

Northern Kentucky University
Statement of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2004 and 2003
(in thousands)

OPERATING REVENUES	2004	2003
Student tuition and fees (net of scholarship allowances of \$14,022 in 2004 and \$11,952 in 2003)	\$ 51,844	\$ 44,081
Federal grants and contracts	9,779	9,366
State and local grants and contracts	8,709	7,074
Nongovernmental grants and contracts	1,611	1,353
Sales and services of educational departments	2,445	1,717
Auxiliary enterprises		
Residence Halls (net of scholarship allowances of \$88 in 2004 and \$93 in 2003)	732	847
Residential Village (net of scholarship allowances of \$287 in 2004 and \$185 in 2003)	3,663	2,417
Other auxiliaries	921	919
Other operating revenues	2,463	1,926
Total operating revenues	<u>82,167</u>	<u>69,700</u>
 OPERATING EXPENSES		
Educational and general		
Instruction	48,102	48,257
Research	788	441
Public service	4,613	4,707
Libraries	3,597	3,246
Academic support	9,799	9,596
Student services	8,448	7,988
Institutional support	13,424	13,248
Operation and maintenance of plant	9,565	9,142
Depreciation	6,583	5,868
Student aid	10,076	9,125
Auxiliary enterprises		
Residence Halls	462	668
Residential Village	2,929	1,280
Other auxiliaries	363	350
Auxiliary depreciation	1,107	702
Other expenses	243	227
Total operating expenses	<u>120,099</u>	<u>114,845</u>
Net loss from operations	<u>(37,932)</u>	<u>(45,145)</u>
 NONOPERATING REVENUES (EXPENSES)		
State appropriations	45,127	45,258
Investment income	249	1,818
Interest on capital asset-related debt	(3,330)	(2,783)
Other nonoperating revenues (expenses)	152	558
Net nonoperating revenues	<u>42,198</u>	<u>44,851</u>
Income (loss) before other revenues, expenses, gains or losses	<u>4,266</u>	<u>(294)</u>
Capital appropriations	126	599
Capital grants and gifts	1,524	1,694
Total other revenues	<u>1,650</u>	<u>2,293</u>
Increase in net assets	<u>5,916</u>	<u>1,999</u>
 NET ASSETS		
Net assets-beginning of year	104,444	102,445
Net assets-end of year	<u>\$ 110,360</u>	<u>\$ 104,444</u>

See accompanying notes to the financial statements.

Northern Kentucky University
Statement of Cash Flows
For the Years Ended June 30, 2004 and 2003
(in thousands)

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	\$ 51,560	\$ 45,171
Grants and contracts	20,028	17,674
Payments to suppliers	(31,453)	(31,336)
Payments for salaries and benefits	(81,475)	(76,917)
Loans issued to students	(768)	(569)
Collection of loans to students	604	580
Auxiliary enterprise receipts:		
Residence Halls	786	895
Residential Village	3,725	2,504
Other auxiliaries	908	904
Sales and service of educational departments	2,360	1,708
Other receipts (payments)	2,403	1,904
Net cash used by operating activities	<u>(31,322)</u>	<u>(37,482)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	45,127	45,258
Agency and loan program receipts	38,420	33,198
Agency and loan program disbursements	(38,017)	(33,349)
Other nonoperating receipts (payments)	371	351
Net cash provided by noncapital financing activities	<u>45,901</u>	<u>45,458</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES		
Proceeds from capital debt and leases	10,377	18,912
Capital appropriations	-	-
Capital grants and gifts received	646	1,408
Purchases of capital assets	(19,118)	(27,712)
Principal paid on capital debt and leases	(6,595)	(5,509)
Interest paid on capital debt and leases	(3,264)	(2,658)
Net cash used by capital financing activities	<u>(17,954)</u>	<u>(15,559)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	-	1,974
Interest on investments	1,108	1,859
Net cash provided by investing activities	<u>1,108</u>	<u>3,833</u>
NET INCREASE (DECREASE) IN CASH	<u>(2,267)</u>	<u>(3,750)</u>
Cash-beginning of year	46,104	49,854
Cash-end of year	<u>\$ 43,837</u>	<u>\$ 46,104</u>
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH USED BY OPERATING ACTIVITIES:		
Net loss from operations	(37,932)	(45,145)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	7,690	6,570
Changes in assets and liabilities:		
Receivables, net	(839)	(569)
Other assets	(104)	(455)
Accounts payable	(82)	481
Deferred revenue	295	1,449
Long-term liabilities	(350)	187
Net cash used by operating activities	<u>\$ (31,322)</u>	<u>\$ (37,482)</u>

See accompanying notes to the financial statements.

