



SONOMA STATE UNIVERSITY

Financial Statements

June 30, 2006

(With Independent Auditors' Report Thereon)

SONOMA STATE UNIVERSITY

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KPMG LLP
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

Dr. Ruben Arminana
President
Sonoma State University

We have audited the accompanying financial statements of Sonoma State University (the University) and its aggregate discretely presented component units as of and for the year ended June 30, 2006, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based upon our audit. We did not audit the financial statements of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as it relates to the amounts included for the aggregate discretely presented component units, is based solely on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 2, the financial statements present only the statement of net assets, statement of revenues, expenses, and changes in net assets, and statement of cash flows of the University and do not purport to, and do not, present fairly the financial position of the California State University System as of June 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

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 University and of its aggregate discretely presented component units as of June 30, 2006, and the respective changes in financial position and where applicable, cash flows thereof, for the year then ended in conformity with U.S. generally accepted accounting principles.



Management's discussion and analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

October 13, 2006

SONOMA STATE UNIVERSITY
Management's Discussion and Analysis
June 30, 2006

This section of Sonoma State University's (the University) annual financial report presents our discussion and analysis of the financial performance of the University for the fiscal year ended June 30, 2006. This discussion has been prepared by management and should be read in conjunction with the financial statements and notes.

Introduction to the Financial Statements

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB) Statements No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*. For reporting purposes, the University is considered a special-purpose government engaged in business-type activities.

The financial statements include the statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows. These statements are supported by the notes to the financial statements and this section. All sections must be considered together to obtain a complete understanding of the financial picture of the University.

Statement of Net Assets – The statement of net assets includes all assets and liabilities. Assets and liabilities are reported at their book value, on an accrual basis, as of the statement date. It also identifies major categories of restrictions on the net assets of the University.

Statement 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 on an accrual basis.

Statement of Cash Flows – The statement of cash flows presents the inflows and outflows of cash for the year and is summarized by operating, noncapital financing, capital and related financing, and investing activities. The statement is prepared using the direct method of cash flows and, therefore, presents gross rather than net amounts for the year's activities.

Analytical Overview

Summary

The following discussion highlights management's understanding of the key financial aspects of the University's financial activities. Included is an analysis of current year activities and balances; a discussion of restrictions of University net assets; a discussion of capital assets and long-term debt; and factors impacting future reporting periods.

SONOMA STATE UNIVERSITY
Management's Discussion and Analysis
June 30, 2006

The University's condensed summary of net assets as of June 30, 2006 and 2005 are as follows:

Condensed Summary of Net Assets

June 30

	2006	2005
Assets:		
Current assets	\$ 54,412,125	48,548,810
Capital assets	172,084,336	157,570,595
Other noncurrent assets	26,192,717	21,017,880
Total assets	252,689,178	227,137,285
Liabilities:		
Current liabilities	29,541,715	25,742,470
Long-term debt obligations, net of current portion	98,801,211	96,836,819
Other noncurrent liabilities	8,103,344	8,760,752
Total liabilities	136,446,270	131,340,041
Net assets:		
Invested in capital assets, net of related debt	75,274,343	58,705,963
Restricted, expendable	19,768,664	18,933,219
Unrestricted	21,199,901	18,158,062
Total net assets	\$ 116,242,908	95,797,244

Net Assets

The University's net assets totaled \$116.2 million at June 30, 2006. A significant portion, \$75.3 million of net assets at the end of the year, is invested in capital assets (net of depreciation and related debt). Net assets increased by \$20.4 million between 2005 and 2006. The primary reason for the increase was due to \$20.7 million in capital state appropriations for various projects of which \$16.2 million of the capital state appropriations is to fund the construction of Music/Faculty Office Building, \$475,600 to fund the Ives roof and deck replacement project, \$304,400 to fund the domestic water distribution controls project, \$2.2 million to fund equipment for the Darwin Hall science building, and \$1.4 million for other various capital outlay projects.

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Management's Discussion and Analysis
June 30, 2006

Restricted Resources

Net assets of the University include funds that are restricted by donor or law. The following table summarizes which funds are restricted, the type of restriction, and the amount:

Restricted Net Assets		
June 30		
	2006	2005
Expendable:		
Scholarships and fellowships	\$ 24,531	31,588
Loans	2,869	2,869
Capital projects	17,913,099	17,129,211
Debt service	905,596	1,071,093
Other	922,569	698,458
Total restricted net assets – expendable	\$ 19,768,664	18,933,219

Net assets of the University also include unrestricted categories of net assets. Unrestricted net assets may be designated for use by management of the University and may have legislative or bond indenture requirements associated with their use. These requirements limit the area of operations for which expenditures of unrestricted net assets may be made, and require that unrestricted net assets be designated to support future operations in these areas. Campus housing programs are a primary example. Unrestricted net assets total \$21.2 million.

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Management's Discussion and Analysis
June 30, 2006

The University's condensed summary of revenues, expenses, and changes in net assets for the years ended June 30, 2006 and 2005 is as follows:

Condensed Summary of Revenues, Expenses, and Changes in Net Assets
Year ended June 30

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Student tuition and fees	\$ 27,342,051	24,378,399
Grants, contracts, and gifts	36,565,734	39,177,901
Sales and services of auxiliary enterprises, net	15,383,879	16,908,657
Other operating revenue	3,263,941	3,149,223
Total operating revenues	<u>82,555,605</u>	<u>83,614,180</u>
Operating expenses	<u>(137,362,986)</u>	<u>(137,028,793)</u>
Nonoperating revenues (expenses):		
State appropriations	54,732,877	53,403,811
Investment income	1,425,671	587,093
Other nonoperating revenues (expenses)	<u>(1,746,942)</u>	<u>(1,744,749)</u>
Total nonoperating revenues (expenses)	<u>54,411,606</u>	<u>52,246,155</u>
Other capital-related revenues:		
State appropriations, capital	20,677,096	242,000
Grants and gifts, capital	<u>164,343</u>	<u>8,878,807</u>
Increase in net assets	20,445,664	7,952,349
Beginning net assets	<u>95,797,244</u>	<u>87,844,895</u>
Ending net assets	<u>\$ 116,242,908</u>	<u>95,797,244</u>

Operating Revenues and Expenses

Operating revenues and expenses come from sources that are connected directly to the University's primary business function. This includes revenues from categories such as tuition and fees, grants and contracts that will be used for noncapital purposes, and sales and services of auxiliary enterprises. Expenses include categories such as salaries and wages, benefits, supplies and services, student grants and scholarships, and depreciation. In this discussion and analysis, expenses are reported by functional program such as instruction, academic support, and student services.

Operating Revenues

The University recognized \$82.6 million in operating revenues during this fiscal year, as compared to \$83.6 million in the prior year for a decrease of approximately 1.3%. Grants and contracts contributed the greatest to this decrease. During the fiscal year, the University significantly decreased its grant activity with the California Department of Education by approximately \$2.7 million. Tuition and fees increased due to a moderate increase in the State University Fee. In addition, the University allocated a portion of the scholarship allowances

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Management's Discussion and Analysis

June 30, 2006

to "sales and services of auxiliary enterprises" where in the past it had all been allocated to "student tuition and fees." Sales and services of auxiliary enterprises decreased approximately \$1.5 million which is composed of approximately \$1.2 million relating to the allocation of scholarship allowances to "sales and services of auxiliary enterprises". The remaining decrease represents decreased housing revenue due to the decrease in the housing occupancy rate.

