

***The Ohio State University
Research Foundation
(A Component Unit of The Ohio
State University)***

*Financial Statements for the Years
Ended June 30, 2004 and 2003
and Independent Auditors' Report*

INDEPENDENT AUDITORS' REPORT

Board of Directors
The Ohio State University Research Foundation
Columbus, Ohio

We have audited the accompanying statements of net assets of The Ohio State University Research Foundation (the "Research Foundation"), a component unit of The Ohio State University, as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets, and of cash flows for the years then ended. These financial statements are the responsibility of the Research Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Research Foundation as of June 30, 2004 and 2003, and its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the financial statements, but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2004, on our consideration of the Research Foundation's internal control over financial reporting and our tests of its compliance and other matters. The purpose of that report is to describe the scope of our 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.

Deloitte & Touche LLP

October 15, 2004

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION

(A Component Unit of The Ohio State University)

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2004

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of The Ohio State University Research Foundation for the year ended June 30, 2004, with comparative information for the year ended June 30, 2003. We encourage you to read this MD&A section in conjunction with the audited financial statements and footnotes appearing in this report.

ABOUT THE FINANCIAL STATEMENTS

Along with the State of Ohio, the Research Foundation has implemented a governmental financial reporting model, which is set forth in Governmental Accounting Standards Board ("GASB") Statement Nos. 34 and 35. Under these accounting standards, the Research Foundation will present its financial reports in a single-column "business type activity" format. GASB Statement No. 35 defines business type activities as those financed in whole or in part by fees charged to external parties for goods and services. Most public colleges and universities have elected to use the business type activity format.

In addition to this MD&A section, the financial report includes a statement of net assets, a statement of revenues, expenses and changes in net assets, statement of cash flows and footnotes.

The statement of net assets is the Research Foundation's balance sheet. It reflects the total assets, liabilities, and net assets (equity) of the Research Foundation as of June 30, 2004, with comparative information as of June 30, 2003. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Investment assets are carried at market value. Capital assets, which include the Research Foundation's furniture and equipment, are shown net of accumulated depreciation. Net assets are grouped in the following categories:

- Invested in capital assets, net of plant debt
- Restricted - Nonexpendable (endowment and annuity funds)
- Restricted - Expendable (primarily current restricted and loan funds)
- Unrestricted

The statement of revenues, expenses and changes in net assets is the Research Foundation's income statement. It details how net assets have increased (or decreased) during the Fiscal Year that ended June 30, 2004, with comparative information for Fiscal Year 2003. Depreciation is provided for capital assets, and there are required subtotals for net operating income or loss and net income or loss before additions to nonexpendable funds.

It should be noted that the required subtotal for net operating income or loss will generally reflect a loss for the Research Foundation. This is primarily due to the way operating and non-operating items are being reported. Operating expenses include virtually all Research Foundation expenses. Operating revenues, however, exclude certain significant revenue streams, including our corporate operating budget. Under this

paradigm, our operating loss will increase or decrease based upon the amount of our corporate operating budget.

The statement of cash flows details how cash has increased (or decreased) during the year ended June 30, 2004, with comparative information for Fiscal Year 2003. It breaks out the sources and uses of Research Foundation cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital and related financing activities
- Investing activities

Cash flows associated with the Research Foundation's expendable net assets appear in the operating and noncapital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt, and debt repayments. Purchases and sales of investments are reflected as investing activities.

The footnotes, which follow the financial statements, provide additional details on the numbers in the financial statements.

GENERAL

The Ohio State University Research Foundation is a nonprofit corporation created as a vehicle to promote sponsored research at The Ohio State University (the "University").

