



UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Financial Statements and
Reports in Accordance with the Requirements
of OMB Circular A-133

Year Ended September 30, 2004

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

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KPMG LLP
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Independent Auditors' Report

Board of Trustees
University Corporation for Atmospheric Research
Boulder, Colorado:

We have audited the accompanying consolidated statement of financial position of the University Corporation for Atmospheric Research (UCAR) as of September 30, 2004, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of UCAR's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The consolidated financial statements of UCAR as of and for the year ended September 30, 2003, were audited by other auditors whose report thereon dated January 26, 2004, expressed an unqualified opinion on those consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 2004 consolidated financial statements referred to above present fairly, in all material respects, the financial position of UCAR as of September 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 of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 12, 2005, on our consideration of UCAR's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic consolidated financial statements of UCAR, taken as a whole. The accompanying schedule of expenditures of federal awards for the year ended September 30, 2004 is presented for the purpose of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic 2004 consolidated financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic 2004 consolidated financial statements taken as a whole.

KPMG LLP

January 12, 2005

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Statements of Financial Position

September 30, 2004 and 2003

(In thousands)

Assets	2004	2003
Current assets:		
Cash and cash equivalents (note 4)	\$ 6,792	5,551
Investments (notes 2 and 4)	7,988	2,382
Receivables:		
Government agencies	10,014	10,854
Other (net of allowance for doubtful accounts of \$30 at 2004 and 2003)	3,322	3,389
Other current assets	689	1,899
Total current assets	28,805	24,075
Property (notes 3 and 4):		
Land and improvements	4,758	4,608
Building and building construction	51,035	47,781
Equipment	29,610	28,446
Total	85,403	80,835
Less accumulated depreciation on building and equipment	(35,292)	(31,372)
Property, net	50,111	49,463
Other noncurrent assets:		
Cash equivalents for investment in property (note 4)	12,616	12,479
Investments (notes 2, 4, and 8)	55,317	29,567
Deferred bond charges (note 4)	2,877	2,092
Total other assets	70,810	44,138
Total assets	\$ 149,726	117,676
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 10,397	7,144
Accrued vacation liability	9,187	8,412
Other accrued liabilities	7,130	5,123
Line of credit (note 5)	917	—
Current portion of bonds payable (note 4)	4,460	4,460
Total current liabilities	32,091	25,139
Noncurrent liabilities:		
Bonds payable (note 4)	87,245	66,705
Accrued postretirement benefit obligation (note 7)	8,133	1,519
Other	893	766
Total noncurrent liabilities	96,271	68,990
Net assets:		
Unrestricted	21,035	23,198
Temporarily restricted	329	349
Total net assets	21,364	23,547
Total liabilities and net assets	\$ 149,726	117,676

See accompanying notes to consolidated financial statements.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Statements of Activities

Years ended September 30, 2004 and 2003

(In thousands)

	2004	2003
Changes in unrestricted net assets:		
Revenue, gains, and other support:		
National Science Foundation Cooperative Agreement:		
National Science Foundation funds	\$ 104,785	128,049
Other government agency funds	16,496	19,514
Other government award funds	55,700	45,322
Other contract funds	10,045	10,551
Donated property	—	111
Membership fees	54	42
License fees and royalties	236	238
Investment income (note 2)	4,857	3,376
Total revenues and gains	192,173	207,203
Net assets released from restrictions	62	56
Total revenues, gains, and other support	192,235	207,259
Expenses and losses:		
Program expenses:		
Scientific programs	118,439	112,128
Scientific support facilities	58,420	76,001
Total program expenses	176,859	188,129
Management and general expenses	17,486	16,597
Total expenses (note 9)	194,345	204,726
Loss on disposal of property	53	715
Total expenses and losses	194,398	205,441
Increase (decrease) in unrestricted net assets	(2,163)	1,818
Changes in temporarily restricted net assets:		
Other contract funds	39	147
Investment income (note 2)	3	5
Net assets released from restrictions	(62)	(56)
Increase (decrease) in temporarily restricted net assets	(20)	96
Increase (decrease) in net assets	(2,183)	1,914
Net assets, beginning of year	23,547	21,633
Net assets, end of year	\$ 21,364	23,547

See accompanying notes to consolidated financial statements.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Statements of Cash Flows

Years ended September 30, 2004 and 2003

(In thousands)

