NORTHERN KENTUCKY UNIVERSITY

2003-2004
ANNUAL FINANCIAL REPORT

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Northern Kentucky University
Annual Financial Report
2003-2004

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August 31, 2004

Northern Kentucky University Board of Regents
Highland Heights, KY 41099

Dear Members of the Board:

It is my pleasure to transmit the University's 2003-04 Annual Financial Report. The statements included have been audited by the firm of Crowe, Chizek and Company LLC. Although absorbing a significant reduction in our state support and an internal reallocation of over $2 million in our existing budget to support our core mission, the University ends the fiscal year and begins the new academic year in a strong financial position accentuated by numerous accomplishments over the past year.

Enrollment is at its highest level in the history of the University. For the fall 2004, we welcomed well over 14,000 students which is a total enrollment increase of about 1.6 percent over last year. Enrollment for the fall includes increases in total student population, FTE, undergraduate enrollment, and graduate and law school enrollments. We also anticipate a 5 percent decrease in the number of under-prepared students and a 7.4 percent increase in the number of seniors, which bodes well for retention and graduation rates. We see continued growth in the number of our African-American and Latino students.

This past year, the University took important steps to both protect and enhance the quality and availability of our academic programs in the face of major state budget reductions. We preserved our small class sizes, hired more full-time faculty, expanded the number of undergraduate students involved in research and scholarly activities, and increased the number of undergraduate and graduate programs in response to public demand. The breadth of our academic offerings continues to expand as well. This past year, the College of Professional Studies launched two new online degree programs in Organizational Leadership and the Master of Science in Nursing. The Department of Communications began a new undergraduate degree in Public Relations. The Weekend Business Program began offering the business undergraduate program in a Friday/Saturday/Sunday format and had 276 students enrolled this past spring. The College of Business launched two new degree programs in Sports Business and Business Administration with an emphasis in general business. Masters degree programs were added in Industrial/Organizational Psychology and Liberal Studies.

Evidence of academic quality abounds. NKU is, today, the first choice for an increasing number of the area's best-prepared students. On a national survey of student satisfaction, our graduates scored significantly higher than students from other universities, particularly with reference to quality of instruction, faculty knowledge in their fields, and academic advising. Our graduates continue to be admitted to some of the nation's most prestigious graduate and professional programs. This year, the Chase College of Law achieved bar passage rates that ranked at the top among Kentucky law schools and among the top when compared to schools in Ohio.

Great strides were made this year in advancing the quality of our campus experience with new student retention strategies, planning for the new $34 million student union facility, full-occupancy of our residence halls, and completion of the Albright Fitness Center. Campus facilities continue to improve including the renovation of BEP 200 that is now the Eva G. Farris Auditorium, improvements in the Old Science Building, opening the new parking facility that will add 680 spaces when completed later this fall, the new landscaping along Nunn Drive, and improvements in classrooms and hallways. NKU had another banner year in intercollegiate athletics as nine of our thirteen teams participated in NCAA championship tournaments. NKU ranked tenth nationally among Division II schools in the US Sports Academy Director's Cup competition.

In the area of outreach and public engagement, NKU continues to receive national recognition for its work on behalf of our region and its communities. This spring, the University was selected among four universities to participate in a national project designed to demonstrate best practices in community engagement or what is sometimes referred to as the "stewardship of place." Sponsored by the American Association of State Colleges and Universities and supported by the W.K. Kellogg Foundation, this project is drawing national attention in its effort to strengthen community engagement among the more than 400 comprehensive universities located throughout the nation. We estimate that, last year alone, the University sponsored more than 1,150 outreach programs designed to directly benefit the community while contributing to the learning of our faculty and students. In short, public engagement is becoming a defining quality of our campus in a way that enriches the experience of our faculty and students while working to strengthen our region.

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

Sincerely,

James C. Votruba, President

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, 2004, with selected comparative information for the years ended June 30, 2003 and 2002. 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, 2004. The University's total net assets increased by $5.9 million, or 5.7 percent. This increase resulted from income before other revenues, expenses, gains or losses of $4.3 million and capital appropriations and gifts of $1.6 million. The University's unrestricted net assets increased by $2.7 million for the year from the combined effect of cost cutting and revenue enhancement plans implemented by the University in anticipation of an additional reduction in state appropriations in 2004. The additional reduction did not occur thus enabling the University to establish an unrestricted net asset reserve to provide the flexibility necessary in the current uncertain state budget environment.

