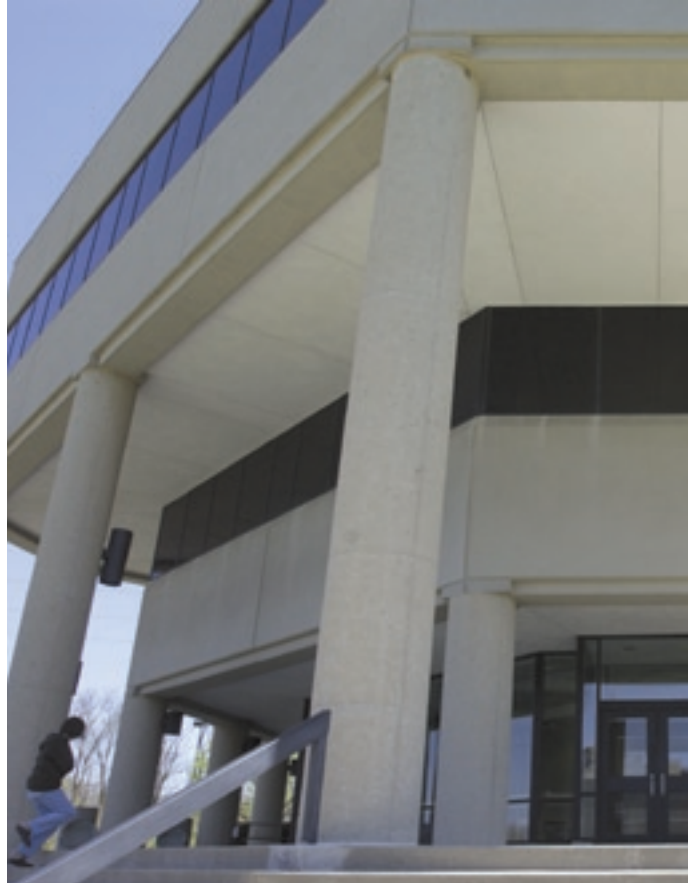


Annual Financial Report



2004-2005





Current as of June 30, 2005

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**Northern Kentucky University
Annual Financial Report
2004-2005**

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T A B L E O F C O N T E N T S

September 22, 2005

Northern Kentucky University Board of Regents
Highland Heights, KY 41099

Dear Members of the Board:

It is my pleasure to transmit the University's 2004-05 Annual Financial Report. The statements included have been audited by the firm of Crowe, Chizek and Company LLC. NKU ends the fiscal year and begins the new academic year in a strong financial position securing increases in both public and private funding for the new fiscal year. The University received \$54 million for construction of the Bank of Kentucky Center and \$6.5 million in recurring funds for additional campus operating support. Also, private support totals reached \$10.2 million, and \$11 million were received in grants and contracts.



Let us focus on a few of the highlights of the past year as well as the challenges of this new academic year:

Enrollment is at its highest level in the history of the University. For the fall 2005, we registered almost 14,500 students, which is a total enrollment increase of about 0.5 percent over last year. Undergraduate enrollment declined slightly due to the new admissions standards, but the incoming students are the most academically prepared class in the University's history (with an average ACT score of 22.8 this fall compared to 21.7 in 2004). The new NKU Academy — a five-week intensive program designed for students who wanted to attend the University but did not meet our admission criteria — was introduced, graduating and admitting the 68 students who enrolled. Law and graduate school enrollments continued to increase with the introduction of new master degree programs in organizational/industrial psychology, liberal studies, and two new counseling programs. Enrollment in on-line courses more than doubled this past spring, which included an on-line master's program in nursing. Other significant indicators related to this year's student profile include an 18 percent increase in the number of honors students and a slight increase in the number of international, Latino and African-American students.

The University continued taking important steps to promote and enhance academic quality. To preserve our small class sizes, we hired 16 additional full-time faculty. We also expanded support for Stealy Library, invested in faculty development and instructional equipment, increased stipends for graduate students, increased the number of undergraduate and graduate programs in response to public demand, and restructured academic areas to strengthen our capacity to serve both our students and our community. We introduced a new program this year called PACE (Program for Adult-Centered Education), which is an intensive undergraduate degree program for working adults. Academic restructuring resulted in a new College of Informatics that will produce graduates with cross-disciplinary skills, including the application of information sciences to many fields. It also created a new School of Nursing and Health Professions, and the joining of the Department of Social Work and Human Services to the College of Education, creating the College of Education and Human Services. In addition, two new associate provost positions have been added to provide leadership related to two major mission priorities in the areas of student success and economic development needs of the region.

Great strides were made this year to advance the quality of our campus experience through new student retention strategies, exciting athletic accomplishments, and facilities and access enhancements. Retention strategies included new early warning programs, academic intervention programs, and a new two-day student orientation program that expanded advising and college preparation for all incoming students. NKU's intercollegiate athletic program won its fourth Great Lakes Valley Conference All Sports Trophy in the past six years. Among many outstanding team accomplishments, the women's softball team set an all-division NCAA record of 55 consecutive victories. Facilities and access enhancements include approval for the construction of the new 8,000- to 10,000-seat The Bank of Kentucky Center, which will make the campus a hub for athletics and a broad range of entertainment and special events. Also included: the construction of the new student union, which will be a hub for student and campus life and which will boost both student recruitment and retention; the completion of the new lake enhancement project, which will include waterfalls, walkways, a bridge and amphitheater; and approval of \$16 million to construct the I-275 connector road to the AA Highway, which will ease traffic and improve campus safety.

A defining quality of NKU is our work on behalf of regional progress. We introduced the "Southern Counties Science Project," which provides professional development opportunities for science teachers in Bracken, Carroll, Gallatin, Grant, Owen and Pendleton counties; offered the MBA program on-site at Citigroup; and took our Department of Theater to rural counties in our region and beyond. Last year, our Center for Integrative Natural Science and Mathematics supported math and science enrichment programs for more than 9,000 P-12 students and 1,400 teachers. The METS Center for Corporate Learning exceeded all expectations last year by serving an attendee headcount of more than 40,000, doubling the previous year. The Scripps Howard Center for Civic Engagement expanded education for citizenship and student involvement in our community. Our new public leadership initiative is providing support to local government leaders as they struggle with complex governance and planning challenges. Currently, our largest and most complex community initiative is the leadership we are providing for Northern Kentucky's yearlong planning initiative called Vision 2015. As part of the initiative, five action teams (each supported by NKU faculty members) are focusing on economic competitiveness, educational excellence, urban renaissance, effective governance and livable communities.

While this past year presented new challenges, we produced many accomplishments. Through creativity, discipline and hard work, we assessed our circumstances, examined our options, and did what needed to be done. With dedicated commitment, we will continue to strive to be an excellent and beneficial leader for our students, our community, our region and our nation.

Sincerely,



James C. Votruba
President



Crowe Chizek and Company LLC
Member Horwath International

REPORT OF INDEPENDENT AUDITORS

Board of Regents
Northern Kentucky University

Secretary of Finance and
Administration Cabinet of the
Commonwealth of Kentucky

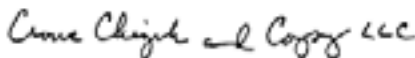
We have audited the accompanying financial statements of the business-type activities and discretely presented component unit of Northern Kentucky University (the "University") as of and for the years ended June 30, 2005 and 2004, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of the Northern Kentucky University Foundation, Inc, (the "Foundation"), a component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation, is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and discretely presented component unit of Northern Kentucky University as of June 30, 2005 and 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1. n., the University restated its financial statements to conform its accounting for Regional University Excellence Trust Fund (RUETF) grants to that required by the RUETF enabling legislation and subsequent interpretive documents.

The Management's Discussion and Analysis (MD&A) on pages 5 through 13 is not a required part of the basic financial statements but is supplementary information required by the Governmental 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 required supplementary information. However, we did not audit the information and express no opinion on it.


Crowe Chizek and Company LLC

Louisville, Kentucky
September 22, 2005

Northern Kentucky University Management's Discussion and Analysis

Northern Kentucky University's (the University) Management Discussion and Analysis of its financial condition provides an overview of the financial performance of the University for the year ended June 30, 2005, with selected comparative information for the years ended June 30, 2004 and 2003. This discussion has been prepared by management and should be read in conjunction with the accompanying financial statements and notes.