	2004	2003
Cash flows from operating activities:		
Change in net assets	\$ (2,183)	1,914
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Donated property	—	(111)
Net realized and unrealized gains on investments	(1,624)	(1,951)
Depreciation and amortization	6,347	6,424
Loss on disposal of property	53	715
Changes in operating assets and liabilities:		
Receivables	907	(2,412)
Other current assets	1,210	(81)
Accounts payable and accrued liabilities	6,035	3,080
Accrued post retirement benefit obligation	6,614	694
Other noncurrent liabilities	127	193
Net cash provided by operating activities	17,486	8,465
Cash flows from investing activities:		
Purchase of property	(6,932)	(7,605)
Purchase of investments	(40,937)	(11,307)
Proceeds from sale of investments	11,205	6,132
Increase in restricted cash equivalents for investment in property	(137)	(6,275)
Net cash used in investing activities	(36,801)	(19,055)
Cash flows from financing activities:		
Proceeds from bond issuance	25,000	29,335
Payments of bonds payable	(4,460)	(4,005)
Proceeds from line of credit	917	—
Payment of line of credit	—	(16,500)
Payments for bond issuance costs	(901)	(933)
Net cash provided by financing activities	20,556	7,897
Increase (decrease) in cash and cash equivalents	1,241	(2,693)
Cash and cash equivalents, beginning of year	5,551	8,244
Cash and cash equivalents, end of year	\$ 6,792	5,551
Supplemental cash flow information:		
UCAR paid interest of \$3,292 and \$3,203 in 2004 and 2003, respectively.		

See accompanying notes to consolidated financial statements.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(1) Organization and Significant Accounting Policies

(a) Organization

The University Corporation for Atmospheric Research (UCAR) is a nonprofit membership corporation engaged in scientific and educational activities in atmospheric research and related fields. UCAR operates the National Center for Atmospheric Research (NCAR) under cooperative agreement with the National Science Foundation (NSF), and also operates other scientific projects funded principally by other United States government agencies. In connection with its operations, UCAR has incurred bond indebtedness (see note 4) and other indebtedness (see notes 5, 7, and 8) for which repayment is primarily dependent upon funding by NSF and other United States government agencies. The ability of NSF and other United States government agencies in any year to provide monies to UCAR is dependent on annual Congressional appropriations.

The prior Cooperative Agreement with NSF became effective October 1, 1998 and had an original expiration date of September 30, 2003, which date has now been extended two years to complete expenditure of funds under that Cooperative Agreement. UCAR and NSF have executed the current Cooperative Agreement, which has a term from October 1, 2003 through September 30, 2008.

Performance of work under United States government awards may be terminated whenever the sponsoring government agency shall determine that such termination is in the best interest of the United States government. Funding under all federal awards is subject to availability of funding as determined by the United States Congress. UCAR's management is unaware of any significant changes to the cooperative agreement or other federal grants in the upcoming year that will significantly impact UCAR's cash flows and its ability to pay current obligations as they become due.

The consolidated financial statements of UCAR include the University Corporation for Atmospheric Research Foundation (Foundation), Intelligent Weather Solutions, Inc. (Solutions), and beginning on June 25, 2003, the Foundation's subsidiary, Peak Weather Resources, Inc. (Peak). All significant intercompany transactions are eliminated. The Foundation was incorporated by UCAR for the purpose of engaging in technology transfer and other scientific, educational, and charitable activities in support of UCAR's mission. UCAR's board of trustees approves the election of the members of the board of directors of the Foundation. The Foundation's revenues relate primarily to license fees and royalties from transferred technology. Solutions and Peak were formed for the purpose of commercializing UCAR-developed technology. On December 1, 2003, the UCAR Foundation board of directors approved the dissolution of Solutions.

(b) Use of Estimates

The preparation of consolidated 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 and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(c) Cash and Cash Equivalents

UCAR considers money market mutual funds and all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

(d) Investments

Investments in equity, government, and other fixed income securities are measured at fair value in the consolidated statements of financial position. These securities are publicly traded and have readily determined fair values. The guaranteed insurance contract is not publicly traded and is recorded at cost. Investment income or loss (including realized and unrealized gains and losses, interest, and dividends) is included in the change in unrestricted net assets unless the income or loss is restricted by donor or law.

(e) Receivables from Government Agencies

Receivables from government agencies consist of amounts owed to UCAR from the federal government based on costs incurred but not yet reimbursed under federal grants or cooperative agreement. No allowance is established for these receivables, as they are considered fully collectible from the federal government.

(f) Concentrations of Credit Risk

UCAR's credit risk is primarily concentrated in receivables from the NSF and other United States government agencies. In the opinion of management, this concentration does not result in increased credit risk due to the nature of the receivables.

(g) Property

Property with title vested in UCAR is capitalized and recorded at cost if the acquisition cost is \$5,000 or more. Donated property is recorded at estimated fair market value at the time of donation. Depreciation is provided using the straight-line method over the estimated useful lives of the property ranging from 3 to 40 years.

Property with title vested in the federal government and other sponsors is not recorded in the consolidated statements of financial position (see note 3).

(h) Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value. For the years ended September 30, 2004 and 2003, management believes there has been no impairment of UCAR's long-lived assets.