Northern Kentucky University Foundation, Inc.
Consolidated Statement of Financial Position

As of June 30, 2004 and 2003
(in thousands)

	2004	2003
ASSETS		
Cash and cash equivalents	\$ 10,400	\$ 7,344
Loans and accounts receivable (less allowance of \$94 in 2004 and \$89 in 2003)	118	154
Accrued interest receivable	3	5
Contributions receivable (less allowance of \$523 in 2004 and \$29 in 2003)	4,873	10,135
Prepaid expenses and deferred charges	11	20
Investments	32,142	24,964
Land, buildings and equipment	3,224	3,251
Accumulated depreciation	(377)	(320)
Museum and art collections	1	431
Total Assets	50,395	45,984
LIABILITIES		
Accounts payable	91	78
Agency fund	3,619	4,083
Annuities payable	246	276
Deferred income	25	25
Notes payable	2,100	2,100
Total Liabilities	6,081	6,562
NET ASSETS		
Unrestricted		
For current operations	88	222
Contributions receivable	76	120
Designated for specific purposes	100	61
Amounts functioning as endowment funds	2,097	1,842
Invested in property, plant and equipment	748	1,204
Total Unrestricted	3,109	3,449
Temporarily restricted		
Unexpended funds received for restricted purposes	4,722	3,166
Contributions receivable	1,204	5,821
Loan funds	159	166
Endowment funds	9,389	6,172
Total temporarily restricted	15,474	15,325
Permanently restricted		
Contributions receivable	3,593	4,194
Endowment funds	22,138	16,454
Total permanently restricted	25,731	20,648
Total Net Assets	44,314	39,422
Total Liabilities and Net Assets	\$ 50,395	\$ 45,984

See accompanying notes to the financial statements.

Northern Kentucky University Foundation, Inc.
Consolidated Statement of Activities
For the Years Ended June 30, 2004 and 2003
(in thousands)

	2004			2003	
	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total	
CHANGES IN NET ASSETS:					
Revenues and Gains					
Gifts, grants and bequests	\$ 223	\$ 2,115	\$ 2,938	\$ 5,276	\$ 9,664
Rental income	97	-	-	97	97
Investment income	101	265	-	366	511
Net gains (losses) on investments	112	3,014	-	3,126	(43)
Other revenue	145	317	-	462	420
Gain/(loss) on asset disposal	-	-	-	-	130
Total Revenues and Gains	678	5,711	2,938	9,327	10,779
Net Assets Released from Restrictions	3,105	(3,105)			
Total Revenues and Gains and Other Support	3,783	2,606	2,938	9,327	10,779
Program Expenses					
Instruction	980	-	-	980	1,842
Research	1	-	-	1	3
Public service	448	-	-	448	441
Libraries	115	-	-	115	13
Academic support	767	-	-	767	188
Student services	325	-	-	325	212
Institutional support	473	-	-	473	316
Operation and maintenance of plan	217	-	-	217	66
Student financial aid	592	-	-	592	780
Total Program Expenses	3,918	-	-	3,918	3,861
Support Expenses					
Management and general	131	-	-	131	259
Fundraising support	206	-	-	206	171
Rental property	180	-	-	180	237
Total Support Expenses	517	-	-	517	667
Total Expenses	4,435	-	-	4,435	4,528
Net transfers in (out)	312	(2,457)	2,145	-	-
Increase (Decrease) in Net Assets	(340)	149	5,083	4,892	6,251
Net Assets – Beginning of Year	3,449	15,325	20,648	39,422	33,171
Net Assets – End of Year	\$ 3,109	\$ 15,474	\$ 25,731	\$ 44,314	\$ 39,422

See accompanying notes to the financial statements.

Northern Kentucky University
Notes to Financial Statements
For the Year Ended June 30, 2004

Note 1 – Organization and Summary of Significant Accounting Policies

a. Reporting Entity

Northern Kentucky University (the University) is a component unit of the Commonwealth of Kentucky and is included in the general-purpose financial statements of the Commonwealth. The Northern Kentucky University Foundation, Inc. (the Foundation) is a legally separate, tax-exempt organization supporting the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation's Board of Directors is self-perpetuating and consists of graduates and friends of the University. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, the resources the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of, the University, the Foundation is considered a component unit of the University and is discretely presented in the University's financial statements. The accompanying financial statements do not include the financial position and result of operation of the Chase College Foundation, Inc. This foundation is a separately incorporated not-for-profit entity organized for the purpose of promoting the educational mission of the University's Salmon P. Chase College of Law. Although this entity benefits the University's Salmon P. Chase College of Law, it is governed by independent Boards of Directors and is not controlled by the University.

