



**ANNUAL
FINANCIAL REPORT**

2005-2006

**Northern Kentucky University and Affiliate
Annual Financial Report
2005-2006**

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

September 15, 2006

Northern Kentucky University Board of Regents
 Highland Heights, KY 41099

Dear Members of the Board:



It is my pleasure to transmit the University's 2005-06 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 public support by nearly \$7 million in operating support over the next two years, \$35.5 million for the new College of Informatics building, second-phase approval for our new Student Union, \$600,000 from the Kentucky Regional Stewardship Trust Fund to support public engagement efforts, and \$1.5 million in recurring dollars for the Kentucky Center for Mathematics, which will improve mathematics preparation across Kentucky. In addition, NKU received \$12.5 million in private and public grants and contracts funds. NKU will continue to pursue excellence in maximizing new and current financial resources!

Let us focus on a few of the highlights of the past year and the continued challenges of the new academic year:

Enrollment is at its highest level in the history of the University. For the fall 2006, we registered almost 14,700 students, which is a total enrollment increase of 4.6% over last year. Undergraduate enrollments increased by 1.8%, even with the new admissions standards. Our entering class is about 200 students larger than last year and is the best prepared in our history. More than 300 of our first-year students have ACT scores of 25 or above. This is a 40% increase over fall 2005. Our two-year implementation of more rigorous admissions standards is now complete and it has been an unqualified success. We anticipate that our African American enrollments will increase slightly this year; our Latino student population is expected to have another substantial increase; our international enrollments are holding steady; and the number of our domestic students studying abroad continues to increase. With the advent of new academic programs geared to working adults, we also expect to see a considerable increase in the number of adults enrolling on our campus. Our new Program for Adult-Centered Education, or PACE, will enroll more than 100 students this fall. Our recent success in putting general studies on-line will allow us to offer complete undergraduate degree programs through the Internet. Graduate enrollment increased by nearly 9%, which maintains the annual growth level of the past several years. Chase enrollment is again strong with 1,117 applications for 151 spaces. Finally, we expect to see more than 300 high school students enrolled in our early admission program. In summary, enrollments look strong and are aligned with the needs of our region.

The University continues to take important steps to promote and enhance the quality of our academic programs. We created a new College of Informatics, the College of Education and Human Services, and the School of Nursing and Health Professions, all reflecting our commitment to expanding our efforts in areas important to our students and the region. We expanded and adapted existing programs to meet the evolving needs of our students by introducing new masters programs in communication, executive leadership and organizational change, the on-line master's degree in education, and the new nursing education track in the MSN program. In addition, we introduced a new interdisciplinary Bachelor of Health Science degree, which will make it possible for professionals with associate degrees in radiologic technology and respiratory care to earn a four-year degree. A proposal for a Doctorate of Education has been developed under the leadership of Dr. Mark Wasicsko, our Bank of Kentucky endowed chair in educational leadership. This year, Chase vaulted into the top 100 law schools worldwide in scholarship output. The Mock Trial and Moot Court teams also distinguished themselves in national and regional competition. Finally, our quality faculty continues to be competitive in receiving externally funded research and scholarly activity, with an increase of 81% in external funding compared with three years ago.

Great strides were made this year in advancing the quality of our campus experience. Student life at NKU continues to reflect a growing appreciation for extracurricular involvement. Students today are more involved than ever in student organizations that grow out of their social, civic, and academic interests. We are seeing major

increases in student community service involvement as part of our emphasis on education for citizenship. In addition, we have seen major increases in students enrolled in co-op and other active learning options. Our intercollegiate athletic program again won the GLVC All-Sports Trophy, the fifth time in seven years. Our women's basketball team was honored by the Women's Basketball Coaches Association as one of the top academic teams in the nation. Our women's team was fifth highest in the nation with a 3.5 GPA. We continue to reflect in our athletics a strong commitment to the importance of academic as well as athletic success. As of this fall, NKU has gone wi-fi! In addition, a new mainframe management information system will be implemented that will include campus management, financial information and human resources modules. Loch Norse (formerly Lake Inferior) is now completed, as is the adjacent Oakley and Eva G. Farris Amphitheater. Construction of the new Student Union is underway and is anticipated to be completed by spring 2008. The new greenhouse and planetarium are being constructed in Hermann Science Center. Construction of our new lighted tennis courts, expected to be completed by late October, is underway and will be located near the Grien Softball Field. The Bank of Kentucky Center location has been cleared and construction will begin this fall with an anticipated completion date of spring 2008. Also this fall, we will see work begin on the adjoining NKU Foundation property. This development will include a 100-bed hotel, office space and retail. The combined investment in both parcels will be close to \$100 million. Add to all of this the new College of Informatics building, the Three Mile connector road, the widening of Johns Hill Road, and a new parking garage for a total of approximately \$230 million in construction over the next several years — half of which is public funding. All of these initiatives are pursued and accomplished to ensure an excellent campus experience for our students.

A defining quality of NKU is our work on behalf of regional progress. Our engagement in the community continues to grow and to receive national, as well as state and local, recognition. Currently, our largest and most complex community initiative is the leadership that we are providing for implementation of Northern Kentucky's year-long planning initiative called Vision 2015. Five action teams, each supported by NKU faculty members, are focused on economic competitiveness, educational excellence, urban renaissance, effective governance and livable communities. One of our most recent and most ambitious community engagement initiatives is called "Strive," which seeks nothing less than to produce the best system of urban education in the nation. Over the past 18 months, leaders from both sides of the river representing P-12 education, higher education, business, government, philanthropy, and the non-profit sector have been developing a new partnership to strengthen urban education, enhance community support for student success, and expand the college pipeline for students enrolled in urban schools. In addition, CINSAM continues to nurture thousands of P-12 students and teachers each year in the areas of mathematics and science. The Department of Theater has done a magnificent job of reaching out to our six southern tier counties. This past spring, NKU was awarded the Kentucky Center for Mathematics, which is charged by the legislature to improve mathematics preparation across Kentucky. The Center reflects the close working relationship that exists between our College of Arts & Sciences and the College of Education and Human Services, and is the University's first center with a statewide mission. The Scripps Howard Center for Civic Engagement and Non-Profit Development continues to expand the number of students involved in service learning and other forms of civic engagement. NKU is the home of Kentucky Campus Compact, which is housed within the Center. We are currently working with the United Way and the Greater Cincinnati Foundation to develop programs that support asset mapping and non-profit leadership throughout the region. NKU's public engagement efforts have focused very heavily on supporting regional economic growth, including the launch of the new Infrastructure Management Institute that will spur economic competitiveness and involve University faculty and students in cutting-edge work. Finally, in the area of public engagement, the Kentucky Regional Stewardship Trust Fund was initiated, providing \$600,000 to each of Kentucky's comprehensive universities to support their public engagement efforts. Kentucky thus becomes the first state in the nation to create a public revenue stream for this purpose. NKU has truly taken a significant leadership role in the national, state, regional and local communities in advancing higher education's public engagement mission.