(i) Deferred Bond Charges

Certain costs incurred by UCAR in connection with issuance of bonds are deferred and are amortized over the period which the related bonds are outstanding.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(j) Revenue and Expense Recognition

Funds from awards and contracts, considered to be exchange transactions, are recognized as revenues when expenses under the award or contract are incurred. Expenses charged to federal awards are subject to government agency audit and possible adjustment. In the opinion of management, such adjustments, if any, will not have a significant impact on the accompanying consolidated financial statements.

(k) Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by UCAR has been limited by donors for a specific purpose, which is generally related to scientific and education activities in atmospheric research.

(l) Donor-Restricted Contributions

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The contributions are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions. In the absence of donor specification that income and gains on donated funds are restricted, such income and gains are reported as income of unrestricted net assets.

(m) Tax Status

UCAR and the Foundation are exempt from income taxes under Internal Revenue Code Section 501(c)(3). Solutions and Peak are taxable entities and account for income taxes in accordance with the liability method. Solutions had no income in 2004 or 2003. Peak had net losses of \$209,000 in 2004 and \$61,000 in 2003.

(n) Reclassifications

Certain prior year balances have been reclassified to conform with the current year presentation.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(2) Investments

UCAR's investment portfolios are pooled for investment purposes. Bond trustee held investments are designated for the acquisition or construction of noncurrent assets or for the liquidation of long-term bonds payable and are classified as other noncurrent assets. Investments consist of the following as of September 30:

	Fair value	
	2004	2003
	(In thousands)	
Corporate investments	\$ 35,672	24,351
Bond trustee held investments	27,633	7,598
Total	<u>\$ 63,305</u>	<u>31,949</u>
Government securities	\$ 35,992	12,714
Equity securities	18,969	14,955
Guaranteed insurance contract	3,150	3,150
Other fixed income securities	5,194	1,130
Total	<u>\$ 63,305</u>	<u>31,949</u>

UCAR's investment income for the years ended September 30 is comprised of the following:

	Fair value	
	2004	2003
	(In thousands)	
Interest and dividends, net	\$ 3,236	1,430
Net realized losses	(319)	(275)
Net unrealized gains	1,943	2,226
Total	<u>\$ 4,860</u>	<u>3,381</u>

(3) Property

Property with title vested in UCAR, including property designated as to a particular purpose, is recorded in the consolidated financial statements.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

Property with title vested in the U.S. Government and other sponsors is not recorded in the consolidated statements of financial position. Purchases of such property, totaling \$15,762,000 and \$40,358,000 in 2004 and 2003, respectively, are recorded as unrestricted expenses in the consolidated statements of activities. UCAR has the responsibility of maintaining property records and reporting balances to the respective sponsors. Government and other sponsor-owned property at cost consists of the following as of September 30:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Real property	\$ 28,958	25,490
Equipment	<u>206,275</u>	<u>148,340</u>
Total	<u>\$ 235,233</u>	<u>173,830</u>

(4) Bonds Payable

(a) 1996 Series A & B Bonds

UCAR borrowed \$9,410,000 in fiscal 1997 through the issuance of County of Boulder, Colorado Development Revenue Bonds, Series 1996 A & B (1996 Series A & B Bonds) to assist in the purchase of a building and to finance the costs of computer networking, maintenance, and other equipment and capital improvements.

As of September 30, 2004 and 2003, the outstanding balance of the 1996 Series A Bonds was \$4,310,000 and \$4,865,000, respectively. The 1996 Series A Bonds bear interest and mature serially as follows in thousands:

4.88% maturing September 1, 2005	\$ 580
5.00% maturing September 1, 2006	320
5.00% maturing September 1, 2007	545
5.13% maturing September 1, 2008	130
5.50% maturing September 1, 2009	135
5.50% thereafter	<u>2,600</u>
Total	<u>\$ 4,310</u>

The 1996 Series A Bonds maturing in 2016 and 2021 are subject to mandatory redemption beginning in 2009.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

As of September 30, 2004 and 2003, the outstanding balance of the 1996 Series B Bonds was \$1,265,000 and \$1,300,000, respectively. The 1996 Series B Bonds are taxable and bear interest and mature serially as follows in thousands:

7.00% maturing September 1, 2006	\$	70
7.63% maturing September 1, 2021		<u>1,195</u>
Total	\$	<u><u>1,265</u></u>

The 1996 Series B Bonds are subject to mandatory redemption annually at a redemption price of 100% of the principal amount plus any accrued interest. Pursuant to the mandatory sinking fund requirements of the 1996 Series B Bonds, UCAR is required to make annual debt service payments to redeem portions of the 1996 Series B Bonds. As of September 30, 2004, mandatory redemptions of bond principal for the next five years and thereafter are as follows in thousands:

Year ending September 30:		
2005	\$	35
2006		35
2007		40
2008		45
2009		45
Thereafter		<u>1,065</u>
Total	\$	<u><u>1,265</u></u>

The 1996 Series A & B Bonds are subject to optional redemption after September 1, 2007, in whole or in part at the option of UCAR, at a redemption price of 100% of the principal amount redeemed plus any accrued interest. The 1996 Series A & B Bonds are not collateralized by the related property. Certain costs incurred by UCAR in connection with the 1996 Series A & B Bonds were deferred and are being amortized over the period which the 1996 Series A & B Bonds are outstanding.