In November 1936, the Ohio Secretary of State issued a charter to The Ohio State University Research Foundation as a nonprofit educational corporation. Incorporators of the Foundation included the renowned inventor Charles F. Kettering and James F. Lincoln, president of the Lincoln Electric Company. The Board of Directors consists of the following member directors:

- Trustee Member (1):
Appointed by the Board of Trustees of the University.
- University Administration Members (3):
Including the Vice President for Research, the Executive Vice President for Academic Affairs and Provost, and the Dean of the Graduate School as designated by the Board of Trustees of the University.
- Faculty Members (4):
Selected from the faculty by the Research Committee of the University Senate.
- Alumni Members (2):
Designated by The Ohio State University Alumni Association from alumni of the University.
- At-Large (1):
Designated by the President of the University from among members of national organizations of distinguished engineers, scientists, and scholars.

The Research Foundation Board of Directors elects officers during the regular annual meeting. The officers include President, Vice President, Secretary, Assistant Secretary, Treasurer and Executive Director of the Research Foundation. The Directors appoint an Executive Committee and other committees as needed.

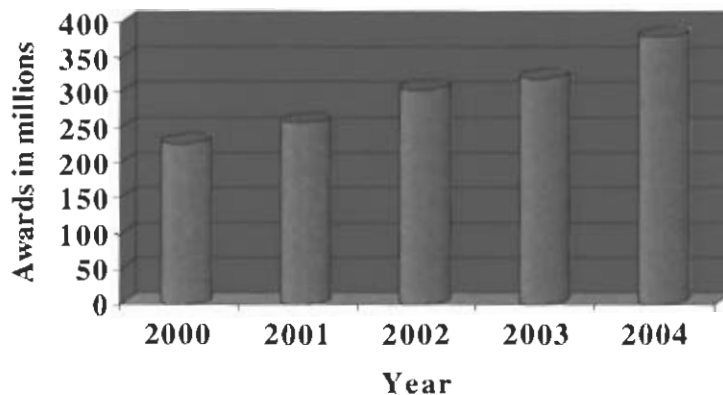
The function of the Research Foundation has evolved over the years in response to the needs of the research community within the University. The Research Foundation began as an organization created to encourage industry sponsorship of University research. It now provides specialized integrated administrative and financial services for research and other activities supported by a wide range of external sponsors.

The Research Foundation does not own or operate research facilities but utilizes facilities provided by the University under an agreement between the Board of Trustees of the University and the Research Foundation. Personnel working on Research Foundation projects are appointed as University personnel and are paid through the University under provisions of the agreement. The Research Foundation Board of Directors approves the operating budget for the Research Foundation's administrative expenses.

FINANCIAL HIGHLIGHTS AND KEY TRENDS

In Fiscal Year 2004, awards were approximately \$380 million, an increase of 19% from 2003. To put this in perspective, awards exceeded \$200 million for the first time in the year 2000 and awards exceeded \$300 million for the first time in the year 2003. This year's increase was mainly attributable to non-federal awards. Awards from the State of Ohio increased by 96% during 2004 and exceeded \$55 million. In addition, in 2004, we experienced modest growth in our federal awards. The National Science Foundation (NSF) and the Department of Labor accounted for most of the federal growth.

Award Growth



Sponsor revenues and expenditures in Fiscal Year 2004 increased by \$31 million (11%) to \$315 million with most of the increase attributable to federal sponsors. The increase in expenditures generated a corresponding 8% increase in Facilities and Administrative expense recovery.

To support our continued growth in sponsored project research, we are investing heavily in PeopleSoft financial tools that support electronic research administration. These tools include the PeopleSoft Grants Management Suite, PeopleSoft Procurement, PeopleSoft General Ledger, and PeopleSoft Human Resources. The PeopleSoft Grants Management Suite consists of a Grants module, a Projects module, a Contracts module, a Billing module, and an Accounts Receivable module. The PeopleSoft conversion is being funded jointly by the University and the Research Foundation.

The Other expense category amount of \$816,054 represents payment from our Operating Reserve for non capital expenditures related to the PeopleSoft investment. The effect of this expenditure on Net Income is discussed below in the statements of revenues, expenses and changes in net assets section.

