

FINANCIAL STATEMENTS

Embry-Riddle Aeronautical University, Inc.

For the Year Ended June 30, 2004

With Report of Independent Certified Public Accountants

Embry-Riddle Aeronautical University, Inc.

Financial Statements

For the Year Ended June 30, 2004

Contents

Report of Independent Certified Public Accountants	1
Statement of Financial Position	3
Statement of Activities.....	4
Statement of Cash Flows	5
Notes to Financial Statements.....	6
Supplementary Information	
Net Assets Class Disaggregation	22
Three-year Comparative Statements of Financial Position	23
Three-year Comparative Statements of Activities	24
Three-year Comparative Statements of	27

Report of Independent Certified Public Accountants

The Board of Trustees
Embry-Riddle Aeronautical University, Inc.

We have audited the accompanying statement of financial position of Embry-Riddle Aeronautical University, Inc. (the “University”) as of June 30, 2004, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the management of the University. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statement referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2004, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 16, 2004 on our consideration of the University’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedule – Net Asset Class Disaggregation listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the financial statements. This schedule is the responsibility of the University’s management. Such schedule has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the financial statements taken as a whole. The information presented in the supplementary information – Comparative Statements of Financial Position, Activities, and Cash Flows for the years ended June 30, 2003 and 2002, was not subject to audit and accordingly we express no opinion on that information.

Ernst + Young LLP

September 16, 2004

Embry-Riddle Aeronautical University, Inc.

Statement of Financial Position

June 30, 2004

(in thousands)

Assets

Current assets:

Cash and cash equivalents	\$ 24,308
Investments (Note 2)	42,607
Accounts and notes receivable, less allowance for doubtful accounts of \$1,126	13,817
Current portion of student loans receivable	1,971
Current portion of contributions receivable (Note 4)	1,739
Inventories	2,868
Prepaid expenses and other current assets	897

Total current assets 88,207

Deposits with fiduciaries (Note 3)	28,242
Long-term accounts and notes receivable	290
Student loans receivable, less current portion and allowance for doubtful accounts of \$700	8,141
Contributions receivable, net – less current portion (Note 4)	751
Land and land improvements, buildings and equipment, at cost, less accumulated depreciation (Note 5)	163,138
Unamortized bond issuance costs	3,589
Other assets	376

Total assets 292,734

Liabilities and net assets

Current liabilities:

Accounts payable and accrued expenses	21,885
Advances for student loans and financial aid	8,760
Current portion of long-term debt (Note 6)	3,681
Student deposits and advance payments	4,734
Unearned tuition and flight fees	10,074

Total current liabilities 49,134

Long-term debt (Note 6) 128,283

Total liabilities 177,417

Net assets (Note 7):

Unrestricted	102,124
Temporarily restricted	3,624
Permanently restricted	9,569

Total net assets 115,317

Total liabilities and net assets \$ 292,734

See notes to financial statements.

Embry-Riddle Aeronautical University, Inc.

Statement of Activities

Year ended June 30, 2004

(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and other additions:				
Tuition	\$ 171,396	\$ –	\$ –	\$171,396
Less institutionally funded scholarships	19,489	–	–	19,489
Net tuition	151,907	–	–	151,907
Flight fees	20,880	–	–	20,880
Other fees	6,054	–	–	6,054
Government grants and contracts	9,004	–	–	9,004
Private gifts	340	–	–	340
Private grants and contracts	1,171	–	–	1,171
Sales and services – educational	225	–	–	225
Auxiliary enterprises (Note 10)	18,327	–	–	18,327
Other revenue	1,736	1	–	1,737
Investment earnings distributed	1	331	–	332
Total revenue and other additions	209,645	332	–	209,977
Net assets released from restrictions	1,888	(1,888)	–	–
Total revenue and other additions	211,533	(1,556)	–	209,977
Expenses (Note 8):				
General academic instruction	72,937	–	–	72,937
Flight instruction	33,621	–	–	33,621
Research	6,938	–	–	6,938
Academic support	11,499	–	–	11,499
Student services	23,541	–	–	23,541
Institutional support	36,465	–	–	36,465
Scholarships	1,500	–	–	1,500
Auxiliary enterprises (Note 10)	19,916	–	–	19,916
Total expenses	206,417	–	–	206,417
Excess(deficiency) of revenues and other additions over(under) expenses	5,116	(1,556)	–	3,560
Nonoperating activities:				
Private gifts – noncurrent	350	1,031	385	1,766
Net realized and unrealized appreciation (depreciation) in fair value of investments	4,295	(687)	2,020	5,628
Investment income	1,249	93	–	1,342
Distribution of prior year investment earnings for spending	(1)	(331)	–	(332)
Total nonoperating activities	5,893	106	2,405	8,404
Change in net assets	11,009	(1,450)	2,405	11,964
Net assets, beginning of year	91,115	5,074	7,164	103,353
Net assets, end of year	\$ 102,124	\$ 3,624	\$ 9,569	\$ 115,317

See notes to financial statements.

Embry-Riddle Aeronautical University, Inc.