(b) 1999 Bonds

UCAR borrowed \$13,760,000 on February 25, 1999 through issuance of County of Boulder, Colorado Industrial Development Revenue Bonds, Series 1999 (1999 Bonds) to fund the purchase of equipment, capital improvements, issuance costs, and a reserve fund.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

As of September 30, 2004 and 2003, respectively, the outstanding balance of the 1999 Bonds was \$6,645,000 and \$8,420,000; the bonds bear interest and mature serially as follows in thousands:

3.80% maturing September 1, 2005	\$	1,610
3.88% maturing September 1, 2006		1,165
4.00% maturing September 1, 2007		735
4.38% maturing September 1, 2008		570
4.10% maturing September 1, 2009		535
4.25% – 4.63% thereafter		<u>2,030</u>
Total	\$	<u><u>6,645</u></u>

The 1999 Bonds maturing on or after September 1, 2009 are subject to optional redemption prior to maturity on or after September 1, 2008, at the option of UCAR, at a redemption price equal to 100% of the principal plus any accrued interest. The 1999 Bonds are not collateralized by the related equipment or improvements purchased by UCAR. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and are being amortized over the period which the 1999 Bonds are outstanding.

(c) 2001 Bonds

UCAR borrowed \$30,030,000 on November 27, 2001 through the issuance of County of Boulder, Development Revenue Refunding Bonds, Series 2001 to refund the 1991 Building Bonds and to establish an escrow account to refund the 1996 Series B Bonds on September 1, 2006.

As of September 30, 2004 and 2003, respectively, the outstanding balance of the 2001 bonds was \$27,295,000 and \$28,130,000. The bonds bear interest and mature serially as follows in thousands:

3.10% maturing September 1, 2005	\$	855
3.30% maturing September 1, 2006		880
3.50% maturing September 1, 2007		910
3.75% maturing September 1, 2008		935
4.50% maturing September 1, 2009		975
4.00% – 5.50% thereafter		<u>22,740</u>
Total	\$	<u><u>27,295</u></u>

The 2001 series Bonds maturing on or after September 1, 2012 are subject to optional redemption on or after September 1, 2011, in whole or part on any date, at a redemption price equal to 100% of the principal amount plus any accrued interest. The Series 2001 Bonds maturing on September 1 in each of the years 2022, 2026, and 2032 are subject to mandatory sinking fund redemption at a redemption price of 100% of the principal amount redeemed plus interest accrued to the redemption date beginning September 1, 2021 and continuing through September 1, 2032. The 2001 Bonds are not collateralized. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and are being amortized over the period which the 2001 Bonds are outstanding.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(d) 2002 Bonds

UCAR borrowed \$29,335,000 on December 18, 2002 through the issuance of County of Boulder, Development Revenue Bonds, Series 2002 to pay in full the \$16,500,000 bank line of credit, refurbish and equip such facilities, and build-out of a 20,000 square foot expansion, and refurbish, improve, and equip other existing facilities of UCAR. The maturity date of the 2002 Bonds is September 1, 2033.

As of September 30, 2004 and 2003, respectively, the outstanding balance of the 2002 bonds was \$27,190,000 and \$28,450,000. The bonds bear interest and mature serially as follows in thousands:

3.00% maturing September 1, 2005	\$	1,380
2.50% maturing September 1, 2006		1,380
3.88% maturing September 1, 2007		1,380
3.10% maturing September 1, 2008		1,240
5.00% maturing September 1, 2009		1,240
3.60% – 5.38% thereafter		<u>20,570</u>
Total	\$	<u><u>27,190</u></u>

The 2002 Series Bonds maturing on or after September 1, 2013 are subject to optional redemption on or after September 1, 2012, in whole or part on any date, at a redemption price equal to 100% of the principal amount plus any accrued interest. The Series 2002 Bonds maturing on September 1 in each of the years 2016, 2018, 2021, 2027, and 2033 are subject to mandatory sinking fund redemption at a redemption price of 100% of the principal amount redeemed plus interest accrued to the redemption date beginning September 1, 2016 and continuing through September 1, 2033. The 2002 Bonds are not collateralized. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and are being amortized over the period which the 2002 bonds are outstanding.

(e) 2003 Bonds

UCAR borrowed \$25,000,000 on December 4, 2003 through the issuance of County of Boulder, Development Revenue Bonds, Series 2003 to construct and equip a new 80,000 square foot research laboratory and office building, and to refurbish, improve, and equip other existing facilities of UCAR. The maturity date of the 2003 Bonds is September 1, 2035.