Financial Highlights

The University's financial position remained strong at June 30, 2005. The University's total net assets increased by \$13.7 million, or 11.7 percent. This increase resulted from income before other revenues, expenses, gains or losses of \$10.8 million and capital appropriations and gifts of \$2.9 million. The University's unrestricted net assets increased by \$5.8 million for the year as a result of cost cutting, revenue enhancements and increases in budgetary reserves related to future construction and renovation projects. In addition, the University increased its unrestricted net assets budget reserve to provide the flexibility necessary in the current uncertain state budget environment.

The University's state appropriations actually declined from \$45.3 million in fiscal year 2003 to \$44.1 million in fiscal year 2005. As a result of the reduction in state funding the University had to reluctantly increase tuition rates to make up for the loss of state appropriations and cover increased operating costs. There is a direct relationship between the growth, or decline, in state support and the University's ability to limit tuition rate increases. In anticipation of a shortfall in state revenues, the University approved an average tuition increase of 15.2 percent for fiscal year 2005 and established a budget reserve in anticipation of a possible state budget reduction. This reserve allowed the University to absorb a reduction of nearly \$2 million in state funding in fiscal year 2005 without disrupting the University's core academic mission.

While the University's state appropriations actually declined since 2003, the University's operating revenues increased significantly. Operating revenues increased from \$68.9 million in fiscal year 2003 to \$95.9 million in 2005; a 39.2 percent increase. The majority of this growth was fueled by a substantial increase in net tuition. Noteworthy increases in revenues from grants and contracts and auxiliary enterprises were also realized and demonstrate the University's continued effort to diversify revenue sources.

An average tuition increase of 15.2 percent combined with a small enrollment increase yielded an increase of \$9.7 million in net tuition revenues for the year. The University strives to keep tuition rates as low as possible; however, the University must balance affordability and quality. With the recent shortfall in state appropriations the University had to increase tuition to preserve academic quality. Although tuition rates have increased, the University still provides an excellent educational value to its students.

The University completed construction of a new parking deck during the year and began construction on the lake enhancement project. Other major projects currently in design include a new student union and The Bank of Kentucky Center. The University continues to work with the Council on Postsecondary Education to address the University's need for additional educational facilities.

Using the Financial Statements

The University's financial report includes three financial statements: the statement of net assets; the statement of revenues, expenses and changes in net assets and the statement of cash flows. These financial statements are prepared in accordance with Government Accounting Standards Board (GASB) principles, which establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis to focus on the University as a whole.

The University's financial statements for the year ended June 30, 2004 have been restated to reflect an adjustment in reporting for the Council on Postsecondary Education's Regional University Endowment Trust Fund program. This change is discussed in detail in Note 1 in the accompanying notes to the financial statements.

Financial statements for the University's component unit, Northern Kentucky University Foundation, Inc., have also been included in accordance with the requirements of GASB Statement No. 39. Financial statements presented for the Foundation consist of the Statement of Financial Position and the Statement of Activities. These statements are prepared in accordance with Financial Accounting Standards Board (FASB) pronouncements.

Statement of Net Assets

The statement of net assets includes all assets and liabilities. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

Statement of Net Assets (in thousands)

	2005	2004	2003
ASSETS			
Current assets	\$ 42,003	\$ 34,916	\$ 32,560
Capital assets, net	152,710	147,059	136,077
Noncurrent assets	25,958	26,649	28,106
Total assets	<u>220,671</u>	<u>208,624</u>	<u>196,743</u>
LIABILITIES			
Current liabilities	23,242	22,405	22,802
Noncurrent liabilities	66,300	68,780	65,384
Total liabilities	<u>89,542</u>	<u>91,185</u>	<u>88,186</u>
NET ASSETS			
Invested in capital assets, net of related debt	81,851	69,732	64,415
Restricted			
Nonexpendable	7,616	7,038	4,712
Expendable	16,784	21,619	24,179
Unrestricted	24,878	19,050	15,251
Total net assets	<u>\$131,129</u>	<u>\$117,439</u>	<u>\$108,557</u>

A review of the University's statement of net assets at June 30, 2005 shows that the University continues to build upon its strong financial foundation.

Assets

The University's assets increased by \$23.9 million, or 12.2 percent, from June 30, 2003 to June 30, 2005 and now total \$220.7 million. The majority of this increase is attributable to the construction of several new facilities, including a power plant, parking deck and student housing facility. These assets were funded primarily with bond proceeds and capital appropriations. The expenditure of capital appropriations resulted in a decline in noncurrent assets, primarily noncurrent cash and cash equivalents, of \$0.7 million and \$1.5 million for the fiscal years ended June 30, 2005 and June 30, 2004, respectively. As a result of the University's significant investment in its campus facilities in recent years, net capital assets have grown to \$152.7 million, or 69.2 percent of total assets as of June 30, 2005.

Current assets increased by \$7.1 million for the year ended June 30, 2005 and \$2.4 million for the year ended June 30, 2004, resulting in a combined increase of \$9.5 million, or 29.0 percent, since June 30, 2003. This increase is attributable to an increase in cash and cash equivalents generated from operations and an increase in notes and accounts receivable balances associated with increases in tuition rates and enrollment.

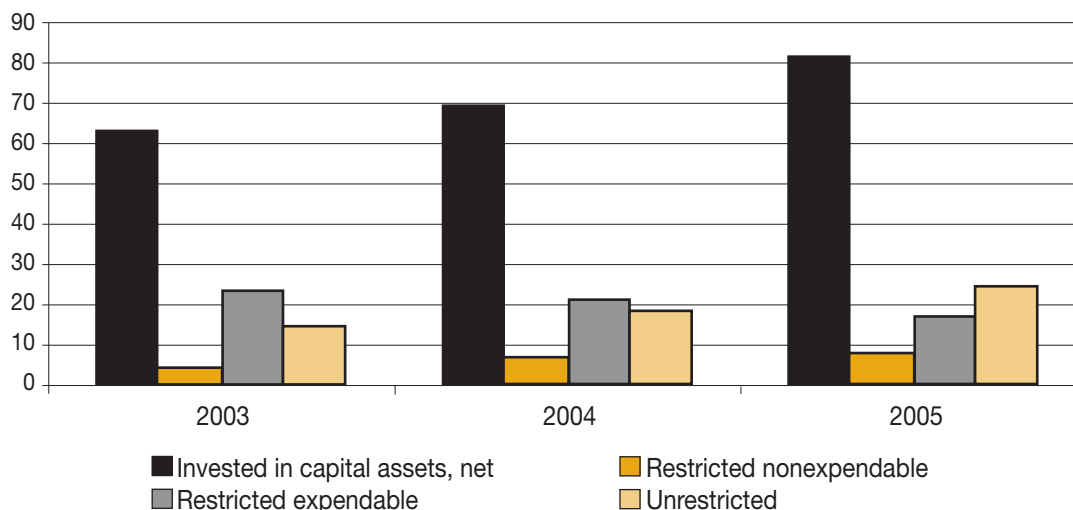
Liabilities

At June 30, 2005, the University's liabilities totaled \$89.5 million as compared to the previous year's \$91.2 million. This decline in liabilities is attributable to a decrease in noncurrent liabilities, primarily long-term debt liabilities. Debt outstanding decreased by \$0.9 million for the year. This decrease is the net result of the issuance of \$6.6 million in capital lease obligations to finance energy management projects, new enterprise software and equipment less principal payments of \$7.5 million. Bonds, notes and capital leases payable for educational buildings, student housing and dining facilities and equipment represented \$70.1 million, or 78.3 percent, of total liabilities at June 30, 2005.

The University's total liabilities increased by \$1.4 million, or 1.5 percent, from June 30, 2003 to June 30, 2005. This modest increase resulted from an increase in current liabilities of \$0.5 million, or 1.9 percent, and an increase in noncurrent liabilities, including bonds, notes and capital leases payable, of \$0.9 million, or 1.4 percent. From a liquidity perspective, current assets cover current liabilities 1.8 times, an indicator of good liquidity. This year's coverage rate is better than the 1.6 rate as of June 30, 2004 and the 1.4 rate for June 30, 2003.

Net Assets

The following chart illustrates the University's net assets for fiscal years 2003, 2004 and 2005 (amounts are presented in millions).