Statement of Cash Flows

Year ended June 30, 2004
(in thousands)

Cash flows from operating activities	
Change in net assets	\$ 11,964
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	15,488
Amortization	598
Gain on sale of equipment	(230)
Equipment acquired through gifts	(351)
Contributions restricted for long-term investment	(2,597)
Change in operating assets and liabilities:	
Accounts and notes receivable	650
Contributions receivable	296
Inventories	927
Prepaid expenses and other assets	2,603
Accounts payable and accrued expenses	6,558
Advances for student loans and financial aid	779
Student deposits and advance payments	(514)
Unearned tuition and flight fees	1,238
Net cash provided by operating activities	37,409
Cash flows from investing activities	
Sale (purchase) of investments	(6,387)
Principal received on student loans receivable	9,803
Loans made to students	(11,455)
Proceeds from sale of land and land improvements, buildings and equipment	287
Capital expenditures	(25,203)
Net cash used in investing activities	(32,955)
Cash flows from financing activities	
Long-term debt proceeds	39,765
Principal payments on long-term debt	(17,669)
Increase in deposits with fiduciaries	(15,933)
Payment of bond issuance costs	(1,822)
Proceeds from contributions restricted for:	
Investment in endowment	2,405
Investment in plant	192
Net cash provided by financing activities	6,938
Change in cash and cash equivalents	11,392
Cash and cash equivalents, beginning of year	12,916
Cash and cash equivalents, end of year	\$ 24,308
Supplemental disclosures of cash flow information:	
Cash paid during the year for interest	\$ 7,477

See notes to financial statements.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements

Year ended June 30, 2004

1. Nature of Operations and Summary of Significant Accounting Policies

General

Embry-Riddle Aeronautical University, Inc. (the “University”), a not-for-profit corporation, offers degrees and technical programs in aviation-related disciplines. These programs are offered at campuses in Daytona Beach, Florida, Prescott, Arizona and at various resident centers throughout the United States and Europe. The University is accredited by the Commission on Colleges of the Southern Association of Colleges and Schools (“SACS”) to award degrees at the Associate, Bachelors, and Masters levels. SACS has most recently reaffirmed the University’s accreditation in 2002 for ten years. The accreditation of the University includes all its units, wherever located. Through a strict evaluation process, the bachelors degree programs in aerospace engineering at both the Daytona Beach and Prescott campuses have been accredited by the Engineering Accreditation Commission of the Accreditation Board for Engineering and Technology (“ABET”). Other ABET accredited programs at the Daytona Beach campus include bachelors degree curricula in aircraft engineering technology, avionics engineering technology, and engineering physics; at the Prescott campus, the electrical engineering program is also accredited by ABET. Daytona Beach business programs are accredited by the Association of Collegiate Business Schools and Programs and the Council of Aviation Accreditation.

Basis of Presentation

The financial statements of the University have been prepared on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when materials or services are received. Expenses incurred at fiscal year-end have been accrued, and expenses applicable to future periods have been deferred. Revenues and expenses of an academic term, such as a summer session, which is conducted over a fiscal year end, are reported totally within the fiscal year in which the program is predominantly conducted.

Net assets are classified into three separate categories. The three net asset categories as reflected in the accompanying financial statements are as follows:

- *Unrestricted* - Net assets which are free of donor-imposed restrictions; all revenues, gains, and losses that are not changes in permanently or temporarily restricted net assets. This category includes realized and unrealized gains on endowment and other long-term investments not specifically restricted by donors. The University’s policy is to reinvest such earnings for future growth and to use these earnings in accordance with donor stipulations as to the original gift corpus.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

- *Temporarily Restricted* - Net assets whose use by the University is limited by donor-imposed stipulations that either expire by passage of time or that can be fulfilled by actions of the University pursuant to those stipulations. Temporarily restricted net assets consist primarily of scholarship funds, funds donated to be applied to construction of new facilities, and equipment donated for use in new facilities.
- *Permanently Restricted* - Net assets whose use by the University is limited by donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the University. Permanently restricted net assets consist primarily of endowed scholarship funds.

Changes in each category are reflected in the statements of activities, certain of which are further categorized as nonoperating. Such activities primarily reflect transactions of a long-term investment or capital nature, including contributions receivable in future periods, contributions subject to donor-imposed restrictions, and gains and losses on investments in excess of the University's spending rule not specifically restricted for use by donors.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the University considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Investments in Common Fund pools, other than the Short-Term Investment Fund, are not included as cash equivalents as there is no maturity date and management does not consider such investments as part of operating cash.

A substantial portion of the balances of cash and cash equivalents are comprised of funds on deposit in demand deposit accounts, balances of which are in excess of the Federal Deposit Insurance Corporation insured amount of \$100,000 per depositor.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Investments and Deposits with Fiduciaries

Investments and deposits with fiduciaries are recorded at their estimated fair value. Gains and losses on investments are reported in the statements of activities as increases or decreases in unrestricted net assets unless their use is restricted by donor-imposed stipulations. Investment income is reported in the period earned as increases in unrestricted net assets unless the use of the assets, from which the income is derived, is limited by donor-imposed restrictions. Gains and losses on investments of a donor-restricted endowment fund are included as changes in temporarily unrestricted net assets.