b. Basis of Presentation

The accompanying consolidated financial statements of the University have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

In accordance with GASB Statement No. 35, Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities (GASB 35) and subsequent standards issued by GASB, the University has elected to report as an entity engaged business-type activities. GASB 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net assets categories:

- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted:**
 - Nonexpendable* – Net assets subject to externally imposed stipulations that they be maintained permanently by the University.
 - Expendable* – Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time. These net assets principally represent amounts for specified capital construction projects.
- **Unrestricted:** Net assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation required by GASB is intended to provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

c. Accrual Basis

The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The University reports as a Business Type Activity (BTA). BTAs are those activities that are financed in whole or part by fees charged to external parties for goods and services.

d. Capital Assets

Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift. Equipment with a unit cost of \$5,000 or more and having an estimated useful life of greater than one year, is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for land improvements, 10 – 40 years buildings and fixed equipment, 10 years for library books and 3 – 10 years for equipment. The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research and public service.

e. Inventories

Inventories are stated at cost (first-in, first-out or average cost).

f. Investments

Investments are stated at fair value.

g. Deferred Revenue

Deferred revenue includes amounts received for tuition and fees prior to the end of the fiscal year but related to the subsequent accounting period. Deferred revenue also includes amounts received from grants and contracts sponsors and state deferred maintenance funds that have not yet been earned.

h. Scholarship Allowances

Student tuition and fee revenues and other student related revenues are reported net of scholarship allowances in the statement of revenues, expenses and changes in net assets. Scholarship allowances are the differences between the stated charge for services provided by the University, and the amounts that are paid by the students or third parties making payments on a student's behalf. To the extent that revenues from such programs are used to satisfy tuition and fees, and other student charges, the University has recorded a scholarship allowance.

i. Restricted Asset Spending Policy

The University's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination on whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

j. Operating Activities

The University defines operating activities, as reported on the statement of revenues, expenses and changes in net assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for services and goods received. Nearly all of the University's expenses are from exchange transactions. Certain significant revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as nonoperating revenues, in accordance with GASB 35.

k. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

l. Component Unit Disclosure

The accompanying financial statements of the Foundation have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Financial Accounting Standards Board. As such certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features.

During the year ended June 30, 2004, the Foundation made distributions of \$2,078,000 to or on behalf of the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Northern Kentucky University Foundation, Inc. at Mark R. Herrmann Center, Nunn Drive, Highland Heights, KY 41099.

m. Other Significant Accounting Policies

Certain items have been reclassified for the year ended June 30, 2003, in order to conform to classifications used for the year ended June 30, 2004.

Note 2 – Cash, Cash Equivalents and Investments

Cash and cash equivalents includes all readily available sources of cash such as petty cash, demand deposits, certificates of deposit and temporary investments in marketable securities with original maturities less than three months. At June 30, 2004, petty cash funds totaled \$18,000 and the carrying amount of the deposits was \$43,819,000 with a corresponding total bank balance of \$45,547,000. Of the bank balance, \$12,750,000 was covered by federal depository insurance, or collateralized with securities held by the pledging bank, or bank's agents, in the University's name and \$32,797,000 was held and invested by the Commonwealth of Kentucky. These deposits were covered by federal depository insurance or by collateral held by the Commonwealth in the Commonwealth's name.

The University's investments are categorized as to the level of risk assumed by the University by the categories described below.

Category 1: Insured or registered, or securities held by the University or its agent in the University's name.

Category 2: Uninsured and unregistered, with securities held by the counter party's trust department or agent in the University's name.

Category 3: Uninsured and unregistered, with securities held by the counter party, or by its trust department or agent, but not in the University's name.

The University's investments as of June 30, 2004, were all Category 1 and consist of U. S. Government Securities with a carrying and market value of \$3,012,000.