Net assets at June 30, 2005 totaled \$131.1 million, or 59.4 percent, of total assets. Net assets invested in capital, net of related debt, totaled \$81.9 million, or 62.4 percent, of total net assets. Restricted and unrestricted net assets represented 18.6 percent and 19.0 percent of total net assets, respectively. Total net assets increased by \$13.7 million, or 11.7 percent. Net assets invested in capital assets, net of related debt increased \$12.1 million. A portion of this increase was associated with the \$4.8 million decline in restricted expendable net assets that resulted from the expenditure of funds restricted for construction projects. Unrestricted net assets increased by \$5.8 million for the year as a result of cost cutting, revenue enhancements and increases in budgetary reserves related to future construction and renovation projects. In addition, the University increased its unrestricted net assets budget reserve to provide the flexibility necessary in the current uncertain state budget environment.

The University's net assets increased by \$22.6 million, or 20.8 percent, from June 30, 2003 to June 30, 2005. Net assets invested in capital assets, net of related debt increased \$17.4 million. A significant portion of this increase resulted from the expenditure of capital appropriations and gifts, including \$12.0 million appropriated by the Commonwealth for the University's recently opened power plant. The expenditure of these and other funds restricted for construction projects contributed to the \$7.4 million decline in restricted expendable net assets for the two year period.

Statement of Revenues, Expenses and Changes in Net Assets

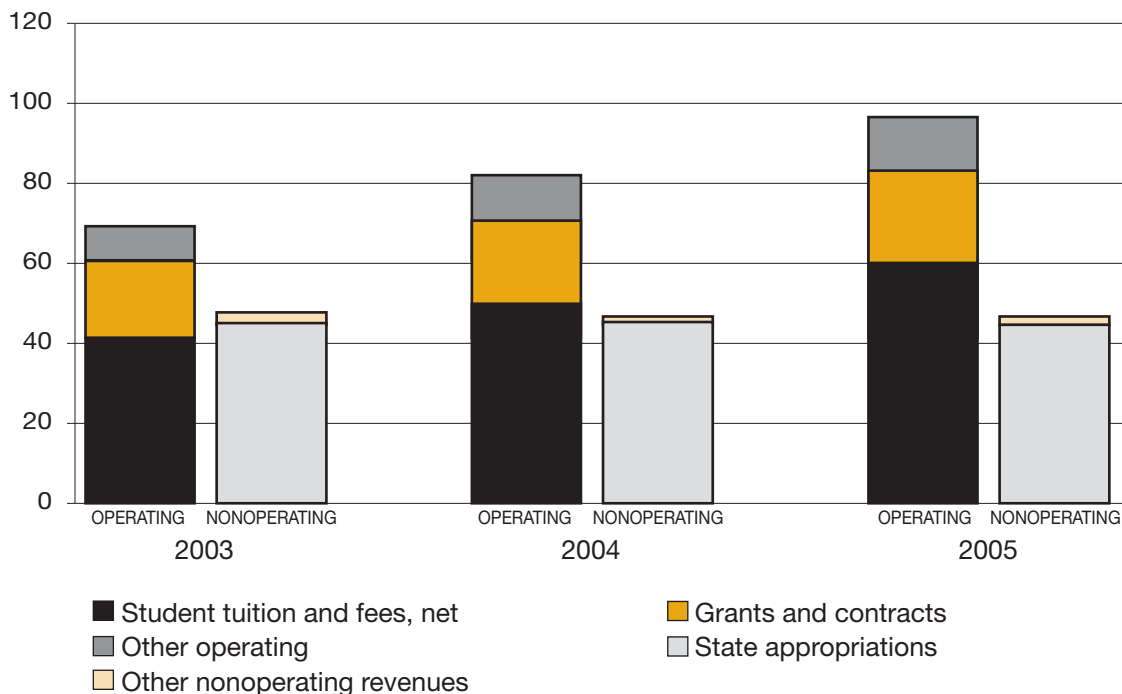
The statement of revenues, expenses and changes in net assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. GASB requires state appropriations to be classified as nonoperating revenues. Accordingly, the University will generate an operating loss prior to the addition of nonoperating 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.

Statement of Revenues, Expenses and Changes in Net Assets (in thousands)

	2005	2004	2003
OPERATING REVENUES			
Student tuition and fees, net	\$ 59,424	\$ 49,741	\$ 42,029
Grants and Contracts	22,776	20,099	17,793
Sales and services of educational departments	2,947	2,445	1,717
Auxiliary enterprises	6,093	5,328	4,198
Other operating revenues	4,685	3,951	3,155
Total operating revenues	<u>95,925</u>	<u>81,564</u>	<u>68,892</u>
OPERATING EXPENSES			
Educational and general	117,370	107,797	104,989
Depreciation	7,115	6,583	5,868
Auxiliary enterprises (including depreciation)	3,749	4,873	3,013
Other expenditures	223	243	227
Total operating expenses	<u>128,457</u>	<u>119,496</u>	<u>114,097</u>
Net loss from operations	(32,532)	(37,932)	(45,205)
NONOPERATING REVENUES (EXPENSES)			
State appropriations	44,069	45,127	45,258
Investment income	2,071	888	1,885
Interest on capital asset-related debt	(3,126)	(3,330)	(2,783)
Other nonoperating revenues (expenses)	270	152	709
Net nonoperating revenues	<u>43,284</u>	<u>42,837</u>	<u>45,069</u>
Income (loss) before other revenues, expenses, gains or losses	<u>10,752</u>	<u>4,905</u>	<u>(136)</u>
Capital appropriations	98	126	599
State endowment match	577	2,327	73
Capital grants and gifts	2,263	1,524	1,621
Total other revenues	<u>2,938</u>	<u>3,977</u>	<u>2,293</u>
Increase in net assets	13,690	8,882	2,157
Net assets-beginning of year, as restated	<u>117,439</u>	<u>108,557</u>	<u>106,400</u>
Net assets-end of year	<u><u>\$ 131,129</u></u>	<u><u>\$ 117,439</u></u>	<u><u>\$ 108,557</u></u>

Operating and Nonoperating Revenues

The following chart illustrates the University's revenues by source (both operating and nonoperating), which were used to fund its operating activities for fiscal years 2003, 2004 and 2005. Significant recurring sources of revenues, including state appropriations, are considered nonoperating revenues as defined by GASB. These revenues support operating expenses; therefore, they are included in the graph of revenues by source (amounts are presented in millions).



Operating and nonoperating revenues totaled approximately \$142.3 million for the year ended June 30, 2005. The most significant sources of revenue for the University are net student tuition and fees (41.7 percent), state appropriations (31.0 percent), and grants and contracts (16.0 percent).

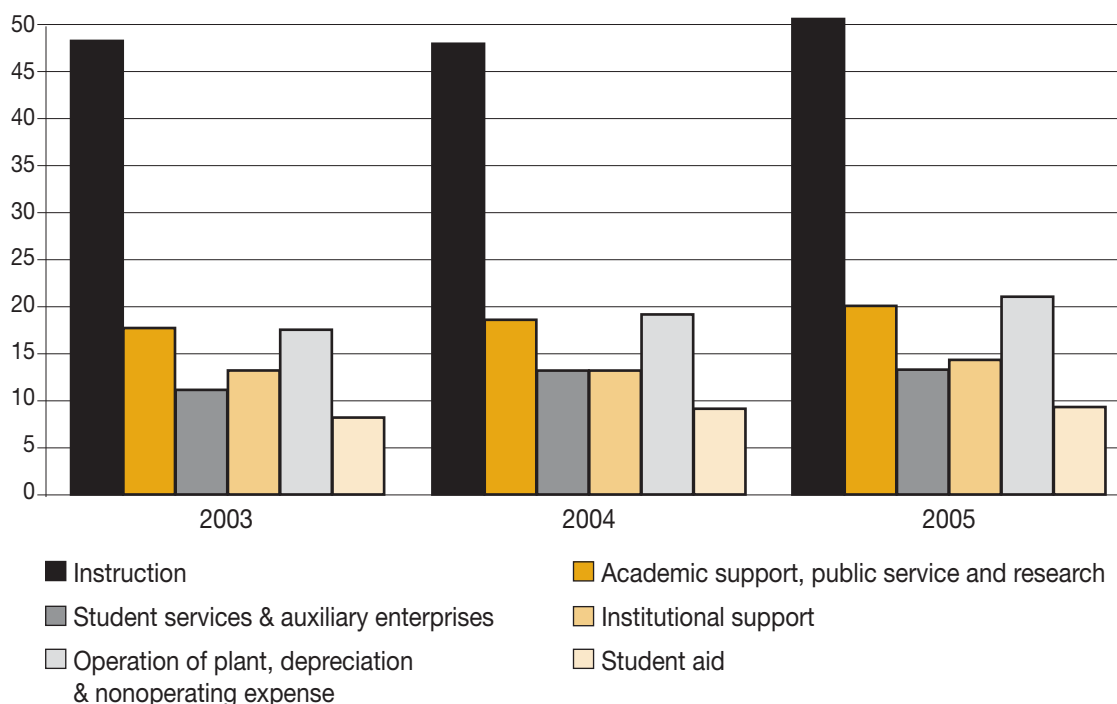
For the fourth consecutive year, economic pressures affecting the Commonwealth resulted in a shortfall in state revenues. As a result of the shortfall, the Commonwealth reduced the University's original appropriation of \$46.0 million for the year ended June 30, 2005 by \$1.9 million, or 4.2 percent. As a consequence, the University's appropriation for the year ended June 30, 2005 was \$1.0 million less than the prior year appropriation of \$45.1 million. The chart above illustrates a shift between operating and nonoperating revenues. While the University's state appropriations, which are classified as nonoperating revenues, declined over the three year period by \$1.2 million, the University's operating revenues increased by \$27.0 million, or 39.2 percent. The majority of this growth was fueled by a substantial increase in net tuition. Noteworthy increases in revenues from grants and contracts and auxiliary enterprises were also realized and demonstrate the University's continued effort to diversify revenue sources.