Operating Expenses

The University's operating expenses consist of salaries and fringe benefits of \$87.4 million, supplies and services of \$38 million, scholarships and fellowships of \$5.1 million, and depreciation of \$6.9 million. Total operating expenses, excluding depreciation, increased by approximately \$300,000 or 0.2%. This increase consisted of increases in instruction, academic support, student services, institutional support, and auxiliary enterprise expenses due to a combination of salary increases and increased health benefit costs offset by a decrease in grants and contracts of approximately 8% due to decreased grant activity with the California Department of Education by approximately \$2.7 million.

Nonoperating and Other Revenues (Expenses)

Nonoperating and other revenues (expenses) come from sources that are not part of the University's primary business functions. Included in this classification are categories such as state appropriations, gifts and grants, investment income, and interest on capital-related debt.

As the University is part of the California State University System, which is an agency of the state of California, the University's operations are funded primarily from appropriations of state tax revenues. Appropriations used for purposes of acquisition of capital assets totaled \$20.7 million for the fiscal year ended June 30, 2006, up from \$242,000 for the fiscal year ended June 30, 2005. Capital state appropriations increased \$20.4 million which included \$16.2 million received for the construction of the Music/Faculty Office Building, \$2.2 million for equipment for the Darwin Hall renovation project, \$475,600 for the Ives roof and deck replacement project, \$304,400 for the domestic water distribution controls project, and approximately another \$1.2 million for other miscellaneous capital outlay projects. General (noncapital) appropriation revenues totaled \$54.7 million, an increase of \$1.3 million from the prior year.

Investment income showed a significant increase of approximately \$840,000 because the University had a larger investment balance than in the prior year.

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Management's Discussion and Analysis
June 30, 2006

Capital Assets and Long-Term Debt Obligations

Capital Assets

Capital assets, net of accumulated depreciation are shown below:

	June 30	
	2006	2005
Land and land improvements	\$ 14,269,727	14,269,727
Works of art and historical treasures	451,416	451,416
Buildings and building improvements	97,465,128	101,591,239
Improvements, other than buildings	5,133,296	5,291,381
Infrastructure	11,650,057	11,835,822
Personal property	7,325,436	7,201,632
Intangible assets	117,382	100,444
Construction work in progress	35,671,894	16,828,934
Total capital assets, net of accumulated depreciation	\$ 172,084,336	157,570,595

At June 30, 2006 and 2005, the University had \$172.1 million and \$157.6 million, respectively, in capital assets, net of accumulated depreciation of \$105.3 million and \$99.3 million, respectively. Depreciation expense totaled \$6.9 million and \$7.1 million for the years ended June 30, 2006 and 2005, respectively.

Current year expenditures for major capital projects in progress during the year and their funding sources:

Green Music Center funded by private donations and systemwide revenue bonds	\$ 2,449,400
Darwin Hall renovation funded by capital appropriations	15,910,270
Total	\$ 18,359,670

See note 5 of the notes to the financial statements for further information on capital assets.

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Management's Discussion and Analysis
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Long-Term Debt Obligations

Debt outstanding at June 30, 2006 and 2005 is summarized below by type of debt instrument:

	June 30	
	2006	2005
Systemwide Revenue Bonds:		
Housing Bonds Series AV	\$ —	7,103,067
Housing Bonds Series AX	—	27,175,000
Housing Bonds Series 2005B	6,705,000	—
Housing Bonds Series 2005C AX	26,095,000	—
Housing Bonds Series 2002A	38,870,000	39,530,000
Housing Bonds Series 2005C Hospitality Center	4,275,000	—
Parking Bonds Series 2002A	9,085,000	9,260,000
Student Union Bonds Series 2004A	15,395,000	15,650,000
Other	478,561	146,565
Unamortized bond premium	1,702,371	—
Unamortized loss on refunding	(1,664,406)	—
Total long-term debt	<u>100,941,526</u>	<u>98,864,632</u>
Less current portion	<u>2,140,315</u>	<u>2,027,813</u>
Long-term debt, net of current portion	<u>\$ 98,801,211</u>	<u>96,836,819</u>

The interest rates on outstanding debt range from 2.5% to 5.5%.

At June 30, 2006 and 2005, the University had \$100.9 million and \$98.9 million, respectively, in debt outstanding.

During the year, the University issued \$4,275,000 of debt through the system-wide revenue bond program. The debt proceeds are being used as partial funding for the construction of the Green Music Center. In addition, the Housing Revenue Bonds Series AV and AX were refunded by the 2005B and 2005C AX Series Housing Revenue Bonds.

Bond Ratings

Moody's Investors Service currently provides an intrinsic rating for the Systemwide Revenue Bonds at A1 and the Student Union Revenue Bonds at A2 (however, these bonds are insured to Aaa). Standard & Poor's currently rates the Systemwide Revenue Bonds at A+ and the Student Union Revenue Bonds at A (however, these bonds are insured to AAA).

See notes 8 through 10 of the notes to the financial statements for further information on long-term debt obligations.

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Management's Discussion and Analysis

June 30, 2006

Factors Impacting Future Periods

Foundation work on the Green Music Center, including the Green Music Center Concert Hall, began in spring 2006. Construction will begin in fall 2006 and is expected to finish in fall 2008. The Green Music Center is a multi-purpose and multi-funded complex. It will consist of a world class concert hall, a music/faculty office building and a conference facility. Funding for the complex comes from private donations, capital appropriations and California State University system-wide revenue bonds. The Foundation is assisting Sonoma State University in the planning and financing for the Green Music Center complex through on-going fundraising activities.

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Statement of Net Assets

June 30, 2006

Assets	<u>University</u>	<u>Discretely presented component units Auxiliary Organizations</u>	<u>Total</u>
Current assets:			
Cash and cash equivalents	\$ 13,948,506	2,786,258	16,734,764
Short-term investments	30,146,842	1,400,345	31,547,187
Accounts receivable, net	8,763,216	847,219	9,610,435
Pledges receivable, net	—	2,350,779	2,350,779
Prepaid expenses and other assets	1,553,561	777,097	2,330,658
Total current assets	<u>54,412,125</u>	<u>8,161,698</u>	<u>62,573,823</u>
Noncurrent assets:			
Restricted cash and cash equivalents	516,944	4,139,325	4,656,269
Accounts receivable, net	18,336,910	—	18,336,910
Student loans receivable, net	1,902,081	—	1,902,081
Pledges receivable, net	—	2,311,393	2,311,393
Endowment investments	—	26,381,482	26,381,482
Other long-term investments	5,425,115	43,673,450	49,098,565
Capital assets, net	172,084,336	7,668,234	179,752,570
Other assets	11,667	2,211,679	2,223,346
Total noncurrent assets	<u>198,277,053</u>	<u>86,385,563</u>	<u>284,662,616</u>
Total assets	<u>252,689,178</u>	<u>94,547,261</u>	<u>347,236,439</u>
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	3,153,632	333,532	3,487,164
Accrued salaries and benefits payable	5,037,468	23,325	5,060,793
Accrued compensated absences – current portion	3,847,329	39,251	3,886,580
Deferred revenue	8,335,911	1,356,214	9,692,125
Due to California State University Risk Management Authority	539,000	—	539,000
Long-term debt obligations – current portion	2,140,315	5,513,230	7,653,545
Other liabilities	6,488,060	1,756,254	8,244,314
Total current liabilities	<u>29,541,715</u>	<u>9,021,806</u>	<u>38,563,521</u>
Noncurrent liabilities:			
Accrued compensated absences, net of current portion	2,058,880	31,546	2,090,426
Deferred revenue	3,400,000	—	3,400,000
Grants refundable	2,155,568	—	2,155,568
Long-term debt obligations, net of current portion	98,801,211	12,697,480	111,498,691
Depository accounts	262,800	—	262,800
Other liabilities	226,096	5,591,103	5,817,199
Total noncurrent liabilities	<u>106,904,555</u>	<u>18,320,129</u>	<u>125,224,684</u>
Total liabilities	<u>136,446,270</u>	<u>27,341,935</u>	<u>163,788,205</u>
Net assets:			
Invested in capital assets, net of related debt	75,274,343	2,155,004	77,429,347
Restricted for:			
Nonexpendable – endowments	—	27,375,602	27,375,602
Expendable:			
Scholarships and fellowships	24,531	488,389	512,920
Loans	2,869	—	2,869
Capital projects	17,913,099	—	17,913,099
Debt service	905,596	1,066,736	1,972,332
Other	922,569	24,637,393	25,559,962
Unrestricted	21,199,901	11,482,202	32,682,103
Total net assets	<u>\$ 116,242,908</u>	<u>67,205,326</u>	<u>183,448,234</u>

See accompanying notes to financial statements.

