or time restrictions are met. Contributions subject to donor-imposed stipulations that the corpus be maintained permanently are recognized as increases in permanently restricted net assets.

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Notes to Financial Statements

June 30, 2004 and 2003

Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. The University reports contributions of plant assets as increases in unrestricted net assets unless the donor places restrictions on their use. Contributions to be received after one year are discounted at a risk-free rate. Amortization of the discount is recorded as additional contribution revenue in accordance with the donor-imposed restrictions, if any, on the contribution. An allowance is recorded for uncollectible contributions based on management's judgment, past collection experience, and other relevant factors.

(c) ***Cash Equivalents***

The University considers all highly liquid debt instruments with maturities of three months or less at the time of purchase to be cash equivalents, except for those that are purchased by the University's investment managers as part of their investment strategies.

(d) ***Plant Assets***

Plant assets are stated as follows:

- Land, land improvements, and buildings – at cost.
- Equipment – at cost.
- Library books – at nominal amount of \$1 per volume.

Depreciation of plant assets is computed on a straight-line basis over their estimated useful lives. No depreciation is computed in the year assets are acquired and a full year's depreciation is computed in the year of disposition. Depreciable lives of land improvements, buildings, and building improvements range from 16 years to 92 years and the depreciable life of equipment is 10 years.

(e) ***U.S. Government Grants Refundable***

Funds provided by the U.S. Government under the Federal Perkins and Nursing Student Loan programs are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the Government and are presented in the accompanying balance sheets as a liability.

(f) ***Split-Interest Agreements***

The University's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts, for which the University serves as trustee, and charitable gift annuities. Assets associated with such split-interest agreements are included in investments. Contributions are recognized at the date the trusts are established or when funds are transferred from the donor to the University after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted annually for changes in the value of the assets, accretion of the discount, and other changes in the estimates of future benefits. Such adjustments are reflected as change in value of split-interest agreements in the accompanying financial statements.

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Notes to Financial Statements

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(g) Operations

The statements of changes in unrestricted net assets distinguish between operating and nonoperating activities. Nonoperating activities principally include investment return in excess of (or less than) amounts authorized for spending by the University's board of trustees (see note 3), investment return on funds held by bond trustees, gain or loss on fixed asset disposal, if any, library book purchases, and depreciation.

(h) Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(i) Other Significant Accounting Policies

Other significant accounting policies are set forth in the following notes.

(3) Investments and Investment Return

Investments are carried at fair value based upon quoted market prices or values provided by the University's external investment managers if no quoted market prices exist.

The following tabulation summarizes the composition of investments at June 30, 2004 and 2003:

	2004		2003	
	Cost	Fair value	Cost	Fair value
Cash and cash equivalents	\$ 1,468,538	1,468,538	2,101,523	2,200,884
Cash and cash equivalents – deferred compensation (note 10)	3,942,416	3,948,843	4,184,611	4,236,718
Common stocks	1,374,535	1,387,747	18,004,470	18,364,579
Mutual funds:				
Equity	49,658,262	52,062,560	29,180,588	24,697,023
International equity	3,965,719	3,859,697	—	—
Fixed income	22,282,084	22,116,553	18,340,726	19,604,170
Distressed debt investment	938,641	1,070,593	—	—
Real estate investments	347,591	361,447	—	—
Mutual funds – deferred compensation (note 10)	2,191,785	2,488,677	2,421,640	2,530,596
Alternative investments	4,790,913	4,868,196	8,177,500	8,502,411
U.S. Government bonds	512,529	498,178	640,521	634,520
Municipal bonds	779,850	791,465	786,504	820,725
	<u>\$ 92,252,863</u>	<u>94,922,494</u>	<u>83,838,083</u>	<u>81,591,626</u>

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Notes to Financial Statements

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Investments include \$2,312,066 and \$2,203,135 of assets held under split-interest agreements at June 30, 2004 and 2003, respectively.

Alternative investments consist of two hedge funds. These alternative investments are less liquid than the University's other investments.