In anticipation of a shortfall in state revenues, the University approved an average tuition increase of 15.2 percent for fiscal year 2005. This rate increase, combined with a small average increase in full-time equivalent enrollment, resulted in the significant increase in net tuition revenue. Net student tuition revenue increased \$9.7 million, or 19.5 percent, to a total of \$59.4 million for the year.

The majority of the University's grants and contracts revenue is derived from federal and state funded financial aid programs. Revenues from these programs, including federal Pell grants and the Kentucky Educational Excellence Scholarship program, grew by approximately \$1.1 million for the year ended June 30, 2005. In addition, the University realized a \$1.6 million, or 24.2 percent increase in non-financial aid related grant and contract revenue.

Operating and Nonoperating Expenses

The following chart illustrates the University's expenses by function (both operating and nonoperating) for fiscal years 2003, 2004 and 2005 (amounts are presented in millions).



As depicted in the chart above, the majority of the University's operating funds are expended directly for the primary mission of the University – instruction \$52.3 million (39.7 percent), and academic support, public service and research \$20.4 million (15.5 percent). Operating and nonoperating expenses increased by \$8.8 million, or 7.1 percent, to a total of \$131.6 million for the year ended June 30, 2005.

The majority of this increase is due to a \$5.7 million, or 8.5 percent, growth in instructional, research, public service and academic support expenses. This increase is a direct result of the University's two-year academic excellence funding plan designed to increase credit hour production in programs of study that expands the University's commitment to servicing its region. Resources were allocated to enhance P-12 education through quality pre-service and in-service programs for teachers, partnerships with P-12 schools and summer enrichment programs for youth. The plan also provided support for regional economic expansion by preparing well-educated graduates in fields that align with the employment needs in the region, as well as provide education and training to support economic competitiveness. This confirms that the University's resource allocations are clearly aligned with the University's strategic priorities and its commitment to academic excellence and community outreach.

One of the University's core values is to provide students access to the University with the opportunity to succeed. The University's continued investment in student financial aid programs, student retention initiatives and student support services reflects this commitment. For the year ended June 30, 2005, student financial aid related to tuition and fees totaled \$22.8 million, including student aid expenses of \$9.6 million and scholarship allowances of \$13.2 million. This represents a \$1.3 million, or 6.2 percent, increase over the prior year. This increase can, in part, be attributed to an increase of \$1.1 million in federal and state financial aid programs. The balance of the increase is primarily attributable to an increase in scholarship programs funded by the University. This increase reflects the University's commitment to providing access to students and rewarding academic excellence.

Statement of Cash Flows

Another important factor to consider when evaluating financial viability is the University's ability to meet financial obligations as they become due. The statement of cash flows presents information related to cash inflows and outflows, summarized by operating, capital, financing and investing activities.

Statement of Cash Flows (in thousands)

	2005	2004	2003
Net cash provided (used) by:			
Operating activities	\$ (24,821)	\$ (31,322)	\$ (37,543)
Noncapital financing activities	44,374	48,228	45,761
Capital and related financing activities	(16,773)	(17,954)	(15,631)
Investing activities	1,987	(1,219)	3,663
Net increase (decrease) in cash	4,767	(2,267)	(3,750)
Cash and cash equivalents, beginning of year	43,837	46,104	49,854
Cash and cash equivalents, end year	<u>\$ 48,604</u>	<u>\$ 43,837</u>	<u>\$ 46,104</u>

The University's cash and cash equivalents increased \$4.8 million primarily as a result of cash flows from tuition and fees and auxiliary enterprise operating activities that are designated for future capital construction projects and academic programs.

Major sources of funds included in operating activities are student tuition and fees (\$58.8 million) and grants and contracts (\$22.2 million). The largest cash payments for operating activities were made to employees (\$88.4 million) and to vendors and contractors (\$31.3 million). The University's \$24.8 million deficit in cash from operating activities was more than offset by appropriations from the Commonwealth. State appropriations are included in noncapital financing activities, as defined by GASB.

The shift in the balance of revenues from nonoperating to operating revenues described earlier is also reflected by the decline in the amount of net cash used by operating activities. The University's cash receipts from operating activities increased by \$25.1 million, or 35.6 percent, from 2003 to 2005. Conversely, cash disbursements for operating activities increased by only \$12.4 million, or 11.5 percent, from 2003 to 2005, resulting in a net \$12.7 million increase in net cash provided by operating activities. The increase in cash receipts was fueled primarily by a \$15.8 million, or 36.7 percent, increase in tuition and a \$4.5 million, or 25.4 percent, increase in grants and contracts.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled approximately \$152.7 million at June 30, 2005, a net increase of \$5.7 million over the prior year end. Additions to capital assets during the year totaled \$14.0 million, including the University's new power plant. Depreciation expenses and net capital asset disposals totaled \$8.3 million for the year.

The University's net capital assets grew by \$16.7 million from June 30, 2003 to June 30, 2005, with increases of \$5.7 million in 2005 and \$11.0 million in 2004. This growth reflects the University's effort to increase its capacity to accommodate recent enrollment growth.

At June 30, 2005, the University had several capital construction projects underway, including a lake redesign/amphitheater and the renovation of several academic buildings. In addition, several major projects were in the design phase, including a new student union facility and The Bank of Kentucky Center.

Debt

The following is a summary of the University's outstanding debt summarized by revenue pledge as of June 30, 2005, 2004 and 2003 (in thousands):

	2005	2004	2003
Consolidated Educational Buildings Revenue Bonds	\$33,790	\$38,545	\$33,290
Housing and Dining System Revenue Bonds	3,150	3,360	3,560
Capital lease – Residential Village/Suites	23,176	24,555	25,879
Notes payable and municipal lease obligations	10,591	5,126	4,926
	<u>\$70,707</u>	<u>\$71,586</u>	<u>\$67,655</u>

Debt outstanding decreased by \$0.9 million for the year. This decrease is the net result of the issuance of \$6.6 million in capital lease obligations to finance energy management projects, new enterprise software and equipment less principal payments of \$7.5 million.

For the year ended June 30, 2004, the University's outstanding debt had increased by \$3.9 million. This increase is the net result of the issuance of \$10.6 million in revenue bonds and capital lease obligations to finance a new parking deck, land acquisitions and equipment less principal payments of \$6.7 million.

The University has taken advantage of the historically low interest rate environment that we have enjoyed recently through the prudent issuance of bonds and capital leases to finance the construction of new buildings and equipment acquisitions. The University takes seriously its role of financial stewardship and works hard to manage its financial resources effectively, including the prudent use of debt to finance capital construction and major equipment acquisitions. A strong debt rating is an important indicator of the University's success in this area. In 2002, in recognition of the University's strong financial position, Moody's Investors Service upgraded its bond ratings on the University's Consolidated Educational Building Revenue Bonds from A3 to A2 and Housing and Dining System Revenue Bonds from Baa1 to A3. The University's financial position is even stronger today as evidenced by increasing debt coverage ratios and Moody's recent reaffirmation of the University's A2 rating.