SONOMA STATE UNIVERSITY

Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2006

	<u>University</u>	<u>Discretely presented component units Auxiliary Organizations</u>	<u>Total</u>
Revenues:			
Operating revenues:			
Student tuition and fees (net of scholarship allowances of \$4,105,292)	\$ 27,342,051	2,355,952	29,698,003
Grants and contracts, noncapital:			
Federal	25,984,876	28,865	26,013,741
State and local	7,914,281	211,580	8,125,861
Nongovernmental	2,666,577	—	2,666,577
Sales and services of educational activities	—	23,743	23,743
Sales and services of auxiliary enterprises (net of scholarship allowances of \$1,216,681)	15,383,879	5,391,275	20,775,154
Other operating revenues	3,263,941	1,551,800	4,815,741
Total operating revenues	<u>82,555,605</u>	<u>9,563,215</u>	<u>92,118,820</u>
Expenses:			
Operating expenses:			
Instruction	35,874,420	370,710	36,245,130
Public service	31,318,972	30,964	31,349,936
Academic support	9,865,257	710,014	10,575,271
Student services	10,767,994	3,467,648	14,235,642
Institutional support	14,671,327	306,880	14,978,207
Operation and maintenance of plant	12,203,230	—	12,203,230
Student grants and scholarships	5,106,851	12,773	5,119,624
Auxiliary enterprise expenses	10,684,581	5,667,794	16,352,375
Depreciation	6,870,354	357,670	7,228,024
Total operating expenses	<u>137,362,986</u>	<u>10,924,453</u>	<u>148,287,439</u>
Operating loss	<u>(54,807,381)</u>	<u>(1,361,238)</u>	<u>(56,168,619)</u>
Nonoperating revenues (expenses):			
State appropriations, noncapital	54,732,877	—	54,732,877
Gifts, noncapital	1,305,929	1,624,661	2,930,590
Investment income, net	1,425,671	999,289	2,424,960
Endowment income	—	2,830,011	2,830,011
Interest on capital-related debt	(4,924,154)	(449,367)	(5,373,521)
Other nonoperating revenues (expenses), net	1,871,283	(451,511)	1,419,772
Net nonoperating revenues	<u>54,411,606</u>	<u>4,553,083</u>	<u>58,964,689</u>
Income (loss) before other additions	<u>(395,775)</u>	<u>3,191,845</u>	<u>2,796,070</u>
State appropriations, capital	20,677,096	—	20,677,096
Grants and gifts, capital	164,343	(60,708)	103,635
Additions to permanent endowments	—	737,178	737,178
Increase in net assets	<u>20,445,664</u>	<u>3,868,315</u>	<u>24,313,979</u>
Net assets:			
Net assets at beginning of year	<u>95,797,244</u>	<u>63,337,011</u>	<u>159,134,255</u>
Net assets at end of year	<u>\$ 116,242,908</u>	<u>67,205,326</u>	<u>183,448,234</u>

See accompanying notes to financial statements.

SONOMA STATE UNIVERSITY

Statement of Cash Flows

Year ended June 30, 2006

	University
Cash flows from operating activities:	
Student tuition and fees	\$ 27,936,323
Federal grants and contracts	27,396,516
State and local grants and contracts	10,010,856
Nongovernmental grants and contracts	2,548,953
Payments to suppliers	(33,753,719)
Payments to employees	(87,172,379)
Payments to students	(5,106,851)
Sales and services of auxiliary enterprises	15,366,031
Other receipts	2,791,183
Net cash used in operating activities	(39,983,087)
Cash flows from noncapital financing activities:	
State appropriations	54,539,941
Gifts and grants received for other than capital purposes	1,305,929
Federal loan program receipts	26,567,411
Federal loan program disbursements	(26,440,430)
Other	1,641,346
Net cash provided by noncapital financing activities	57,614,197
Cash flows from capital and related financing activities:	
Proceeds from capital debt	39,745,770
State appropriations	20,997,056
Capital grants and gifts	151,523
Acquisition of capital assets	(23,375,128)
Transfer to escrow agent	(36,000,970)
Principal paid on capital debt and leases	(1,668,004)
Interest paid on capital debt and leases	(4,925,121)
Net cash used in capital and related financing activities	(5,074,874)
Cash flows from investing activities:	
Proceeds from sales and maturities of investments	43,585,663
Purchases of investments	(58,606,412)
Investment income received	1,306,558
Net cash used in investing activities	(13,714,191)
Net decrease in cash and cash equivalents	(1,157,955)
Cash and cash equivalents at beginning of year	15,623,405
Cash and cash equivalents at end of year	\$ 14,465,450
Summary of cash and cash equivalents at end of year:	
Cash and cash equivalents	\$ 13,948,506
Restricted cash and investments	516,944
Total cash and cash equivalents at end of year	\$ 14,465,450

SONOMA STATE UNIVERSITY

Statement of Cash Flows

Year ended June 30, 2006

	<u>University</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (54,807,381)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation	6,870,354
Change in assets and liabilities:	
Accounts receivable, net	3,399,517
Prepaid expenses and other assets	(195,848)
Accounts payable	216,575
Accrued salaries and benefits	463,646
Accrued compensated absences	3,438
Deferred revenue	346,940
Due to California State University Risk Management Authority	(578,000)
Depository accounts	(272,200)
Other liabilities	4,569,872
Net cash used in operating activities	<u>\$ (39,983,087)</u>
Supplemental schedule of noncash transactions:	
Contributed capital assets	\$ 8,939
Capital asset transferred from the Office of the Chancellor	3,881
Accrued capital asset costs (purchased but unpaid at year end)	(1,733,788)

See accompanying notes to financial statements.

SONOMA STATE UNIVERSITY

Notes to Financial Statements

June 30, 2006

(1) Organization

Sonoma State University (the University) was established as a campus of the California State University under the state of California Education Code to offer undergraduate and graduate instruction for professional and occupational goals emphasizing a broad liberal arts education. As one of 23 campuses in the California State University System (the System), the University is included in the financial statements of the System. Responsibility for the University is vested in the Trustees of the System (the Trustees) who, in turn, appoint the Chancellor, the chief executive officer of the System, and the University president, the chief executive officer of the University.

The University provides instruction for baccalaureate and masters' degrees and certificate programs and operates various auxiliary enterprises such as student dormitories, student unions, and parking facilities. In addition, the University administers a variety of financial aid programs which are funded primarily through state and federal programs.

(2) Summary of Significant Accounting Policies

(a) *Financial Reporting Entity*

In accordance with Governmental Accounting Standards Board (GASB) Statements No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, the accompanying financial statements include the accounts of the University and the University's four recognized auxiliary organizations. These auxiliary organizations are legally separate entities that provide services primarily to the University's students and faculty. Separate financial statements are issued for each of the recognized auxiliary organizations and may be obtained from the University.