Deposits with fiduciaries held in trust to be used for specified purposes as required by related debt covenants, the interest earned on the deposits, and the deposits with fiduciaries that are held in trust primarily to pay for group health insurance claims are all classified as unrestricted.

Revenues and Student Accounts Receivable

Student tuition and related fees are recorded as revenue in the fiscal year in which the course term is predominately conducted. Resident center tuition and related expenses are recorded in the fiscal year in which each specific resident center term is predominately conducted.

Registration deposits, housing deposits and other advance payments related to future academic terms are recorded as unearned tuition and flight fees until earned by the University.

Student Loans Receivable

Student loans receivable consist of uncollateralized loans to former and current students of the University with various interest rates and repayment terms. It is not practicable to determine the fair value of student loans receivable, since such loans are primarily federally sponsored and have significant government-imposed restrictions as to marketability, interest rates, and repayment terms.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Contributions

Contributions received, including unconditional promises, are recognized as revenues when the donor's commitment is received. Unconditional promises are recognized at the estimated present value of the future cash flows, net of allowances. Promises made and collected in the same reporting period are recorded when received in the appropriate net asset category. Promises of noncash assets are recorded at their estimated fair value. Conditional promises are recorded when donor stipulations are substantially met (see Note 4).

Inventories

Inventories are stated using either the lower of cost (determined on the first-in, first-out method) or estimated market value, specific identification or average cost methods, based on the type of inventory item, and, in some cases, Federal Aviation Administration ("FAA") requirements.

Land and Land Improvements, Buildings and Equipment, and Depreciation Expense

Land and land improvements, buildings and equipment are stated at cost at date of acquisition (estimated fair value when received by gift). Interest associated with land and land improvements and buildings and equipment additions, if material, is capitalized from the date of the borrowing until assets are ready for their intended use. Interest of approximately \$6,158,000 was expensed for the year ended June 30, 2004. Interest of approximately \$1,286,000 was capitalized for the year ended June 30, 2004.

Depreciation expense and amortization expense for assets recorded under capital leases, which is included within depreciation expense, is calculated using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Land improvements	7
Buildings	7 - 30
Equipment	2 - 10

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

For reporting purposes, land and land improvements and buildings and equipment are included in unrestricted net assets, whether purchased with temporarily restricted or unrestricted funds. Where temporarily restricted funds are used, such amounts are reported as a transfer from restricted net assets to unrestricted net assets.

Unamortized Bond Issuance Costs

Unamortized bond issuance costs incurred in connection with bond issues are being amortized on the effective yield method over the lives of the respective bond issues. Amortization expense for the year ended June 30, 2004 was approximately \$598,000.

Federal and State Income Taxes

The University is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). Earnings from unrelated business activities are immaterial. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

Auxiliary Enterprise Operations

Auxiliary enterprise operations consist primarily of student housing, book sales, student center services and activities under a FAA contract (see Note 10).

Fair Value of Financial Instruments

Except as set forth elsewhere in these notes, the University's financial instruments are carried in the statements of financial position at amounts that approximate their fair values.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities 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.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

2. Investments

Investments consist of the following (in thousands) at June 30, 2004:

Mutual funds:

Commonfund Intermediate Fund	\$ 308
American Funds EuroPacific Growth Fund	3,476
Coast Access Ltd	497
Merrill Lynch CMA Money Fund	1
American Funds Fundamental Investors Fund	7,779
Sphinx Access Ltd	983
AIM Small Cap Opportunities Fund	3,743
MFS Capital Opportunities Fund	0
Franklin Balance Sheet Investment Fund	3,859
AIM Blue Chip Fund	0
American Growth Fund of America	7,646
Putnam International Growth Fund	0
Templeton Foreign Fund	3,227
Pimco Bond Fund	7,809
457b TIAA/CREF	99
Pimco Diversified Fund	3,076
457f Rabbi Trust	104
	<hr/>
	\$42,607
	<hr/>
Investment income	\$ 1,342
Net realized and unrealized gains (losses)	5,628
	<hr/>
	\$ 6,970
	<hr/>

3. Deposits with Fiduciaries

Deposits with fiduciaries consist of the following (in thousands) at June 30, 2004:

Money market accounts	\$24,238
U.S. bonds, notes, and bills	3,990
Other notes	14
	<hr/>
	\$28,242
	<hr/>

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

4. Contributions Receivable

Contributions receivable consist of the following (in thousands) at June 30, 2004:

Unconditional promises expected to be collected in:	
Less than one year	\$1,739
One year to five years	1,798
More than five years	20
	<hr/>
	3,557
Less:	
Unamortized discount	239
Allowance for uncollectible pledges	828
	<hr/>
	\$2,490
	<hr/>

Contributions receivable are reported in the statements of financial position as follows:

Current portion	\$1,739
Long-term portion	751
	<hr/>
	\$2,490
	<hr/>

The contributions receivable balance contains a pledge by one donor in the amount of \$1,816,230. This amount represents approximately 51% of the gross contributions receivable balance.