FACTORS IMPACTING FUTURE PERIODS

The University's vision is to become a preeminent, learner centered, metropolitan university recognized for its contributions to the intellectual, social, economic, cultural and civic vitality of our region and the Commonwealth. The University's commitment to partnering with its region and the Commonwealth to help advance economic and social progress was clearly demonstrated last year when the University was selected among four universities to participate in a national project designed to demonstrate best practice in community engagement or what is sometimes referred to as "stewardship of place." At the same time, the University has made enormous progress across the full breadth of its academic mission resulting in an increase in its capacity to serve both its students and community.

Today's complex, global economy depends upon advanced knowledge and knowledgeable workers. For our region to be economically competitive, it is essential that we provide for the learning needs of a highly educated workforce. The public is looking for the University to provide high quality and affordable education. The University is well positioned to achieve these goals with the support of the Commonwealth. With this full partnership with the state, we will continue to grow and expand our community partnerships in support of the challenges that confront our metropolitan region. Kentucky's economic future will depend on the continued economic growth of northern Kentucky. The region's continued economic growth will, in turn, depend heavily on the University's capacity to support that growth in a variety of ways. Additional funding for the University is an investment in the future of both the region and the Commonwealth.

The University's state appropriations actually declined from \$45.3 million in fiscal year 2003 to \$44.1 million in fiscal year 2005. As a result of the reduction in state funding the University had to reluctantly to increase tuition rates to make up for the loss of state appropriations and cover increased operating costs. There is a direct relationship between the growth, or decline, in state support and the University's ability to limit tuition rate increases. In anticipation of a shortfall in state revenues, the University approved an average tuition increase of 15.2 percent for fiscal year 2005 and established a budget reserve in anticipation of a possible state budget reduction. This reserve allowed the University to absorb a reduction of nearly \$2 million in state funding in fiscal year 2005 without disrupting the University's core academic mission.

For fiscal year 2006, the Commonwealth's economic outlook has brightened considerably. As a result of the budget bill passed during the 2005 legislative session, the University's appropriation was increased by \$6.5 million in recurring funds for additional campus operating support – the highest percentage increase of any of the universities. This appropriation in part recognizes the vital role Northern Kentucky University plays in the future of the northern Kentucky region and the Commonwealth. On a cautionary note, Kentucky will go into 2006 legislative session with a structural deficit of several hundred million, which creates some funding uncertainty. The University responded by increasing our reserves in order to protect against possible reductions.

While the University realizes that improved state funding is critical to its future success, management also recognizes that the University must continue its efforts to diversify revenue sources and contain costs. The University's continued investment in its fund raising capacity reflects the University's commitment to enhance and diversify revenue sources. This investment continues to pay dividends as demonstrated by the success of the University's recent fund raising campaign. The University's two-year academic excellence funding plan is designed, in part, to increase credit hour production in programs of study that expands the University's commitment to servicing its region. This plan will enhance net tuition revenues. In addition, a significant increase in federal and state grant funding has also provided additional resources to accomplish the full breadth of the University's mission. The University's comprehensive strategy provides it with the flexibility to invest in strategic initiatives and entrepreneurial revenue enhancement opportunities.

Over the next five years, the University intends to meet or exceed targets established by the Council on Postsecondary Education for enrollment, degree production, community engagement, college affordability and other key indicators that will measure the University's contribution to the new public agenda; five questions, one mission: better lives for Kentucky's people. The creation of Gateway Community and Technical College has expanded postsecondary opportunity for residents of our region, which allows the University to focus more directly on what our region wants and needs us to become. The University's Board of Regents approved new higher admission standards effective for the fall of 2005. Even though admissions standards increased, the preliminary fall 2005 headcount numbers reflect an overall increase in enrollment. The impact of the new admissions standards has been dramatic. The incoming class has significantly fewer under-prepared students and a considerably higher average ACT score resulting in the most academically prepared class in the University's history.

The University's resource allocation process is driven by this vision and by a set of core values that embodies the essence of a successful metropolitan university. Management believes the University is in excellent financial condition and well positioned to weather changing economic and market conditions. The University's future looks bright as it continues to invest its resources strategically to increase its capacity to serve its students, the region and of the Commonwealth.

Northern Kentucky University
Statement of Net Assets
June 30, 2005 and 2004
(in thousands)

	2005	2004
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 35,904	\$ 29,927
Notes, loans and accounts receivable, net	4,642	3,545
Other current assets	1,457	1,444
Total current assets	<u>42,003</u>	<u>34,916</u>
Noncurrent Assets		
Cash and cash equivalents	12,700	13,910
Investments	10,212	10,091
Notes, loans and accounts receivable, net	2,467	2,102
Capital assets, net	152,710	147,059
Other noncurrent assets	579	546
Total noncurrent assets	<u>178,668</u>	<u>173,708</u>
Total assets	<u>220,671</u>	<u>208,624</u>
 LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	10,248	10,199
Deferred revenue	4,435	4,472
Long-term liabilities-current portion	8,559	7,734
Total current liabilities	<u>23,242</u>	<u>22,405</u>
Noncurrent Liabilities		
Deposits	782	1,163
Deferred revenue	155	199
Long-term liabilities	65,363	67,418
Total noncurrent liabilities	<u>66,300</u>	<u>68,780</u>
Total liabilities	<u>89,542</u>	<u>91,185</u>
 NET ASSETS		
Invested in capital assets, net of related debt	81,851	69,732
Restricted		
Nonexpendable	7,616	7,038
Expendable	16,784	21,619
Unrestricted	24,878	19,050
Total net assets	<u>\$131,129</u>	<u>\$117,439</u>

See accompanying notes to the financial statements.

Northern Kentucky University Foundation, Inc.
Statement of Financial Position
For the Years Ended June 30, 2005 and 2004
(in thousands)

	2005	2004
ASSETS		
Cash and cash equivalents	\$ 9,617	\$ 10,400
Loans and accounts receivable (less allowance of \$102 in 2005 and \$94 in 2004)	97	118
Accrued interest receivable	23	3
Contributions receivable (less allowance of \$27 in 2005 and \$523 in 2004)	9,649	4,873
Prepaid expenses and deferred charges	12	11
Investments	37,565	32,142
Land, buildings and equipment	3,224	3,225
Accumulated depreciation	(435)	(377)
Total Assets	<u>59,752</u>	<u>50,395</u>
LIABILITIES		
Accounts payable	49	91
Agency fund	4,156	3,619
Annuities payable	206	246
Deferred income	25	25
Funds held in trust for Northern Kentucky University	8,208	7,079
Notes payable	2,100	2,100
Total Liabilities	<u>14,744</u>	<u>13,160</u>
NET ASSETS		
Unrestricted		
For current operations	393	78
Contributions receivable	67	76
Amounts functioning as endowment funds	1,789	1,996
Invested in property, plant and equipment	697	748
Total Unrestricted	<u>2,946</u>	<u>2,898</u>
Temporarily restricted		
Unexpended funds received for restricted purposes	4,410	4,831
Contributions receivable	6,327	1,204
Loan funds	151	159
Endowment funds	11,141	9,603
Total temporarily restricted	<u>22,029</u>	<u>15,797</u>
Permanently restricted		
Contributions receivable	3,254	3,593
Endowment funds	16,779	14,947
Total permanently restricted	<u>20,033</u>	<u>18,540</u>
Total Net Assets	<u>45,008</u>	<u>37,235</u>
Total Liabilities and Net Assets	<u>\$ 59,752</u>	<u>\$ 50,395</u>

See accompanying notes to the financial statements

Northern Kentucky University
Statement of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2005 and 2004
(in thousands)