The discretely presented Auxiliary Organizations are as follows:

- Sonoma State University Academic Foundation, Inc.
- Sonoma State Enterprises, Inc.
- Sonoma Student Union Corporation
- Associated Students of Sonoma State University, Inc.

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Notes to Financial Statements

June 30, 2006

Summary information for the discretely presented auxiliary organizations is as follows:

June 30, 2006	Sonoma State University Academic Foundation, Inc.	Sonoma State Enterprises, Inc.	Sonoma Student Union Corporation	Associated Students of Sonoma State University, Inc.	Total
Current assets	\$ 5,023,250	1,617,761	561,822	958,865	8,161,698
Capital assets, net	1,099,371	6,174,558	357,373	36,932	7,668,234
Noncurrent assets	72,926,687	5,790,642	—	—	78,717,329
Total assets	<u>79,049,308</u>	<u>13,582,961</u>	<u>919,195</u>	<u>995,797</u>	<u>94,547,261</u>
Current liabilities	1,614,855	7,087,037	77,894	242,020	9,021,806
Noncurrent liabilities	18,301,718	—	15,315	3,096	18,320,129
Total liabilities	<u>19,916,573</u>	<u>7,087,037</u>	<u>93,209</u>	<u>245,116</u>	<u>27,341,935</u>
Invested in capital assets, net of related debt	1,099,371	661,328	357,373	36,932	2,155,004
Restricted	53,568,120	—	—	—	53,568,120
Unrestricted	4,465,244	5,834,596	468,613	713,749	11,482,202
Total net assets	<u>\$ 59,132,735</u>	<u>6,495,924</u>	<u>825,986</u>	<u>750,681</u>	<u>67,205,326</u>
Operating Revenues:					
Student tuition and fees	—	—	1,370,000	985,952	2,355,952
Grants and contracts, noncapital	—	—	—	240,445	240,445
Sales and services of educational activities	23,743	—	—	—	23,743
Sales and services of auxiliary enterprises, net	—	4,869,750	380,522	141,003	5,391,275
Other	176,868	1,328,267	(1,429)	48,094	1,551,800
Total operating revenues	<u>200,611</u>	<u>6,198,017</u>	<u>1,749,093</u>	<u>1,415,494</u>	<u>9,563,215</u>
Operating Expenses:					
Instruction	370,710	—	—	—	370,710
Public service	30,964	—	—	—	30,964
Academic support	710,014	—	—	—	710,014
Student services	8,355	—	2,080,881	1,378,412	3,467,648
Institutional support	306,880	—	—	—	306,880
Student grants and scholarships	7,710	—	5,063	—	12,773
Auxiliary enterprise expenses	—	5,667,794	—	—	5,667,794
Depreciation	34,415	284,566	30,072	8,617	357,670
Total operating expenses	<u>1,469,048</u>	<u>5,952,360</u>	<u>2,116,016</u>	<u>1,387,029</u>	<u>10,924,453</u>
Nonoperating revenues (expenses) and capital additions	4,778,178	(376,462)	13,810	76,849	4,492,375
Contributions to endowments	737,178	—	—	—	737,178
Increase (decrease) in net assets	4,246,919	(130,805)	(353,113)	105,314	3,868,315
Beginning net assets	54,885,816	6,626,729	1,179,099	645,367	63,337,011
Ending net assets	<u>\$ 59,132,735</u>	<u>6,495,924</u>	<u>825,986</u>	<u>750,681</u>	<u>67,205,326</u>

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The auxiliary organizations are presented in the accompanying financial statements as component units due to the nature and significance of their relationship with the University. The relationships are such that exclusion of these organizations from the reporting entity would render the financial statements incomplete, primarily due to the activities that the organizations carry out on behalf of the University, such as foodservice and academic support. The auxiliary organizations are discretely presented to allow the financial statement users to distinguish them from the University.

The financial statements present only the statement of net assets, statement of revenues, expenses, and changes in net assets, and statement of cash flows of the University and do not purport to, and do not, present fairly the financial position of the California State University System as of June 30, 2006 and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

(b) *Basis of Presentation*

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with U.S. generally accepted accounting principles, as prescribed by the GASB. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

The financial statements required by GASB Statement Nos. 34 and 35 include a statement of net assets, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows. As a public institution, the University is considered a special-purpose government under the provisions of GASB Statement No. 35. The University records revenue in part from fees and other charges for services to external users and, accordingly, has chosen to present its financial statements using the reporting model for special-purpose governments engaged only in business-type activities. This model allows all financial information for the University to be reported in a single column in each of the financial statements, accompanied by aggregated financial information for the auxiliary organizations. In accordance with the business-type activities reporting model, the University prepares its statement of cash flows using the direct method.

The auxiliary organizations included in these financial statements apply the accounting and reporting standards promulgated by GASB.

(c) *Election of Applicable FASB Statements*

The University has elected not to adopt the pronouncements issued by the Financial Accounting Standards Board (FASB) after November 30, 1989.

(d) *Classification of Current and Noncurrent Assets and Liabilities*

The University considers assets to be current that can reasonably be expected, as part of its normal business operations, to be converted to cash and be available for liquidation of current liabilities within 12 months of the statement of net assets date. Liabilities that reasonably can be expected, as part of normal University business operations, to be liquidated within 12 months of the statement of net assets date are considered to be current. All other assets and liabilities are considered to be noncurrent.

SONOMA STATE UNIVERSITY

Notes to Financial Statements

June 30, 2006

(e) ***Cash and Cash Equivalents***

The University considers all highly liquid investments with an original maturity date of three months or less to be cash and cash equivalents.

(f) ***Investments***

Investments are reflected at fair value using quoted market prices. Realized and unrealized gains and losses are included in the accompanying statement of revenues, expenses, and changes in net assets as investment income, net.

(g) ***Capital Assets***

Capital assets are stated at cost or estimated historical cost if purchased, or if donated, at estimated fair value at date of donation. Capital assets, including infrastructure, with a value of \$5,000 or more and with a useful life of one year or more are capitalized. Title to all assets, whether purchased, constructed, or donated, is held by the state of California. Although title is not with the University for land and buildings, the University has exclusive use of these assets and is responsible for the maintenance of these assets and thus has recorded the cost of these assets on the accompanying financial statements. Capital assets, with the exception of land and land improvements, works of art and historical treasures, and construction work in progress, are depreciated on a straight-line basis over their estimated useful lives, which range from 5 to 40 years. Library books, unless considered rare collections, are capitalized and depreciated over a 10-year period. Periodicals and subscriptions are expensed as purchased. Works of art and historical treasures are valued at cost if purchased or the fair market value at the date of donation if contributed. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend its life are expensed as incurred.

Depreciation expense is shown separately in the statement of revenues, expenses, and changes in net assets rather than being allocated among other categories of operating expenses.

(h) ***Deferred Revenue***

Deferred revenue consists primarily of fees collected in advance for summer and fall terms, continuing education programs, and payments received in accordance with an operating lease agreement.

(i) ***Compensated Absences***

University employees accrue annual leave at rates based on length of service and job classification.

(j) ***Grants Refundable***

The University periodically receives contributions from the federal government in support of its operation of the Federal Perkins and Nursing Loan programs, approved Title IV loan programs. The federal government has the ability to terminate its support of these programs at any time and to request the University to return those contributions that it has made on a cumulative basis. Accordingly, the federal contributions received and retained by the University at year end are considered to be liabilities of the University and are reflected as such in the accompanying statement of net assets.

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Notes to Financial Statements

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(k) Net Assets

The University's net assets are classified into the following net asset categories:

Invested in capital assets, net of related debt – Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted – nonexpendable – Net assets subject to externally imposed conditions that the University retain them in perpetuity. Net assets in this category consist of endowments held by the University or its related auxiliaries.