The University maintains an investment pool for certain investments. The pool is managed to achieve the maximum prudent long-term total return. The University's board of trustees has authorized a policy designed to preserve the value of these investments in real terms (after inflation) and provide a predictable flow of funds to support operations. This policy permits the use of total return (dividend and interest income and investment gains) at a rate (spending rate) of 5% of the three-year moving average fair value of the pooled investments. In accordance with the above spending rate, \$2,960,337 and \$3,332,015 of investment return was made available for the years ended June 30, 2004 and 2003, respectively, to support operations of the University. In addition, the University also utilized investment return of \$114,603 and \$240,077 in fiscal 2004 and 2003, respectively.

The following summarizes the University's total investment return (excluding investment return on assets held under split-interest and deferred compensation arrangements) and its classification in the financial statements for the years ended June 30, 2004 and 2003:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
2004:				
Dividends and interest on investments (net of expenses of \$345,946)	\$ 106,340	1,369,994	3,292	1,479,626
Net appreciation in fair value of investments	<u>1,298,022</u>	<u>10,237,677</u>	<u>25,157</u>	<u>11,560,856</u>
Total return on investments	1,404,362	11,607,671	28,449	13,040,482
Investment return appropriated for operations	<u>521,174</u>	<u>2,553,766</u>	—	<u>3,074,940</u>
Excess of total return on investments over investment return appropriated for operations	<u>\$ 883,188</u>	<u>9,053,905</u>	<u>28,449</u>	<u>9,965,542</u>

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	Unrestricted	Temporarily restricted	Permanently restricted	Total
2003:				
Dividends and interest on investments (net of expenses of \$465,045)	\$ 342,960	898,886	9,658	1,251,504
Net appreciation in fair value for investments	(2,389,314)	3,413,412	37,103	1,061,201
Total return on investments	(2,046,354)	4,312,298	46,761	2,312,705
Investment return appropriated for operations	657,034	2,915,058	—	3,572,092
Excess (deficiency) of total return on investments over investment return appropriated for operations	\$ (2,703,388)	1,397,240	46,761	(1,259,387)

(4) Contributions Receivable

Unconditional promises to give are reported in the financial statements as contributions receivable and as revenue of the appropriate net asset class. Contributions receivable due more than one year from the date of the financial statements are recorded net of a discount to reflect the present value of future cash flows. Contributions receivable consist of the following at June 30, 2004 and 2003:

	2004	2003
Amounts expected to be collected in:		
Less than one year	\$ 1,285,639	745,380
One to five years	6,021,619	2,448,704
More than five years	3,250,000	—
	10,557,258	3,194,084
Less discount to present value, from 4.6% to 6.5%	(1,411,906)	(504,943)
Less allowance for uncollectible amounts	(632,091)	(188,595)
	\$ 8,513,261	2,500,546

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Notes to Financial Statements
June 30, 2004 and 2003

(5) Plant Assets

Plant assets at June 30, 2004 and 2003 consist of the following:

	<u>2004</u>	<u>2003</u>
Land	\$ 11,285,092	11,285,092
Land improvements	5,964,748	5,789,449
Buildings and building improvements	276,457,546	270,126,754
Equipment	86,421,437	75,702,939
Library books	899,490	887,571
	<u>381,028,313</u>	<u>363,791,805</u>
Total	381,028,313	363,791,805
Less accumulated depreciation	<u>(105,250,677)</u>	<u>(93,380,455)</u>
	<u>\$ 275,777,636</u>	<u>270,411,350</u>

Included in buildings and building improvements is \$16,227,000 relating to a building received in exchange for use of land. See note 9 for discussion on Judicial Training Institute.

(6) Notes Payable

To meet its short-term working capital needs, the University entered into a two-tranche \$60,000,000 secured line of credit, which expired on January 31, 2005; however, it was extended to July 1, 2005. Tranche A is for \$35,000,000 and interest is based on the Prime/Fed Funds rate of the banking institution minus 1.75% or LIBOR plus 0.75%. Tranche B is for a maximum of \$25,000,000 and interest is based on the Prime/Fed Funds rate of the banking institution minus 1.25% or LIBOR plus 1.25%. At June 30, 2004, \$35,000,000 and \$9,940,000 were outstanding under Tranche A and Tranche B, respectively, at an average interest rate of 2.33%. At June 30, 2003, \$35,000,000 and \$8,400,000 were outstanding under Tranche A and Tranche B, respectively, at an average interest rate of 2.7%.