	2005	2004
OPERATING REVENUES		
Student tuition and fees (net of scholarship allowances of \$13,198 in 2005 and \$12,014 in 2004)	\$ 59,424	\$ 49,741
Federal grants and contracts	10,910	9,779
State and local grants and contracts	10,264	8,709
Nongovernmental grants and contracts	1,602	1,611
Sales and services of educational departments	2,947	2,445
Auxiliary enterprises		
Residence Halls (net of scholarship allowances of \$79 in 2005 and \$85 in 2004)	782	735
Residential Village (net of scholarship allowances of \$251 in 2005 and \$277 in 2004)	4,128	3,672
Other auxiliaries	1,183	921
Other operating revenues	4,685	3,951
Total operating revenues	<u>95,925</u>	<u>81,564</u>
OPERATING EXPENSES		
Educational and general		
Instruction	52,257	48,102
Research	1,149	788
Public service	4,839	4,613
Libraries	3,651	3,597
Academic support	10,717	9,799
Student services	9,545	8,448
Institutional support	14,570	13,424
Operation and maintenance of plant	11,029	9,565
Depreciation	7,115	6,583
Student aid	9,613	9,461
Auxiliary enterprises		
Residence Halls	518	465
Residential Village	1,589	2,938
Other auxiliaries	430	363
Auxiliary depreciation	1,212	1,107
Other expenses	223	243
Total operating expenses	<u>128,457</u>	<u>119,496</u>
Net loss from operations	<u>(32,532)</u>	<u>(37,932)</u>
NON OPERATING REVENUES (EXPENSES)		
State appropriations	44,069	45,127
Investment income	2,071	888
Interest on capital asset-related debt	(3,126)	(3,330)
Other non operating revenues (expenses)	270	152
Net non operating revenues	<u>43,284</u>	<u>42,837</u>
Income (loss) before other revenues, expenses, gains or losses	<u>10,752</u>	<u>4,905</u>
Capital appropriations	98	126
State endowment match	577	2,327
Capital grants and gifts	2,263	1,524
Total other revenues	<u>2,938</u>	<u>3,977</u>
Increase in net assets	<u>13,690</u>	<u>8,882</u>
NET ASSETS		
Net assets-beginning of year, as restated	117,439	108,557
Net assets-end of year	<u>\$ 131,129</u>	<u>\$ 117,439</u>

See accompanying notes to the financial statements.

Northern Kentucky University Foundation, Inc.

Statement of Activities

For the Year Ended June 30, 2005

(in thousands)

	<u>Unrestricted</u> <u>Net Assets</u>	<u>Temporarily</u> <u>Restricted</u> <u>Net Assets</u>	<u>Permanently</u> <u>Restricted</u> <u>Net Assets</u>	<u>Total</u>
CHANGES IN NET ASSETS:				
Revenues and Gains				
Gifts, grants and bequests	\$ 177	\$ 7,564	\$ 1,479	\$ 9,220
Rental income	97	-	-	97
Investment income	164	494	-	658
Net gains (losses) on investments	168	1,411	-	1,579
Other revenue	87	734	-	821
Total Revenues and Gains	<u>693</u>	<u>10,203</u>	<u>1,479</u>	<u>12,375</u>
Net Assets Released from Restrictions	<u>4,132</u>	<u>(4,132)</u>	<u>-</u>	<u>-</u>
Total Revenues and Gains and Other Support	4,825	6,071	1,479	12,375
 Program Expenses				
Instruction	220	-	-	220
Research	7	-	-	7
Public service	531	-	-	531
Libraries	45	-	-	45
Academic support	126	-	-	126
Student services	309	-	-	309
Institutional support	435	-	-	435
Operation and maintenance of plant	1,795	-	-	1,795
Student financial aid	690	-	-	690
Total Program Expenses	<u>4,158</u>	<u>-</u>	<u>-</u>	<u>4,158</u>
Support Expenses				
Management and general	131	-	-	131
Fundraising support	122	-	-	122
Rental property	191	-	-	191
Total Support Expenses	<u>444</u>	<u>-</u>	<u>-</u>	<u>444</u>
Total Expenses	4,602	-	-	4,602
Net transfers in (out)	<u>(175)</u>	<u>161</u>	<u>14</u>	<u>-</u>
 Increase (Decrease) in Net Assets	48	6,232	1,493	7,773
Net Assets – Beginning of Year, as restated	<u>2,898</u>	<u>15,797</u>	<u>18,540</u>	<u>37,235</u>
Net Assets – End of Year	<u><u>\$ 2,946</u></u>	<u><u>\$ 22,029</u></u>	<u><u>\$ 20,033</u></u>	<u><u>\$ 45,008</u></u>

See accompanying notes to the financial statements.

Northern Kentucky University Foundation, Inc.

Statement of Activities

For the Year Ended June 30, 2004

(in thousands)

	Unrestricted	Temporarily	Permanently	
	Net Assets	Restricted	Restricted	
	Net Assets	Net Assets	Net Assets	Total
CHANGES IN NET ASSETS:				
Revenues and Gains				
Gifts, grants and bequests	\$ 144	\$ 2,194	\$ 611	\$ 2,949
Rental income	97	-	-	97
Investment income	101	215	-	316
Net gains (losses) on investments	112	2,425	-	2,537
Other revenue	45	417	-	462
Total Revenues and Gains	499	5,251	611	6,361
Net Assets Released from Restrictions	3,818	(3,818)	-	-
Total Revenues and Gains and Other Support	4,317	1,433	611	6,361
Program Expenses				
Instruction	980	-	-	980
Research	1	-	-	1
Public service	448	-	-	448
Libraries	115	-	-	115
Academic support	767	-	-	767
Student services	325	-	-	325
Institutional support	473	-	-	473
Operation and maintenance of plant	217	-	-	217
Student financial aid	592	-	-	592
Total Program Expenses	3,918	-	-	3,918
Support Expenses				
Management and general	131	-	-	131
Fundraising support	206	-	-	206
Rental property	180	-	-	180
Total Support Expenses	517	-	-	517
Total Expenses	4,435	-	-	4,435
Net transfers in (out)	(264)	(1,881)	2,145	-
Increase (Decrease) in Net Assets	(382)	(448)	2,756	1,926
Net Assets – Beginning of Year, as restated	3,279	16,245	15,785	35,309
Net Assets – End of Year	\$ 2,897	\$ 15,797	\$ 18,541	\$ 37,235

See accompanying notes to the financial statements.

Northern Kentucky University
Statement of Cash Flows
For the Years Ended June 30, 2005 and 2004
(in thousands)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	\$ 58,802	\$ 49,457
Grants and contracts	22,156	20,028
Payments to suppliers	(31,295)	(30,850)
Payments for salaries and benefits	(88,410)	(81,475)
Loans issued to students	(613)	(768)
Collection of loans to students	550	604
Auxiliary enterprise receipts:		
Residence Halls	805	789
Residential Village	4,252	3,734
Other auxiliaries	1,472	908
Sales and service of educational departments	2,929	2,360
Other receipts (payments)	4,531	3,891
Net cash used by operating activities	<u>(24,821)</u>	<u>(31,322)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	44,069	45,127
State endowment match	577	2,327
Agency and loan program receipts	44,758	38,420
Agency and loan program disbursements	(45,126)	(38,017)
Other nonoperating receipts (payments)	96	371
Net cash provided by noncapital financing activities	<u>44,374</u>	<u>48,228</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES		
Proceeds from capital debt and leases	6,584	10,377
Capital grants and gifts received	1,829	646
Purchases of capital assets	(14,674)	(19,118)
Principal paid on capital debt and leases	(7,373)	(6,595)
Interest paid on capital debt and leases	(3,139)	(3,264)
Net cash used by capital financing activities	<u>(16,773)</u>	<u>(17,954)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	2,628	-
Purchases of investments and investment pool shares	(2,686)	(2,460)
Interest on investments	2,045	1,241
Net cash provided by investing activities	<u>1,987</u>	<u>(1,219)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>4,767</u>	<u>(2,267)</u>
Cash and cash equivalents-beginning of year	43,837	46,104
Cash and cash equivalents-end of year	<u><u>\$ 48,604</u></u>	<u><u>\$ 43,837</u></u>
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH USED BY OPERATING ACTIVITIES:		
Net loss from operations	\$ (32,532)	\$ (37,932)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	8,327	7,690
Changes in assets and liabilities:		
Receivables, net	(1,141)	(839)
Other assets	(104)	(104)
Accounts payable	686	(82)
Deferred revenue	326	295
Long-term liabilities	(383)	(350)
Net cash used by operating activities	<u><u>\$ (24,821)</u></u>	<u><u>\$ (31,322)</u></u>

See accompanying notes to the financial statements.

Northern Kentucky University
Notes to Financial Statements
For the Year Ended June 30, 2005

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 in business-type activities. BTAs are those activities that are financed in whole or part by fees charged to external parties for goods and services. 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.