Note 3 – Notes, Loans and Accounts Receivable

Notes, loans and accounts receivable as of June 30, 2004 and 2003 are as follows (in thousands):

	2004			2003		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Student loans	\$ 2,873	\$ (444)	\$ 2,429	\$ 2,762	\$ (439)	\$ 2,323
Reimbursement receivable – grants and contracts	997		997	801		801
Accrued interest receivable	94		94	765		765
Other	2,665	(538)	2,127	1,911	(322)	1,589
	<u>\$ 6,629</u>	<u>\$ (982)</u>	<u>\$ 5,647</u>	<u>\$ 6,239</u>	<u>\$ (761)</u>	<u>\$ 5,478</u>
Current portion			3,545			3,407
Noncurrent portion			<u>\$ 2,102</u>			<u>\$ 2,071</u>

Note 4 – Capital Assets, net

Capital assets as of June 30, 2004 are summarized as follows (in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Ending Reductions</u>	<u>Balance</u>
Land	\$ 3,791	\$ 406		\$ 4,197
Land improvements	5,387	1,104		6,491
Buildings	172,621	13,634	\$ 103	186,152
Equipment	16,168	2,701	323	18,546
Library books	23,363	1,365	189	24,539
Construction in process	6,249		428	5,821
	<u>227,579</u>	<u>19,210</u>	<u>1,043</u>	<u>245,746</u>
Accumulated depreciation				
Land improvements	1,371	153		1,524
Buildings	66,060	4,815	45	70,830
Equipment	7,112	1,668	271	8,509
Library books	16,959	1,054	189	17,824
	<u>91,502</u>	<u>7,690</u>	<u>505</u>	<u>98,687</u>
Capital assets, net	<u>\$ 136,077</u>	<u>\$ 11,520</u>	<u>\$ 538</u>	<u>\$ 147,059</u>

Note 5 – Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of June 30, 2004 and 2003 are as follows (in thousands):

	2004	2003
Payable to vendors and contractors	\$ 4,286	\$ 5,673
Accrued expenses, primarily payroll and vacation leave	3,025	2,790
Employee withholdings and deposits payable to third parties	2,888	2,795
	<u>\$ 10,199</u>	<u>\$ 11,258</u>

Note 6 – Deferred Revenue

Deferred revenue as of June 30, 2004 and 2003 is as follows (in thousands):

	2004	2003
Unearned summer school revenues	\$ 3,270	\$ 3,070
Unearned grants and contracts revenue	613	490
Unearned state deferred maintenance pool funds	100	156
Other	688	937
	<u>\$ 4,671</u>	<u>\$ 4,653</u>

Note 7 – Long-term Liabilities

Long-term liabilities as of June 30, 2004 are summarized as follows (in thousands):

	Balance			Balance	Current	Noncurrent
	7/1/2003	Additions	Reductions	6/30/2004	Portion	Portion
Consolidated Educational Buildings Revenue Bonds	\$33,290	\$ 9,450	\$ 4,195	\$38,545	\$ 4,755	\$33,790
Housing and Dining Revenue Bonds	3,560		200	3,360	210	3,150
CVU note payable	349		111	238	116	122
Municipal lease obligations	4,577	1,161	850	4,888	854	4,034
Capital lease	25,879		1,324	24,555	1,378	23,177
Total bonds, notes and capital leases	<u>67,655</u>	<u>10,611</u>	<u>6,680</u>	<u>71,586</u>	<u>7,313</u>	<u>64,273</u>
Faculty Retirement and Deferred Compensation	1,432	430	781	1,081	421	660
Federal portion of Perkins Loans	2,322	50		2,372		2,372
Arbitrage rebate liability	113			113		113
Total other liabilities	<u>3,867</u>	<u>480</u>	<u>781</u>	<u>3,566</u>	<u>421</u>	<u>3,145</u>
Total long-term liabilities	<u>\$71,522</u>	<u>\$11,091</u>	<u>\$ 7,461</u>	<u>\$75,152</u>	<u>\$ 7,734</u>	<u>\$67,418</u>

The outstanding Consolidated Educational Buildings Revenue Bonds (CEBRB) consist of CEBRB Series A, B, H, I, J, K and L with interest rates ranging from 4.01 percent to 5.97 percent and various maturity dates through May 1, 2023. Student tuition and fees and proceeds from a United States Department of Education annual interest grant are pledged as security for the University's outstanding CEBRB. The reserve requirements for all CEBRB issues have been fully funded as of June 30, 2004.

The outstanding Housing and Dining System Revenue Bonds (Housing and Dining) consist of Housing and Dining Series B and C with interest rates ranging from 3.0 percent to 7.8 percent and various maturity dates through November 1, 2020. The gross revenues of the Housing and Dining system operations are pledged for the retirement of the Housing and Dining System Revenue Bonds. The reserve requirements for all Housing and Dining issues had been fully funded as of June 30, 2004, with the exception of the housing renewals and replacements reserve. Planned allocations to this reserve over the next two years will increase the current balance, \$323,000, to the required level of \$348,000.