Although considerable internal resources were redirected to the PeopleSoft conversion project, we properly managed our increased expenditure growth and we continued to improve our internal processes.

STATEMENT OF NET ASSETS

From June 30, 2003 to June 30, 2004, our cash balances increased by \$1.7 million (4%). The statement of cash flows, which is discussed in more detail below, provides additional detail on sources and uses of Research Foundation cash.

Following is a summary of the major components of the net assets of the Research Foundation for the years ended June 30, 2004 and 2003:

	2004	2003
CURRENT ASSETS	\$ 80,317,903	\$ 76,050,230
Non current assets:		
Furniture and equipment	<u>931,029</u>	<u>964,887</u>
Total assets	<u>\$ 81,248,932</u>	<u>\$ 77,015,117</u>
CURRENT LIABILITIES	\$ 75,110,027	\$ 70,390,620
Non current liabilities:		
Accrued vacation and sick leave	<u>223,146</u>	<u>152,266</u>
Total liabilities	<u>75,333,173</u>	<u>70,542,886</u>
Net assets:		
Invested in capital assets	931,029	964,887
Unrestricted	<u>4,984,730</u>	<u>5,507,344</u>
Total net assets	<u>5,915,759</u>	<u>6,472,231</u>
Total liabilities and net assets	<u>\$ 81,248,932</u>	<u>\$ 77,015,117</u>

Accounts receivable and unbilled project costs increased by roughly 7% this year. This increase is consistent with our 11% expenditure growth. The growth in the Accounts Receivable balance is comprised of invoices less than 60 days old. We continue to see process improvements in our billing and collection areas.

The \$713,019 decrease in our Accounts Payable Trade account is a product of continued processing improvements in the Accounts Payable department.

The \$2.2 million increase the Accounts Payable due to the University is due to the large growth in sponsored project payroll expenditures in the last quarter of the fiscal year.

Accrued Payroll increased by \$1.4 million this year. In addition to the payroll accrual, this line item contains payroll amounts due to the University. Last year, we overpaid the University due to a timing change within the PeopleSoft Human Resource system. This overpayment resulted in last year's payable amount being lower than expected.

The significant growth in our sponsored project billable expenses generated a corresponding 8% increase in our Facilities and Administration payable to the University.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

We experienced another year of significant growth in sponsored project revenue and expenditures. Our sponsored project revenue/expenditures increased by 11% from last year with the largest growth areas being sponsored project personnel expenditures and sponsored project materials and supplies. These two categories accounted for \$11.7 million of the \$11.2 million increase, respectively. The growth in materials and supplies expense produced a significant increase in transaction volume in our Procurement area.

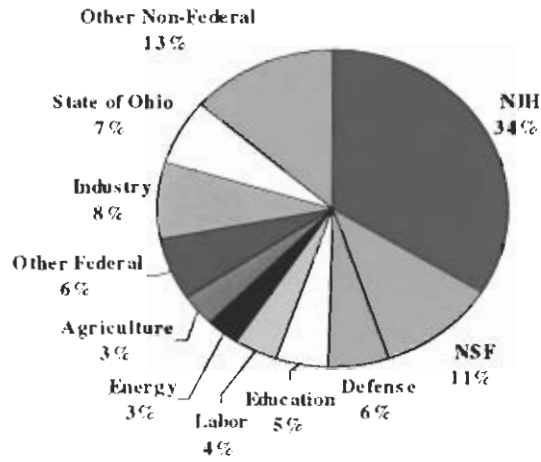
Our interest income decreased by approximately \$123,000 due to lower interest rates on our investment accounts managed by the University.

We recognize Sponsored Project Revenue as Sponsored Project Expenses are incurred. The excerpt below from our statement of revenues, expenses and changes in net assets demonstrates this relationship.