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 for 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, 2005, and 2004, the Foundation made payments on behalf of the University of \$1,388,000 and \$1,840,000, respectively. In addition, the Foundation transferred to the University \$2,770,000 in 2005 and \$2,078,000 in 2004 for restricted purposes. Complete financial statements for the Foundation can be obtained from the Northern Kentucky University Foundation, Inc. at Lucas Administrative Center, Suite 221, Nunn Drive, Highland Heights, KY 41099.

m. Other Significant Accounting Policies

Certain items have been reclassified for the year ended June 30, 2004, in order to conform to classifications used for the year ended June 30, 2005.

n. Adjustment for Regional University Excellence Trust Fund

The University has determined that funds provided from the Commonwealth of Kentucky's Regional University Excellence Trust Fund (RUETF) are University funds and should be reported as revenues and net assets on the University's financial statements. The RUETF matching grants had previously been recorded as revenues and net assets of the Foundation. The Kentucky General Assembly appropriated these funds for the purpose of encouraging private investment in public higher education activities within the Commonwealth. These funds were made available to match private endowment gifts. The Commonwealth's Council on Postsecondary Education was designated to oversee the distribution and use of these funds. The Council transfers the endowment funds to the University for management and investment. The University transfers these state match funds to the Foundation, a nonaffiliated foundation under the governing laws of the Commonwealth, for investment purposes. Pledges related to the matched endowment gifts, both received and outstanding, have been recorded on the Foundation's financial statements.

Net assets for the fiscal year ended June 30, 2004 as previously reported have being restated as follows:

Net Assets, July 1, 2003, as previously reported	\$ 104,444
Adjustments to net assets for prior years:	-
Record RUETF matching endowment net assets	4,113
Net assets, July 1, 2003, as restated	<u>108,557</u>
Increase in net assets, as previously reported	5,916
Adjustments to net assets:	
State endowment match	2,327
Investment income	639
Increase in net assets, as restated	<u>8,882</u>
Net assets, June 30, 2004, as restated	<u>\$ 117,439</u>

o. Change in Accounting Principle

On July 1, 2005, the University adopted the provisions of Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*. This new standard revises the requirements regarding disclosure of custodial credit risk and establishes requirements regarding disclosure of credit risk, concentration of credit risk, interest rate risk and foreign currency risk. Adoption of GASB 40 had no effect on the net assets and change in net assets.

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 debt securities with original maturities less than three months. At June 30, 2005, petty cash funds totaled \$18,100 and the carrying amount of the deposits was \$48,586,000 with a corresponding total bank balance of \$48,604,000. Of the bank balance, \$16,223,000 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 \$35,797,000 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.

Investments

The investments which the University may purchase are limited by the Commonwealth's law and the University's bond resolutions to the following (1) securities or obligations which are fully guaranteed by the U.S. Government or agencies of the U.S. Government as to principal and interest; (2) certificates of deposit or time deposits of banks, trust companies or national banking associations which are insured by the Federal Deposit Insurance Corporation; and (3) mutual funds investing solely in U.S. securities.

The following schedule reports the fair values and maturities (using the segmented time distribution method) for the University's investments at June 30, 2005:

Investment Type	2005			2004
	Fair Value	Investment Maturities		Fair Value
		Less than One Year	One to Five Years	
U.S. Treasury Securities	\$ 2,004,000	\$ 522,000	\$ 1,482,000	\$ 3,012,000
Total	2,004,000	<u>\$ 522,000</u>	<u>\$ 1,482,000</u>	3,012,000
Investments Not Sensitive to Interest Rate Risk:				
Foundation Endowment Pool	8,208,000			7,079,000
Total Investments	<u>\$ 10,212,000</u>			<u>\$ 10,091,000</u>

See note 13.a.4 for composition of the Foundation investment pool.

Interest Rate Risk: The University's investment strategy is designed to match the life of the asset with the date the liability occurs. As stated in the University's investment policy, the bond resolution governs the investment of bond reserves. The bond resolution limits the investment maturities by the lesser of the remaining life of the bond issue or ten years. Certificates of deposit can have a maturity of not more than two years from the date of issue. At June 30, 2005 all investments with maturities from one to five years are subject to the bond resolution requirements.

Note 3 – Notes, Loans and Accounts Receivable

Notes, loans and accounts receivable as of June 30, 2005 and 2004 are as follows (in thousands):

	2005		
	Gross Receivable	Allowance	Net Receivable
Student loans	\$ 2,889	\$ (425)	\$ 2,464
Student account receivables	2,225	(816)	1,409
Reimbursement Rec- Grants and Contracts	2,017	-	2,017
Other	1,219	-	1,219
	<u>\$ 8,350</u>	<u>\$ (1,241)</u>	7,109
Current portion			4,642
Noncurrent portion			<u>\$ 2,467</u>

	2004		
	Gross Receivable	Allowance	Net Receivable
Student loans	\$ 2,873	\$ (444)	\$ 2,429
Student account receivables	1,750	(538)	1,212
Reimbursement Rec- Grants and Contracts	997	-	997
Other	1,009	-	1,009
	<u>\$ 6,629</u>	<u>\$ (982)</u>	5,647
Current portion			3,545
Noncurrent portion			<u>\$ 2,102</u>

Note 4 – Capital Assets, net

Capital assets for the years ended June 30, 2005 and 2004 are summarized as follows (in thousands):

	<u>July 1, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2005</u>
Cost:				
Land	\$ 4,197	\$ 128	-	\$ 4,325
Land improvements	6,491	255	-	6,746
Buildings	186,152	9,580	-	195,732
Equipment	18,546	1,930	193	20,283
Library books	24,539	1,470	300	25,709
Construction in process	5,821	669		6,490
	<u>245,746</u>	<u>14,032</u>	<u>493</u>	<u>259,285</u>
Accumulated Depreciation				
Land improvements	1,524	175	-	1,699
Buildings	70,830	5,268	-	76,098
Equipment	8,509	1,770	139	10,140
Library books	17,824	1,114	300	18,638
	<u>98,687</u>	<u>8,327</u>	<u>439</u>	<u>106,575</u>
Capital assets, net	<u>\$ 147,059</u>	<u>\$ 5,705</u>	<u>\$ 54</u>	<u>\$ 152,710</u>
	<u>July 1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2004</u>
Cost:				
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, 2005 and 2004 are as follows (in thousands):

	2005	2004
Payable to vendors and contractors	\$ 5,644	\$ 4,286
Accrued expenses, primarily payroll and vacation leave	2,673	3,025
Employee withholdings and deposits payable to third parties	1,931	2,888
	<u>\$ 10,248</u>	<u>\$ 10,199</u>

Note 6 – Deferred Revenue

Deferred revenue as of June 30, 2005 and 2004 is as follows (in thousands):

	2005	2004
Unearned summer school revenues	\$ 2,708	\$ 3,270
Unearned grants and contracts revenue	759	613
Unearned auxiliary revenue	978	307
Other	145	481
	<u>\$ 4,590</u>	<u>\$ 4,671</u>

Note 7 – Long-term Liabilities

The changes in long-term liabilities for the years ended June 30, 2005 and 2004 are summarized as follows (in thousands):

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Current Portion	Noncurrent Portion
Consolidated Educational Buildings Revenue Bonds	\$ 38,545	\$ -	\$ 4,755	\$ 33,790	\$ 4,815	\$ 28,975
Housing and Dining Revenue Bonds	3,360	-	210	3,150	220	2,930
CVU note payable	238	-	116	122	122	-
Municipal capital lease obligations	4,888	6,584	1,003	10,469	1,703	8,766
Capital lease	24,555	-	1,379	23,176	1,442	21,734
Total bonds, notes and capital leases	<u>71,586</u>	<u>6,584</u>	<u>7,463</u>	<u>70,707</u>	<u>8,302</u>	<u>62,405</u>
Faculty retirement and deferred compensation	1,081	96	472	705	257	448
Federal portion of Perkins loans	2,372	25	-	2,397	-	2,397
Arbitrage rebate liability	113	-	-	113	-	113
Total other liabilities	<u>3,566</u>	<u>121</u>	<u>472</u>	<u>3,215</u>	<u>257</u>	<u>2,958</u>
Total long-term liabilities	<u>\$ 75,152</u>	<u>\$ 6,705</u>	<u>\$ 7,935</u>	<u>\$ 73,922</u>	<u>\$ 8,559</u>	<u>\$ 65,363</u>

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion	Noncurrent 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 capital 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 CEHRB 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 CEHRB. The reserve requirements for all CEHRB issues have been fully funded as of June 30, 2005.