Restricted – expendable – Net assets subject to externally imposed conditions that can be fulfilled by the actions of the University or by the passage of time.

Unrestricted – All other categories of net assets. In addition, unrestricted net assets may be designated for use by management of the University or have legislative or bond indenture requirements associated with their use. These requirements limit the area of operations for which expenditures of net assets may be made and require that unrestricted net assets be designated to support future operations in these areas. Campus housing programs are a primary example of operations that have unrestricted net assets with designated uses.

The University has adopted a policy of generally utilizing restricted – expendable funds, prior to unrestricted funds, when an expense is incurred for purposes for which both are available.

(l) Classification of Revenues and Expenses

The University considers operating revenues and expenses in the statement of revenues, expenses, and changes in net assets to be those revenues and expenses that result from exchange transactions or from other activities that are connected directly to the University's primary functions. Exchange transactions include charges for services rendered and the acquisition of goods and services. Certain other transactions are reported as nonoperating revenues and expenses or capital contributions in accordance with GASB Statement No. 35. These nonoperating activities include the University's operating and capital appropriations from the State of California, net investment income, gifts, and interest expense.

The State of California appropriates funds to the System on an annual basis. The appropriations are, in turn, allocated among the campuses by the Office of the Chancellor. Appropriations are recognized as revenue when authorization is received, and are reported as either noncapital appropriations when used to support general operations or capital appropriations when used for capital projects.

Student tuition and fee revenue, and sales and services of auxiliary enterprises, including revenues from student housing programs, are presented net of scholarships and fellowships applied to student accounts. Certain other scholarship amounts are paid directly to, or refunded to, the student and are reflected as expenses.

SONOMA STATE UNIVERSITY

Notes to Financial Statements

June 30, 2006

(m) Income Taxes

The System was established under the state of California Education Code as an agency of the state of California. As a campus of the System, the University is generally not subject to federal or state income taxes. However, the University remains subject to income taxes on any net income that is derived from a trade or business, regularly carried on and not in furtherance of the purpose for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole.

(n) Eliminations

All significant nonexchange transactions between the University and the discretely presented auxiliary organizations have been eliminated from the total column.

(o) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the accompanying financial statements. Actual results could differ from those estimates.

(3) Cash and Cash Equivalents and Investments

The University's cash and cash equivalents and investments as of June 30, 2006 are classified in the accompanying financial statements as follows:

Cash and cash equivalents	\$ 13,948,506
Restricted cash and cash equivalents	<u>516,944</u>
Total cash and cash equivalents	<u>14,465,450</u>
Short-term investments	30,146,842
Other long-term investments	<u>5,425,115</u>
Total investments	<u>35,571,957</u>
Total cash and cash equivalents and investments	<u><u>\$ 50,037,407</u></u>

(a) Cash and Cash Equivalents

At June 30, 2006, cash and cash equivalents consisted of demand deposits held at Wachovia Bank, Bank of America, the State Treasury and petty cash. Total cash and cash equivalents of \$14,465,450 had a corresponding carrying value balance with Wachovia Bank, Bank of America and the State Treasury of \$15,352,808 at June 30, 2006. The differences related primarily to deposits in transit and outstanding checks.

(b) Investments

At June 30, 2006, the University's investment portfolio consists primarily of investments held in the California State University Investment Pool, an internal investment pool, as well as interest-bearing

SONOMA STATE UNIVERSITY

Notes to Financial Statements

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accounts held in the State Treasury. For the California State University Investment Pool, separate accounting is maintained as to the amounts allocable to the various funds and programs.

Investment Policy

State law and regulations require that surplus monies of the University must be invested. The primary objective of the University's investment policy is to safeguard the principal. The secondary objective is to meet the liquidity needs of the University. The third objective is to return an acceptable yield. The University's investment policy authorizes funds held in local trust accounts under Education Code Sections 89721 and 89724 to be invested in any of the securities authorized by Government Code Section 16430 and Education Code Section 89724, subject to certain limitations. In general, the University's investment policy permits investments in the State of California Surplus Money Investment Fund and Metropolitan West Securities, Inc. (MetWest).

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the University manages its exposure to interest rate risk is by purchasing a combination of short-term and mid-term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or nearing maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The University monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio. The weighted average maturity of the University's investment portfolio for each investment type as of June 30, 2006 is presented in the table below.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

The following table presents the fair value, weighted average maturity, and actual rating by investment type of the University's investment portfolio as of June 30, 2006:

Investment type	Fair value	Weighted average maturity (in years)	Rating as of year end			
			AAA	Aa	A	Not rated
Money market mutual funds	\$ 226,417	0.01	\$ —	—	—	226,417
Certificates of deposit	2,152,511	1.41	—	807,119	1,345,392	—
Commercial Paper	878,080	0.01	—	—	—	878,080
U.S. agency securities	665,634	1.46	665,634	—	—	—
Mortgage-backed securities	49,482	10.57	49,482	—	—	—
Corporate and fixed income securities	4,329,243	1.74	198,820	1,205,839	2,924,584	—
Surplus Money Investment Fund	27,259,462	0.42	—	—	—	27,259,462
Total	35,560,829		\$ 913,936	2,012,958	4,269,976	28,363,959
Not subject to ratings:						
U.S. Treasury securities	11,128	1.85				
Total Investments	\$ 35,571,957					

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Concentration of Credit Risk

The University's investment policy contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. As of June 30, 2006, there were no investments representing 5% or more of the University's investment portfolio.

For information regarding the investments of the individual discretely presented auxiliary organizations, please refer to the separately issued auxiliary organizations reports.

(4) Accounts Receivable

Accounts receivable at June 30, 2006 consisted of the following:

	<u>Current</u>	<u>Noncurrent</u>	<u>Total</u>
State appropriations	\$ 1,576,397	18,336,910	19,913,307
Auxiliary organizations	170,465	—	170,465
Student accounts	110,130	—	110,130
Government grants and contracts	5,961,124	—	5,961,124
State of California Surplus Money			
Investment Fund	248,247	—	248,247
Other	752,039	—	752,039
	<u>8,818,402</u>	<u>18,336,910</u>	<u>27,155,312</u>
Less allowance for doubtful accounts	<u>(55,186)</u>	<u>—</u>	<u>(55,186)</u>
Total	<u>\$ 8,763,216</u>	<u>18,336,910</u>	<u>27,100,126</u>

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Notes to Financial Statements

June 30, 2006

(5) Capital Assets

Capital asset activity for the year ended June 30, 2006 consisted of the following:

	<u>Balance June 30, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>Transfers of Completed CWIP</u>	<u>Transfers from/to CO/Campus</u>	<u>Balance June 30, 2006</u>
Nondepreciable capital assets:						
Land and land improvements	\$ 14,269,727	—	—	—	—	14,269,727
Works of art and historical treasures	451,416	—	—	—	—	451,416
Construction work in progress	<u>16,828,934</u>	<u>19,255,002</u>	<u>—</u>	<u>(412,042)</u>	<u>—</u>	<u>35,671,894</u>
Total nondepreciable capital assets	<u>31,550,077</u>	<u>19,255,002</u>	<u>—</u>	<u>(412,042)</u>	<u>—</u>	<u>50,393,037</u>
Depreciable capital assets:						
Buildings and building improvements	162,956,733	107,531	(199,795)	61,795	—	162,926,264
Improvements, other than buildings	18,242,598	263,284	—	350,247	—	18,856,129
Infrastructure	19,450,095	244,554	—	—	—	19,694,649
Personal property:						
Equipment	12,838,804	1,157,219	(966,294)	—	264,338	13,294,067
Library books and materials	10,946,464	554,411	(158,532)	—	—	11,342,343
Intangible assets	<u>841,198</u>	<u>68,278</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>909,476</u>
Total depreciable capital assets	<u>225,275,892</u>	<u>2,395,277</u>	<u>(1,324,621)</u>	<u>412,042</u>	<u>264,338</u>	<u>227,022,928</u>
Total cost	<u>256,825,969</u>	<u>21,650,279</u>	<u>(1,324,621)</u>	<u>—</u>	<u>264,338</u>	<u>277,415,965</u>
Less accumulated depreciation:						
Buildings and building improvements	(61,365,494)	(4,105,632)	9,990	—	—	(65,461,136)
Improvements, other than buildings	(12,951,217)	(771,616)	—	—	—	(13,722,833)
Infrastructure	(7,614,273)	(430,319)	—	—	—	(8,044,592)
Personal property:						
Equipment	(8,033,630)	(1,109,983)	886,034	—	(260,457)	(8,518,036)
Library books and materials	(8,550,006)	(401,464)	158,532	—	—	(8,792,938)
Intangible assets	<u>(740,754)</u>	<u>(51,340)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(792,094)</u>
Total accumulated depreciation	<u>(99,255,374)</u>	<u>(6,870,354)</u>	<u>1,054,556</u>	<u>—</u>	<u>(260,457)</u>	<u>(105,331,629)</u>
Net capital assets	\$ <u>157,570,595</u>	<u>14,779,925</u>	<u>(270,065)</u>	<u>—</u>	<u>3,881</u>	<u>172,084,336</u>

For information regarding the capital assets of the individually discretely presented auxiliary organizations, please refer to the separately issued auxiliary organizations' reports.

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Notes to Financial Statements

June 30, 2006

(6) Property on Operating Leases

The University entered into an operating lease agreement with the Cotati-Rohnert Park Unified School District (C-RP District) for use of certain facilities located on the University campus for 25 years commencing July 1, 1999. In accordance with the agreement, the C-RP District is occupying approximately 15,000 square feet for classroom and office space. The University has received payments of \$5,000,000 in accordance with the operating lease agreement. The receipts are being reflected in deferred revenue and recognized straight line over the term of the lease. The amount of deferred revenue at June 30, 2006 under this operating lease is \$3,600,000. The cost and carrying value of the 15,000 square feet of property under the lease is approximately \$1,055,000 at June 30, 2006.

(7) Lease Obligations

The University is obligated under various operating leases for facility rentals.

Operating leases consist of miscellaneous facility rentals and have terms expiring in various years through fiscal year 2010. In addition, the University has an operating lease expiring in 2008, which was fully prepaid in the amount of \$100,000. The leases can be canceled if the state does not provide adequate funding.

On July 1, 2005, the University entered into a lease agreement with Sonoma State Enterprises, Inc. to sublease back from Sonoma State Enterprises approximately 40,575 square feet of office space located in Salazar Hall. The term of the lease commenced on July 1, 2005 and ends on June 30, 2007. Lease payments to Sonoma State Enterprises, Inc. are paid monthly in the amount of \$81,150 for a total of \$973,800 annually.

Future minimum lease payments under operating leases having remaining terms in excess of one year are as follows:

Year ending June 30:	
2007	\$ 1,778,472
2008	794,810
2009	680,046
2010	<u>97,625</u>
Total minimum lease payments	<u>\$ 3,350,953</u>

Rent expense under operating leases for the year ended June 30, 2006 totaled \$1,765,881.

Lease financing is provided to the System for the construction of various system and campus facilities through its participation with the state of California in the State Public Works Board Lease Revenue Bond Program. Certain capital assets recorded by the University may have been financed under these arrangements. However, since the obligation for the repayment of this financing rests with the System and the proceeds of such financing are not readily identifiable with a campus or project, a substantial portion of such financing is not allocated to the individual campuses of the System. Unallocated Lease Revenue Bonds outstanding for the System as of June 30, 2006 totaled \$554,748,000.

SONOMA STATE UNIVERSITY

Notes to Financial Statements

June 30, 2006

(8) Long-term Debt Obligations

(a) *General Obligation Bond Program*

The General Obligation Bond program of the state of California has provided capital outlay funds for the three segments of California Higher Education through voter-approved bonds. Each of the approved bond programs provides a pool of available funds which is allocated on a project-by-project basis among the University of California, the California State University System, and the Community Colleges. Financing provided to the University through State of California General Obligation Bonds is not allocated to the System by the State of California. This debt remains the obligation of the state and is funded by state tax revenues. Accordingly, such debt is not reflected in the accompanying financial statements. Total General Obligation Bond debt carried by the state related to System projects is approximately \$1,277,682,000 as of June 30, 2006.

(b) *Revenue Bond Programs*

The Revenue Bond Act of 1947 provides the Trustees with the ability to issue revenue bonds to fund five specific self-supporting programs and the health facilities program. The statute has enabled the Trustees to finance student housing, student unions, parking facilities, health facilities, continuing education facilities, and auxiliary organization facilities.

The housing program provides on-campus housing primarily for students. Housing is a self-supporting program deriving its revenues from fees collected for the use of the residence facilities. Funds are used for current operating expenses, maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The student union program provides facilities and programs aimed at creating and enhancing learning experiences outside the classroom by promoting interaction among students, faculty, and staff. The student union program is self-supporting and derives its revenues primarily from student fees and interest income. Funds are used for maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. After payment of all authorized charges, the balances of these funds are available for transfer to the campus auxiliary organization that has contracted with the University to operate the facility. The operating entity may derive additional revenue from facility subrental, recreational and commercial activities, and interest income.

The parking program provides parking facilities. The parking program is self-supporting and derives its revenues primarily from student fees and interest income. Funds are used for construction, repair and maintenance, and principal and interest payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

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The health facilities program provides facilities on campus in which to provide health services to students. The health facilities program derives its revenues primarily from student fees and interest income. Funds are used for current operating expenses, maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The continuing education program provides nonstate-supported courses to students. The continuing education program is self-supporting and derives its revenues primarily from student fees and interest income. Funds are used for current operating expenses, maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The auxiliary organization program provides for certain additional facilities on campus for the benefit of students and staff. The auxiliary organization program derives its revenues primarily from lease income received by the campus from the auxiliary organization using the facility. Funds are used for current operating expenses, maintenance and repair, improvements to facilities, and interest and principal payments on outstanding bonds. Available balances after payment of all operating expenses and required charges remain available for future program expenses and capital needs.

The Systemwide Revenue Bond program, formerly the Housing Revenue Bond program, was approved by the Trustees in fiscal year 2003. This program provides funding for various construction projects, including student residence and dining halls facilities, continuing education buildings, student unions, parking facilities, health facilities, and auxiliary organization facilities at designated campuses within the System as specified by the individual bond documents. It is designed to provide lower cost debt and greater flexibility to finance revenue bond projects of the System. Rather than relying on specific pledged revenues to support specific debt obligations, this program pools several sources of revenue as the pledge for the related revenue producing projects. The System's total outstanding balance of revenue bond indebtedness under the Systemwide Revenue Bond program was \$1,982,433,000 at June 30, 2006. The University's portion of the total outstanding balance under this program was \$100,425,000 at June 30, 2006.

Senior to the Systemwide Revenue Bonds are the Student Union Revenue Bonds Series A, B, and C. At June 30, 2006, the System's outstanding balance for these senior bonds totaled \$70,820,000.