For the third consecutive year, economic pressures affecting the Commonwealth resulted in a shortfall in state revenues. As a result of the shortfall, the Commonwealth reduced the University's original appropriation of $47.1 million for the year ended June 30, 2004 by $2.0 million, or 4.2 percent. As a consequence, the University's appropriation for the year ended June 30, 2004 was $131 thousand less than the prior year appropriation of $45.2 million. The University had established a reserve in anticipation of this budget reduction; therefore, the University was able to continue its critical mission functions without harmful mid-year budget reductions. While the University's state appropriations remained virtually flat for fiscal years 2002, 2003 and 2004 at approximately $45 million, the University's operating revenues increased significantly. Operating revenues increased from $60.3 million in fiscal year 2002 to $82.2 million in 2004; a 36.3 percent increase. The majority of this growth was fueled by a substantial increase in net tuition. For the first time in the University's history, net tuition revenues exceeded the University's state appropriation in 2004. Noteworthy increases in revenues from grants and contracts and auxiliary enterprises were also realized and demonstrate the University's continued effort to diversify revenue sources.

The University's average full-time enrollment equivalent grew by 2.7 percent for the year. This growth combined with an average tuition increase of 13.2 percent resulted in a $7.8 million increase in net tuition and fees for the year ended June 30, 2004. The University strives to keep tuition rates as low as possible; however, the University must balance affordability and quality. With the current shortfall in state appropriations the University has had to increase tuition to preserve academic quality. Although tuition rates have increased, the University still provides an excellent educational value to its students as evidenced by the University's continued strong enrollment growth.

The University completed construction of a new power plant during the year and began construction on a new parking deck. Other major projects currently in design include a new student union and a campus beautification project funded with private contributions. 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.

One of the most important questions asked about University finances is whether the University is better off as a result of the year's activities. One key to answering this question are the financial statements of the University. The statement of net assets; statement of revenues, expenses and changes in net assets and the statement of cash flows present financial information on the University, in a format similar to that used by corporations, and present a long-term view of the University's finances. The University's net assets (the difference between assets and liabilities) are one indicator the University's financial health. Over time, increases or decreases in net assets are one indicator of the improvement or erosion of the University's financial health, when considered in conjunction with non-financial facts such as enrollment levels and conditions of facilities.

Statement of Net Assets

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

Statement of Net Assets (in thousands)

	2004	2003	2002
ASSETS			
Current assets	$ 34,916	$ 32,560	$ 29,363
Capital assets, net	147,059	136,077	112,887
Other noncurrent assets	19,570	23,993	31,987
Total assets	201,545	192,630	174,237
LIABILITIES			
Current liabilities	22,405	22,802	18,840
Noncurrent liabilities	68,780	65,384	52,952
Total liabilities	91,185	88,186	71,792
NET ASSETS			
Invested in capital assets, net of related debt	69,732	64,415	56,286
Restricted			
Nonexpendable			
Expendable	21,578	23,709	29,148
Unrestricted	19,050	16,320	17,011
Total net assets	$ 110,360	$ 104,444	$ 102,445

A review of the University's statement of net assets at June 30, 2004 shows that the University continues to build upon its strong financial foundation.

<u>**Assets**</u>

The University's assets increased by $27.3 million, or 15.7 percent, from June 30, 2002 to June 30, 2004 and now total $201.5 million. The majority of this increase is attributable to the construction of several new facilities, including a power plant and parking deck in 2004 and a new science center and student housing facility in 2003. These assets were funded primarily with bond proceeds, capital appropriations and gifts. The expenditure of these funds resulted in a decline noncurrent assets, primarily noncurrent cash and cash equivalents, of $4.4 million and $8.0 million for the fiscal years ended June 30, 2004 and June 30, 2003, respectively. As a result of the University's significant investment in its campus facilities, net capital assets grew from $112.9 million, or 64.8 percent of total assets, as of June 30, 2002 to $147.1 million, or 73.0 percent of total assets, as of June 30, 2004.