The above line of credit is secured by certain investments of the University. Interest expense on the notes payable for the years ended June 30, 2004 and 2003 was \$865,333 and \$802,761, of which \$231,337 and \$377,699 has been capitalized in plant assets, respectively.

As of June 30, 2004, the University has a standby letter of credit outstanding for \$561,211, which has been applied against Tranche A of the note payable.

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Notes to Financial Statements

June 30, 2004 and 2003

(7) Long-Term Debt

Long-term debt at June 30, 2004 and 2003 consists of the following:

	2004	2003
Long-term leases of the Dormitory Authority of the State of New York (DASNY or the Authority) (a):		
Revenue Bonds, Pace University issue, \$26,075,000, Series 2000, due serially to 2029 at interest rates ranging from 4.75% to 5.88% per annum, net of unamortized original issue premium of \$235,614 and \$245,038, at June 30, 2004 and 2003, respectively	\$ 25,080,614	25,520,039
Revenue Bonds, Pace University issue, \$60,000,000, Series 1997, due serially to 2026 at interest rates ranging from 5% to 5.75% per annum, net of unamortized original issue discount of \$604,273 and \$631,739 at June 30, 2004 and 2003, respectively	53,825,727	54,928,260
Bonds payable to the U.S. Department of Housing and Urban Development (HUD) (b):		
Bonds issued to Briarcliff College assumed by Pace University as a result of a purchase agreement in 1977 with Briarcliff College maturing in annual installments ranging from \$42,000 to \$101,000 through 2016:		
1954 issue, \$224,000, at 3.6%	—	24,000
1961 issue, \$548,000, at 3.5%	202,000	223,000
1966 issue, \$1,115,000, at 3%	544,000	577,000
Bonds issued to the College of White Plains assumed by Pace University as a result of a consolidation in 1975 with the College of White Plains, maturing in annual installments ranging from \$20,000 to \$45,000 through 2016 with interest at 3%	567,500	602,500
Long-term note payable (c)	1,499,113	—
Total long-term debt	\$ 81,718,954	81,874,799

- (a) The Series 2000 Revenue Bonds payable to the Authority were issued to finance the acquisition and renovation of a 15-story building located in lower Manhattan. The 76,000 square-foot building is being used by the University for student and staff housing and other related activities. The Series 2000 Revenue Bonds are secured by tuition and fees in an amount equal to the interest, principal, and sinking fund installments required in a given year. Under the Series 2000 bond agreement, the University maintains a debt service reserve fund on deposit with a trustee. At June 30, 2004 and 2003, \$3,111,655 and \$3,153,151, respectively, of debt service reserve funds and \$29,495 and \$29,021, respectively, of rebate funds were included in funds held by bond trustees, at fair value.

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The Series 1997 Revenue Bonds payable to the Authority were issued to finance various projects and retire other indebtedness of the University as follows: retirement of the credit agreement with The Chase Manhattan Bank used to initially finance the construction of the Goldstein Center; expansion of instructional space at the law school on the White Plains campus; technology initiatives, including various acquisitions of equipment and installation of networks and connections; renovation and repair projects (including preservation and enhancement) to extend the useful lives of various facilities; acquisition of property adjacent to the White Plains campus; and retirement of the remaining principal outstanding on the Series 1985 Revenue Bonds. The Series 1997 Revenue Bonds are secured by mortgages on certain of the University's properties, security interest in certain fixtures, furnishings, and equipment, and pledges of revenues limited in each year to the greatest amount payable by the Authority in any bond year for the principal. Under the Series 1997 bond agreement, the University maintains a debt service reserve fund on deposit with a trustee. At June 30, 2004 and 2003, \$7,179,242 and \$7,251,326, respectively, of debt service reserve funds and \$1,056,072 and \$581,457, respectively, of building and equipment reserve funds were included in funds held by bond trustees, at fair value.

- (b) The bond issues are secured by first mortgages on the dormitory facilities and liens on and pledges of the net revenues derived from the operation of the facilities.
- (c) On August 27, 2003, the University entered into a \$2,000,000 note payable at an interest rate of 9.32%. The note is payable over 36 months with the final payment due August 31, 2006.

Interest incurred for the years ended June 30, 2004 and 2003 was \$4,801,259 and \$4,736,479, respectively.