On April 22, 1998, the University entered into a facilities lease for student housing facilities for biennial terms renewable until final termination on December 1, 2011 or as provided in the lease. Title to the housing facilities will transfer to the University upon termination of the facilities lease. The future minimum lease payments are to be paid from revenues of the leased facilities. For accounting purposes, the facilities lease represents a capital lease with an imputed interest rate of 4.58 percent.

On August 1, 2002, the University entered into a second facilities lease for student housing facilities for biennial terms renewable until final termination on December 1, 2027 or as provided in the lease. Title to the housing facilities will transfer to the University upon termination of the facilities lease. The future minimum lease payments are to be paid from revenues of the leased facilities. For accounting purposes, the facilities lease represents a capital lease with an imputed interest rate of 4.88 percent.

Principal maturities and interest on bonds, notes and capital leases for the next five years and in subsequent five-year periods are as follows (in thousands):

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 7,313	\$ 3,178	\$ 10,491
2006	7,668	2,846	10,514
2007	7,706	2,506	10,212
2008	5,518	2,154	7,672
2009	5,625	1,905	7,530
2008-2014	19,491	6,020	25,511
2015-2019	7,736	3,400	11,136
2020-2024	6,750	1,692	8,442
2025-2028	3,779	380	4,159
Total	<u>\$ 71,586</u>	<u>\$ 24,081</u>	<u>\$ 95,667</u>

Note 8 – Pension Plans and Accrued Compensated Absences

Employees of the University are covered by one of two pension plans:

a. Defined Contribution Plan

A Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF) sponsored plan, adopted by the Board of Regents in July 1970, is available upon completion of one year's service, to all regular full-time members of the faculty, administrative officers and others who have educational related duties. The TIAA-CREF retirement plan is a defined contribution, money purchase retirement plan. The employees contribute 5 percent of their base salary to the plan, and the University contributes 10 percent. All payments are vested immediately and the contracts with the providers are owned by the individual employees. The employee is entitled to various payment options upon retirement. Benefit payments at retirement depend on the total contributions with interest deposited into the employee's account. Retirement benefits can begin upon retirement or termination of employment with the University. Covered payroll totaled \$29,250,000 and \$27,783,000 for the years ended June 30, 2004 and 2003. Expenditures for the University's portion amounted to \$2,925,000 and \$2,778,000 for the years ended June 30, 2004 and 2003.

b. Defined Benefit Plan

Plan Description - All regular employees not participating in the above plan are required to participate in the Kentucky Employees Retirement System (KERS), a cost sharing - multiple employer public employee retirement system. KERS is a defined benefit plan providing for retirement, disability, death benefits and health insurance. Each employee covered by KERS is entitled to a monthly benefit equal to 1.97 percent, except as otherwise provided by KERS, of the member's average final monthly compensation multiplied by the number of credited years of service upon attainment of age 65. The average final compensation is calculated using the five highest paid fiscal years. Participants have a fully vested interest after the completion of 60 months of service, 12 of which are current service. KERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky, 40601-6124 or by calling (502) 564-4646.

Funding Policy - Benefit and contribution rates are established by state statute. For the fiscal year ended June 30, 2004, University employees were required to contribute 5 percent of their annual covered salary and the University was required to contribute 5.89 percent of covered payroll. The University's contributions to KERS for the years ending June 30, 2004, 2003 and 2002 were \$1,353,000, \$1,283,000 and \$1,158,000, respectively, equal to the required contributions for each year.

c. Deferred Compensation Plans

The University, through participation in the Commonwealth of Kentucky plan, offers its employees two deferred compensation plans created in accordance with Internal Revenue Code Sections 457 and 401(k). The plans, available to all Commonwealth employees, permit them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

All compensation deferred under Section 457, all property and rights purchased with that compensation and all income attributable to that compensation, property or rights belong solely to the Commonwealth and the University until paid to the employee or beneficiary, subject only to the claims of the Commonwealth's and University's general creditors. Participants' rights under the plan are equal to those

of general creditors of the Commonwealth and the University in an amount equal to the fair market value of the deferred account for each participant. The market value of the University's share of the Section 457 plan assets, as of June 30, 2004 and 2003, were \$1,208,000 and \$1,089,000, respectively. All compensation deferred under Section 401(k) and resultant assets belong to the plan participants.