5. Land and Land Improvements, Buildings and Equipment

Land and land improvements, buildings and equipment consist of the following (in thousands) at June 30, 2004:

Land and land improvements	\$ 18,696
Buildings	169,574
Equipment	91,046
Construction in progress	15,667
	<hr/>
Less accumulated depreciation and amortization	(131,845)
	<hr/>
	\$ 163,138
	<hr/>

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

5. Land and Land Improvements, Buildings and Equipment (continued)

The University has revenue-earning assets under an operating lease with an original cost of \$7,522,000 (\$1,215,000, net of accumulated depreciation at June 30, 2004 (see Note 10)).

Assets under capital leases, which are included in land and land improvements, buildings and equipment, consist of the following (in thousands) at June 30, 2004:

Land	\$ 1,244
Buildings	1,164
Equipment	<u>535</u>
Less accumulated amortization	<u>(955)</u>
	<u><u>\$ 1,988</u></u>

The following is a schedule of future minimum lease payments under capital leases together with the present value of the minimum lease payments as of June 30, 2004 (in thousands):

2005	\$ 292
2006	182
2007	177
2008	177
2009	177
Thereafter	<u>1,213</u>
Total minimum lease payments	2,218
Less amounts representing interest	<u>(736)</u>
Present value of net minimum lease payments	<u><u>\$ 1,482</u></u>

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

5. Land and Land Improvements, Buildings and Equipment (continued)

Amounts representing interest reduce net minimum lease payments to the present value calculated at the University's incremental borrowing rate at the inception of the leases. The present value of net minimum lease payments is reflected in the June 30, 2004 statement of financial position as current and noncurrent long-term debt of \$202,000 and \$1,280,000 respectively.

In March 2000, the University entered into a multi-party real estate transaction. Under the terms of the transaction, the University deeded title to a building with a book value of approximately \$1.6 million to another party to the transaction. In exchange for the deeding of the building, the University acquired a building and entered into an agreement as assignee of the lease for the land upon which the acquired building is located. Under the terms of the land lease, which expires in May 2026, the University has the option to pay \$100,000 and acquire title to the land. As a result of the transaction, the University recorded land under capital lease and building of approximately \$1.2 million each, along with a capital lease obligation for approximately \$850,000.

6. Long-Term Debt

Long-term debt at June 30, 2004 consists of the following (in thousands):

	Interest Rate	Payable in Installments ending in Fiscal Year	Principal Outstanding June 30 2004	Reference to Note 6 (1) – (11) below
<u>Capital Lease Obligations</u>				
501 S. Clyde Morris Blvd. land	6.58%	2026	\$ 814	(1)
Modular buildings and lighting project	7.75%	2011	596	(2)
Telephone System	9.4%	2005	72	
			1,482	
<u>Notes Payable</u>				
Apartment Complex #2	3.0%	2021	676	(3)
FAA building	12.25%	2008	2,753	(4)
Other land, buildings and equipment	6.79-14.27%	2005	103	
Prescott building	8.0%	2006	406	(5)
			\$ 3,938	

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

6. Long-Term Debt (continued)

<u>Bonds Payable</u>	Interest Rate	Payable in Installments ending in Fiscal Year	Principal Outstanding June 30 2004	Reference to Note 6 (1) – (11) below
Volusia County Educational Facilities Authority Revenue Bonds, 1996	5.50-6.125%	2027	\$ 45,158	(6)
Volusia County Educational Facilities Authority Revenue Bonds, 1999A	5.75%	2029	12,291	(7)
Volusia County Educational Facilities Authority Revenue Bonds, 1999B	4.0-5.5%	2022	29,981	(8)
Volusia County Educational Facilities Authority Revenue Bonds, 2003	2.50-5.20%	2033	37,939	(9)
Student Center Bonds	3.0%	2015	840	(10)
Housing Bonds	3.0%	2008	240	(10)
Academic Building Bonds	3.0%	2008	95	(10)
			<u>126,544</u>	
Total long-term debt			131,964	
Current portion			<u>(3,681)</u>	
Long-term portion			<u>\$128,283</u>	
Estimated fair value of long-term debt			<u>\$140,753</u>	(11)

- (1) Capital lease obligation to Volusia County for land lease in the original amount of \$850,000. The lease was entered into as part of a multi-party real estate transaction whereby the University exchanged a building with a book value of approximately \$1,600,000, for a building located on the land under lease, along with the assumption of the land lease (see Note 5).
- (2) Non-taxable capital lease obligation to Banc One Leasing in the original amount of \$1,118,000 is collateralized by a security interest in modular buildings and a lighting project for the Prescott Campus.
- (3) Note payable to the Department of Housing and Urban Development in the original amount of \$1,169,000 is collateralized by a first mortgage on Apartment Complex #2 including furnishings and equipment.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