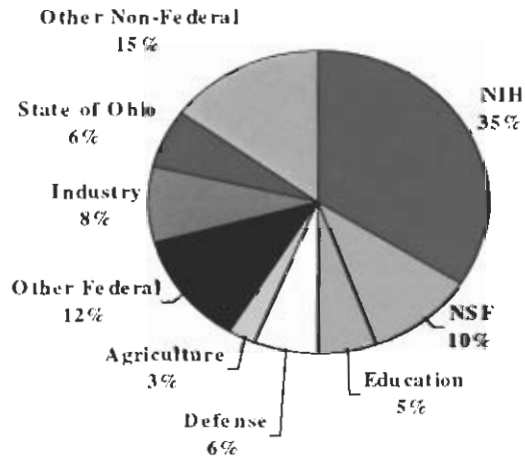
	2004	2003
SPONSOR PROJECT REVENUE	<u>\$ 314,753,335</u>	<u>\$ 283,708,255</u>
EXPENDITURES AND TRANSFERS:		
Sponsored project expenses:		
Personnel	\$ 143,319,889	\$ 131,570,659
Materials and services	86,085,869	74,883,703
Equipment	11,416,169	8,979,284
Travel	6,344,233	5,887,200
F&A charged by the University	<u>67,587,175</u>	<u>62,387,409</u>
TOTAL	<u>\$ 314,753,335</u>	<u>\$ 283,708,255</u>

Sponsored Project Revenue/Expenses in Fiscal Year 2004 increased by \$31 million (11%) from Fiscal Year 2003. Federal sponsors generated the majority of our revenue. Our largest sponsor is the National Institutes of Health (NIH) accounting for 34% of our total sponsored revenue.

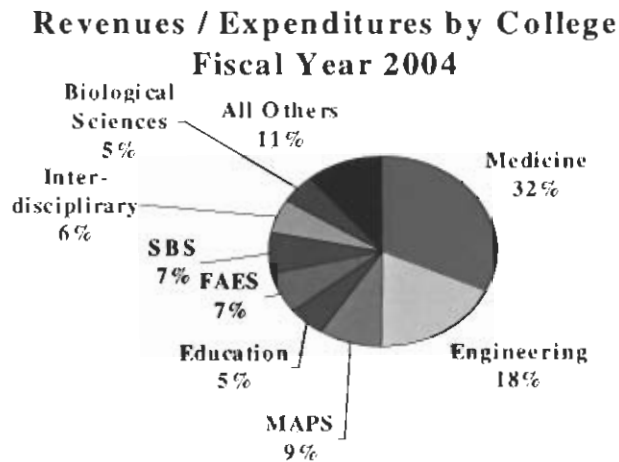
Revenues / Expenditures by Source Funds Fiscal Year 2004



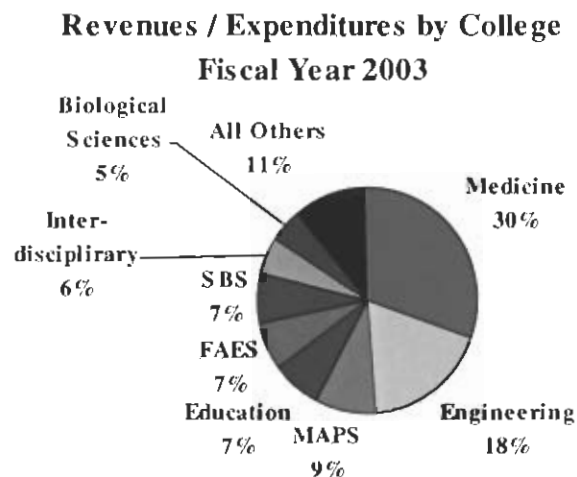
Revenues / Expenditures by Source Funds Fiscal Year 2003



Twenty-eight colleges generated Sponsored Project Revenue in Fiscal Year 2004. The disciplines of Medicine and Engineering combined to generate 50% of our Sponsored Project Revenue.



Twenty-eight colleges generated Sponsored Project Revenue in fiscal year 2003. The disciplines of Medicine and Engineering combined to generate 48% of our Sponsored Project Revenue.