This past year reflected another major step forward in advancing our capacity to serve our students, our region and the Commonwealth. To all who contributed to our progress – faculty, staff, students and community leaders – I extend a special thanks!

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 consolidated 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, 2006 and 2005, 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated 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, 2006 and 2005, 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.

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 13, 2006

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, 2006, with selected comparative information for the years ended June 30, 2005 and 2004. 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, 2006. The University's total net assets increased by \$18.6 million, or 14.7 percent. This increase resulted from income before other revenues, expenses, gains or losses of \$16.9 million and capital appropriations and gifts of \$1.7 million. The University's unrestricted net assets increased by \$10.7 million for the year as a result of revenue enhancements and increases in budgetary reserves related to fiscal year 2007 operating needs, anticipated software implementation costs and future construction projects. In addition, the University increased its unrestricted net assets budgetary reserve to provide the flexibility necessary in the current uncertain state budget environment. A strong debt rating is an important indicator of the University's financial strength. The University's current A2 Bond rating, assigned by Moody's Investors Service to the University's Consolidated Educational Building Revenue Bonds, reflects the University's solid financial position.

The University's state appropriations increased by \$7.3 million, or 16.5 percent, for year ended June 30, 2006. This increase followed a period where the University's appropriations had actually declined from \$45.3 million in fiscal year 2003 to \$44.1 million for fiscal year 2005. The increase in state appropriations helped reverse the recent trend where virtually all of the University's new revenues were generated by operating revenues, including significant increases in net tuition.

Even though the University raised its admissions standards for fall 2005, enrollment continued to increase with the University welcoming its most academically prepared class in the University's history. This enrollment increase combined with an average tuition rate increase of 11.3 percent resulted in a \$6.1 million increase in net tuition for fiscal year 2006. The University strives to keep tuition rates as low as possible, balancing affordability and quality. The University's tuition increase for fiscal year 2007 will be less than 10 percent as a result, in large part, to recent increases in state appropriations. Although tuition rates have increased, the University still provides an excellent educational value to its students.

At June 30, 2006, the University had several major capital construction projects underway, including a new student union facility, Bank of Kentucky Center, greenhouse, and a digital classroom. In addition, several major projects were in the design phase, including a new parking garage. 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.

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.

Condensed Statement of Net Assets (in thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
ASSETS			
Current assets	\$ 55,331	\$ 42,003	\$ 34,916
Capital assets, net	157,235	152,710	147,059
Noncurrent assets	<u>26,340</u>	<u>25,958</u>	<u>26,649</u>
Total assets	<u>238,906</u>	<u>220,671</u>	<u>208,624</u>
LIABILITIES			
Current liabilities	31,162	23,242	22,405
Noncurrent liabilities	<u>58,064</u>	<u>66,300</u>	<u>68,780</u>
Total liabilities	<u>89,226</u>	<u>89,542</u>	<u>91,185</u>
NET ASSETS			
Invested in capital assets, net of related debt	82,835	81,851	69,732
Restricted			
Nonexpendable	7,616	7,616	7,038
Expendable	23,605	16,784	21,619
Unrestricted	<u>35,624</u>	<u>24,878</u>	<u>19,050</u>
Total net assets	<u>\$ 149,680</u>	<u>\$ 131,129</u>	<u>\$ 117,439</u>

A review of the University's statement of net assets at June 30, 2006 shows that the University continues to build upon its strong financial foundation.

Assets

The University's assets increased by \$30.3 million, or 14.5 percent, from June 30, 2004 to June 30, 2006 and now total \$238.9 million. The majority of this increase is attributable to a growth in current assets and net capital assets. Current assets increased by \$13.3 million for the year ended June 30, 2006 and \$7.1 million for the year ended June 30, 2005, resulting in a combined increase of \$20.4 million, or 58.5 percent, since June 30, 2004. This increase is attributable to an increase in cash and cash equivalents related to operating and construction reserves and an increase in notes and accounts receivable balances associated with increases in tuition rates and enrollment.

Net capital assets increased by \$4.5 million for the year ended June 30, 2006 and \$5.7 million for the year ended June 30, 2005, resulting in a combined increase of \$10.2 million, or 6.9 percent, since June 30, 2004. This increase is related to the construction of several new facilities and land improvements, including a new student union, parking deck, and lake development/amphitheater. These assets were funded primarily with debt proceeds, capital appropriations, and private gifts. As a result of the University's significant investment in its campus facilities in recent years, net capital assets have grown to \$157.2 million, or 65.8 percent of total assets as of June 30, 2006.

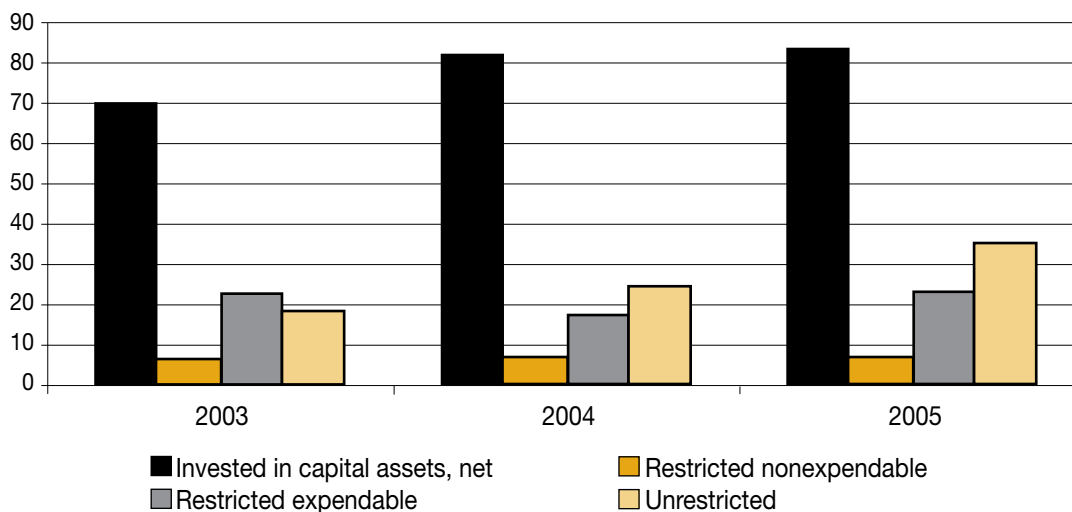
Liabilities

At June 30, 2006, the University's liabilities totaled \$89.2 million compared to the previous year's \$89.5 million. This decline in liabilities is attributable to a decrease in long-term liabilities. Debt outstanding decreased by \$2.0 million for the year. This decrease is the net result of the issuance of \$6.4 million in notes and capital lease obligations to finance the new student union construction and new enterprise software and equipment less principal payments of \$8.4 million. Bonds, notes and capital leases payable for educational buildings, student housing and dining facilities, software and equipment represented \$68.7 million, or 77.0 percent, of total liabilities at June 30, 2006.