Pursuant to the March 1, 2000 and December 4, 1996 loan agreements related to the DASNY Series 2000 Revenue Bonds and DASNY Series 1997 Revenue Bonds, respectively, the University is required to adhere to financial covenants outlined in these agreements, including the Expendable Net Assets Maintenance Requirement which requires the University to maintain expendable net assets (unrestricted and temporarily restricted net assets, exclusive of plant equity, and inclusive of postretirement benefit obligation) at a market value equal to at least 50% of outstanding long-term indebtedness and the Additional Indebtedness restriction which requires the University to not incur additional long-term indebtedness without written consent.

The University advised both its Bond Insurer and DASNY that it failed to achieve the Expendable Net Assets Maintenance Requirement for the fiscal years ended June 30, 2004 and 2003 in that the ratio is approximately .11 and (.05), respectively, rather than the .50 required under the 2000 and 1996 loan agreements. Additionally, the University advised its Bond Insurer and DASNY that it entered into additional long-term debt in fiscal 2004 without prior written consent. The University requested that the Bond Insurer waive any possible events of default arising under the 2000 and 1996 agreements which could result from these violations.

The University has received waivers from the Bond Insurer for the Expendable Net Assets Maintenance Requirement covenant violation for June 30, 2004 and 2003, as well as for June 30, 2005. In addition, the University received waivers for the Additional Indebtedness default from the Bond Insurer and DASNY.

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(8) Debt Service – Long-Term Debt

Debt service relating to long-term debt for the next five years is as follows:

	<u>Long-term leases to DASNY</u>	<u>Bonds payable to HUD</u>	<u>Long-term note payable</u>	<u>Total</u>
June 30, 2005:				
Principal	\$ 1,715,000	93,000	654,544	2,462,544
Interest, reserves, and fees	4,511,868	47,665	112,255	4,671,788
	<u>\$ 6,226,868</u>	<u>140,665</u>	<u>766,799</u>	<u>7,134,332</u>
June 30, 2006:				
Principal	\$ 1,805,000	94,000	718,241	2,617,241
Interest, reserves, and fees	4,426,118	44,765	48,559	4,519,442
	<u>\$ 6,231,118</u>	<u>138,765</u>	<u>766,800</u>	<u>7,136,683</u>
June 30, 2007:				
Principal	\$ 1,895,000	102,000	126,328	2,123,328
Interest, reserves, and fees	4,334,063	41,760	1,474	4,377,297
	<u>\$ 6,229,063</u>	<u>143,760</u>	<u>127,802</u>	<u>6,500,625</u>
June 30, 2008:				
Principal	\$ 2,010,000	104,000	—	2,114,000
Interest, reserves, and fees	4,225,043	38,580	—	4,263,623
	<u>\$ 6,235,043</u>	<u>142,580</u>	<u>—</u>	<u>6,377,623</u>
June 30, 2009:				
Principal	\$ 2,130,000	105,000	—	2,235,000
Interest, reserves, and fees	4,101,543	35,335	—	4,136,878
	<u>\$ 6,231,543</u>	<u>140,335</u>	<u>—</u>	<u>6,371,878</u>

(9) Judicial Training Institute

On April 5, 2000, the University entered into a loan agreement with the Authority for the issuance of up to \$17,500,000 State Judicial Institute at Pace University Insured Lease Revenue Bonds, Series 2000 (the bonds) dated July 1, 2000. In July 2000, bonds with a face value of \$16,105,000 plus accrued interest were issued. Proceeds from the bonds were used to finance the construction of a judicial training facility on the University's White Plains campus to serve as the New York State Judicial Training Institute (the Institute). The Institute was established to serve as a statewide center for continuing education, training, and research for all judges and justices of the Unified Court System (the System). The bonds are

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due serially through 2020 at interest rates ranging from 4.5% to 5.5% per annum with interest payable every October 1 and principal, sinking fund installments, and interest payable every April 1. These bonds are solely payable from certain revenues, funds, and assets pledged by the System as security for the payment thereof, including certain rental payments to be made by the System to the University pursuant to an agreement of sublease, also dated April 5, 2000, in amounts sufficient to pay the principal, sinking fund installments, and interest on the bonds. Payments to be made under the sublease have been assigned to the Authority pursuant to an assignment of sublease and rent agreement, dated April 5, 2000, between the University and the Authority that requires the System to make payments to the Authority by March 31 of each year. The loan agreement between the Authority and the University is without recourse to the University and the University's obligation thereunder on account of payments due on the Series 2000 Bonds are payable solely from the aforesaid rental payments as received under the sublease with the System. The obligation of the System to make payments of rent under the sublease is subject to annual appropriations by the State of New York for such purpose. The bond proceeds and related obligation are not included in the accompanying financial statements.