Current assets increased by $2.4 million for the year ended June 30, 2004 and $3.2 million for the year ended June 30, 2003, resulting in a combined increase of $5.6 million, or 18.9 percent, since June 30, 2002. This increase is attributable to an increase in cash and cash equivalents generated from operations and an increase in notes and accounts receivable balances.

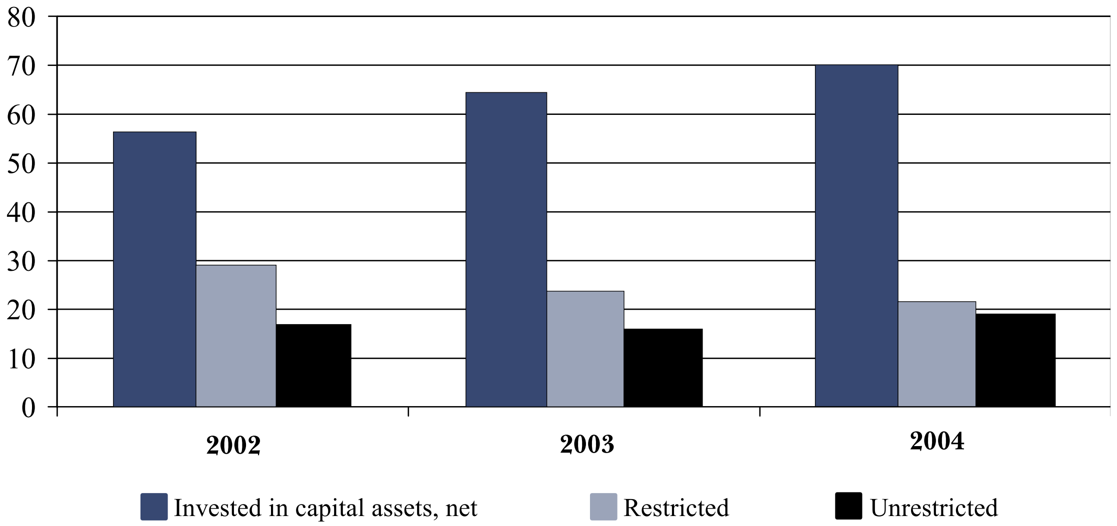
Liabilities

At June 30, 2004, the University's liabilities totaled approximately $91.2 million. Bonds, notes and capital leases payable for educational buildings, student housing and dining facilities and equipment represented $71.6 million, or 78.5 percent, of total liabilities. Debt outstanding increased by $3.9 million for the year. This increase is the net result of the issuance of $10.6 million in revenue bonds and capital lease obligations to finance a new parking deck, land acquisitions and equipment less principal payments of $6.7 million.

Bonds, notes and capital leases payable also increased by $13.4 million for the year ended June 30, 2003 yielding a combined increase of $17.3 million since June 30, 2002. The majority of this net increase in outstanding debt is attributable to the issuance of bonds and capital leases to finance the construction of a parking deck and student housing facilities. In addition, the University has taken advantage of the current historically low interest rate environment through the prudent issuance of capital leases to finance land and equipment acquisitions, including a digital telephone system.

Net Assets

The following chart illustrates the University's net assets for fiscal years 2002, 2003 and 2004 (amounts are presented in millions).



Net assets at June 30, 2004 totaled $110.4 million, or 54.8 percent, of total assets. Net assets invested in capital, net of related debt, totaled $69.7 million, or 63.2 percent, of total net assets. Restricted and unrestricted net assets represented 19.6 percent and 17.2 percent of total net assets, respectively. Total net assets increased by $5.9 million, or 5.7 percent. Net assets invested in capital assets, net of related debt increased $5.3 million. A portion of this increase was associated with the $2.1 million decline in restricted expendable net assets that resulted from the expenditure of funds restricted for construction projects. Unrestricted net assets increased by $2.7 million for the year from the combined effect of cost cutting and revenue enhancement plans implemented by the University in anticipation of an additional reduction in state appropriations in 2004. The additional reduction did not occur thus enabling the University to establish an unrestricted net asset reserve to provide the flexibility necessary in the current uncertain state budget environment.