SONOMA STATE UNIVERSITY

Notes to Financial Statements

June 30, 2006

Long-term debt obligations of the University as of June 30, 2006 consist of the following:

<u>Description</u>	<u>Interest rate</u>	<u>Fiscal year maturity date</u>	<u>Original issue amount</u>	<u>Amount outstanding</u>
Systemwide Revenue Bonds:				
Housing Bonds Series 2005B	4.00 – 5.00%	2022	\$ 7,115,000	6,705,000
Housing Bonds Series 2005C AX	3.00 – 5.00%	2031	26,095,000	26,095,000
Housing Bonds Series 2002A	3.00 – 5.00%	2034	40,165,000	38,870,000
Housing Bonds Series 2005C				
Hospitality Center	4.50 – 5.00%	2038	4,275,000	4,275,000
Parking Bonds Series 2002A	3.00 – 5.50%	2032	9,630,000	9,085,000
Student Union Bonds				
Series 2004A	2.50 – 5.00%	2035	15,650,000	15,395,000
Other:				
CIHS Modular Building	5.20%	2009	325,598	79,296
Darwin Remodel	4.23%	2011	500,000	399,265
				100,903,561
Total long-term debt				100,903,561
Unamortized bond premium				1,702,371
Unamortized loss on refunding				(1,664,406)
Total long-term debt				100,941,526
Less current portion				2,140,315
Long-term debt, net of current portion				\$ 98,801,211

Long-term debt principal obligations and related interest mature in the following fiscal years:

	<u>Principal</u>	<u>Interest</u>
2007	\$ 2,140,315	4,839,906
2008	2,314,078	4,768,457
2009	2,441,111	4,674,476
2010	2,541,832	4,568,638
2011	2,651,225	4,454,722
2012-2016	14,110,000	20,432,340
2017-2021	16,910,000	16,662,143
2022-2026	20,010,000	11,989,341
2027-2031	24,860,000	6,456,956
2032-2036	12,405,000	1,196,750
2037-2041	520,000	25,613
	\$ 100,903,561	80,069,342

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Long-term debt obligations of the discretely presented auxiliary organizations have been issued to purchase or construct facilities for University-related uses. For information regarding the long-term debt obligations of the individual discretely presented auxiliary organizations, please refer to the separately issued auxiliary organizations' reports.

(9) Advance Refundings

(a) *Current Year Refundings*

In August 2005, the University defeased Housing System Revenue Bonds Series AV by placing a portion of the proceeds from the issuance of the Systemwide Revenue Bonds Series 2005B refunding bonds in an irrevocable trust with the State Treasurer to provide for all future debt service payments on the refunded bonds. The proceeds from the Series 2005B refunding bonds were used to purchase U.S. government securities that were placed in an escrow account. The investments and fixed earnings from the investments are considered sufficient to fully service the defeased debt until the debt is called or matured. This transaction will reduce the University's total debt service payments by \$587,518 over the life of the bonds. The economic gain (difference between net present values of the debt service payments on the old debt and new debt) from this transaction was \$446,445. Accordingly, the refunded bonds have been considered defeased and therefore removed as a liability from the accompanying financial statements. The series AV defeased bonds subsequently matured on November 1, 2005, and accordingly had no outstanding balance as of June 30, 2006.

In October 2005, the University defeased Housing System Revenue Bonds Series AX by placing a portion of the proceeds from the issuance of the Systemwide Revenue Bonds Series 2005C refunding bonds in an irrevocable trust with the State Treasurer to provide for all future debt service payments on the refunded bonds. The proceeds from the Series 2005C refunding bonds were used to purchase U.S. government securities that were placed in an escrow account. The investments and fixed earnings from the investments are considered sufficient to fully service the refunded debt until the debt is called or matured. This transaction will reduce the University's total debt service payments by \$2,626,258 over the life of the bonds. The economic gain (difference between net present values of the debt service payments on the old debt and new debt) from this transaction was \$839,850. Accordingly, the refunded bonds have been considered defeased and therefore removed as a liability from the accompanying financial statements. The amount of the University's defeased bonds outstanding as of June 30, 2006 totaled \$26,645,000.

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(10) Long-term Liabilities Activity

Long-term liabilities activity for the year ended June 30, 2006 was as follows:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Current portion</u>
Accrued compensated absences	\$ 5,902,771	3,850,767	(3,847,329)	5,906,209	3,847,329
Long-term debt obligations (note 8):					
Housing Revenue Bonds	73,808,067	37,485,000	(35,348,067)	75,945,000	1,660,000
Parking Revenue Bonds	9,260,000	—	(175,000)	9,085,000	185,000
Student Union Bonds 2004A	15,650,000	—	(255,000)	15,395,000	260,000
Other	146,565	500,000	(168,004)	478,561	35,315
Total	98,864,632	37,985,000	(35,946,071)	100,903,561	2,140,315
Unamortized bond premium	—	1,760,770	(58,399)	1,702,371	—
Unamortized loss on refunding	—	(1,722,903)	58,497	(1,664,406)	—
Total long-term debt obligations	98,864,632	38,022,867	(35,945,973)	100,941,526	2,140,315
Total long-term liabilities	\$ 104,767,403	41,873,634	(39,793,302)	106,847,735	5,987,644

(11) Pension Plan and Postretirement Benefits

(a) Plan Description

The University, as an agency of the state of California, contributes to the California Public Employees' Retirement System (CalPERS). The state's plan with CalPERS is an agent multiple-employer defined-benefit pension plan. For the University, the plan acts as a cost-sharing multiple-employer defined-benefit pension plan which provides a defined-benefit pension and postretirement benefit program for substantially all eligible University employees. CalPERS functions as an investment and administrative agent for its members. The plan also provides survivor, death, and disability benefits. Eligible employees are covered by the Public Employees' Medical and Hospital Care Act (PEMHCA) for medical benefits.

CalPERS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS annual financial report may be obtained from the California Public Employees' Retirement System Executive Office – 400 P Street – Sacramento, California 95814.

(b) Funding Policy

University personnel are required to contribute 5% of their monthly earnings in excess of \$513 to CalPERS. The University is required to contribute at an actuarially determined rate; the current rate is approximately 15.942% of annual covered payroll. The contribution requirements of the plan members are established and may be amended by CalPERS.

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The University's contributions to CalPERS for the most recent three fiscal years were equal to the required contributions and were as follows:

2004	\$	8,912,350
2005		10,150,855
2006		9,779,721

(c) Faculty Early Retirement Program

During fiscal year 2004, the System implemented the Faculty Early Retirement Program, which was authorized by Executive Order S-8-04 issued by the Governor on May 6, 2004. In order to enroll in the program, participants must meet the CalPERS retirement eligibility requirements of age 50 or more on the date of retirement and have five years or more of service credit. Eligible employees who elect to participate in this program will receive two additional years of service credit in their retirement income calculation if their (1) separation date is no earlier than May 5, 2004, and no later than July 27, 2004, and (2) CalPERS retirement date is no earlier than May 6, 2004, and no later than July 28, 2004. In return, the System must contribute to CalPERS an amount representing the actuarial equivalent of the value of this benefit. The early retirement benefit is not dependent upon future services and, therefore, is already earned as of June 30, 2004 by those who have elected to participate in the program. The University's total estimated liability under the program is \$897,507, of which \$192,423 was paid during fiscal year 2006. As of June 30, 2006, the University's remaining liability of \$434,678 has been recorded as a component of accrued salaries and benefits payable.

(12) Self-Insurance Program

The System and certain auxiliary organizations have established a public entity risk pool, California State University Risk Management Authority (CSURMA), a blended component unit of the System, to manage centrally workers' compensation, industrial and nonindustrial disability, and general organizational risks. The System's self-insurance claims liability includes estimated amounts that will be required for future payments of claims that have been reported and claims related to events that have occurred but not been reported. The estimated liability is actuarially determined using individual case basis valuations and statistical analyses. Although considerable variability is inherent in such estimates, management believes that the liability is a reasonable estimate at June 30, 2006.