The University's total liabilities decreased by \$2.0 million, or 2.1 percent, from June 30, 2004 to June 30, 2006. This decline resulted from an increase in current liabilities of \$8.8 million, or 39.1 percent, and a decrease in noncurrent liabilities, including bonds, notes and capital leases payable, of \$10.7 million, or 15.6 percent. From a liquidity perspective, current assets cover current liabilities 1.8 times, an indicator of good liquidity. This year's coverage rate equaled the 1.8 rate as of June 30, 2005 and was better than the 1.6 rate as of June 30, 2004.

Net Assets

The following chart illustrates the University's net assets for fiscal years 2004, 2005 and 2006 (amounts are presented in millions).



Net assets at June 30, 2006 totaled \$149.7 million, or 62.7 percent, of total assets. Net assets invested in capital, net of related debt, totaled \$82.8 million, or 55.3 percent, of total net assets. Restricted and unrestricted net assets represented 20.9 percent and 23.8 percent of total net assets, respectively. Total net assets increased by \$18.6 million, or 14.1 percent at June 30, 2006, compared to June 30, 2005. Net assets invested in capital assets, net of related debt increased \$1.0 million. The University's unrestricted net assets increased by \$10.7 million for the year as a result of revenue enhancements and increases in budgetary reserves related to fiscal year 2007 operating needs, anticipated software implementation costs and future construction projects. In addition, the University increased its unrestricted net assets budgetary reserve to provide the flexibility necessary in the recent uncertain state budget environment.

The University's net assets increased by \$32.2 million, or 27.5 percent, from June 30, 2004 to June 30, 2006. Net assets invested in capital assets, net of related debt increased \$13.1 million. Restricted expendable and nonexpendable net assets increased by a combined \$2.6 million while unrestricted net assets increased by \$16.6 million from June 30, 2004 to June 30, 2006.

Statement of Revenues, Expenses and Changes in Net Assets

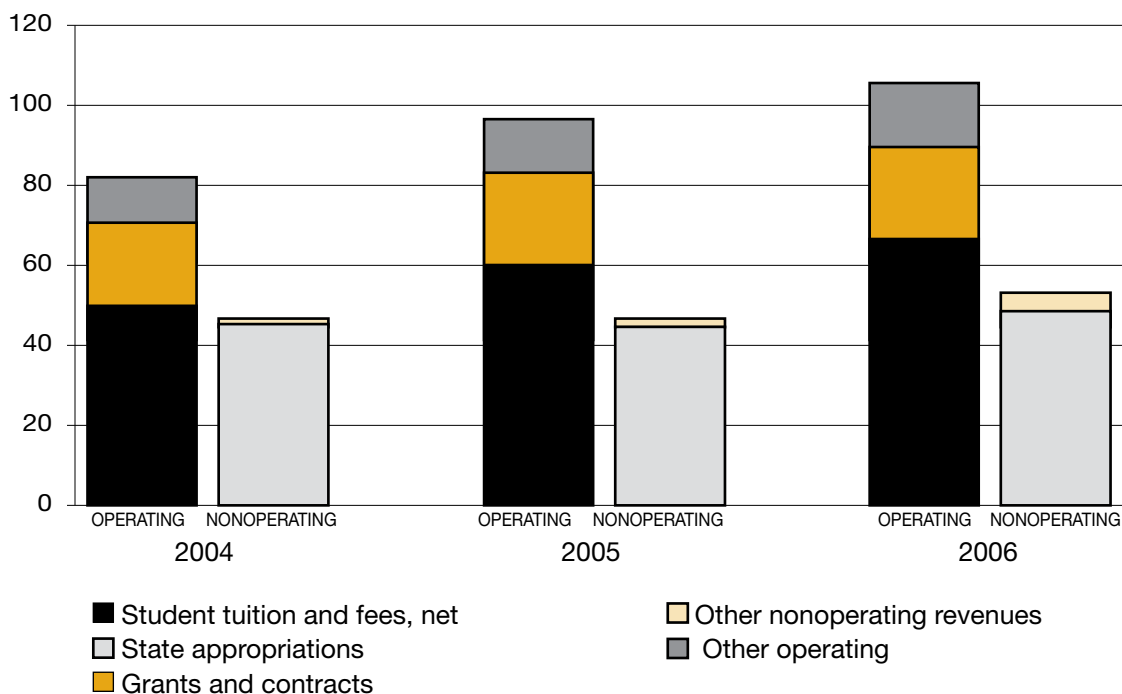
The statement of revenues, expenses and changes in net assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. GASB requires state appropriations to be classified as nonoperating revenues. Accordingly, the University will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

	<u>2006</u>	<u>2005</u>	<u>2004</u>
OPERATING REVENUES			
Student tuition and fees, net	\$ 65,530	\$ 59,424	\$ 49,741
Grants and Contracts	23,960	22,776	20,099
Sales and services of educational departments	3,224	2,947	2,445
Auxiliary enterprises	6,295	6,093	5,328
Other operating revenues	5,674	4,685	3,951
Total operating revenues	<u>104,683</u>	<u>95,925</u>	<u>81,564</u>
OPERATING EXPENSES			
Educational and general	128,121	117,370	107,797
Depreciation	7,504	7,115	6,583
Auxiliary enterprises (including depreciation)	4,005	3,749	4,873
Other expenditures	188	223	243
Total operating expenses	<u>139,818</u>	<u>128,457</u>	<u>119,496</u>
Net loss from operations	<u>(35,135)</u>	<u>(32,532)</u>	<u>(37,932)</u>
NONOPERATING REVENUES (EXPENSES)			
State appropriations	51,334	44,069	45,127
Investment income	3,585	2,071	888
Interest on capital asset-related debt	(3,022)	(3,126)	(3,330)
Other nonoperating revenues (expenses)	150	270	152
Net nonoperating revenues	<u>52,047</u>	<u>43,284</u>	<u>42,837</u>
Income before other revenues, expenses, gains or losses	<u>16,912</u>	<u>10,752</u>	<u>4,905</u>
Capital appropriations	102	98	126
State endowment match	0	577	2,327
Capital grants and gifts	1,537	2,263	1,524
Total other revenues	<u>1,639</u>	<u>2,938</u>	<u>3,977</u>
Increase in net assets	<u>18,551</u>	<u>13,690</u>	<u>8,882</u>
Net assets-beginning of year	<u>131,129</u>	<u>117,439</u>	<u>108,557</u>
Net assets-end of year	<u>\$ 149,680</u>	<u>\$ 131,129</u>	<u>\$ 117,439</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 2004, 2005 and 2006. 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).