6. Long-Term Debt (continued)

- (4) Note payable in the original amount of \$7,522,000 is collateralized by an absolute assignment of rents from the FAA facilities and a first mortgage on the land and building, including furnishings and equipment (see Note 10).
- (5) Note payable to First American Title in the original amount of \$800,000 is collateralized by a security interest in the building.
- (6) The Series 1996 bonds were issued to fund various construction and renovation projects on the Daytona Beach campus and the Prescott campus. The bonds were issued under an agreement whereby the Volusia County Educational Facilities Authority issued and sold revenue bonds in the original amount of \$51,195,000 and loaned the proceeds to the University. The bonds were issued net of a discount of approximately \$586,000. The balance of the discount was approximately \$522,000 at June 30, 2004. The effective interest rate of the bond issue is 6.08%. The loan agreement contains various restrictive covenants, the most significant of which includes limitations on additional indebtedness.
- (7) The Series 1999A bonds were issued to fund various capital improvements to the Daytona Beach campus. The bonds were issued under an agreement whereby the Volusia County Educational Facilities Authority issued and sold revenue bonds in the original amount of \$12,380,000 and loaned the proceeds to the University. The bonds were issued net of a discount of approximately \$89,000. There was no amortization of the bond discount recorded during the year ended June 30, 2004, as the bonds are not payable until beginning in 2024. The effective interest rate of the bond issue is 5.75%. The loan agreement contains various restrictive covenants, the most significant of which includes limitations on additional indebtedness.
- (8) The Series 1999B bonds were issued to advance refund approximately \$27,000,000 of the Series 1992 bonds. The bonds were issued under an agreement whereby the Volusia County Educational Facilities Authority issued and sold revenue bonds in the original amount of \$31,375,000 and loaned the proceeds to the University. The bonds were issued net of a discount of approximately \$382,000. The balance of the discount was approximately \$369,000 at June 30, 2004. The effective interest rate of the bond issue is 5.43%. The loan agreement contains various restrictive covenants, the most significant of which includes limitations on additional indebtedness.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

6. Long-Term Debt (continued)

- (9) The Series 2003 bonds were issued to fund various construction and renovation projects on the Prescott campus and to refund approximately \$14,000,000 of the Series 1992 bonds. The bonds were issued under an agreement whereby the Volusia County Educational Facilities Authority issued and sold revenue bonds in the original amount of \$39,835,000 and loaned the proceeds to the University. The bonds were issued net of a discount of approximately \$304,000. The balance of the discount was approximately \$292,000 at June 30, 2004. The effective interest rate of the bond issue is 5.20%. The loan agreement contains various restrictive covenants, the most significant of which includes limitations on additional indebtedness.
- (10) Embry-Riddle Aeronautical University, Inc. Student Center Bonds, Housing Bonds, and Academic Building Bonds are each collateralized by a first mortgage on any property constituting the facilities and site and a first lien and pledge of gross revenues of the building.
- (11) The University engages a third party to assist in the determination of the estimated fair value of its long-term debt. The fair values of the University's long-term debt are estimated using discounted cash flow analyses based on the University's current incremental borrowing rates for similar types of borrowing arrangements.

Maturities of long-term debt in each of the next five fiscal years and thereafter are as follows (in thousands):

2005	\$ 3,703
2006	3,772
2007	3,839
2008	3,319
2009	3,024
Thereafter	115,563
	<hr/>
	\$ 133,220
Unamortized Bond Discount	(1,256)
	<hr/>
	\$ 131,964

The unamortized bond discount relating to long-term debt maturing in 2005 is \$22,000.

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

7. Net Assets

Net assets at June 30, 2004 consist of the following (in thousands):

Internally designated for student loans	\$ 2,426
Internally designated for future capital acquisitions	5,866
Quasi endowment funds	20,973
Debt service funds	3,951
Invested in plant	42,475
Undesignated	<u>26,433</u>
Total unrestricted net assets	\$ 102,124
Donor restricted	1,414
Donor pledges	2,139
Annuity and living trusts	<u>71</u>
Total temporarily restricted net assets	3,624
True endowment pledges	349
True endowment	<u>9,220</u>
Total permanently restricted net assets	<u>9,569</u>
Total net assets	<u><u>\$ 115,317</u></u>

Net assets in the amount of approximately \$1,888,000 were released from restrictions during the year ended June 30, 2004. The expenditures were restricted by purpose and were made in the following categories (in thousands):

Donations Restricted for Capital Asset Construction or Acquisition	\$ 1,271
Donations Restricted for Scholarships	516
Donations restricted for Non-Capital Programs or Acquisitions	<u>101</u>
Net assets released from restrictions	<u><u>\$ 1,888</u></u>

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

8. Interest Expense, Depreciation Expense, and Operation and Maintenance of Plant

Interest expense, depreciation expense, and operation and maintenance of plant for the year ended June 30, 2004 are allocated to the University's various functional areas as follows (in thousands):

Interest expense	
General academic instruction	\$ 1,373
Flight instruction	302
Institutional support	277
Academic support	34
Student services	872
Scholarships	3
Research	13
Auxiliary enterprises	3,284
	<u>\$ 6,158</u>
Depreciation and amortization expense	
General academic instruction	\$ 3,405
Flight instruction	2,182
Institutional support	3,898
Academic support	586
Student services	1,888
Scholarships	122
Research	397
Auxiliary enterprises	3,010
	<u>\$ 15,488</u>
Operating and Maintenance of Plant	
General academic instruction	\$ 1,882
Flight instruction	612
Institutional support	358
Academic support	406
Student services	1,165
Scholarships	1
Research	3
Auxiliary enterprises	2,780
	<u>\$ 7,207</u>

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

9. Retirement Plan

Retirement benefits are provided through a noncontributory defined contribution plan covering all qualified employees. The Plan is administered through the Teachers Insurance and Annuity Association, a national organization used to fund pension benefits for educational institutions, and through the Vanguard Group of mutual funds. Retirement plan expense for the year ended June 30, 2004 was approximately \$4,838,000.