On April 23, 2003, the City of White Plains issued a certificate of occupancy evidencing completion of the judicial training facility and the University recorded the value (\$16,208,704) of the building and a corresponding deferred rental revenue. The deferred rental revenue will be recognized on a straight-line basis over the life of the land lease, May 1, 2003 through June 30, 2020. For the year ended June 30, 2004, \$944,196 was recognized as rental revenue.

(10) Retirement and Deferred Compensation Plans

The University has defined contribution retirement annuity plans with Teachers' Insurance and Annuity Association of America and College Retirement Equities Fund, Fidelity Investments, and T. Rowe Price which cover substantially all full-time employees. The University makes annual plan contributions which are vested immediately for the benefit of the participants. The University's contributions under the plan for the years ended June 30, 2004 and 2003 amounted to \$6,110,926 and \$6,078,528, respectively.

The University offered a deferred compensation plan to substantially all full-time employees. Amounts deferred are invested by the University in consultation with the participant. Such amounts consist of cash and cash equivalents and mutual funds and are included in investments (\$6,437,520 in 2004 and \$6,767,314 in 2003) in the accompanying balance sheets and continue to be the assets of the University subject to claims of its creditors. Contributions to this plan have been limited since the enactment of the Tax Reform Act of 1986.

(11) Postretirement Benefits Other than Pensions

The University sponsors a plan to provide certain health care and life insurance benefits for retirees. The University's employees may become eligible for these benefits if they retire while working for the University. Benefits and eligibility may be modified from time to time.

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Information with respect to this unfunded plan as of and for the years ended June 30, 2004 and 2003 is as follows:

	<u>2004</u>	<u>2003</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 51,816,193	44,858,864
Service cost	992,901	1,276,538
Interest cost	3,189,946	3,416,574
Benefits paid	(1,668,407)	(1,605,351)
Plan amendments	—	(7,484,562)
Actuarial (gain) loss	(1,858,359)	11,354,130
Benefit obligation at end of year	<u>52,472,274</u>	<u>51,816,193</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	—	—
Employer contribution	1,668,407	1,605,351
Benefits paid	(1,668,407)	(1,605,351)
Fair value of plan assets at end of year	<u>—</u>	<u>—</u>
Funded status	(52,472,274)	(51,816,193)
Prior service cost	(8,556,181)	(9,652,578)
Unrecognized net loss	6,779,081	8,973,621
Accrued postretirement benefit obligation	<u>\$ (54,249,374)</u>	<u>(52,495,150)</u>

The net periodic postretirement benefit expense for 2004 and 2003 includes the following components:

	<u>2004</u>	<u>2003</u>
Service cost	\$ 992,901	1,276,538
Interest cost	3,189,946	3,416,574
Amortization of prior service cost	(1,096,397)	(257,320)
Amortization of net gain (loss)	336,181	(78,077)
Net periodic postretirement benefit expense	<u>\$ 3,422,631</u>	<u>4,357,715</u>

	<u>2004</u>	<u>2003</u>
Benefit obligation weighted average assumptions as of June 30, 2004 and 2003:		
Discount rate	6.50%	6.25%
Benefit cost weighted average assumptions for the years ended June 30, 2004 and 2003:		
Discount rate	6.25%	7.25%

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For measurement purposes, a 10.5% annual rate of increase in the medical per capita cost of covered health care benefits was assumed for pre-age and post-age 65 coverage for the year ended June 30, 2004, decreasing to 4.5% to 2011 and remaining at that level thereafter. A 6.75% annual rate of increase in the Medicare Part B premiums was assumed for the year ended June 30, 2004. The health care cost trend rate assumption has a significant effect on the accrual. A 1% increase in the rate translates to an increase in the accumulated postretirement benefit obligation of \$6,804,297 in 2004 (\$6,736,105 in 2003) and an increase in the service and interest cost of \$654,862 in 2004 (\$361,358 in 2003). A 1% decrease in the rate translates to a decrease in the accumulated postretirement benefit obligation of \$5,521,943 in 2004 (\$5,699,781 in 2003) and a decrease in the service and interest cost of \$515,683 in 2004 (\$924,490 in 2003).