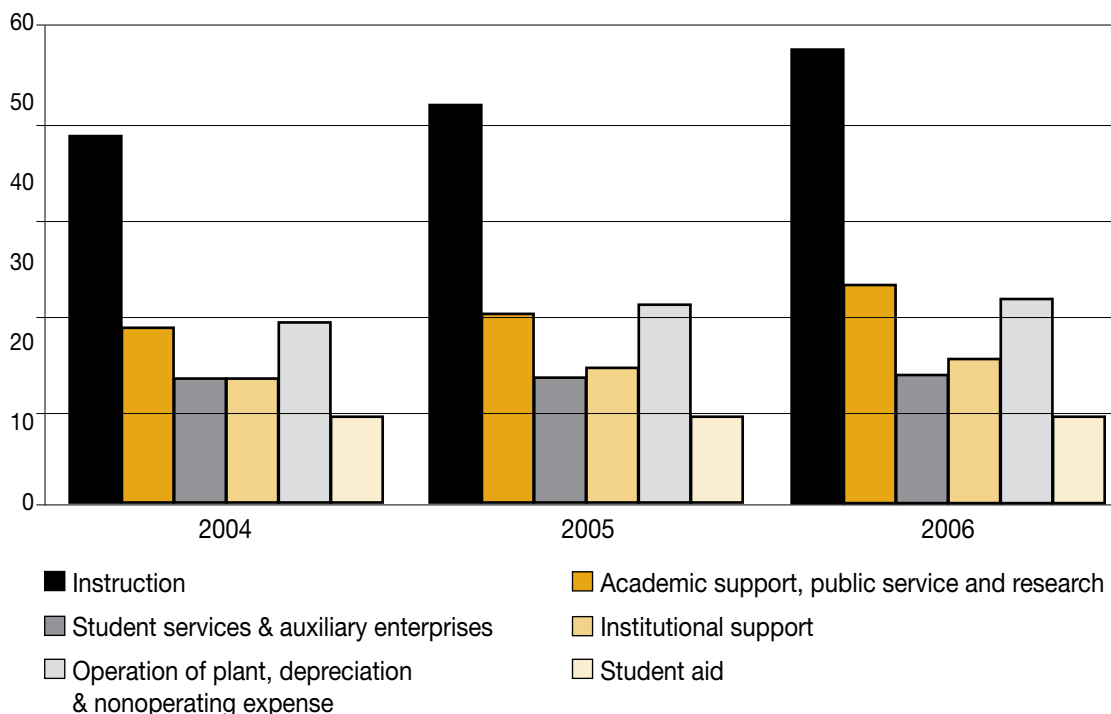
Operating and nonoperating revenues totaled approximately \$159.8 million for the year ended June 30, 2006. The most significant sources of revenue for the University are net student tuition and fees (41.0 percent), state appropriations (32.1 percent), and grants and contracts (15.0 percent).

For the first time in recent years, the University's state appropriations increased. The University's appropriations had actually declined from \$45.3 million for fiscal year 2003 to \$44.1 million for fiscal year 2005, a 2.6 percent decline. The University's appropriation increased by \$7.3 million, or 16.5 percent, for year ended June 30, 2006. The chart above illustrates a shift between operating and nonoperating revenues. While the University's nonoperating revenues, including state appropriations, have increased by \$8.9 million, or 19.3 percent, since June 30, 2004, the University's operating revenues have increased by \$23.1 million, or 28.3 percent. The majority of the growth in operating revenues was fueled by a substantial increase in net tuition, which increased by \$6.1 million in fiscal years 2006 and \$9.7 million in fiscal year 2005. The growth in net tuition resulted from an average tuition rate increased by 11.3 percent for fiscal year 2006 and 15.2 percent for fiscal year 2005, combined with small enrollment increases each year.

Noteworthy increases in revenues from grants and contracts, auxiliary enterprises and other operating revenues were also realized and demonstrate the University's continued effort to diversify revenue sources. The majority of the University's grants and contracts revenue is derived from federal and state funded financial aid programs. For fiscal year 2006 the University's revenues from these programs increased by a modest 1.2 percent. In addition, the University realized a \$1.0 million, or 12.3 percent increase in non-financial aid related grant and contract revenue for the year ended June 30, 2006. Combined with the prior year increase of \$1.6 million, non-financial aid related grant and contract revenues have increased by 41.2 percent over the past two fiscal years.

Operating and Nonoperating Expenses

The following chart illustrates the University's expenses by function (both operating and nonoperating) for fiscal years 2004, 2005 and 2006 (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 \$56.5 million (40.4 percent), and academic support, public service and research \$23.4 million (16.7 percent). Operating and nonoperating expenses increased by \$11.3 million, or 8.6 percent, to a total of \$142.8 million for the year ended June 30, 2006.

The majority of this increase is due to a \$7.2 million, or 9.9 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. 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. The establishment of the College of Informatics represents an example of the University's commitment to align with the employment needs of the region. 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 fiscal year 2006 budget included initiatives designed to broaden access to the University, including program expansion at the Grant County Center, establishing adult-centered programming and a summer academy for under-prepared students. 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, 2006, student financial aid related to tuition and fees totaled \$23.3 million, including student aid expenses of \$9.4 million and scholarship allowances of \$13.9 million. This represents a \$0.6 million, or 2.8 percent, increase over the prior year.

Operation of maintenance of plant expenses increased by \$1.4 million, or 12.6 percent, for the year. Nearly half of this increase is attributable to a significant increase in utility expenses. Depreciation expenses totaled \$8.7 million for the year, representing a 3.9 percent increase over the prior year.

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)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Net cash provided (used) by:			
Operating activities	\$ (25,446)	\$ (24,821)	\$ (31,322)
Noncapital financing activities	51,895	44,374	48,228
Capital and related financing activities	(16,371)	(16,773)	(17,954)
Investing activities	3,490	1,987	(1,219)
Net increase (decrease) in cash	<u>13,568</u>	<u>4,767</u>	<u>(2,267)</u>
Cash and cash equivalents, beginning of year	48,604	43,837	46,104
Cash and cash equivalents, end year	<u>\$ 62,172</u>	<u>\$ 48,604</u>	<u>\$ 43,837</u>

The University's cash and cash equivalents increased \$13.6 million in 2006 as compared to an increase of \$4.8 million in 2005. Cash provided by operating and noncapital financing activities increased by a combined \$6.9 million for 2006 and \$2.6 million for 2005. Total cash provided from noncapital financing activities increased by \$7.5 million for 2006, largely due to a \$7.3 million increase in the University's state appropriations for the year.

Major sources of funds included in operating activities are student tuition and fees (\$65.9 million) and grants and contracts (\$25.0 million). The largest cash payments for operating activities were made to employees (\$94.0 million) and to vendors and contractors (\$37.8 million).

The University's cash receipts from operating activities increased by \$25.2 million, or 30.1 percent, from 2004 to 2006. Conversely, cash disbursements for operating activities increased by only \$19.3 million, or 17.1 percent, from 2004 to 2006, resulting in a net \$5.9 million increase in net cash provided by operating activities.