The University Appropriation line item represents the Research Foundation's fiscal year operating budget. The Research Administration expenditure line represents our annual expenditures against our operating budget. The difference between these two line items is our budget surplus (deficit) for the fiscal year. It is important to note that we did not overspend our cash budget this fiscal year.

Additionally, for financial statement purposes, any non-capital spending from our operating reserve will flow through the income statement as other operating expense and will therefore reduce net income. In 2004, we funded PeopleSoft conversion expense in the amount of \$816,054 and collection salary expense in the amount of \$61,552 from our operating reserve.

The schedule below lists the items that account for this year's financial statement loss.

University Appropriation (Corporate Budget)	\$ 7,345,964
Research Administration (Corporate Expense)	(7,433,628)
Net Loss before Interest and Conversion Expenses	(121,522)
Plus Interest Income	381,104
Net Income before Conversion Expenses	259,582
Less Conversion Expenses funded from	
Operating Reserves (Other Operating Expense)	(816,054)
Net Loss after Conversion Expenses	(556,472)

The Transfers from the University for Specified Expenditures line item represents payments from the University to the Research Foundation for rent and utilities for off campus research space. The Research Foundation pays the rent and utilities for off campus research space and it is included in the Expenditures Specified by the University line item. There is no net impact from these transactions in either our statement of revenues, expenses and changes in net assets or our statement of cash flows.

THE STATEMENTS OF CASH FLOWS

The primary source of cash receipts for operating activities consists of payments from sponsors. Cash outlays represent payments for personnel, materials, services, equipment, and travel incurred for Sponsored Research activities.

It should be noted that our corporate expenditures are carried in Cash Flows from Operating Activities and our corporate operating budget is carried in Net Cash Provided by Noncapital Financing Activities. This will usually result in a large negative cash flow from operations and a large positive cash flow from noncapital financing activities.

The reduction in cash flow due to our Operating loss is explained above. It results from the accounting treatments for both our corporate budget/expense and our PeopleSoft conversion expense.

Net cash provided by investing activities decreased by approximately \$123,000 due to a lower return on our investments.

FUTURE

In August of next year, the Research Foundation will abandon its 40 year-old legacy grants management system. Our legacy system will be replaced by state of the art PeopleSoft products. This investment is necessary to manage our future growth and to provide improved service to our customers. The PeopleSoft conversion project has been operating on time and under budget. We feel confident that we will have a successful conversion.

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

ASSETS	2004	2003
CURRENT ASSETS:		
Cash and cash equivalents	\$41,304,810	\$39,622,470
Accounts receivable and unbilled project costs	38,753,337	36,186,905
Other receivables	<u>259,756</u>	<u>240,855</u>
Total current assets	80,317,903	76,050,230
FURNITURE AND EQUIPMENT—		
Net of accumulated depreciation of approximately \$130,000 and \$87,000 in 2004 and 2003, respectively	<u>931,029</u>	<u>964,887</u>
TOTAL	<u>\$81,248,932</u>	<u>\$77,015,117</u>
 LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable:		
Trade	\$ 7,409,154	\$ 8,122,173
The Ohio State University	10,654,940	8,422,318
Accrued payroll	2,372,446	999,751
Accrued vacation and sick leave	497,360	539,420
Deferred revenue—sponsors	34,274,982	33,221,344
Facilities and administrative costs payable to University departments	13,869,495	12,523,504
Designated funds for University departments	<u>6,031,650</u>	<u>6,562,110</u>
Total current liabilities	75,110,027	70,390,620
ACCRUED VACATION AND SICK LEAVE—Long-term	<u>223,146</u>	<u>152,266</u>
Total liabilities	<u>75,333,173</u>	<u>70,542,886</u>
NET ASSETS:		
Invested in capital assets	931,029	964,887
Unrestricted	<u>4,984,730</u>	<u>5,507,344</u>
Total net assets	<u>5,915,759</u>	<u>6,472,231</u>
TOTAL	<u>\$81,248,932</u>	<u>\$77,015,117</u>

See notes to financial statements.