As of September 30, 2004 the outstanding balance of the 2003 bonds was \$25,000,000. The bonds bear interest and mature serially as follows in thousands:

2.00% maturing September 1, 2006	\$	665
2.10% maturing September 1, 2007		1,325
2.45% maturing September 1, 2008		1,325
3.00% maturing September 1, 2009		1,270
3.00% – 5.00% thereafter		<u>20,415</u>
Total	\$	<u><u>25,000</u></u>

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

The 2003 Series Bonds maturing on or after September 1, 2014 are subject to optional redemption on or after September 1, 2013, in whole or part on any date, at a redemption price equal to 100% of the principal amount plus any accrued interest. The Series 2003 Bonds maturing on September 1 in each of the years 2023, 2028 and 2035 are subject to mandatory sinking fund redemption at a redemption price of 100% of the principal amount redeemed plus interest accrued to the redemption date beginning September 1, 2023 and continuing through September 1, 2035. The 2003 Bonds are not collateralized. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and will be amortized over the period which the 2003 bonds are outstanding.

(f) *Arbitrage Liability*

The Internal Revenue Code (IRC), as amended, requires that cumulative income earned from investing tax-exempt bond proceeds in excess of the related bond interest expense (arbitrage) be rebated to the federal government, generally every five years or upon repayment of the underlying bonds. As of September 30, 2004 and 2003, UCAR has recorded an estimated liability for cumulative arbitrage of approximately \$0 and \$80,000, respectively. UCAR has \$26,000 and \$85,000 in cash and cash equivalents as of September 30, 2004 and 2003, respectively, that are held by the trustee for payment of such liabilities.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(g) Bond Assets

As of September 30, 2004 and 2003, included in cash and cash equivalents, cash equivalents for investment in property, and investments purchased in accordance with the related bond documents, are the following amounts either held in a reserve fund for payment of bond principal for the 1996, 1999, 2001, 2002 and 2003 bonds or otherwise restricted under the bond agreements:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Cash (overdraft) and cash equivalents:		
2002 Bonds	\$ (495)	(379)
2001 Bonds	623	577
1999 Bonds	(3,043)	(2,707)
1996 Series A & B Bonds	<u>753</u>	<u>984</u>
Total cash and cash equivalents	<u>(2,162)</u>	<u>(1,525)</u>
Cash equivalents for investment in property:		
2003 Bonds	7,230	—
2002 Bonds	2,682	8,559
1999 Bonds	2,059	3,920
1996 Bonds	<u>645</u>	<u>—</u>
Total cash equivalents for investment in property	<u>12,616</u>	<u>12,479</u>
Short-term investments:		
2001 Bonds	75	75
1999 Bonds	<u>707</u>	<u>1,391</u>
Total short-term investments	<u>782</u>	<u>1,466</u>
Long-term investments:		
2003 Bonds	15,389	—
2002 Bonds	6,976	2,007
2001 Bonds	3,408	3,485
1999 Bonds	1,078	—
1996 Series A & B Bonds	<u>—</u>	<u>640</u>
Total long-term investments	<u>26,851</u>	<u>6,132</u>
Total	\$ <u><u>38,087</u></u>	<u><u>18,552</u></u>

(5) Other Debt

UCAR has a \$3,000,000 borrowing base under a bank line of credit agreement. The line of credit agreement matures on February 28, 2005 and borrowings thereunder will accrue interest at the variable rate of LIBOR plus 2.00% (3.16% at September 30, 2004). There was \$917,000 and \$0 outstanding as of September 30, 2004 and 2003, respectively.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(6) Retirement Contribution Plan

UCAR has a defined contribution plan available to all regular full-time and part-time employees. Participants are required to contribute 5% of regular salary excluding overtime, and may contribute an additional amount in accordance with IRC guidelines. UCAR is required to contribute 10% of the participant's annual regular salary. UCAR reserves the right to modify or discontinue the plan at any time. Amounts paid under the plan were \$8,632,000 and \$8,261,000 for the years ended September 30, 2004 and 2003, respectively.

(7) Postretirement Benefits

UCAR sponsors certain medical and dental benefits for employees and their eligible dependents, who were full-time employees, have worked fifteen years and have retired after age 50. Premiums for medical and dental benefits are paid by the retirees. Such premiums are, however, effectively subsidized by UCAR allowing the retirees to pay company-wide rates, which are derived using actuarial assumptions attributable to both active and retired employees.

On September 30, 1998, UCAR amended its retiree medical plan. Under the amendment UCAR may terminate its subsidy of retiree medical premiums. Continuation of the subsidy is primarily contingent on the periodic renewal of the NSF Cooperative Agreement. Based on UCAR's history of providing these benefits, the postretirement benefit obligation has been calculated assuming the Plan will continue in perpetuity.