d. Retirement Incentive Program

A faculty retirement incentive program was adopted in September 1994, by the Board of Regents. Each early retiree receives salary and benefits for three years. The salary for each participant for the first year is equal to 50 percent of their academic year salary upon retirement, and 25 percent for the second and the third year. At June 30, 2004 and 2003, the University had recognized an accrued liability of \$789,000 and \$1,432,000, which is equal to the future salary and benefits that the current 31 participants will receive under the plan. An "eligible employee" shall mean a full-time, tenured faculty member with a minimum 15 years of tenure or tenure-track collegiate service. Each year the University, in its sole discretion, determines who is allowed to participate under this plan and the contribution, if any, to the program with respect to such year. The University shall have no obligation to reserve or otherwise set aside funds for the program.

e. Compensated Absences

University employees begin to accumulate annual vacation allowance from the initial date of employment; however, no vacation is granted until three months of continuous employment have been completed. The maximum accumulation of vacation leave is limited to the number of days that can be accumulated in twelve months, based upon length of service and employment classification. Employees are paid their accumulated vacation upon termination, subject to certain limitations. At June 30, 2004 and 2003, the University had recognized an accrued vacation liability of \$1,571,000 and \$1,446,000, respectively.

Note 9 – Operating Expenses By Natural Classification

The University's operating expenses by natural classification were as follows for the years ended June 30, 2004 and 2003 (in thousands):

	2004	2003
Salaries and wages	\$ 66,346	\$ 63,163
Employee benefits	14,888	13,747
Utilities	3,336	2,984
Supplies and other services	17,540	19,049
Depreciation	7,690	6,570
Student scholarships and financial aid	10,299	9,332
	<u>\$ 120,099</u>	<u>\$ 114,845</u>

Note 10 – Risk Management

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups, purchase of commercial insurance or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and other named perils between \$500 and \$500,000 per occurrence. Losses in excess of \$500,000 are insured by commercial carriers up to \$500 million per occurrence principally on an actual cash value basis. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to \$200,000 for any one person and \$350,000 for multiple claims resulting from a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a risk retention group or commercial insurance. There have been no significant reductions in insurance coverage from 2003 to 2004. Settlements have not exceeded insurance coverage during the past three years.

Note 11 – Contingencies and Commitments

The University is a party to various litigation and other claims in the ordinary course of business. University officials are of the opinion, based upon the advice of legal counsel, that the ultimate resolution of these matters will not have a material effect on the financial position of the University.

The estimated cost to complete construction under contract at June 30, 2004 was approximately \$4,314,000. Such construction is principally financed by appropriations from the Commonwealth of Kentucky and proceeds from bonds.

Note 12 – Segment Information

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds are outstanding. A segment has a specifically identifiable revenue stream pledged in support of revenue bonds and has related expenses, gains and losses and assets and liabilities, that are required by an external party to be accounted for separately. The University has one segment that meets the reporting requirements of GASB: the Northern Kentucky University Housing and Dining System (Housing and Dining System).

The Housing and Dining System is an organizational unit of the University that manages the University's student dormitory housing units. The gross revenues from the dormitory housing units are pledged for retirement of the Consolidated Housing and Dining System Revenue Bonds.

Condensed Statement of Net Assets at June 30, 2004 and 2003 (in thousands)

	2004 Housing & Dining	2003 Housing & Dining
Assets:		
Current assets	\$ 464	\$ 418
Noncurrent assets	2,433	2,610
Total assets	<u>2,897</u>	<u>3,028</u>
Liabilities:		
Current liabilities	293	309
Noncurrent liabilities	3,150	3,360
Total liabilities	<u>3,443</u>	<u>3,669</u>
Net assets:		
Invested in capital, net of related debt	(1,285)	(1,310)
Restricted	659	654
Unrestricted	80	15
Total net assets	<u>\$ (546)</u>	<u>\$ (641)</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30, 2004 and 2003 (in thousands)

	2004 Housing & Dining	2003 Housing & Dining
Operating revenues	\$ 844	\$ 942
Operating expenses	<u>(627)</u>	<u>(857)</u>
Operating income	217	85
Nonoperating revenues	9	14
Nonoperating expenses	<u>(131)</u>	<u>(173)</u>
Increase (decrease) in net assets	95	(74)
Net assets, beginning of year	(641)	(567)
Net assets, end of year	<u>\$ (546)</u>	<u>\$ (641)</u>

Condensed Statement of Cash Flows for the years ended June 30, 2004 and 2003 (in thousands)

	2004 Housing & Dining	2003 Housing & Dining
Net cash flows provided by operating activities	\$ 424	\$ 268
Net cash flows provided by investing activities	15	223
Net cash flows used in capital and related financing activities	(325)	(369)
Net cash flows used in non-capital financing activities	-	-
Net increase in cash and cash equivalents	<u>114</u>	<u>122</u>
Cash and cash equivalents, beginning of year	628	506
Cash and cash equivalents, end of year	<u>\$ 742</u>	<u>\$ 628</u>