10. Federal Aviation Administration Contract

The University has a contract with the FAA for the service, staffing and maintenance of a management training center, having dormitory and classroom space, and the lease thereof to the FAA, for an initial period of 10 years (which commenced in October 1987) with two 5-year renewal options. The first option was exercised February 11, 1997 to extend the lease through August 21, 2002. The second option was exercised July 10, 2002 to extend the lease through August 2, 2007. Minimum annual payments under the contract are \$1,977,000, including \$1,010,000 for the lease of the facility.

The FAA management training center was constructed for \$7,522,000 under a turn-key arrangement and financed by a \$7,522,000, 12.25%, 20-year first mortgage note, the outstanding balance of which was \$2,753,000 at June 30, 2004. The University has entered into an agreement whereby under certain circumstances it may convey or be required to convey for a nominal sum the FAA management training center subject only to the permanent financing.

11. Commitments and Contingencies

Operating Leases

The University leases land, buildings, and equipment for its operation. Total rental expense for the year ended June 30, 2004 was approximately \$2,493,000. Future minimum rental payments required under noncancelable operating leases extending beyond June 30, 2004, are as follows (in thousands):

2005	\$ 6,088
2006	5,772
2007	4,811
2008	2,619
2009	1,602
	<hr/>
	\$20,892

Embry-Riddle Aeronautical University, Inc.

Notes to Financial Statements (continued)

11. Commitments and Contingencies (continued)

Unionized Labor Force

Approximately 100 full-time flight instructors and flight simulator instructors in the Daytona Beach area, employed by the University, belong to the International Association of Machinists and Aerospace Workers, AFL-CIO, whose contract expires in June 2005.

Litigation

The University is involved in litigation on a number of matters, which arise in the normal course of business, none of which, in the opinion of the administration, are expected to have a material adverse effect on the University's financial statements.

Supplementary Information

Embry-Riddle Aeronautical University, Inc.

Net Assets Class Disaggregation

June 30, 2004
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Assets				
Current assets:				
Cash and cash equivalents	\$ 24,308	\$ –	\$ –	\$ 24,308
Investments (Note 2)	31,582	1,722	9,303	42,607
Accounts and notes receivable, less allowance for doubtful accounts of \$1,126	13,817	–	–	13,817
Current portion of student loans receivable	1,971	–	–	1,971
Current portion of contributions receivable	262	1,327	150	1,739
Inventories	2,868	–	–	2,868
Prepaid expenses and other current assets	897	–	–	897
Total current assets	75,705	3,049	9,453	88,207
Deposits with fiduciaries	28,242	–	–	28,242
Long-term accounts and notes receivable	290	–	–	290
Student loans receivable, less current portion and allowance for doubtful accounts of \$700	8,141	–	–	8,141
Contributions receivable, net – less current portion	56	580	115	751
Land and land improvements, buildings and equipment, at cost, less accumulated depreciation	163,138	–	–	163,138
Unamortized bond issuance costs	3,589	–	–	3,589
Other assets	376	–	–	376
Total assets	279,537	3,629	9,568	292,734
Liabilities and net assets				
Current liabilities:				
Accounts payable and accrued expenses	21,881	4	–	21,885
Advances for student loans and financial aid	8,760	–	–	8,760
Current portion of long-term debt	3,681	–	–	3,681
Student deposits and advance payments	4,734	–	–	4,734
Unearned tuition and flight fees	10,074	–	–	10,074
Total current liabilities	49,130	4	–	49,134
Long-term debt	128,283	–	–	128,283
Total liabilities	177,413	4	–	177,417
Net assets	102,124	3,624	9,569	115,317
Total liabilities and net assets	\$279,537	\$ 3,628	\$ 9,569	\$292,734

Embry-Riddle Aeronautical University, Inc.

Three-year Comparative Statements of Financial Position

June 30, 2004, 2003, and 2002

(in thousands)