The following table sets forth the components of the accrued postretirement benefit obligation as of September 30, all of which are unfunded based on the amended plan:

	2004	2003
	(In thousands)	
Accumulated postretirement benefit obligation:		
Retirees	\$ 9,121	9,190
Fully eligible active employees	12,982	11,348
Other active participants	11,788	10,305
Total	\$ 33,891	30,843
Accrued postretirement benefit obligation	\$ 8,133	1,519

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

The following table sets forth the components of UCAR's expense for postretirement benefits for the years ended September 30:

	2004	2003
	(In thousands)	
Service cost of benefits earned	\$ 1,785	299
Interest cost on accumulated postretirement benefit obligation	2,122	347
Amortization	3,309	552
Postretirement benefit expense	\$ 7,216	1,198
Benefit payment	\$ 603	503

For the year ended September 30, 2004, the postretirement benefit obligation was measured using a 13% annual rate of increase in health care costs for those under age 65 and 16% for those over age 65 decreasing to 5% and 6%, respectively, in 2008. For the year ended September 30, 2003, the postretirement benefit obligation was measured using a 14% annual rate of increase in health care costs for those under age 65 and 17% for those over age 65 decreasing to 6% and 9%, respectively, in 2007. The weighted average discount rate used in determining the accumulated postretirement benefit obligations is 6% and 6.25% as of September 30, 2004 and 2003, respectively. A 1% increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation as of September 30, 2004 by \$4,066,940 and the aggregate service and interest cost in 2004 by \$458,163.

(8) Commitments

As a part of its investment portfolio, UCAR has committed to invest up to \$704,000, \$500,000 and \$500,000 in three limited investment partnerships. As of September 30, 2004 and 2003, UCAR has invested \$114,316 and \$46,875, respectively, in one partnership and \$424,500 and \$375,750, respectively, in the second partnership, and \$500,000 and \$0, respectively, in the third partnership. These investments are in equity securities with readily determinable fair market values. These investments are included in the equity securities line item in note 2.

UCAR leases property under operating leases. Total rental expense under all operating leases was approximately \$1,353,000 and \$1,313,000, respectively, for 2004 and 2003.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

As of September 30, 2004, UCAR's future minimum rentals under operating leases, which may be terminated by UCAR in the event of insufficient funding, are as follows in thousands:

Year ending September 30:		
2005	\$	1,096
2006		1,085
2007		1,110
2008		305
2009		118
Thereafter		3,757
Total minimum lease payments required	\$	7,471

At September 30, 2004 and 2003, UCAR had unfilled purchase order commitments of approximately \$46,246,000 and \$35,478,000, respectively.

UCAR is a party to litigation arising in the normal course of business. Management does not believe that such litigation will have a material adverse impact on UCAR's consolidated financial statements.

(9) Expenses

Expenses for operating activities for the years ended September 30 are as follows:

	2004	2003
	(In thousands)	
Salaries and employee benefits	\$ 113,949	110,411
Postretirement benefit expense	7,216	1,198
Applied indirect costs (net of depreciation and amortization)	2,388	(539)
Purchased services	27,485	26,350
Purchases of property titled with the Sponsor (see note 3)	15,762	40,358
Materials and supplies	7,899	8,230
Travel	10,112	9,149
Depreciation	6,231	6,309
Amortization	116	116
Interest	3,187	3,144
Total	\$ 194,345	204,726

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2004 and 2003

(10) Fair Value of Financial Instruments

UCAR has estimated the fair value of its financial instruments using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates herein are not necessarily indicative of the amounts UCAR could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The carrying amounts reported in the consolidated statements of financial position for cash and cash equivalents, receivables, accounts payable, and accrued liabilities approximate fair value due to their short maturities. The fair value of investments, with the exception of the guaranteed insurance contract, is based on quoted market prices and the fair value of bonds payable is based on current traded values. The carrying amount of the guaranteed insurance contract approximates fair value.

The carrying amounts and fair values of UCAR's investments and bonds payable as of September 30, 2004 and 2003 are as follows:

	2004		2003	
	Carrying amount	Fair value	Carrying amount	Fair value
	(In thousands)			
Investments	\$ 63,305	63,305	31,949	31,949
Bonds payable	91,705	94,542	71,165	72,761

REPORTS REQUIRED BY OMB CIRCULAR A-133

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Schedule of Expenditures of Federal Awards

Year ended September 30, 2004

(In thousands)