Capital and related financing activities include proceeds from capital debt and leases of \$6.4 million and capital appropriations and capital grants and gifts of \$1.6 million. Purchases of capital assets totaled \$12.9 million for the year. Investing activities for the year included a \$1.2 million increase in investment income resulting from improved investment yields.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, increased by \$4.5 million for the year ended June 30, 2006. Depreciation expenses and net capital asset disposals totaled \$8.8 million for the year. Additions to capital assets during the year totaled \$13.3 million, including a new student union, parking deck, lake development/amphitheater and administrative software systems. These assets were funded primarily with debt proceeds, capital appropriations and private gifts. As a result of the University's significant investment in its campus facilities in recent years, net capital assets have grown to \$157.2 million, or 65.8 percent of total assets as of June 30, 2006.

The University's net capital assets grew by \$10.2 million from June 30, 2004 to June 30, 2006, with increases of \$4.5 million in 2006 and \$5.7 million in 2005. This growth reflects the University's effort to increase its capacity, including much needed parking and student housing facilities, to accommodate continued enrollment growth.

At June 30, 2006, the University had several major capital construction projects underway, including a new student union facility, Bank of Kentucky Center, greenhouse and a digital classroom. In addition, several major projects were in the design phase, including a new parking garage.

Debt

The following is a summary of the University's outstanding debt summarized by revenue pledge as of June 30, 2006, 2005 and 2004 (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Consolidated Educational Buildings Revenue Bonds	\$ 28,975	\$ 33,790	\$ 38,545
Housing and Dining System Revenue Bonds	2,930	3,150	3,360
Capital lease – Residential Village/Suites	21,733	23,176	24,555
Notes payable and municipal lease obligations	15,079	10,591	5,126
	<u>\$ 68,717</u>	<u>\$ 70,707</u>	<u>\$ 71,586</u>

Debt outstanding decreased by \$2.0 million for the year. This decrease is the net result of the issuance of \$6.4 million in notes and capital lease obligations to finance the new student union construction and new enterprise software and equipment less principal payments of \$8.4 million.

For the year ended June 30, 2005, the University's outstanding debt had decreased by \$0.9 million for the year. This decrease was 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.

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. The University's current A2 Bond rating assigned by Moody's Investors Service to the University's Consolidated Educational Building Revenue Bonds, reflects the University's solid financial position.

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". The Commonwealth created the Kentucky Regional Stewardship Trust Fund to support public engagement. This fund will provide \$0.6 million to each of Kentucky's comprehensive universities to support their public engagement efforts. Kentucky thus becomes the first state in the nation to create a public revenue stream for this purpose. These funds will enable the university to continue to expand its community outreach efforts. The University has taken a significant leadership role in the national, state, regional and local communities in advancing higher education's public engagement mission. 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.

In full partnership with the state, the University will continue to grow and expand its 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.

For fiscal year 2006, for the first time in recent years, the University's state appropriations increased. The University's appropriations had actually declined from \$45.3 million for fiscal year 2003 to \$44.1 million for fiscal year 2005, a 2.5 percent decline. The University's appropriation increased by \$7.3 million, or 16.5 percent, for year ended June 30, 2006. In addition, the university is scheduled to receive an increase in appropriations of nearly \$7 million in operating support over the next two years. There is a direct relationship between the growth, or decline, in state support and the University's ability to limit tuition rate increases. The increased support from the state enabled the university to hold its tuition rate increase for fiscal year 2007 under 10 percent.

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 University's two-year implementation of more rigorous admissions standards is now complete and it has been a terrific success. Enrollment is at its highest level in the history of the University! Even though admissions standards increased, the preliminary fall 2006 headcount numbers reflect an overall increase in enrollment. Undergraduate enrollments increased even with the new admissions standards. The incoming class is about 200 students larger and 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 and Affiliate
Consolidated Statement of Net Assets**

June 30, 2006 and 2005
(in thousands)

	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 48,999	\$ 35,904
Notes, loans and accounts receivable, net	5,056	4,642
Other current assets	1,276	1,457
Total current assets	55,331	42,003
Noncurrent Assets		
Cash and cash equivalents	13,173	12,700
Investments	10,304	10,212
Notes, loans and accounts receivable, net	2,222	2,467
Capital assets, net	157,235	152,710
Other noncurrent assets	641	579
Total noncurrent assets	183,575	178,668
Total assets	238,906	220,671
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	11,195	10,248
Deferred revenue	5,458	4,435
Long-term liabilities-current portion	14,509	8,559
Total current liabilities	31,162	23,242
Noncurrent Liabilities		
Deposits	784	782
Deferred revenue	124	155
Long-term liabilities	57,156	65,363
Total noncurrent liabilities	58,064	66,300
Total liabilities	89,226	89,542
NET ASSETS		
Invested in capital assets, net of related debt	82,835	81,851
Restricted		
Nonexpendable	7,616	7,616
Expendable	23,605	16,784
Unrestricted		
Total net assets	\$ 149,680	\$ 131,129

See accompanying notes to the financial statements

Northern Kentucky University Foundation, Inc.

Statement of Financial Position

For the Years Ended June 30, 2006 and 2005

(in thousands)

	<u>2006</u>	<u>2005</u>
ASSETS		
Cash and cash equivalents	\$ 10,406	\$ 9,617
Loans and accounts receivable	104	120
Contributions receivable	8,459	9,649
Prepaid expenses and deferred charges	50	12
Investments	42,549	37,565
Land, buildings and equipment	3,224	3,224
Accumulated depreciation	<u>(494)</u>	<u>(435)</u>
Total Assets	<u>64,298</u>	<u>59,752</u>
LIABILITIES AND NET ASSETS		
Accounts payable	68	49
Agency fund	5,597	4,156
Annuities payable	167	206
Deferred income	25	25
Deposits in custody	8,919	8,208
Notes payable	<u>2,100</u>	<u>2,100</u>
Total Liabilities	16,876	14,744
NET ASSETS		
Unrestricted		
For current operations	546	393
Contributions receivable	39	67
Amounts functioning as endowment funds	1,927	1,789
Invested in property, plant and equipment	<u>630</u>	<u>697</u>
Total Unrestricted	<u>3,142</u>	<u>2,946</u>
Temporarily restricted		
Unexpended funds received for restricted purposes	3,932	4,410
Contributions receivable	5,973	6,327
Loan funds	153	151
Endowment funds	<u>13,466</u>	<u>11,141</u>
Total temporarily restricted	<u>23,524</u>	<u>22,029</u>
Permanently restricted		
Contributions receivable	2,447	3,254
Endowment funds	<u>18,309</u>	<u>16,779</u>
Total permanently restricted	<u>20,756</u>	<u>20,033</u>
Total net Assets	47,422	45,008
Total Liabilities and Net Assets	<u>\$ 64,298</u>	<u>\$ 59,752</u>

See accompanying notes to the financial statements

Northern Kentucky University and Affiliate
Consolidated Statement of Revenues, Expenses and Changes in Net Assets