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
OPERATING REVENUES—		
Sponsor project revenue	<u>\$ 314,753,335</u>	<u>\$ 283,708,255</u>
Total operating revenues	<u>314,753,335</u>	<u>283,708,255</u>
OPERATING EXPENSES—		
Sponsor project:		
Personnel	143,319,889	131,570,659
Materials and services	86,085,869	74,883,703
Equipment	11,416,169	8,979,284
Travel	6,344,233	5,887,200
Facilities and administrative cost charged by the University	67,587,175	62,387,409
Research administration	7,433,628	6,875,740
Depreciation	33,858	35,969
Other operating expense	<u>816,054</u>	<u>335,165</u>
Total operating expenses	<u>323,036,875</u>	<u>290,955,129</u>
OPERATING LOSS	(8,283,540)	(7,246,874)
NONOPERATING REVENUES:		
University appropriation	7,345,964	6,817,944
Interest	<u>381,104</u>	<u>504,567</u>
(LOSS) INCOME BEFORE OTHER REVENUES, EXPENSES, GAINS, LOSSES AND TRANSFERS	(556,472)	75,637
TRANSFERS FROM THE UNIVERSITY FOR SPECIFIED EXPENDITURES	184,152	558,245
EXPENDITURES SPECIFIED BY THE UNIVERSITY	<u>(184,152)</u>	<u>(558,245)</u>
(DECREASE) INCREASE IN NET ASSETS	(556,472)	75,637
NET ASSETS—Beginning of year	<u>6,472,231</u>	<u>6,396,594</u>
NET ASSETS—End of year	<u>\$ 5,915,759</u>	<u>\$ 6,472,231</u>

See notes to financial statements.

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
OPERATING ACTIVITIES:		
Operating loss	\$(8,283,540)	\$(7,246,874)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	33,858	35,969
Decrease (increase) in operating assets and increase (decrease) in operating liabilities:		
Accounts receivable and unbilled project costs	(2,566,432)	(1,928,403)
Other receivables	(18,901)	350,616
Accounts payable—trade	(713,019)	(354,165)
Accounts payable—The Ohio State University	2,232,622	(78,650)
Accrued payroll	1,372,695	949,015
Accrued vacation and sick leave	28,820	112,363
Deferred revenue—sponsors	1,053,638	3,822,405
Facilities and administrative costs payable to University departments	1,345,991	1,974,743
Designated funds for University departments	<u>(530,460)</u>	<u>746,139</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>\$(6,044,728)</u>	<u>\$(1,616,842)</u>

See notes to financial statements.

(Concluded)

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION (A Component Unit of The Ohio State University)

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2004 AND 2003

1. ORGANIZATION

The Ohio State University Research Foundation (the "Research Foundation"), a component unit of The Ohio State University (the "University"), is a nonprofit educational corporation created in 1936 as a vehicle to promote the development, implementation, and coordination of sponsored research at the University in the furtherance of the University's educational objectives. The Research Foundation's financial statements and accounts are consolidated with the University's for purposes of complying with the University's reporting requirements.

2. ACCOUNTING POLICIES

The following is a summary of certain significant accounting policies followed in the preparation of the financial statements:

Basis of Presentation—The financial statements of the Research Foundation have been prepared on an accrual basis in accordance with accounting principles generally accepted in the United States of America. In accordance with Government Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Research Foundation follows GASB guidance as applicable to proprietary funds and Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Revenue Recognition—Substantially all of the Research Foundation's revenues are derived from restricted grants and cost reimbursement contracts which provide for the recovery of direct and related facilities and administrative costs, subject to audit. The Research Foundation recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related facilities and administrative costs is generally recorded at fixed rates negotiated with the Department of Health and Human Services, the cognizant federal audit agency.

Revenues derived from grants and contracts are reported as operating revenues. Transactions which are capital, finance or investment related are reported as nonoperating revenues. University appropriations and interest earned on cash investments are reported as nonoperating revenues.