The University's net assets increased by $7.9 million, or 7.7 percent, from June 30, 2002 to June 30, 2004. Net assets invested in capital assets, net of related debt increased $13.4 million. A significant portion of this increase resulted from the expenditure of capital appropriations and gifts, including $12.0 million appropriated by the Commonwealth in fiscal year 2002 for the University's new power plant. The expenditure of these and other funds restricted for construction projects contributed to the $7.5 million decline in restricted expendable net assets for the two year period.

Statement of Revenues, Expenses and Changes in Net Assets

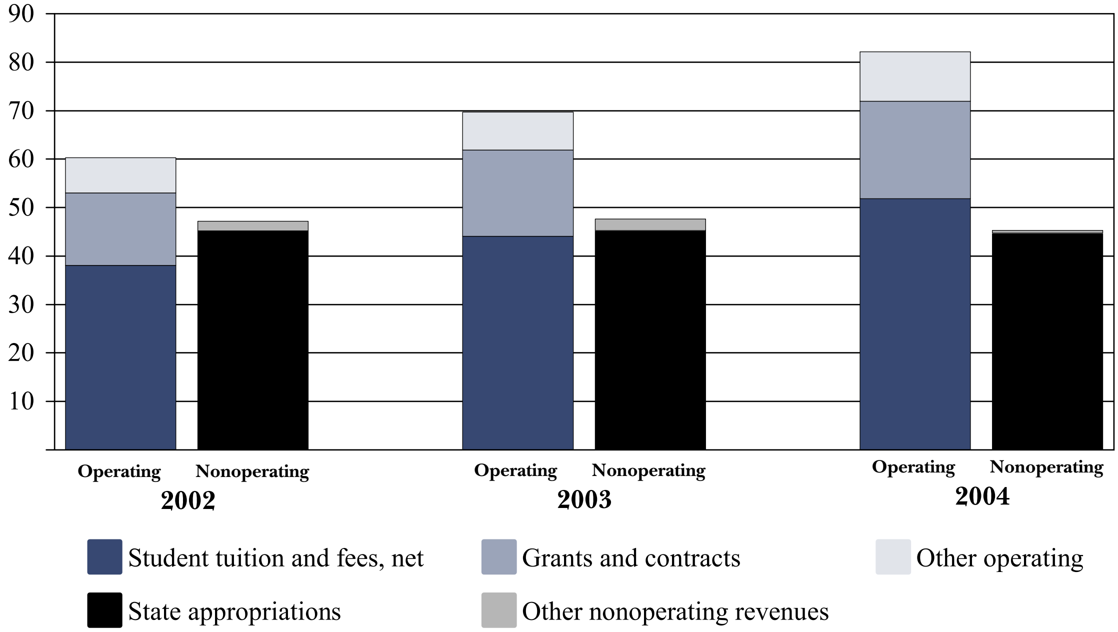
The statement of revenues, expenses and changes in net assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. GASB requires state appropriations to be classified as nonoperating revenues. Accordingly, the University will generate an operating loss prior to the addition of nonoperating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

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

	2004	2003	2002
OPERATING REVENUES			
Student tuition and fees, net	$ 51,844	$ 44,081	$ 38,073
Grants and contracts	20,099	17,793	14,997
Sales and services of educational departments	2,445	1,717	1,210
Auxiliary enterprises	5,316	4,183	3,888
Other operating revenues	2,463	1,926	2,118
Total operating revenues	82,167	69,700	60,286
OPERATING EXPENSES			
Educational and general	108,412	105,750	93,087
Depreciation	6,583	5,868	4,622
Auxiliary enterprises (including depreciation)	4,861	3,000	2,590
Other expenditures	243	227	229
Total operating expenses	120,099	114,845	100,528
Net loss from operations	(37,932)	(45,145)	(40,242)
NONOPERATING REVENUES (EXPENSES)			
State appropriations	45,127	45,258	45,202
Investment income	249	1,818	1,957
Interest on capital asset–related debt	3,330)	(2,783)	(2,808)
Other nonoperating revenues (expenses)	152	558	(253)
Net nonoperating revenues	42,198	44,851	44,098
Income (loss) before other revenues, expenses, gains or losses	4,266	(294)	3,856
Capital appropriations	126	599	13,745
Capital grants and gifts	1,524	1,694	873
Total other revenues	1,650	2,293	14,618
Increase in net assets	5,916	1,999	18,474
Net assets-beginning of year	104,444	102,445	83,971
Net assets-end of year	$ 110,360	$ 104,444	$ 102,445

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 2002, 2003 and 2004. 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 $127.7 million for the year ended June 30, 2004. The most significant sources of revenue for the University are net student tuition and fees (40.6 percent), state appropriations (35.3 percent), and grants and contracts (15.7 percent).