For the Years Ended June 30, 2006 and 2005

(in thousands)

	2006	2005
OPERATING REVENUES		
Student tuition and fees		
(net of scholarship allowances of \$13,928 in 2006 and \$13,198 in 2005)	\$ 65,530	\$ 59,424
Federal grants and contracts	10,647	10,910
State and local grants and contracts	11,043	10,264
Nongovernmental grants and contracts	2,270	1,602
Sales and services of educational departments	3,224	2,947
Auxiliary enterprises		
Residence Halls		
(net of scholarship allowances of \$93 in 2006 and \$79 in 2005)	831	782
Residential Village		
(net of scholarship allowances of \$289 in 2006 and \$251 in 2005)	4,106	4,128
Other auxiliaries	1,358	1,183
Other operating revenues	5,674	4,685
Total operating revenues	104,683	95,925
OPERATING EXPENSES		
Educational and general		
Instruction	56,515	52,379
Research	1,325	1,149
Public service	5,818	4,839
Libraries	3,740	3,651
Academic support	12,518	10,717
Student services	10,240	9,545
Institutional support	16,145	14,570
Operation and maintenance of plant	12,421	11,029
Depreciation	7,504	7,115
Student aid	9,399	9,491
Auxiliary enterprises		
Residence Halls	535	518
Residential Village	1,740	1,589
Other auxiliaries	579	430
Auxiliary depreciation	1,151	1,212
Other expenses	188	223
Total operating expenses	139,818	128,457
Net loss from operations	(35,135)	(32,532)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	51,334	44,069
Investment income	3,585	2,071
Interest on capital asset-related debt	(3,022)	(3,126)
Other nonoperating revenues (expenses)	150	270
Net nonoperating revenues	52,047	43,284
Income before other revenues, expenses, gains or losses	16,912	10,752
Capital appropriations	102	98
State endowment match	-	577
Capital grants and gifts	1,537	2,263
Total other revenues	1,639	2,938
Increase (decrease) in net assets	18,551	13,690
NET ASSETS		
Net assets-beginning of year, as restated	131,129	117,439
Net assets-end of year	\$ 149,680	\$ 131,129

See accompanying notes to the financial statements

Northern Kentucky University Foundation, Inc.
Statement of Activities

For the Year Ended June 30, 2006

(in thousands)

	Unrestricted	Temporarily	Permanently	Total
	Net Assets	Restricted	Restricted	
		Net Assets	Net Assets	
CHANGES IN NET ASSETS:				
Revenues and Gains				
Gifts, grants and bequests	\$ 245	\$ 2,351	\$ 561	\$ 3,157
Rental income	106	-	-	106
Investment income	154	515	-	669
Net gains (losses) on investments	163	2,463	-	2,626
Other revenue	75	798	-	873
Total Revenues and Gains	743	6,127	561	7,431
Net Assets Released from Restrictions	4,431	(4,431)	-	-
Total Revenues and Gains and Other Support	5,174	1,696	561	7,431
Program Expenses				
Instruction	507	-	-	507
Research	5	-	-	5
Public service	741	-	-	741
Libraries	103	-	-	103
Academic support	200	-	-	200
Student services	302	-	-	302
Institutional support	520	-	-	520
Operation and maintenance of plant	1,363	-	-	1,363
Student financial aid	844	-	-	844
Total Program Expenses	4,585	-	-	4,585
Support Expenses				
Management and general	135	-	-	135
Fundraising support	66	-	-	66
Rental property	231	-	-	231
Total Support Expenses	432	-	-	432
Total Expenses	5,017	-	-	5,017
Net transfers in (out)	39	(201)	162	-
Increase (Decrease) in Net Assets	196	1,495	723	2,414
Net Assets - Beginning of Year	2,946	22,029	20,033	45,008
Net Assets - End of Year	\$ 3,142	\$ 23,524	\$ 20,756	\$ 47,422

See accompanying notes to the financial statements

Northern Kentucky University Foundation, Inc.
Statement of Activities

For the Year Ended June 30, 2005
(in thousands)

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
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	693	10,203	1,479	12,375
Net Assets Released from Restrictions	4,132	(4,132)	-	-
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	4,158	-	-	4,158
Support Expenses				
Management and general	131	-	-	131
Fundraising support	122	-	-	122
Rental property	191	-	-	191
Total Support Expenses	444	-	-	444
Total Expenses	4,602	-	-	4,602
Net transfers in (out)	(175)	161	14	-
Increase (Decrease) in Net Assets	48	6,232	1,493	7,773
Net Assets – Beginning of Year, as restated	2,898	15,797	18,540	37,235
Net Assets – End of Year	\$ 2,946	\$ 22,029	\$ 20,033	\$ 45,008

See accompanying notes to the financial statements

**Northern Kentucky University and Affiliate
Consolidated Statement of Cash Flows**

For the Years Ended June 30, 2006 and 2005

(in thousands)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	\$ 65,904	\$ 58,802
Grants and contracts	24,970	22,156
Payments to suppliers	(37,791)	(31,295)
Payments for salaries and benefits	(93,990)	(88,410)
Loans issued to students	(653)	(613)
Collection of loans to students	685	550
Auxiliary enterprise receipts:		
Residence Halls	846	805
Residential Village	4,192	4,252
Other auxiliaries	1,228	1,472
Sales and service of educational departments	3,336	2,929
Other receipts (payments)	5,827	4,531
Net cash used by operating activities	(25,446)	(24,821)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	51,334	44,069
State endowment match	-	577
Agency and loan program receipts	51,159	44,758
Agency and loan program disbursements	(51,136)	(45,126)
Other nonoperating receipts (payments)	538	96
Net cash provided by noncapital financing activities	51,895	44,374
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES		
Proceeds from capital debt and leases	6,357	6,584
Capital appropriations	96	-
Capital grants and gifts received	1,513	1,829
Purchases of capital assets	(12,854)	(14,674)
Principal paid on capital debt and leases	(8,491)	(7,373)
Interest paid on capital debt and leases	(2,992)	(3,139)
Net cash used by capital financing activities	(16,371)	(16,773)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	520	2,628
Purchases of investments and investment pool shares	(516)	(2,686)
Interest on investments	3,486	2,045
Net cash provided by investing activities	3,490	1,987
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	13,568	4,767
Cash and cash equivalents-beginning of year	48,604	43,837
Cash and cash equivalents-end of year	\$ 62,172	\$ 48,604
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH USED BY OPERATING ACTIVITIES:		
Net loss from operations	(35,135)	(32,532)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	8,655	8,327
Changes in assets and liabilities:		
Receivables, net	(449)	(1,141)
Other assets	67	(104)
Accounts payable	634	686
Deferred revenue	1,043	326
Long-term liabilities	(261)	(383)
Net cash used by operating activities	\$ (25,446)	\$ (24,821)

See accompanying notes to the financial statements

**Northern Kentucky University and Affiliate
Notes to Consolidated Financial Statements
For the Year Ended June 30, 2006**

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 consolidated financial statements of the University include the operations of the Northern Kentucky University Research Foundation; an affiliated non-profit corporation. 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, 2006, and 2005, the Foundation made payments on behalf of the University of \$2,052,000 and \$1,388,000, respectively. In addition, the Foundation transferred to the University \$2,533,000 in 2006 and \$2,770,000 in 2005 for restricted purposes. Complete financial statements for the Foundation can be obtained from the Northern Kentucky University Foundation, Inc. at the Lucas Administrative Center Room 221, Nunn Drive, Highland Heights, KY 41099.

m. Other Significant Accounting Policies

Certain items have been reclassified for the year ended June 30, 2005, in order to conform to classifications used for the year ended June 30, 2006.