<u>Grantor</u>	<u>Program Description</u>	<u>CFDA number</u>	<u>Expenditure</u>
Research and development cluster:			
Direct federal expenditures:			
Department of Commerce:			
National Oceanic and Atmospheric Administration	DOC Research and Development	11.000	\$ 2,349
National Oceanic and Atmospheric Administration	Climate and Atmospheric Research	11.431	13,739
National Oceanic and Atmospheric Administration	Meteorologic & Hydrologic Modernization Development	11.467	5,720
			<u>21,808</u>
Department of Defense:			
U.S. Air Force	DOD Research & Development	12.000	1,507
U.S. Air Force	Air Force Defense Research Sciences Program	12.800	226
U.S. Army	DOD Research & Development	12.000	6,190
Department of Defense	DOD Research & Development	12.000	449
Naval Research Laboratory	DOD Research & Development	12.000	577
Office of Naval Research	DOD Research & Development	12.000	26
Office of Naval Research	Basic & Applied Scientific Research	12.300	329
U.S. Navy	DOD Research & Development	12.000	28
			<u>9,332</u>
Department of the Interior:			
U.S. Geophysical Survey	DOI Research & Development	15.000	171
U.S. Geophysical Survey	U.S. Geological Survey-Research & Data Collection	15.808	5
			<u>176</u>
Department of Energy			
	DOE Research & Development	81.000	977
	Office of Science Financial Assistance Program	81.049	2,847
			<u>3,824</u>
Department of Transportation:			
Department of Transportation	DOT Research & Development	20.000	9
Federal Aviation Administration	DOT Research & Development	20.000	54
Federal Aviation Administration	Aviation Research Grants	20.108	12,008
Federal Railroad Administration	DOT Research & Development	20.000	21
			<u>12,092</u>
Environmental Protection Agency	EPA Research & Development	66.000	481
			<u>481</u>
Federal Emergency Management Agency	FEMA Research & Development	83.000	8
			<u>8</u>
National Aeronautics and Space Administration	NASA Research & Development	43.000	15,485
	Aerospace Education Services Program	43.001	98
			<u>15,583</u>

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Schedule of Expenditures of Federal Awards

Year ended September 30, 2004

(In thousands)

<u>Grantor</u>	<u>Program Description</u>	<u>CFDA number</u>	<u>Expenditure</u>
National Science Foundation	Mathematical and Physical Sciences	47.049	\$ 771
	Geosciences	47.050	100,932
	Computer & Information Science & Engineering	47.070	36
	Biological Sciences	47.074	(7)
	Social, Behavioral & Economic Sciences	47.075	157
	Education & Human Resources	47.076	3,453
	Polar Programs	47.078	1,623
Smithsonian Institution	Smithsonian Research & Development	60.000	<u>7</u>
			<u>7</u>
U.S. Department of Agriculture	USDA Research & Development	10.000	<u>292</u>
			<u>292</u>
Total direct federal expenditures			<u>170,568</u>

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Schedule of Expenditures of Federal Awards

Year ended September 30, 2004

(In thousands)

Grantor	Contract number	CFDA number	Expenditure
Pass-through federal expenditures:			
Department of Commerce:			
RS Information Systems, Inc	PO04-000621	11.000	\$ 28
University of Colorado	0401.07.150D	11.431	8
GSSL, Inc	DG133R04CN0138	11.440	8
			<hr/> 44
Department of Defense:			
Mississippi State University	N62306-01-D-7110/0062	12.000	164
Eastman Kodak Company	03-Z6202-49430	12.000	97
Desert Research Institute	03-DAS 89	12.000	10
University of Rhode Island	122000/535496	12.300	32
University of Miami	P758080	12.300	19
			<hr/> 322
Department of Energy:			
Oak Ridge Associated Universities	11-4778	81.000	133
Northwest Research Associates Inc	NWRA-04-S-074	81.000	58
Sandia National Laboratory	30935	81.000	58
Tulane University	TUL-172-03/04	81.000	18
Battelle Institute	13134	81.000	7
Oak Ridge Associated Universities	11-4322	81.000	1
University of Minnesota	T530648001	81.119	79
			<hr/> 354
National Aeronautics and Space Administration:			
University of Colorado	BS0054778	43.000	2,116
Science Applications International Corporation	4400071487	43.000	449
Lockheed Martin Corporation	SC01R2201M	43.000	177
Stanford University	PY-2345	43.000	173
Georgia Institute of Technology	G-35-B86-G1	43.000	81
University of Michigan	F007484	43.000	78
Georgia Institute of Technology	458-06	43.000	65
University of California Los Angeles	0965-G-CB470	43.000	51
Boston University	177828	43.000	40
Boston University	180001	43.000	35
University of Illinois at Urbana-Champaign	02-309	43.000	32
Jet Propulsion Laboratory	1248551	43.000	30
Georgia Institute of Technology	G-35-B83-G1	43.000	29
QSS Group Inc	011787	43.000	26
Jet Propulsion Laboratory	1258264	43.000	24
University of Colorado	25156	43.000	24
University of Illinois at Urbana-Champaign	2-326	43.000	12
Hampton University	04-16	43.000	10
University of Colorado	0000016179	43.000	7
Space Telescope Science Institute	HST-GO-09447.05-A	43.000	6
Colorado State University	G-1949-1	43.000	6
North Carolina State University	2004-0226-01	43.000	5
Space Telescope Science Institute	HST-GO-09832.01A	43.000	5
University of Alaska	UAF 03-0024	43.001	35
University of Rhode Island	072304/0000234	43.002	79
			<hr/> 3,595