Cash and Cash Equivalents—Cash and cash equivalents consist of demand deposit accounts and certificates of deposit with original maturities of less than 90 days. The Research Foundation's cash, except for the Huntington National Bank balance, is in the University account and is commingled with other University related entities and invested daily in overnight investment vehicles, which are considered cash equivalents. However they are not required to be categorized under GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements*. Investment income is allocated to the Research Foundation based on their ownership of the funds included in the University's account.

The portion of the Huntington National Bank balance of approximately \$629,000 and \$2,114,000 for June 30, 2004 and 2003, respectively, which was uninsured by federal deposit insurance as of June 30, 2004 and 2003 was approximately \$529,000 and \$2,014,000, respectively. The uninsured balance is collateralized by pools of securities pledged by the depository bank and are held in the name of the respective bank.

Receivables—Receivables are reported at their gross value when earned as the underlying exchange transaction occurs. An estimated receivable has been recorded for services rendered but not yet billed as of June 30, 2004 and 2003. The receivable was arrived at primarily by taking the subsequent payments of expenses related to cost reimbursement contracts invoiced after year-end, and recording at year-end the portions incurred and reimbursable from sponsors as of year-end.

Furniture and Equipment—Furniture and equipment are recorded at cost, and the capitalization threshold is \$3,000. Provision is made for depreciation of physical properties at rates calculated to absorb costs generally over the asset's estimated useful life of five years. Depreciation is calculated using the straight-line method. Depreciation expense was \$33,858 and \$35,969 for the years ended June 30, 2004 and 2003, respectively.

Expenditures for maintenance and repairs are charged to operating expenses as incurred; major renewals and betterments are capitalized. When furniture and equipment become fully depreciated, the assets and related accumulated depreciation are removed from the accounts.

	June 30, 2003	Additions	Adjustments	June 30, 2004
Capital assets:				
Furniture and equipment	\$ 1,052,158	\$ -	\$ 9,342	\$ 1,061,500
Less accumulated depreciation	<u>87,271</u>	<u>33,858</u>	<u>9,342</u>	<u>130,471</u>
Net capital assets	<u>\$ 964,887</u>	<u>\$ (33,858)</u>	<u>\$ -</u>	<u>\$ 931,029</u>

In-Kind Income—The Research Foundation is a component unit of The Ohio State University. As part of the relationship, transfers of funds occur between the University and the Research Foundation for certain sponsor project expenditures and research administration.

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 and 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.

New Accounting Pronouncements—The Research Foundation has adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* ("GASB 39"), an amendment of GASB Statement No. 14, *The Financial Reporting Entity*, as of July 1, 2002. The Research Foundation believes that it has properly identified and reported as a component unit of the Ohio State University each organization that meets the criteria established in GASB 39.

3. DESIGNATED FUNDS FOR UNIVERSITY DEPARTMENTS

Designated funds for University departments represent unrestricted funds resulting from residual amounts from certain completed projects that are for use at the discretion of University departments and funds payable to the University from royalties held by the Research Foundation.

4. TAX-EXEMPT STATUS

The Research Foundation is exempt from federal taxes on income under Section 501(c)(3) of the Internal Revenue Code.

5. RETIREMENT PLAN

All eligible University personnel assigned to the Research Foundation are covered by the Public Employees Retirement System (“PERS”). Employees may opt out of PERS and participate in the Alternative Retirement Plan (“ARP”) if they meet certain eligibility requirements.

Defined Benefit Plans—PERS offers statewide cost-sharing multiple-employer defined benefit pension plans. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefits are established by state statute. PERS issues a separate, publicly available financial report that includes financial statements and required supplemental information. The report may be obtained by contacting PERS. PERS Ohio 277 East Town Street Columbus, OH 43215-4642 (614) 466-2085, (800) 222-PERS (7377) or www.opers.org.

In addition to the retirement benefits described above, PERS provides postemployment health care benefits.