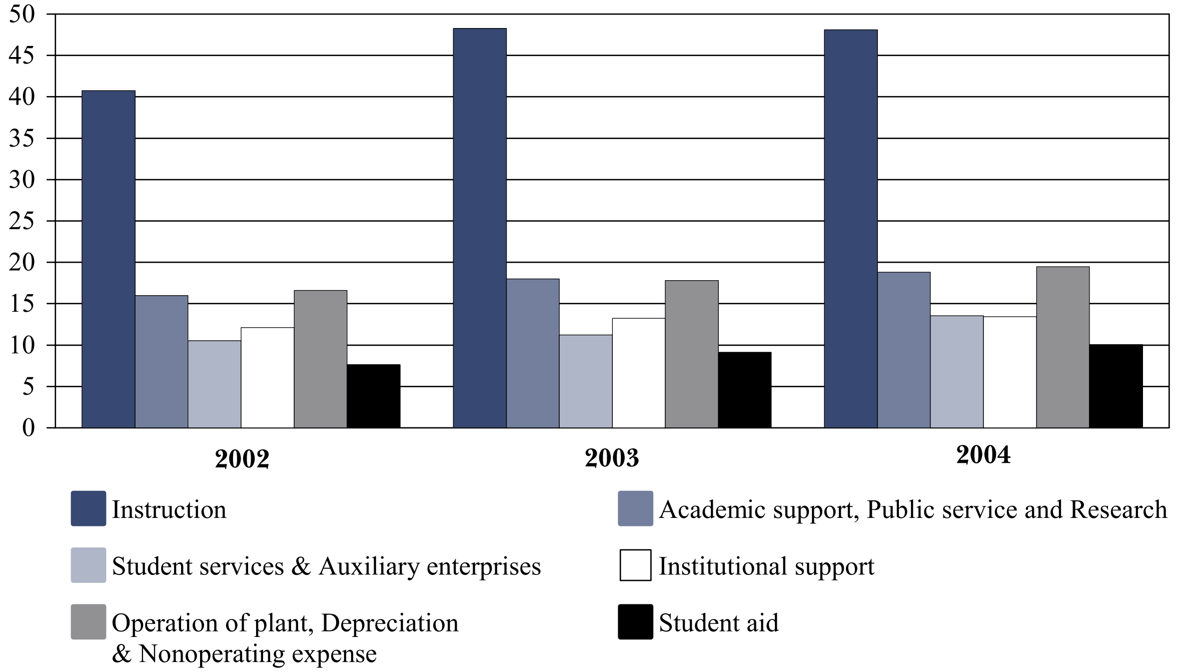
For the third consecutive year, economic pressures affecting the Commonwealth resulted in a shortfall in state revenues. As a result of the shortfall, the Commonwealth reduced the University's original appropriation of $47.1 million for the year ended June 30, 2004 by $2.0 million, or 4.2 percent. As a consequence, the University's appropriation for the year ended June 30, 2004 was $131 thousand less than the prior year appropriation of $45.2 million. The chart above illustrates a shift between operating and nonoperating revenues. While the University's state appropriations remained virtually flat for fiscal years 2002, 2003 and 2004 at approximately $45 million, the University's operating revenues increased significantly. The majority of this growth was fueled by a substantial increase in net tuition. For the first time in the University's history, net tuition revenues exceeded the University's state appropriation in 2004. Noteworthy increases in revenues from grants and contracts and auxiliary enterprises were also realized and demonstrate the University's continued effort to diversify revenue sources.