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Schedule of Expenditures of Federal Awards

Year ended September 30, 2004

(In thousands)

<u>Grantor</u>	<u>Contract number</u>	<u>CFDA number</u>	<u>Expenditure</u>
National Science Foundation			
Boston University	GC177085NGA	47.000	\$ 639
Assoc of Univ for Research in Astronomy	MOU – ATST	47.000	340
Carnegie Mellon University	1120085-110615	47.000	330
University of California, Davis	009323-01	47.000	60
Assoc of Univ for Research in Astronomy	P15263B	47.000	55
Oregon State University	S0666A-A	47.000	54
University of California San Diego	10217581	47.000	54
Carnegie Mellon University	1120444-145302	47.000	28
University of Colorado	26625	47.000	26
University of Colorado	SPO 46476	47.000	13
Old Dominion University Research Foundation	300051-39865	47.000	5
Incorporated Research Institutions for Seismology	347	47.000	4
Washington State University	G001159	47.050	184
The University of Iowa	88272	47.050	98
University of Colorado	26917	47.050	3
Indiana University	10404-0128	47.050	2
University of Colorado	25308	47.076	68
Columbia University	DUE-02-26292	47.076	33
University of Michigan	F007699	47.076	19
University of Colorado	153-9680	47.076	18
Michigan State University	612238U	47.076	11
			2,044
Environmental Protection Agency			
Washington State University	G001499	66.000	26
University of Colorado	154-0289	66.000	8
Georgia Institute of Technology	G-35-B20-S1	66.500	20
			54
Total pass-through federal expenditures			6,413
Total research and development cluster expenditures			\$ 176,981

See accompanying notes to schedule of expenditures of federal awards.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Schedule of Expenditures of Federal Awards

September 30, 2004

(1) Basis of Presentation

The University Corporation for Atmospheric Research (UCAR) operates the National Center for Atmospheric Research under cooperative agreement with the National Science Foundation (NSF) and also operates other scientific projects funded principally by other federal agencies for the purposes of research and development. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

Funds related to total federal expenditures in the Schedule of Federal Awards are included in the consolidated financial statements of UCAR in the consolidated statement of activities under revenues from NSF Cooperative Agreement and other government award funds.

(2) Federal Property

During fiscal year 2004, UCAR expended approximately \$14.5 million of federal funds to purchase property for which title is vested with the federal government. As of September 30, 2004, UCAR had responsibility for approximately \$230.5 million of property for which title is vested with the federal government.

**Report on Internal Control over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Consolidated Financial Statements
Performed in Accordance with *Government Auditing Standards***

Board of Trustees
University Corporation for Atmospheric Research
Boulder, Colorado:

We have audited the consolidated financial statements of the University Corporation for Atmospheric Research (UCAR), as of and for the year ended September 30, 2004, and have issued our report thereon dated January 12, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered UCAR's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether UCAR's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Audit and Finance Committee, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 12, 2005

**Report on Compliance with Requirements Applicable to the Major Program
and on Internal Control over Compliance in Accordance with OMB Circular A-133**

Board of Trustees
University Corporation for Atmospheric Research
Boulder, Colorado:

Compliance

We have audited the compliance of the University Corporation for Atmospheric Research (UCAR) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended September 30, 2004. UCAR's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of UCAR's management. Our responsibility is to express an opinion on UCAR's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about UCAR's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of UCAR's compliance with those requirements.

In our opinion, UCAR complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2004.

Internal Control over Compliance

The management of UCAR is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered UCAR's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Audit and Finance Committee, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 12, 2005

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Schedule of Findings and Questioned Costs

Year ended September 30, 2004

I. Summary of Auditors' Results

1. The independent auditors' report on the consolidated financial statements expressed an unqualified opinion.
2. No reportable conditions or material weaknesses in internal control over financial reporting were identified.
3. No instance of noncompliance considered material to the consolidated financial statements was disclosed by the audit.
4. No reportable conditions or material weaknesses in internal control over compliance requirements applicable to major federal award programs were identified.
5. The independent auditors' report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by section 510(a) of OMB Circular A-133.
7. The University Corporation for Atmospheric Research's (UCAR) major program was:
Research and Development Cluster
8. A threshold of \$3,000,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. UCAR did qualify as a low-risk auditee as the term is defined in OMB Circular A-133.

II. Financial Statement Findings Section

No matters are reportable.

III. Federal Award Findings and Questioned Cost Section

No matters are reportable.