PERS currently provides postemployment health care benefits to retirees with ten or more years of qualifying service credit. These benefits are advance-funded on an actuarially determined basis and are financed through employer contributions and investment earnings. PERS determines the amount, if any, of the associated health care costs that will be absorbed by PERS. Under Ohio Revised Code (“ORC”), funding for medical costs paid from the funds of PERS is included in the employer contribution rate. For the fiscal year ended December 31, 2003, PERS allocated 5.0% of the employer contribution rate to fund the health care program for retirees.

The actuarial value of assets available for these benefits at December 31, 2002 (the date of the system’s latest actuarial review) was \$10.0 billion. There were 364,881 active contributing benefit recipients eligible for postemployment benefits as of December 31, 2003.

In December 2001, PERS adopted the Health Care “Choices” Plan. This plan is available to employees hired after January 1, 2003 who have no prior service credit accumulated towards post retirement health care benefits. This plan will incorporate a cafeteria plan approach in which the benefit recipient chooses coverage options best meeting his or her requirements, and benefits are earned on a graded scale from ten to thirty years (as opposed to the ten year vesting requirement for the existing post retirement health care benefit plan. PERS is now considering extending the “Choices” plan to all active members and benefit recipients, but this decision has not been finalized as of June 30, 2004.

Defined Contribution Plan—The ARP is a defined contribution pension plan. Full-time administrative and professional staff and faculty may choose to enroll in ARP in lieu of PERS. Classified civil service employees are not eligible to participate in ARP. ARP does not provide disability benefits, annual cost-of-living adjustments, postretirement health care benefits or death benefits to plan members and

beneficiaries. Benefits are entirely dependent on the sum of contributions and investment returns earned by each participant's choice of investment options.

PERS also offers a defined contribution plan, the Member-Directed Plan ("MD"). The MD plan does not provide disability benefits, annual cost-of-living adjustments, postretirement health care benefits or death benefits to plan members and beneficiaries. Benefits are entirely dependent on the sum of contributions and investment returns earned by each participant's choice of investment options.

Combined Plans—PERS also offers a combined plan. This is a cost-sharing multiple-employer defined benefit plan that has elements of both a defined benefit and defined contribution plan. PERS provides retirement, disability, survivor and postretirement health benefits to qualifying members of the combined plan.

Funding Policy—ORC provides PERS statutory authority to set employee and employer contributions. Contributions equal to those required by PERS are required for ARP. For employees enrolling in ARP, ORC requires a portion (which may be revised pursuant to periodic actuarial studies) of the employer contribution be contributed to PERS to enhance the stability of these plans. The required contributions rates (as a percentage of covered payroll) for plan members and the Research Foundation are as follows for 2004, 2003 and 2002:

	Employee Share	Employer Share
July 1, 2001—June 30, 2002	8.5 %	13.31 %
July 1, 2002—June 30, 2003	8.5	13.31
July 1, 2003—June 30, 2004	8.5	13.31

For the years ended June 30, 2004, 2003 and 2002 the Research Foundation reimbursed the University for the following costs for contributions associated with the retirement plans:

Year Ending	Contributions	
	PERS	ARP
2002	\$474,952	\$137,937
2003	526,897	92,335
2004	545,948	96,395

6. CONTINGENCIES

The Research Foundation is a party in various legal actions. While the final outcome cannot be determined at this time, management is of the opinion that the liability, if any, for these legal actions will not have a material adverse effect on the Research Foundation's financial position.

The Research Foundation, as an associated foundation, is covered under the University's self-insurance arrangements and commercial insurance policies. The University is self-insured for employee health benefits; and employee life, accidental death, and dismemberment benefits. Additional details regarding these self-insurance arrangements are provided in Note 5 to the University's financial statements. The University also carries commercial insurance policies for various property, casualty, and excess liability risks. Over the past three years, settlement amounts related to these insured risks have not exceeded the University's coverage amounts.

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