In anticipation of a shortfall in state revenues, the University approved an average tuition increase of 13.2 percent for fiscal year 2004. This rate increase, combined with a 2.7 percent average increase in full-time equivalent enrollment, resulted in the significant increase in net tuition revenue. Net student tuition revenue increased $7.8 million, or 17.6 percent, to a total of $51.8 million for the year.

The majority of the University's grants and contracts revenue is derived from federal and state funded financial aid programs. Revenues from these programs, including federal Pell grants and the Kentucky Educational Excellence Scholarship program, grew by approximately $1.9 million for the year ended June 30, 2004. This increase contributed to a 17.3 percent growth in the University's scholarship allowance.

Operating and Nonoperating Expenses

The following chart illustrates the University's expenses by function (both operating and nonoperating) for fiscal years 2002, 2003 and 2004 (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 $48.1 million (39.0 percent), and academic support, public service and research $18.8 million (15.3 percent). Operating and nonoperating expenses increased by $5.8 million, or 4.9 percent, to a total of $123.4 million for the year ended June 30, 2004. The majority of this increase resulted from increased auxiliary enterprises expenses associated with the new student housing facility that opened this year and a growth in academic support, public services, research and student financial aid expenses. This confirms that the University's resource allocations are clearly aligned with the University's strategic priorities and its commitment to academic excellence and community outreach. Total instructional expenses remained unchanged compared to the prior year primarily due to the decline in instructional equipment expenses. As depicted in the chart above, instructional expenses grew significantly from 2002 to 2003. This increase was attributable, in part, to major acquisitions of instructional equipment for the new Science Center and Metropolitan Educational Training Services Center facilities in 2003. In addition, equipment expenses were down in instruction, and institution wide, as a result of the delay in equipment purchases related to the University's budget reduction plan that was implemented in anticipation of additional state appropriation cuts.

One of the University's core values is to provide students access to the University with the opportunity to succeed. The University's continued investment in student financial aid programs and student support services reflects this commitment. For the year ended June 30, 2004, student financial aid related to tuition and fees totaled $24.1 million, including student aid expenses of $10.1 million and scholarship allowances of $14.0 million. This represents a $3.0 million, or 14.2 percent, increase over the prior year. This increase can, in part, be attributed to an increase of $1.9 million in federal and state financial aid programs. The balance of the increase is primarily attributable to an increase in scholarship and reciprocity programs funded by the University. This increase reflects the University's commitment to providing access to students and rewarding academic excellence.

Statement of Cash Flows

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

Statement of Cash Flows (in thousands)

	2004	2003	2002
Net cash provided (used) by:			
Operating activities	$ (31,322)	$ (37,482)	$ (33,128)
Noncapital financing activities	45,901	45,458	44,970
Capital and related financing activities	(17,954)	(15,559)	(6,225)
Investing activities	1,108	3,833	2,718
Net increase (decrease) in cash	(2,267)	(3,750)	8,335
Cash and cash equivalents, beginning of year	46,104	49,854	41,519
Cash and cash equivalents, end of year	$ 43,837	$ 46,104	$ 49,854

The University's cash and cash equivalents decreased $2.3 million primarily as a result of the expenditure of capital appropriations received in prior fiscal years for the construction and acquisition of capital assets in the year ended June 30, 2004. Net cash disbursements of $8.1 million related to capital acquisitions and principal and interest payments of $9.9 million resulted in capital and related financing activities cash disbursements of $18.0 million.

Major sources of funds included in operating activities are student tuition and fees ($51.6 million) and grants and contracts ($20.0 million). The largest cash payments for operating activities were made to employees ($81.5 million) and to vendors and contractors ($31.5 million). The University's $31.3 million deficit in cash from operating activities was more than offset by appropriations from the Commonwealth. State appropriations are included in noncapital financing activities, as defined by GASB.

The shift in the balance of revenues from nonoperating to operating revenues described earlier is also reflected by the decline in the amount of net cash used by operating activities. The University's total cash generated from operating activities increased by $20.7 million, or 33.6 percent, from fiscal year 2002 to fiscal year 2004. This increase was fueled primarily by a $12.6 million, or 33.3 percent, increase in tuition and a $5.0 million, or 32.8 percent, increase in grants and contracts. Conversely, payments for operating activities increased by only $18.9 million, or 19.9 percent, from 2002 to 2004.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled approximately $147.1 million at June 30, 2004, a net increase of $11.0 million over the prior year end. Additions to capital assets during the year totaled $19.2 million, including the University's new power plant. Depreciation expenses and net capital asset disposals totaled $8.2 million for the year.