	2004	2003	2002
Assets		<i>(unaudited)</i>	<i>(unaudited)</i>
Current assets:			
Cash and cash equivalents	\$ 24,308	\$ 12,916	\$ 14,005
Investments	42,607	36,220	30,210
Accounts and notes receivable, less allowance for doubtful accounts of \$1,126, \$1,346 and \$1,083	13,817	14,609	11,063
Current portion of student loans receivable	1,971	2,035	1,362
Current portion of contributions receivable	1,739	1,404	269
Inventories	2,868	3,795	3,323
Prepaid expenses and other current assets	897	3,395	3,931
Total current assets	<u>88,207</u>	<u>74,374</u>	<u>64,163</u>
Deposits with fiduciaries	28,242	12,309	41,524
Long-term accounts and notes receivable	290	148	215
Student loans receivable, less current portion and allowance for doubtful accounts of \$700, \$417 and \$622	8,141	6,425	7,046
Contributions receivable, net – less current portion	751	1,382	357
Land and land improvements, buildings and equipment, at cost, less accumulated depreciation	163,138	153,129	145,237
Unamortized bond issuance costs	3,589	2,365	3,471
Other assets	376	481	296
Total assets	<u>292,734</u>	<u>250,613</u>	<u>262,309</u>
Liabilities and net assets			
Current liabilities:			
Accounts payable and accrued expenses	21,885	15,327	10,699
Advances for student loans and financial aid	8,760	7,981	7,472
Current portion of long-term debt	3,681	3,511	3,272
Student deposits and advance payments	4,734	5,248	3,820
Unearned tuition and flight fees	10,074	8,836	6,877
Total current liabilities	<u>49,134</u>	<u>40,903</u>	<u>32,140</u>
Long-term debt	128,283	106,357	136,615
Total liabilities	<u>177,417</u>	<u>147,260</u>	<u>168,755</u>
Commitments and contingencies			
Net assets:			
Unrestricted	102,124	91,115	82,362
Temporarily restricted	3,624	5,074	4,694
Permanently restricted	9,569	7,164	6,498
Total net assets	<u>115,317</u>	<u>103,353</u>	<u>93,554</u>
Total liabilities and net assets	<u>\$ 292,734</u>	<u>\$ 250,613</u>	<u>\$ 262,309</u>

Embry-Riddle Aeronautical University, Inc.

Three-year Comparative Statements of Activities

Year ended June 30, 2004

(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and other additions:				
Tuition	\$171,396	\$ –	\$ –	\$ 171,396
Less institutionally funded scholarships	19,489	–	–	19,489
Net tuition	151,907	–	–	151,907
Flight fees	20,880	–	–	20,880
Other fees	6,054	–	–	6,054
Government grants and contracts	9,004	–	–	9,004
Private gifts	340	–	–	340
Private grants and contracts	1,171	–	–	1,171
Sales and services – educational	225	–	–	225
Auxiliary enterprises (Note 10)	18,327	–	–	18,327
Other revenue	1,736	1	–	1,737
Investment earnings distributed	1	331	–	332
Total revenue and other additions	209,645	332	–	209,977
Net assets released from restrictions	1,888	(1,888)	–	–
Total revenue and other additions	211,533	(1,556)	–	209,977
Expenses (Note 8):				
General academic instruction	72,937	–	–	72,937
Flight instruction	33,621	–	–	33,621
Research	6,938	–	–	6,938
Academic support	11,499	–	–	11,499
Student services	23,541	–	–	23,541
Institutional support	36,465	–	–	36,465
Scholarships	1,500	–	–	1,500
Auxiliary enterprises (Note 10)	19,916	–	–	19,916
Total expenses	206,417	–	–	206,417
Excess of revenues and other additions over expenses	5,116	(1,556)	–	3,560
Nonoperating activities:				
Private gifts – noncurrent	350	1,031	385	1,766
Net realized and unrealized appreciation (depreciation) in fair value of investments	4,295	(687)	2,020	5,628
Investment income	1,250	93	–	1,343
Distribution of prior year investment earnings for spending	(2)	(331)	–	(333)
Total nonoperating activities	5,893	106	2,405	8,404
Increase (Decrease) in net assets	11,009	(1,450)	2,405	11,964
Net assets, beginning of year	91,115	5,074	7,164	103,353
Net assets, end of year	\$ 102,124	\$ 3,624	\$ 9,569	\$ 115,317

Embry-Riddle Aeronautical University, Inc.

Three-year Comparative Statements of Activities (continued)

Year ended June 30, 2003 (unaudited)
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and other additions:				
Tuition	\$ 145,729	\$ –	\$ –	\$ 145,729
Less institutionally funded scholarships	13,828	–	–	13,828
Net tuition	131,901	–	–	131,901
Flight fees	24,244	–	–	24,244
Other fees	5,539	–	–	5,539
Government grants and contracts	8,214	–	–	8,214
Private gifts	871	–	–	871
Private grants and contracts	876	–	–	876
Sales and services – educational	234	–	–	234
Auxiliary enterprises	16,810	–	–	16,810
Other revenue	2,435	884	–	3,319
Investment earnings distributed	177	261	–	438
Total revenue and other additions	191,301	1,145	–	192,446
Net assets released from restrictions	3,797	(3,797)	–	–
Total revenue and other additions	195,098	(2,652)	–	192,446
Expenses:				
General academic instruction	69,775	–	–	69,775
Flight instruction	32,494	–	–	32,494
Research	5,770	–	–	5,770
Academic support	8,418	–	–	8,418
Student services	21,128	–	–	21,128
Institutional support	34,480	–	–	34,480
Scholarships	1,203	–	–	1,203
Auxiliary enterprises	19,991	–	–	19,991
Total expenses	193,259	–	–	193,259
Excess(deficiency) of revenues over(under) expenses and other additions	1,839	(2,652)	–	(813)
Nonoperating activities:				
Private gifts – noncurrent	4,401	3,173	530	8,104
Net realized and unrealized appreciation (depreciation) in fair value of investments	878	(35)	143	986
Investment income	1,812	155	(7)	1,960
Distribution of prior year investment earnings for spending	(177)	(261)	–	(438)
Total nonoperating activities	6,914	3,032	666	10,612
Change in net assets	8,753	380	666	9,799
Net assets, beginning of year	82,362	4,694	6,498	93,554
Net assets, end of year	\$ 91,115	\$ 5,074	\$ 7,164	\$ 103,353

Embry-Riddle Aeronautical University, Inc.