Northern Kentucky University Foundation, Inc.
Notes to Consolidated Financial Statements
For the Year Ended June 30, 2004

Note 1 – Summary of Significant Accounting Policies

a. Scope of Statements

Northern Kentucky University Foundation, Inc. (the Foundation) is a legally separate, tax-exempt organization supporting Northern Kentucky University. The Foundation acts primarily as a fund-raising organization to supplement the resources of the Northern Kentucky University. The consolidated financial statements of the Foundation include the assets of the Foundation and its former subsidiary corporation, the Small Business Incubator of Northern Kentucky, Inc. that ceased operations June 30, 2002. The SBI was dissolved and its assets transferred to the Foundation during the year ended June 30, 2003.

b. Basis of Presentation

In accordance with pronouncements of the Financial Accounting Standards Board, these statements are presented on the accrual basis of accounting, and have been prepared to focus on the Foundation as a whole and to present transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of fund balances and transactions into three classes of net assets - permanently restricted, temporarily restricted and unrestricted net assets.

Net assets and changes therein are classified as follows:

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Foundation. Generally, the donors of these assets permit the Foundation to use the returns on the related investments over time for general or specific purposes.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met by actions of the Foundation and/or the passage of time. Temporarily restricted net assets are generally established in support of colleges or departments of the University, often for specific purposes such as faculty support, scholarships and fellowships, library acquisitions, equipment or building projects and other specific purposes.

Unrestricted net assets - Net assets not subject to donor-imposed stipulations.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets are reported as reclassifications between the applicable classes of net assets.

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at an appropriate rate commensurate with the risks involved. Amortization of discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions on the contributions. An allowance for uncollectible contributions receivable is provided based upon management's judgment of such factors as prior collection history, type of contribution and nature of the fund-raising activity.

Income and realized net gains on long-term investments are reported as follows:

- As increases in permanently restricted net assets – if the terms of the gift require that they be added to the principal of a permanent endowment fund
- As increases in temporarily restricted net assets – if the terms of the gift impose restrictions on the use of the income
- As increases in unrestricted net assets – in all other cases

c. Cash and Cash Equivalents

Cash and cash equivalents includes all readily available sources of cash such as petty cash, demand deposits and temporary investments in marketable securities with maturities of less than three months. Cash and cash equivalents representing investments purchased with endowment net assets are reported as investments.

d. Investments

The Foundation's investments are recorded in the financial statements at fair value. The value of publicly traded fixed income and equity securities is based upon quoted market prices and exchange rates, if applicable. The Foundation invests its endowment investment portfolio and allocates the related earnings for expenditure in accordance with the total return concept. A distribution of endowment return that is independent of the cash yield and appreciation of investments earned during the year is provided for program support.

The Foundation has adopted an endowment spending policy designed to stabilize annual spending levels and to preserve the value of the endowment portfolio. The spending policy attempts to achieve these objectives by using a spending rate which has ranged from 3% to 5% in recent years, combined with a smoothing rule which adjusts spending gradually to changes in the endowment market value. The actual rate of spending will vary depending on the rate of growth or decline in market value of the endowment investment portfolio.

The market values of the Foundation's investments as of June 30, 2004 and 2003 are categorized below (in thousands):

	2004	2003
Type of investments:		
Short-term money market funds	\$ 312	\$ 547
Fixed income funds	4,956	8,855
Equity funds and common stock	23,258	13,845
Certificates of deposit	150	450
Municipal bonds	198	207
Hedge funds	3,010	-
Real estate	-	795
Other	258	265
Total Investments	<u>\$ 32,142</u>	<u>\$ 24,964</u>

The Foundation records the cost of managing its endowment portfolio as a decrease in investment income within the appropriate net asset class in the Statement of Activities. For the years ended June 30, 2004 and 2003, investment managers' fees were \$94,607 and \$91,751 respectively.

At June 30, 2004, the current market value of certain endowment accounts was less than the amount required to be maintained as principal for those endowments. The amount by which the required balances of those endowments exceeded current market value is \$305,190.

e. Fixed Assets and Depreciation

The cost of expenditures for land, buildings, improvements, equipment, art and museum collections and the fair market value of donated capital assets in excess of \$5,000 are capitalized. Annual depreciation is computed on a straight-line basis, beginning in the month of acquisition, at rates based on useful lives of 25 to 40 years for buildings and improvements and 3 to 5 years for furnishings and equipment. Depreciation expense for the years ended June 30, 2004 and 2003 was \$59,945 and \$59,906, respectively, and is reported as support expenses under rental property in the statement of activities.