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Changes in the System's self-insurance claims liability for the two years ended June 30, 2006 are as follows:

Liability at June 30, 2004	\$ 118,711,000
Incurred claims and changes in estimates	33,419,000
Claim payments	<u>(34,491,000)</u>
Liability at June 30, 2005	117,639,000
Incurred claims and changes in estimates	23,938,000
Claim payments	<u>(29,201,000)</u>
Liability at June 30, 2006	112,376,000
Less current portion	<u>(27,441,000)</u>
Long-term liability at June 30, 2006, net of current portion	<u>\$ 84,935,000</u>

The University maintains excess general liability insurance coverage provided by Schools Excess Liability Fund (SELF), a Joint Powers Authority, with coverage for individual claims between \$1,000,000 and \$49,000,000 per occurrence. The University purchases excess workers' compensation insurance provided by the Insurance Corporation of Hanover (ICH) to limits of \$50,000,000 in excess of \$2,500,000 self-insured retention and coverage from American Home Assurance Company (AIG) for limits of \$50,000,000 in excess of \$50,000,000. There have been no settlements in the most recent three fiscal years that have exceeded insurance limits. Although the University maintains excess policies with SELF, ICH, AIG, and other insurers, the ultimate responsibility for payment of claims resides with the University.

The University's allocation of the System's total self-insurance claims liability as of June 30, 2006 was approximately 3%, or \$3,386,000. This allocation reflects the University's estimated share of the ultimate cost of settling claims relating to events that have occurred on or before June 30, 2006. All but \$539,000 has been paid by the University to CSURMA at June 30, 2006.

The University's payable due to CSURMA totaled \$539,000 at June 30, 2006, which is recorded as a current liability in the accompanying financial statements

(13) Commitments and Contingencies

Federal grant programs are subject to review by the grantor agencies, which could result in requests for reimbursement to grantor agencies for disallowed expenditures. Management believes that it has adhered to the terms of its grants and that any disallowed expenditures resulting from such review would not have a material effect on the financial position of the University.

Contractual commitments for construction projects unexpended as of June 30, 2006 totaled \$11,190,228. These expenditures will be funded primarily from state appropriations and Systemwide Revenue Bonds.

The University is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the University's financial position, changes in net assets, or liquidity.

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Notes to Financial Statements

June 30, 2006

(14) Classification of Operating Expenses

The University has elected to report operating expenses by functional classification in the statements of revenues, expenses, and changes in net assets, but to provide the natural classification of those expenses as an additional disclosure. For the year ended June 30, 2006, operating expenses by natural classification consisted of the following:

	<u>Salaries</u>	<u>Benefits</u>	<u>Scholarships and fellowships</u>	<u>Supplies and other services</u>	<u>Depreciation</u>	<u>Total</u>
Functional classification:						
Instruction	\$ 25,483,639	7,798,044	—	2,592,737	—	35,874,420
Public service	12,462,471	3,814,233	—	15,042,268	—	31,318,972
Academic support	6,031,207	2,088,917	—	1,745,133	—	9,865,257
Student services	6,263,996	2,140,134	—	2,363,864	—	10,767,994
Institutional support	9,717,455	3,345,014	—	1,608,858	—	14,671,327
Operation and maintenance of plant	4,955,581	2,137,751	—	5,109,898	—	12,203,230
Student grants and scholarships	—	—	5,106,851	—	—	5,106,851
Auxiliary enterprise expenses	700,204	508,846	—	9,475,531	—	10,684,581
Depreciation	—	—	—	—	6,870,354	6,870,354
Total	<u>\$ 65,614,553</u>	<u>21,832,939</u>	<u>5,106,851</u>	<u>37,938,289</u>	<u>6,870,354</u>	<u>137,362,986</u>

(15) Transactions with Related Entities

The System is an agency of the State of California and, as such, processes substantially all of its revenue and expenditure activity through the Office of the California State Controller. Noncapital and capital state appropriations allocated to the University through the Office of the Chancellor aggregated \$54,732,877 and \$20,677,096, respectively, for the year ended June 30, 2006. Noncapital and capital state appropriations receivable aggregated \$1,576,397 and \$18,336,910, respectively, at June 30, 2006.

The University received lottery revenue from the State of California in the amount of \$1,759,000 for the year ended June 30, 2006 and was recorded in other nonoperating revenues and expenses.

The University pays its bond debt service payments by transferring the money to the Chancellor's Office who in turn pays the actual debt service payment. The amount of money held at the Chancellor's Office at June 30, 2006 for future debt service payments is \$1,719,025 and is classified in short term investments.

As headquarters for the System, the Office of the Chancellor administers certain activities centrally for the individual campuses. Primary among these activities are management of capital projects, debt administration, and risk pool administration. The costs associated with the operations of the Office of the Chancellor are not allocated to the individual universities' financial statements.

The University has recorded capital assets that have been financed by the System that are not reflected in the accompanying financial statements. For the year ended June 30, 2006, \$244,554 in additions of capital assets are included in other nonoperating revenues in the accompanying financial statements.

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The University provides operational support to its auxiliary organizations such as strategic planning, executive management, contract and procurement services, accounting, human services, and facility services. The auxiliary organizations pay the University a fee on a semi-annual basis in an amount in accordance with the policies for reimbursement of costs established by the Trustees. Effective June 20, 2002, the University had entered into an agreement with one of its auxiliary organizations, Sonoma State Enterprises, Inc., in which the auxiliary prepaid \$6,100,000 to the University for these types of services over the next 20 years and was recognized as deferred revenue in the accompanying statement of net assets as of June 30, 2003. This amount was to be recognized evenly over the service period. Effective July 1, 2003, the agreement to receive prepaid management and support services was terminated and the amounts previously advanced to the University by Sonoma State Enterprises, Inc. were recharacterized as the acquisition of capital leasehold improvements to office space located in Salazar Hall. In consideration of the \$6,100,000 of capital leasehold improvements to Salazar Hall, the University agreed to lease to Sonoma State Enterprises, Inc. 40,575 square feet of office space located in Salazar Hall for \$1 annually with the term of the lease beginning July 1, 2003 and ending June 30, 2033. The lease is subject to 1) the use of the property for civil defense purposes or in the event of a State or national emergency, and 2) unanticipated need of Trustees to meet the demands of the educational objectives of the University. The right to the use of any property included in this lease shall cease upon written notice by the President of the campus to Lessee that the property is needed for the exclusive use of Trustees. Sonoma State Enterprises Inc. has entered into an agreement to lease back these premises to the University for \$81,150 a month commencing July 1, 2005 and ending on June 30, 2007 (see note 7).

The accompanying financial statements also include the following transactions with discretely presented auxiliary organizations and other related parties:

Reimbursements from recognized Auxiliary Organizations for salaries of University employees working on contracts, grants, and other programs	\$ 3,756,510
Amounts receivable from the Office of the Chancellor	33,363
Amounts payable to the Office of the Chancellor	27,385
Amounts receivable from recognized Auxiliary Organizations	170,465
Amounts payable to recognized Auxiliary Organizations	139,942
Payments to recognized Auxiliary Organizations for services, space, and programs	2,095,277
Reimbursements from recognized Auxiliary Organizations for other than salaries of University personnel	2,433,527
Gifts-in-kind to the University from the Sonoma State University Academic Foundation	8,939

(16) Subsequent Events

On September 20, 2006, the Board of Trustees authorized the sale and issuance of Systemwide Revenue Bond Anticipation Notes and the related sale and issuance of the Systemwide Revenue Bonds in an amount not-to-exceed \$12,910,000. The bond proceeds will be used to help fund the construction of the Green Music Center.