The Citadel
The Military College of South Carolina

Management's Discussion and Analysis
June 30, 2003

Overview of the Financial Statements and Financial Analysis

The Citadel is pleased to present its financial statements for fiscal year 2003. While audited financial statements for fiscal year 2002 are not presented with this report, condensed operations and financial position data will be presented in this section in order to illustrate certain increases and decreases. However, the emphasis of discussions about these statements will be on current year data. In addition, this discussion will focus on operations and financial position of the primary institution—The Citadel, and will not include its component unit—The Citadel Trust.

This report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB) in Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis—for State and Local Governments,* and Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Colleges and Universities.* These financial statements focus on the financial condition of the College, the results of operations and cash flows of the College as a whole.

There are three financial statements presented: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and, the Statement of Cash Flows. These statements present financial information in a format similar to that used by private corporations. The College's net assets (the difference between assets and liabilities) are one indicator of the improvement or erosion of the College's financial health when considered with non-financial facts such as enrollment levels and the condition of the facilities.

This discussion and analysis of the College's financial statements provide an overview of its financial activities for the year. One major activity—a $27.6 million dollar reconstruction project of Padgett-Thomas Barracks (P-T Barracks) stands out throughout all the College's statistics. This project is partially funded with a $15 million federal construction grant. As of June 30, 2003, all federal funds had been drawn in anticipation of disbursement within 90 days of the grant ending date. This construction activity affects construction in progress, cash on hand, deferred income, accounts payable and construction retainages.

Summary of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the College as of the end of the fiscal year. The Statement of Net Assets is a point of time financial statement. The purpose of the Statement of Net Assets is to present to the readers of the financial statements a fiscal snapshot of The Citadel. The Statement of Net Assets presents end-of-year data concerning Assets (property that we own and what we are owed by others), Liabilities (what we owe to others and have collected from others before we have provided the service), and Net Assets (Assets minus Liabilities). It is prepared under the accrual basis of accounting, where revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service to us, regardless of when cash is exchanged.

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the institution. They are also able to determine how much the institution owes vendors, investors, and lending institutions. Finally, the Statement of Net Assets provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the institution.

Net assets are divided into three major categories. The first category, invested in capital assets, net of debt, provides the institution's equity in property, plant, and equipment owned by the institution. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. Restricted nonexpendable net assets consist solely of the College's permanent endowment funds which are only available for investment purposes. Expendable restricted net assets are available for expenditure by the institution but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted assets are available to the institution for any lawful purpose of the institution. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the College's unrestricted net assets have been designated for various academic and research programs and initiatives.

Condensed Summary of Net Assets (***thousands of dollars***)

	2003	2002	Increase/ (Decrease)	Percent Change
Assets:				
Current assets	$ 21,695	$ 20,796	$ 899	4.32%
Capital assets, net	88,556	80,534	8,022	9.96%
Other assets	8,553	2,318	6,235	268.98%
Total Assets	118,804	103,648	15,156	14.62%
Liabilities:				
Current Liabilities	15,224	7,671	7,553	98.46%
Noncurrent Liabilities	25,873	27,085	(1,212)	(4.47)%
Total Liabilities	41,097	34,756	6,341	18.24%
Net Assets:				
Invested in capital assets, net of debt	63,550	56,324	7,226	12.83%
Restricted – expendable	4,963	3,752	1,211	32.28%
Unrestricted	9,194	8,816	378	4.29%
Total Net Assets	$ 77,707	$ 68,892	$ 8,815	12.80%

- Total Assets of the College increased by $15.2 million. Capital assets increased $8 million, driven by a $10.9 million increase in Construction In Progress, due almost exclusively to P-T Barracks. This construction in progress increase is partially offset by $3.2 million in depreciation, creating a net increase in capital assets of $8.0 million. The category of Other Assets increased by $6.2 million primarily due to $5.9 million of federal funds drawn in advance for P-T Barracks.

- Total liabilities of The Citadel increased by $6.3 million. Current Liabilities increased $7.5 million, primarily due to deferred revenue recognized for P-T Barracks. This deferred revenue is the result of $5.9 million of federal funds drawn in advance mentioned in the previous paragraph. Accounts payable—primarily for construction projects—creates the remaining increase in the current liability category. Non current liabilities decreased by $1.2 million due to payments on bonds, capital leases and notes payable.

- Although all categories of Net Assets increased during the year, the $8.8 million overall increase was largely attributable to the increase in capital assets, net of debt, of $7.2 million—primarily due to the P-T Barracks construction project.

Summary of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or non-operating. A public college's dependency on state aid and gifts will result in operating deficits. The GASB requires State Appropriations and gifts to be classified as non-operating revenues. The utilization of long-lived assets, referred to as Capital Assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

Changes in total net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of the statement is to present the revenues received by the institution, both operating and non-operating, and the expenses paid by the institution, operating and non-operating and any other revenues, expenses, gains and losses received or spent by the institution.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the institution. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the institution. Non-operating revenues are revenues received for which goods and services are not provided. State capital appropriations and capital grants and gifts are considered neither operating nor non-operating revenues and are reported after "Income before other revenues, expenses, gains or losses."