Equipment purchased or assets constructed through the Foundation for use by Northern Kentucky University are recorded by the Foundation as a program expense. During 2004, the Foundation transferred ownership of substantially all of its museum and art collection assets to the University.

f. Net assets Released from Restrictions

Reclassification of net assets is based upon the satisfaction of the purpose for which the net assets were restricted or the completion of a time stipulation. Restricted contributions and net investment returns earned are reported as temporarily restricted support and reclassified as unrestricted when any donor-imposed restrictions are satisfied.

g. Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles 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 income, revenues and expenses during the reporting period. Actual results could differ from those estimates.

h. Other Significant Accounting Policies

Certain items may have been reclassified for the year ended June 30, 2003, in order to conform to classifications used for the year ended June 30, 2004.

Note 2 – Notes Payable

The Foundation has a \$2.1 million open-end mortgage note payable collateralized by a first mortgage on certain land and buildings owned by the Foundation. The note principal is due on or before December 31, 2006. Monthly payments of interest at the lender's floating prime rate (4.0% at June 30, 2004) were current at June 30, 2004.

Note 3 – Unconditional and Conditional Promises to Give

Unconditional promises to give that are expected to be collected within one year are recorded at their net realizable value. Amounts expected to be collected in future years are recorded at the present value of estimated future cash flows. The discounts are computed using a risk free interest rate as of fiscal year-end. Amortization of the discount is included in contribution revenue.

At June 30, 2004 and 2003, the Foundation recognized contributions based on the following unconditional promises to give (in thousands):

	2004	2003
Purpose:		
Endowment giving	\$ 3,979	\$ 4,530
Capital purposes	190	4,550
Operating programs	1,312	1,471
Gross unconditional promises	5,481	10,551
Less: Discount and allowance for uncollectible accounts	(608)	(416)
Net unconditional promises to give	\$ 4,873	\$ 10,135
Amounts due in:		
Less than one year	4,335	6,404
One to five years	1,104	4,120
More than five years	42	27
Total	\$ 5,481	\$ 10,551

The discount rate used to calculate the present value of contributions receivable at June 30, 2004 and 2003 was 3.0% and 1.38%, respectively.

Conditional promises to give are not included as support until such time as the conditions are substantially met. At June 30, 2004, the Foundation had received conditional promises to give of approximately \$2,800,000, consisting of the face value of life insurance policies, net of accumulated cash surrender value.

Note 4 – Pension Plan

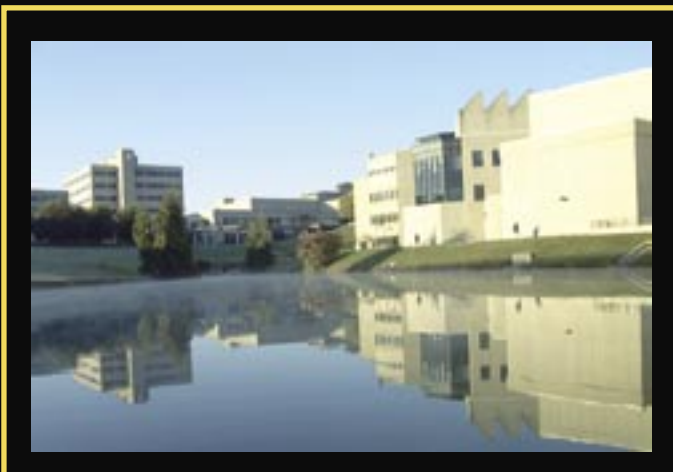
During fiscal year 2003, an employee of the Foundation participated in a defined contribution pension plan, sponsored by the Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF). The TIAA-CREF retirement plan is a defined contribution, money-purchase retirement plan. The Foundation contributed 15 percent of the employee's base salary to the plan. All payments are vested immediately and the contracts with the providers are owned by the individual participant. The participant is entitled to various payment options upon retirement. Benefit payments at retirement depend on the total contributions with interest deposited into the participant's account. Retirement benefits can begin upon retirement or termination of employment. Employer contributions to the plan were \$6,809 for the year ended June 30, 2003. At June 30, 2004, the Foundation had no employees participating in a pension plan.

Note 5 – Contingent Liabilities

Legal counsel for the Foundation have advised that they know of no pending or threatened litigation, claims or assessments involving the Foundation that could have a material adverse financial effect on the Foundation.

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