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, 2005, 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.

The outstanding municipal lease obligations as of June 30, 2005 consist of master lease obligations issued through a local bank totaling \$5,806,000, with interest rates ranging from 2.59 percent to 3.68 percent, and a lease obligation of \$4,663,000, with an interest rate of 3.76 percent, for an energy management project. The energy management lease will be paid with guaranteed energy savings.

The outstanding capital leases as of June 30, 2005 consist of two student housing facility leases of \$8,815,000 and \$14,361,000 entered into on April 22, 1998 and August 1, 2002, respectively. For accounting purposes, these leases represent capital leases with imputed interest rates of 4.58 and 4.88 percent, respectively. The 1998 facilities lease is renewable for biennial terms until final termination on December 1, 2011 or as provided in the lease. The 2002 lease is renewable for biennial terms until final termination on December 1, 2027 or as provided in the lease. Title to both housing facilities will transfer to the University upon termination of the facilities leases. The future minimum lease payments are to be paid from revenues of the leased facilities.

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):

Fiscal Year	Principal	Interest	Total
2006	\$ 8,302	\$ 3,030	\$ 11,332
2007	8,449	2,708	11,157
2008	6,281	2,328	8,609
2009	6,404	2,052	8,456
2010	6,375	1,768	8,143
2011-2015	17,420	5,521	22,941
2016-2020	8,437	3,078	11,515
2021-2025	6,143	1,385	7,528
2026-2027	2,896	217	3,113
Total	<u>\$ 70,707</u>	<u>\$ 22,087</u>	<u>\$ 92,794</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 \$31,429,000 and \$29,250,000 for the years ended June 30, 2005 and 2004, respectively. Expenditures for the University's portion amounted to \$3,143,000 and \$2,925,000 for the years ended June 30, 2005 and 2004, respectively.

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, 2005, 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 for non-hazardous pay and 19.47 percent for hazardous pay. The University's contributions to KERS for the years ending June 30, 2005, 2004 and 2003 were \$1,503,000, \$1,353,000 and \$1,283,000, 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, 2005 and 2004, were \$1,313,000 and \$1,208,000, 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, 2005 and 2004, the University had recognized an accrued liability of \$358,000 and \$789,000, 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, 2005 and 2004, the University had recognized an accrued vacation liability of \$1,751,000 and \$1,571,000, 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, 2005 and 2004 (in thousands):

	2005	2004
Salaries and wages	\$ 70,265	\$ 66,346
Employee benefits	16,363	14,888
Utilities	3,715	3,336
Supplies and other services	19,943	17,540
Depreciation	8,327	7,690
Student scholarships and financial aid	9,844	9,696
	<u>\$ 128,457</u>	<u>\$ 119,496</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 2004 to 2005. 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, 2005 was approximately \$981,000. 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, 2005 and 2004 (in thousands)

	2005	2004
Assets:		
Current assets	\$ 583	\$ 464
Noncurrent assets	2,261	2,433
Total assets	<u>2,844</u>	<u>2,897</u>
Liabilities:		
Current liabilities	322	293
Noncurrent liabilities	2,930	3,150
Total liabilities	<u>3,252</u>	<u>3,443</u>
Net assets (deficit):		
Invested in capital, net of related debt	(1,243)	(1,285)
Restricted	669	659
Unrestricted	166	80
Total net assets (deficit)	<u>\$ (408)</u>	<u>\$ (546)</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30, 2005 and 2004 (in thousands)

	2005	2004
Operating revenues	\$ 904	\$ 844
Operating expenses	(664)	(627)
Operating income	240	217
Nonoperating revenues	21	9
Nonoperating expenses	(123)	(131)
Increase (decrease) in net assets	138	95
Net assets (deficit), beginning of year	(546)	(641)
Net assets (deficit), end of year	<u>\$ (408)</u>	<u>\$ (546)</u>

Condensed Statement of Cash Flows for the years ended June 30, 2005 and 2004 (in thousands)

	2005	2004
Net cash flows provided by operating activities	\$ 398	\$ 424
Net cash flows provided by investing activities	98	15
Net cash flows used in capital and related financing activities	(307)	(325)
Net increase in cash and cash equivalents	189	114
Cash and cash equivalents, beginning of year	742	628
Cash and cash equivalents, end of year	<u>\$ 931</u>	<u>\$ 742</u>

Note 13 – Northern Kentucky University Foundation, Inc. Notes to Financial Statements

a. Summary of Significant Accounting Policies

1. 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.

2. 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

3. 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.

4. 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 significant exposure to a number of risks including interest rate, market and credit risks for both marketable and non-marketable securities. Due to the level of risk exposure, it is possible that near-term valuation changes for investment securities may occur to an extent that could materially affect the amounts reported in the Foundation's financial statements.

All true endowment investments and long-term net assets functioning as endowment are managed in a pool, unless special considerations or donor stipulations require that they be held separately.

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 percent to 5 percent 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, 2005 and 2004 are categorized below (in thousands):

	2005	2004
Type of investments:		
Short-term money market funds	\$ 182	\$ 312
Fixed income funds	6,521	4,956
Equity funds and common stock	26,206	23,258
Certificates of deposit	-	150
Municipal bonds	193	198
Hedge funds	4,184	3,010
Real estate	-	-
Other	279	258
Total Investments	\$ 37,565	\$ 32,142

The investments of the Foundation are commingled with certain investments which the Foundation holds in trust for Northern Kentucky University. The market value of funds held in trust for the University at June 30, 2005 and 2004 were \$8,207,603 and \$7,078,351 respectively.

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. Some of the Foundation's investment managers report investment

transactions net of fees. For the years ended June 30, 2005 and 2004, separately stated investment managers' fees were \$72,344 and \$94,607 respectively.

At June 30, 2005, 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 \$79,396.

5. 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, 2005 and 2004 was \$59,131 and \$59,945, 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.

6. 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.

7. 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.

8. Other Significant Accounting Policies

Certain items may have been reclassified for the year ended June 30, 2004, in order to conform to classifications used for the year ended June 30, 2005.

b. 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 (6.0 percent at June 30, 2005) were current at June 30, 2005.

c. 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, 2005 and 2004, the Foundation recognized contributions based on the following unconditional promises to give (in thousands):

	2005	2004
Purpose:		
Endowment giving	\$ 3,419	\$ 3,979
Capital purposes	6,407	190
Operating programs	943	1,312
Gross unconditional promises	10,769	5,481
Less: Discount and allowance for uncollectible accounts	(1,120)	(608)
Net unconditional promises to give	\$ 9,649	\$ 4,873
Amounts due in:		
Less than one year	1,898	4,335
One to five years	5,443	1,104
More than five years	3,428	42
Total	\$ 10,769	\$ 5,481

The discount rate used to calculate the present value of contributions receivable at June 30, 2005 and 2004 was 3.0 percent. Conditional promises to give are not included as support until such time as the conditions are substantially met. At June 30, 2005, the Foundation had received conditional promises to give of approximately \$2,750,000, consisting of the face value of life insurance policies, net of accumulated cash surrender value.

d. Adjustment for Regional University Excellence Trust Fund

The Foundation holds certain funds, consisting of endowment matching funds received by Northern Kentucky University from the Commonwealth of Kentucky's Regional University Excellence Trust Fund, which were subsequently transferred to the Foundation for management and investment.

The Foundation has previously reported these funds and accumulated earnings in the same manner as other permanently restricted endowment funds received from private donors for the benefit of the University. The University has determined that such funds should be reported as revenue and net assets on the University's financial statements and has advised that the Foundation should report the funds as being held in trust for the University.

Net assets for the fiscal year ended June 30, 2004 as previously reported have been restated as follows:

Net Assets, July 1, 2003, as previously reported	\$ 39,422
Adjustments to net assets for prior years:	
Remove RUETF matching endowment net assets	(4,113)
Net Assets, July 1, 2003 as restated	<u>35,309</u>
 Increase in net assets, as previously reported	 4,892
Adjustments to net assets:	
Funds received to be held in trust for NKU	(2,327)
Investment income attributed to funds held in trust for NKU	(50)
Investment gains attributed to funds held in trust for NKU	(589)
Increase in net assets, as restated	<u>1,926</u>
Net Assets, June 30, 2004 as restated	<u><u>\$ 37,235</u></u>

e. 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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