Three-year Comparative Statements of Activities (continued)

Year ended June 30, 2002 (unaudited)
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and other additions:				
Tuition	\$ 129,600	\$ –	\$ –	\$ 129,600
Less institutionally funded scholarships	12,445	–	–	12,445
Net tuition	117,155	–	–	117,155
Flight fees	20,852	–	–	20,852
Other fees	5,634	–	–	5,634
Government grants and contracts	5,390	–	–	5,390
Private gifts	337	–	–	337
Private grants and contracts	1,054	–	–	1,054
Sales and services – educational	329	–	–	329
Auxiliary enterprises	16,445	–	–	16,445
Other revenue	1,502	8	3	1,513
Investment earnings distributed	142	300	–	442
Total revenue and other additions	168,840	308	3	169,151
Net assets released from restrictions	1,695	(1,695)	–	–
Total revenue and other additions	170,535	(1,387)	3	169,151
Expenses:				
General academic instruction	63,089	–	–	63,089
Flight instruction	27,302	–	–	27,302
Research	5,333	–	–	5,333
Academic support	7,250	–	–	7,250
Student services	20,013	–	–	20,013
Institutional support	29,455	–	–	29,455
Scholarships	1,151	–	–	1,151
Auxiliary enterprises	18,858	–	–	18,858
Total expenses	172,451	–	–	172,451
Excess(deficiency) of revenues over(under) expenses and other additions	(1,916)	(1,387)	3	(3,300)
Nonoperating activities:				
Private gifts – noncurrent	55	3,274	305	3,634
Net realized and unrealized appreciation (depreciation) in fair value of investments	(1,948)	(465)	(7)	(2,420)
Investment income	3,579	159	(18)	3,720
Distribution of prior year investment earnings for spending	(142)	(300)	–	(442)
Total nonoperating activities	1,544	2,668	280	4,492
Change in net assets	(372)	1,281	283	1,192
Net assets, beginning of year	82,734	3,413	6,215	92,362
Net assets, end of year	\$ 82,362	\$ 4,694	\$ 6,498	\$ 93,554

Embry-Riddle Aeronautical University, Inc.

Three-year Comparative Statements of Cash Flows

Years ended June 30, 2004, 2003, and 2002

(in thousands)

	2004	2003	2002
		<i>(unaudited)</i>	<i>(unaudited)</i>
Cash flows from operating activities			
Change in net assets	\$ 11,964	\$ 9,799	\$ 1,192
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation	15,488	12,167	10,479
Amortization	598	1,106	57
Gain on sale of equipment	(230)	(219)	(83)
Equipment acquired through gifts	(351)	(2,186)	(383)
Contributions restricted for long-term investment	(2,597)	(2,728)	(1,487)
Change in operating assets and liabilities:			
Accounts and notes receivable	650	(3,479)	(877)
Contributions receivable	296	(2,160)	3
Inventories	927	(472)	(38)
Prepaid expenses and other assets	2,603	351	(3,544)
Accounts payable and accrued expenses	6,558	4,628	(2,399)
Advances for student loans and financial aid	779	509	359
Student deposits and advance payments	(514)	1,428	(523)
Unearned tuition and flight fees	1,238	1,959	2,171
Net cash provided by operating activities	37,409	20,703	4,927
Cash flows from investing activities			
Sale (purchase) of investments	(6,387)	(6,010)	7,813
Principal received on student loans receivable	9,803	3,775	2,555
Loans made to students	(11,455)	(3,827)	(2,643)
Proceeds from sale of land and land improvements, buildings and equipment	287	1,840	225
Capital expenditures	(25,203)	(19,494)	(21,952)
Net cash used in investing activities	(32,955)	(23,716)	(14,002)
Cash flows from financing activities			
Long-term debt proceeds	39,765	-	-
Principal payments on long-term debt	(17,669)	(30,019)	(2,275)
Decrease (Increase) in deposits with fiduciaries	(15,933)	29,215	6,373
Payment of bond issuance costs	(1,822)	-	-
Proceeds from contributions restricted for:			
Investment in endowment	2,405	666	283
Investment in plant	192	2,062	1,204
Net cash provided by financing activities	6,938	1,924	5,585
Change in cash and cash equivalents	11,392	(1,089)	(3,490)
Cash and cash equivalents, beginning of year	12,916	14,005	17,495
Cash and cash equivalents, end of year	\$ 24,308	\$ 12,916	\$ 14,005
Supplemental disclosures of cash flow information:			
Cash paid during the year for interest	\$ 7,477	\$ 8,409	\$ 8,721