The University's net capital assets grew by $34.2 million from June 30, 2002 to June 30, 2004, with increases of $11.0 in 2004 and $23.2 million in 2003. This growth reflects the University's effort to increase its capacity to accommodate the significant growth in enrollment that the University has experienced in recent years.

At June 30, 2004, the University had several major capital construction projects underway, including the construction of a new parking deck (scope $8.5 million). In addition, several major projects were in the design phase, including a new student union facility ($34 million scope).

Debt

The following is a summary of the University's outstanding debt summarized by revenue pledge as of June 30, 2004, 2003 and 2002 (in thousands):

	2004	2003	2002
Consolidated Educational Buildings Revenue Bonds	$ 38,545	$ 33,290	$ 37,285
Housing and Dining System Revenue Bonds	3,360	3,560	3,755
Capital lease – Residential Village/Suites	24,555	25,879	11,845
Notes payable and municipal lease obligations	5,126	4,926	1,367
	$ 71,586	$ 67,655	$ 54,252

Debt outstanding increased approximately $3.9 million for the year. This increase is the net result of the issuance of $10.6 million in revenue bonds and capital lease obligations to finance a new parking deck, land acquisitions and equipment less principal payments of $6.7 million.

For the year ended June 30, 2003, the University's outstanding debt had increased by $13.4 million. This increase is the net result of the issuance of $18.9 million in capital lease obligations to finance equipment and new student housing less principal payments of $5.5 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. In 2002, in recognition of the University's strong financial position, Moody's Investors Service upgraded its bond ratings on the University's Consolidated Educational Building Revenue Bonds from A3 to A2 and Housing and Dining System Revenue Bonds from Baa1 to A3.

FACTORS IMPACTING FUTURE PERIODS

Today's complex, global economy depends upon advanced knowledge and knowledgeable workers. For our region to be economically competitive, it is essential that we provide for the learning needs of a highly educated workforce. The public is looking for the University to provide high quality and affordable education. The University is well positioned to achieve these goals with the full support of the Commonwealth. The Commonwealth must fully fund the University's growth and continue efforts to achieve equity in our funding relative to both our benchmark institutions and the other Kentucky comprehensive institutions. Without this full partnership with the state, we will be unable to continue growing and unable to expand our community partnerships in support of the challenges that confront our metropolitan region. Kentucky's economic future will depend on the continued economic growth of northern Kentucky. The region's continued economic growth will, in turn, depend heavily on the University's capacity to support that growth in a variety of ways. Equitable funding for the University is an investment in the future of both the region and the Commonwealth.

For the third consecutive year, economic pressures affecting the Commonwealth resulted in a shortfall in state revenues. As a result of the shortfall, the University's state appropriations remained virtually flat for fiscal years 2002, 2003 and 2004 at approximately $45 million. There is a direct relationship between the growth, or decline, in state support and the University's ability to limit tuition rate increases. In anticipation of a shortfall in state revenues, the University approved an average tuition increase of 13.2 percent for fiscal year 2004. The state budget picture remains uncertain. The University again established a budget reserve in anticipation of a possible budget reduction in fiscal year 2005. In addition, the University increased tuition rates an average of 15.2 percent for 2005 and continued its marginal revenue growth strategy to generate additional resources. Preliminary enrollment for fall 2004 is up, resulting in a projected increase in net tuition receipts.

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 recent investment in its fund raising capacity reflects the University's commitment to enhance and diversify revenue sources. This investment is paying dividends as demonstrated by the success of the University's current fund raising campaign. 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 growth, retention and graduation. Our partnership with Gateway Community and Technical College is a model for the entire state. This demonstrates what can happen when a two-year campus and a university set out to build a seamless and mutually supportive relationship on behalf of the public that we both serve. Since its founding in 1968, the University has been virtually an open admissions university. This was necessary because we functioned as both the community college and the four-year university and it was important for us to assure broad access to postsecondary education for our local population. The creation of Gateway has expanded postsecondary opportunity for residents of our region, which allows the University to focus more directly on what our region wants and needs us to become. The University's Board of Regents approved new admission standards that will be implemented over two years beginning in the fall of 2005. The University and Gateway are working together to ensure that movement between our two institutions is seamless and that we are working in complimentary ways to support the educational needs of our region.