Projected plan contributions and benefit payments for each of the next five fiscal years and the five years thereafter are as follows:

2005	\$	2,292,310
2006		2,543,720
2007		2,741,966
2008		2,977,023
2009		3,156,787
2010 through 2014		18,356,667

During 2003, the plan was amended to reflect an increase in the medical co-payment of \$5 effective January 1, 2004 and subsequent increases of \$5 every four years. The plan was further amended to reflect a three tier drug co-payment of \$10/\$20/\$30 with increases of \$5 every five years. Retiree cost sharing will now be required as follows: (a) Employees hired prior to January 1, 1996, and who retire after August 31, 2005, will contribute at the same cost share dollar amount as immediately prior to retirement; and (b) Employees hired after December 31, 1995, but before October 1, 2000, and retire with more than 25 years of service will also be subject to the same cost share dollar amount as immediately prior to retirement. The 2003 amendments reduced the postretirement benefit obligation by \$7,484,562. In accordance with the 2001 plan amendment, postretirement health care and life insurance benefits coverage for employees hired after October 1, 2000 has been eliminated.

In December 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) became law. The University has elected to defer the effects of the Act; therefore, the measures of accumulated postretirement benefit obligation and net periodic postretirement benefit cost do not reflect the effects if any, associated with the Federal subsidy provided by the Act. The University is still in the process of reviewing the impact of the Act in order to conclude whether the benefits provided by the postretirement medical benefits are actuarially equivalent to Part D under the Act. Specific authoritative guidance could require the University to change previously reported information.

(12) Faculty Retirement Incentive Plan

During fiscal 2000, the University offered an early retirement incentive plan (the Plan) to qualified faculty. Under the Plan, qualified faculty had the option of (1) electing to receive one and one-half years of base salary at the last full-time salary prior to retirement paid over eighteen months immediately following retirement, or (2) teaching an annual one half of the normal course load compensated at the rate of 75% of

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regular annual base salary and continuation of benefits for three years. At June 30, 2004 and 2003, the present value (discounted at 6.5%) of the amounts due under the Plan was \$305,412 and \$693,000, respectively, and is included in accounts payable and accrued liabilities in the accompanying balance sheets.

(13) Commitments

The University leases office and classroom space under several lease agreements expiring at various dates through October 31, 2021. The minimum annual rentals in connection with such leases are as follows:

	<u>Amount</u>
Year ending June 30:	
2005	\$ 9,004,446
2006	7,210,064
2007	7,582,269
2008	5,812,905
2009	5,908,791
2010 and thereafter	<u>62,682,862</u>
	<u>\$ 98,201,337</u>

Total rental expense for the years ended June 30, 2004 and 2003 was \$8,096,989 and \$8,986,120, respectively.

(14) Self-Insurance

Effective January 1, 1993, the University established a self-insurance plan for employee medical benefits, exclusive of those benefits provided by Health Maintenance Organizations (HMOs). Under the provisions of this plan, insurance carriers provide claims processing and administrative functions, as well as stop-loss coverage for claims (on a calendar year basis) in excess of \$7,679,948 and \$6,801,309 for the years ended December 31, 2004 and 2003, respectively. The expense for this program for the years ended June 30, 2004 and 2003 was approximately \$6,990,000 and \$5,350,000, respectively. A liability for claims incurred but not reported of approximately \$879,000 and \$829,000 as of June 30, 2004 and 2003, respectively, is included in accounts payable and accrued liabilities in the accompanying balance sheets.

(15) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets at June 30, 2004 and 2003 are principally available to support the Lubin School of Business and academic chairs. Certain temporarily restricted net assets available to support the Lubin School of Business are expendable only for projects approved by the donor's designee.