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, 2006, petty cash funds totaled \$18,000 and the carrying amount of the deposits was \$62,154,000 with a corresponding total bank balance of

\$62,172,000. Of the bank balance, \$17,134,000 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 \$48,440,000 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, 2006:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities</u>	
		<u>Less than One Year</u>	<u>One to Five Years</u>
U.S. Treasury Securities	\$ 1,417,000	\$ 626,000	\$ 791,000
Total	\$ 1,417,000	\$ 626,000	\$ 791,000
Investments Not Sensitive to Interest Rate Risk:			
Foundation Endowment Pool	\$ 8,887,000		
Total Investments	\$10,304,000		

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

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

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, 2006 all investments with maturities from one to five years are compliant with the bond resolution requirements.

Note 3 – Notes, Loans and Accounts Receivable

Notes, loans and accounts receivable as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Student loans	\$ 2,814	\$ (399)	\$ 2,415
Student account receivables	3,395	(1,236)	2,159
Reimbursement Rec- Grants and Contracts	1,719		1,719
Other	985		985
Total	\$ 8,913	\$ (1,635)	\$ 7,278
Current portion			5,056
Noncurrent portion			2,222
Total			\$ 7,278

	2005		
	Gross		Net
	Receivable	Allowance	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
Total	<u>\$ 8,350</u>	<u>\$ (1,241)</u>	<u>\$ 7,109</u>
Current portion			4,642
Noncurrent portion			2,467
Total			<u>\$ 7,109</u>

Note 4 – Capital Assets, net

Capital assets for the years ended June 30, 2006 and 2005 are summarized as follows (in thousands):

	<u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2006</u>
Cost:				
Land	\$ 4,325	\$ 102	\$ -	\$ 4,427
Land Improvements	6,746	2,227	201	8,772
Buildings	195,732	2,978	37	198,673
Equipment	20,283	1,438	154	21,567
Library books	25,709	1,549	341	26,917
Construction in process	<u>6,490</u>	<u>5,027</u>	<u>-</u>	<u>11,517</u>
	259,285	13,321	733	271,873
Accumulated Depreciation				
Land Improvements	1,699	193	86	1,806
Buildings	76,098	5,274	15	81,357
Equipment	10,140	2,009	150	11,999
Library books	<u>18,638</u>	<u>1,179</u>	<u>341</u>	<u>19,476</u>
	<u>106,575</u>	<u>8,655</u>	<u>592</u>	<u>114,638</u>
Capital assets, net	<u>\$ 152,710</u>	<u>\$ 4,666</u>	<u>\$ 141</u>	<u>\$ 157,235</u>
	<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	<u>5,821</u>	<u>669</u>	<u>-</u>	<u>6,490</u>
	245,746	14,032	493	259,285
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	<u>17,824</u>	<u>1,114</u>	<u>300</u>	<u>18,638</u>
	<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>

Note 5 – Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Payable to vendors and contractors	\$ 6,199	\$ 5,644
Accrued expenses, primarily payroll and vacation leave	3,105	2,673
Employee withholdings and deposits payable to third parties	1,891	1,931
	<u>\$ 11,195</u>	<u>\$ 10,248</u>

Note 6 – Deferred Revenue

Deferred revenue as of June 30, 2006 and 2005 is as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Unearned summer school revenues	\$ 3,066	\$ 2,708
Unearned grants and contracts revenue	1,533	759
Unearned auxiliary revenue	753	978
Other	230	145
Total	<u>\$ 5,582</u>	<u>\$ 4,590</u>
Current	5,458	4,435
noncurrent	124	155
Total	<u>\$ 5,582</u>	<u>\$ 4,590</u>

Note 7 – Long-term Liabilities

The changes in long-term liabilities for the years ended June 30, 2006 and 2005 are summarized as follows (in thousands):

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>	<u>Current</u> <u>Portion</u>	<u>Noncurrent</u> <u>Portion</u>
Consolidated Educational Buildings Revenue Bonds	\$ 33,790	\$ -	\$ 4,815	\$ 28,975	\$ 5,075	\$ 23,900
Housing and Dining Revenue Bonds	3,150	-	220	2,930	235	2,695
ALCo Note	-	6,000	-	6,000	6,000	-
CVU note payable	122	-	122	-	-	-
Municipal capital lease obligations	10,469	357	1,747	9,079	1,670	7,409
Capital lease	23,176	-	1,443	21,733	1,504	20,229
Total bonds, notes and capital leases	<u>70,707</u>	<u>6,357</u>	<u>8,347</u>	<u>68,717</u>	<u>14,484</u>	<u>54,233</u>
Faculty retirement and deferred compensation	705	72	333	444	25	419
Federal portion of Perkins loans	2,397	-	6	2,391	-	2,391
Arbitrage rebate liability	113	-	-	113	-	113
Total other liabilities	<u>3,215</u>	<u>72</u>	<u>339</u>	<u>2,948</u>	<u>25</u>	<u>2,923</u>
Total long-term liabilities	<u>\$ 73,922</u>	<u>\$ 6,429</u>	<u>\$ 8,686</u>	<u>\$ 71,665</u>	<u>\$ 14,509</u>	<u>\$ 57,156</u>

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2005</u>	<u>Current</u> <u>Portion</u>	<u>Noncurrent</u> <u>Portion</u>
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>

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, 2006.

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, 2006.

The outstanding municipal lease obligations as of June 30, 2006 consist of master lease obligations issued through a local bank totaling \$4,677,000, with interest rates ranging from 2.59 percent to 4.65 percent, and a lease obligation of \$4,402,000, 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, 2006 consist of two student housing facility leases of \$7,720,000 and \$14,041,000 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.

In March 2006, the University entered into a Kentucky Asset/Liability Commission Project Note ("ALCo") in the amount of \$6,000,000 in order to fund the initial construction costs for a new student union building. This note is a floating rate interim funding vehicle available for up to 3.5 years until issuance of new bonds has occurred. Interest only payments are due each month equal to the BMA Index plus .45% not to exceed an annual rate of 9%.