Condensed Summary of Revenues, Expenses and Changes in Net Assets *(thousands of dollars)*

	2003	2002	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student tuition and fees	$ 14,704	$ 13,219	$ 1,485	11.23%
Sales and services	20,968	20,321	647	3.18%
Grants and contracts	4,045	3,465	580	16.74%
Other operating revenues	846	888	(42)	(4.73%)
Total operating revenues	40,563	37,893	2,670	7.05%
Operating Expenses:				
Compensation & employee benefits	34,780	33,943	837	2.47%
Services & supplies	24,669	22,617	2,052	9.07%
Utilities	2,477	2,229	248	11.13%
Depreciation	3,199	3,222	(23)	(0.71)%
Scholarships & fellowships	2,227	2,127	100	4.70%
Total operating expenses	67,352	64,138	3,214	5.01%
Operating loss	(26,789)	(26,245)	(544)	2.07%
Nonoperating Revenues (Expenses):				
State appropriations	15,755	17,710	(1,955)	(11.04)%
Grants	4,733	4,000	733	18.33%
Gifts	1,758	1,626	132	8.12%
Investment income	837	675	162	24.00%
Interest expense	(1,342)	(1,256)	(86)	6.85%
Other nonoperating revenues/expenses	116	119	(3)	(2.52)%
Total nonoperating revenues (expenses)	21,857	22,874	(1,017)	(4.45)%
Income before other revenues, expenses, special & extraordinary items & transfers	(4,932)	(3,371)	(1,561)	46.31%
Capital grants & appropriations	10,553	2,787	7,766	278.65%
Gain/(loss) on disposal of capital assets	(11)	--	(11)	(5600.00)%
Transfers from Citadel Trust	3,205	3,907	(702)	(17.97)%
Change in Net Assets	8,815	3,323	5,492	165.29%
Net Assets, Beginning	68,892	65,569	3,323	5.07%
Net Assets, Ending	$ 77,707	$ 68,892	$ 8,815	12.80%

The Condensed Summary of Revenues, Expenses and in Net Assets reflects a positive year with an increase in Net Assets at the end of the year. Some highlights of the information presented on this Summary are as follows:

- The College experienced a $2.7 million increase in operating revenues. This is comprised primarily of fee increases for student tuition and fees which generated an additional $1.5 million to compensate for State budget cuts, and an increase in auxiliary fees ($.8 million) required to keep auxiliaries self supporting. An additional $.6 million came from increased lottery funded scholarship grants.

- Operating expenses at The College increased by $3.2 million. The largest portion of this increase is $2 million increase in expenditures for services and supplies. This includes $1.9 million for non-capitalized repairs to Deas Hall. Compensation and employee benefits increased $.8 million due to a 2% pay raise for all employees in January 2003.

- The $1.0 million reduction in Nonoperating Revenues and Expenses was due to a decrease in State Appropriations ($2 million), offset by $.7 increase in new operating grants (primarily lottery-funded technology grants) and $.2 increase in investment income. The College experienced two separate mid-year budget cuts from the State. The stock market turnaround during the last 6 months of the fiscal year created an increase in investment income.

- The increase of $7.8 million in capital grants and appropriations is attributable to the federal grant for PT Barracks construction.

Statement of Cash Flows

The final statement presented is the Statement of Cash Flows. The Statement of Cash Flows presents detailed information about the cash activity of the College during the year. The statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by the operating activities of the institution. The second section reflects cash flows from non-capital financing activities. This section reflects the cash received and spent for non-operating, non-investing, and non-capital financing purposes. The third section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The fourth section reflects the cash flows from investing activities and shows the purchases, proceeds, and interest received from investing activities. The fifth section reconciles the net cash used to the operating income or loss reflected on the Statement of Revenues. Expenses, and Changes in Net Assets.

Capital Asset and Debt Administration

No buildings were placed in service in fiscal year 2003. Most of the $10.9 million increase in Construction in Progress is related to P-T Barracks construction, which is slated for completion at the end of fiscal year 2004. A $2.2 million revitalization of Deas Hall was well under way by the close of this fiscal year. The College refunded and retired the $3 million Series 2001 Athletic Facilities Revenue Bond due February 2004 by issuing a 15-year, $3,150,0000 Athletic Facilities Refunding Revenue Bond in February 2003.

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Economic Outlook

The economic position of The Citadel is closely tied to that of the State of South Carolina. The State closed fiscal year 2003 with a $22 million operating deficit, which followed a $155 million deficit in the previous year, primarily due to collections falling below estimates for income and sales taxes. The State imposed mid-year budget cuts and sequestered funds, which they eventfully cut during fiscal year 2003. State Constitutional requirements to restore amounts withdrawn from the State's General Reserve to balance the 2004 budget make fiscal year 2004 budget cuts to State agencies a near certainty.

In anticipation of the State's economic condition, and in recognition that The Citadel budget for fiscal year 2004 reflects State Appropriation funding of less than one-fourth of the total College budget, The Citadel Board of Visitors adopted a 18.2 percent tuition increase for in-state and 14.5 percent increase for out-of-state students.

Although a year characterized by budget cuts and no cost-of- living raises looms for The Citadel, tuition increases for in-state students are mitigated by South Carolina Education Lottery scholarships—Palmetto Fellows ($6,700), LIFE ($4,700 plus $300 book allowance), and the first year HOPE ($2,650).

Despite the economic downturn and State budget cuts, The Citadel finished the fiscal year better off than in the previous year. Proof lies beyond the quantifiable increase in net assets of $8 million, but can also be found in the fact that many more students desire to attend The Citadel than can be accepted, and those that are accepted have record high SAT scores and high school rankings. The lottery plays an important part in the economic life of the College and its students. The College has benefited from funds allocated for technology. Students have benefited from lottery-funded scholarships.