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Permanently restricted net assets at June 30, 2004 and 2003 are restricted to investment in perpetuity, with investment return principally available to support scholarships and fellowships and academic chairs.

(16) Scholarships and Fellowships

Tuition and fees are presented net of amounts awarded to students to defray their cost of attending the University. The amount awarded totaled \$43,269,891 and \$38,236,630 for the years ended June 30, 2004 and 2003, respectively.

(17) Expenses

Expenses are reported in the statements of changes in unrestricted net assets in categories recommended by the National Association of College and University Business Officers. The University's primary program services are instruction and research. Expenses reported as academic support, student services, and auxiliary enterprises are incurred in support of these primary program services. Institutional support includes fund-raising expenses of \$3,297,522 and \$2,616,069 for the years ended June 30, 2004 and 2003, respectively. For purposes of reporting fund-raising expenses, the University includes only those fund-raising costs incurred by its institutional advancement office. Contributions and private gifts and grants for the years ended June 30, 2004 and 2003 were \$18,027,198 and \$10,606,342, respectively.

(18) Fair Value of Financial Instruments

The carrying amount of cash, student accounts receivable, grants and other receivables, accounts payable and accrued liabilities, and notes payable approximates fair value because of the short maturity of these financial instruments. The fair value of investments and contributions is disclosed in notes 3 and 4, respectively.

A reasonable estimate of the fair value of loans receivable from students under government loan programs could not be made because the notes are not salable and can only be assigned to the U.S. Government or its designees. The fair value of the loans receivable from students under University loan programs approximates carrying value.

The carrying amount of long-term debt approximates fair value because these financial instruments bear interest at various rates, which, when averaged, are not significantly different from current market rates for loans with similar maturities and credit quality.

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(19) Allocation of Certain Expenses

The University allocates operation and maintenance of plant, depreciation, and interest expenses based upon building square footage and the use of each facility. For the year ended June 30, 2004 (with comparative totals for 2003), the following allocation of expenses was included in the accompanying statements of changes in unrestricted net assets:

	<u>Allocated expenses</u>				Total per statement of changes in unrestricted net assets
	Operation and maintenance of plant	Depreciation	Interest and other debt-related	Direct expenses	
Instruction	\$ 5,608,012	2,854,572	931,479	91,872,614	101,266,677
Research	104,537	53,211	14,789	2,822,510	2,995,047
Academic support	3,972,016	2,021,823	561,922	28,058,635	34,614,396
Student services	2,895,072	1,473,640	409,567	26,001,095	30,779,374
Institutional support	2,775,142	1,412,594	1,026,596	38,065,906	43,280,238
Auxiliary enterprises	8,040,115	4,092,554	2,699,064	11,460,390	26,292,123
Total 2004	<u>\$ 23,394,894</u>	<u>11,908,394</u>	<u>5,643,417</u>	<u>198,281,150</u>	<u>239,227,855</u>
Total 2003	<u>\$ 23,119,888</u>	<u>9,959,719</u>	<u>5,353,809</u>	<u>187,436,957</u>	<u>225,870,373</u>

(20) Contingency

The University is involved in various legal proceedings and claims arising in the normal course of business. Management of the University does not expect the ultimate resolution of these actions to have a material adverse effect on the University's financial position.

(21) Impact of September 11, 2001 Events

As a result of the September 11, 2001 attack on the World Trade Center, the leased space and all equipment, furniture, and fixtures where the University's World Trade Institute (WTI) operated were totally destroyed.

The University has insurance policies covering loss of physical property, as well as business interruption. In addition, the University qualified for Federal Emergency Management Agency (FEMA) aid for the build out of replacement space lost at the World Trade Center. During the fiscal years ended June 30, 2004 and 2003, the University recorded insurance recoveries and FEMA aid totaling \$1,550,526 and \$4,897,404, respectively. At June 30, 2004, no FEMA aid or insurance recoveries receivables are outstanding. At June 30, 2003, FEMA aid and insurance recovery receivables totaling \$1,137,530 were included in grants and other receivables in the accompanying balance sheets. No costs and losses were incurred during fiscal year ended June 30, 2004. Costs and losses incurred during the fiscal year ended June 30, 2003 related to the events of September 11, 2001 amounted to \$176,927.