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

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 14,484	\$ 2,988	\$ 17,472
2008	6,319	2,341	8,660
2009	6,444	2,062	8,506
2010	6,418	1,776	8,194
2011	5,765	1,506	7,271
2012-2016	13,919	4,790	18,709
2017-2021	7,876	2,718	10,594
2022-2026	5,511	1,100	6,611
2027-2028	1,981	99	2,080
<u>Total</u>	<u>\$ 68,717</u>	<u>\$ 19,380</u>	<u>\$ 88,097</u>

* Interest on variable rate debt is estimated based on rates in effect at June 30, 2006.

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 con-

tributions with interest deposited into the employee's account. Retirement benefits can begin upon retirement or termination of employment with the University. Covered payroll totaled \$34,572,000 and \$31,429,000 for the years ended June 30, 2006 and 2005, respectively. Expenditures for the University's portion amounted to \$3,457,000 and \$3,143,000 for the years ended June 30, 2006 and 2005, 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, 2006, 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 18.84% for hazardous pay. The University's contributions to KERS for the years ending June 30, 2006, 2005 and 2004 were \$1,685,000, \$1,503,000 and \$1,353,000, 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, 2006 and 2005, were \$1,440,000 and \$1,313,000, 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, 2006 and 2005, the University had recognized an accrued liability of \$24,000 and \$358,000, 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, 2006 and 2005, the University had recognized an accrued vacation liability of \$2,068,000 and \$1,751,000, 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, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Salaries and wages	\$ 76,672	\$ 70,265
Employee benefits	17,363	16,363
Utilities	4,497	3,715
Supplies and other services	22,734	19,943
Depreciation	8,655	8,327
Student scholarships and financial aid	9,897	9,844
	<u>\$ 139,818</u>	<u>\$ 128,457</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, 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 2005 to 2006. Settlements have not exceeded insurance coverage during the past three years. The University self-insures worker's compensation, and has recorded an estimate for asserted claims at June 30, 2006. Current liabilities related to self-insurance are detailed in Note 5, above.

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, 2006 was approximately \$28,642,000. 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, 2006 and 2005 (in thousands)

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets	\$ 709	\$ 583
Noncurrent assets	358	354
Capital assets, net	1,733	1,907
Total Assets	<u>2,800</u>	<u>2,844</u>
Liabilities:		
Current liabilities	343	322
Noncurrent liabilities	2,695	2930
Total liabilities	<u>3,038</u>	<u>3,252</u>
Net assets (deficit):		
Invested in capital, net of related debt	(1,197)	(1,243)
Restricted	696	669
Unrestricted	263	166
Total net assets (deficit)	<u>\$ (238)</u>	<u>\$ (408)</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30, 2006 and 2005 (in thousands)

	<u>2006</u>	<u>2005</u>
Operating revenues		
Room rental	886	824
Board revenue	53	42
Other	18	38
Total operating revenues	<u>957</u>	<u>904</u>
Operating expenses		
Depreciation	174	168
Total operating expenses	<u>717</u>	<u>664</u>
Operating income	240	240
Nonoperating revenues		
Nonoperating expenses	42	21
	(112)	(123)
Increase (decrease) in net assets	170	138
Net assets (deficit), beginning of year	(408)	(546)
Net assets (deficit), end of year	<u>\$ (238)</u>	<u>\$ (408)</u>

Condensed Statement of Cash Flows for the years ended June 30, 2006 and 2005 (in thousands)

	<u>2006</u>	<u>2005</u>
Net cash flows provided by operating activities	\$ 394	\$ 398
Net cash flows provided by investing activities	42	98
Net cash flows used in capital and related financing activities	(305)	(307)
Net increase in cash and cash equivalents	131	189
Cash and cash equivalents, beginning of year	931	742
Cash and cash equivalents, end of year	<u>\$ 1062</u>	<u>\$ 931</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, investments in equity securities with readily determinable fair value and all debt securities are reported at their fair value.

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 estimated fair value of investments is based on quoted market prices, except for alternative investments for which quoted market prices are not available. The alternative investments, which are not readily marketable, are carried at estimated fair values as provided by the investment managers. The estimated fair value of certain alternative investments, such as private equity interests, is based on valuations provided by the external investment managers adjusted for cash receipts, cash disbursements and distributions through June 30. The Foundation believes the carrying amount of these financial instruments is a reasonable estimate of fair value. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such difference could be material.

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% to 5% in recent years, combined with a smoothing rule which adjusts spending gradually to changes in the endowment market value. The actual rate of spending will vary depending on the rate of growth or decline in market value of the endowment investment portfolio.

The market values of the Foundation's investments as of June 30, 2006 and 2005 are categorized below (in thousands):

	<u>2006</u>	<u>2005</u>
Type of investments:		
Short-term money market funds	\$ 69	\$ 182
Fixed income funds	6,380	6,521
Equity funds and common stock	30,556	26,206
Municipal bonds	187	193
Hedge funds	4,493	4,184
Alternative investments	631	-
Other	233	279
Total Investments	<u>\$ 42,549</u>	<u>\$ 37,565</u>

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, 2006 and 2005 were \$8.919 million and \$8.208 million respectively.

At June 30, 2006, the Foundation had committed \$4.5 million of its endowment investment resources to alternative investments, of which \$3.847 million had not yet been called by the investment managers. Alternative investments for which commitments have been made consist of private equity, venture capital, real estate, and real assets.

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, 2006 and 2005, separately stated investment managers' fees were \$67 thousand and \$72 thousand respectively.

At June 30, 2006, 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 \$37 thousand.

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 each of the years ended June 30, 2006 and 2005 was \$59 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, 2005, in order to conform to classifications used for the year ended June 30, 2006.

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 (8.0% at June 30, 2006) were current at June 30, 2006.

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, 2006 and 2005, the Foundation recognized contributions based on the following unconditional promises to give (in thousands):

	<u>2006</u>	<u>2005</u>
Purpose:		
Endowment giving	\$ 2,549	\$ 3,419
Capital purposes	6,340	6,407
Operating programs	867	943
Gross unconditional promises	9,756	10,769
Less: Discount and allowance or uncollectible accounts	(1,297)	(1,120)
Net unconditional promises to give	<u>\$ 8,459</u>	<u>\$ 9,649</u>
 Amounts due in:		
Less than one year	3,221	1,898
One to five years	4,808	5,443
More than five years	1,727	3,428
Total	<u>\$ 9,756</u>	<u>\$ 10,769</u>

The discount rate used to calculate the present value of contributions receivable at June 30, 2006 and 2005 was 5.25% and 3.0% respectively.

Conditional promises to give are not included as support until such time as the conditions are substantially met. At June 30, 2006, the Foundation had received conditional promises to give of approximately \$1.6 million, consisting of the face value of life insurance policies, net of accumulated cash surrender value.

d. 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 reports these funds and accumulated earnings as assets held in trust for Northern Kentucky University. Investment earnings, gains and losses and expenditures from these funds are reported as changes in the balance held in trust rather than as revenue and expenses of the Foundation.

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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