In the area of outreach and public engagement, the University continues to receive national recognition for its work on behalf of our region and its communities. Two years ago, a national study identified University among six comprehensive universities that were involved in cutting-edge work related to community engagement. This spring, 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 the "stewardship of place."

Northern Kentucky University's vision to become a preeminent, learner-centered, metropolitan university recognized for its contributions to the intellectual, social, economic, cultural and civic vitality of its region and of the Commonwealth. 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 well positioned to maintain its strong financial condition and level of excellence in service to its students, region and of the Commonwealth.

Crowe Chizek and Company LLC
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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 statements of net assets of Northern Kentucky University (the "University") as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. 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, an entity included as a component unit as required by Statement No. 39 of the Governmental Accounting Standards Board*,* as of June 30, 2004 and 2003 and for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Northern Kentucky University and Northern Kentucky University Foundation, Inc. (component unit) as of June 30, 2004 and 2003, and the results of its operations and its cash flows 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 4 through 12 is not a required part of the 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

Crowe Chizek and Company LLC

Louisville, Kentucky
August 31, 2004

Northern Kentucky University
Statement of Net Assets
June 30, 2004 and 2003
(in thousands)

	2004	2003
ASSETS		
Current Assets		
Cash and cash equivalents	$ 29,927	$ 27,718
Notes, loans and accounts receivable, net	3,545	3,407
Other current assets	1,444	1,435
Total current assets	34,916	32,560
Noncurrent Assets		
Cash and cash equivalents	13,910	18,386
Investments	3,012	3,200
Notes, loans and accounts receivable, net	2,102	2,071
Capital assets, net	147,059	136,077
Other noncurrent assets	546	336
Total noncurrent assets	166,629	160,070
Total assets	201,545	192,630
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	10,199	11,258
Deferred revenue	4,472	4,308
Long-term liabilities-current portion	7,734	7,236
Total current liabilities	22,405	22,802
Noncurrent Liabilities		
Deposits	1,163	753
Deferred revenue	199	345
Long-term liabilities	67,418	64,286
Total noncurrent liabilities	68,780	65,384
Total liabilities	91,185	88,186
NET ASSETS		
Invested in capital assets, net of related debt	69,732	64,415
Restricted		
Nonexpendable	-	-
Expendable	21,578	23,709
Unrestricted	19,050	16,320
Total net assets	$ 110,360	$ 104,444

See accompanying notes to the financial statements.

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

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

See accompanying notes to the financial statements.

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

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

See accompanying notes to the financial statements.

Northern Kentucky University Foundation, Inc.
Consolidated Statement of Financial Position
As of June 30, 2004 and 2003
(in thousands)

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

See accompanying notes to the financial statements.

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

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

See accompanying notes to the financial statements.

Note 1 – Organization and Summary of Significant Accounting Policies

a. Reporting Entity

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

b. Basis of Presentation

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

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

- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- **Restricted:**

  Nonexpendable – Net assets subject to externally imposed stipulations that they be maintained permanently by the University.

  Expendable – Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time. These net assets principally represent amounts for specified capital construction projects.

- **Unrestricted**: Net assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

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

c. Accrual Basis

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

d. Capital Assets

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

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

e. Inventories

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

f. Investments

Investments are stated at fair value.

g. Deferred Revenue

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

h. Scholarship Allowances

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

i. Restricted Asset Spending Policy

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

j. Operating Activities

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

k. Use of Estimates

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

l. Component Unit Disclosure

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

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

m. Other Significant Accounting Policies

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

Note 2 – Cash, Cash Equivalents and Investments

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

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

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

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

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

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

Note 3 – Notes, Loans and Accounts Receivable

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

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

Note 4 – Capital Assets, net

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

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

Note 5 – Accounts Payable and Accrued Liabilities

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

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

Note 6 – Deferred Revenue

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

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

Note 7 – Long-term Liabilities

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

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

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

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

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

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

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

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

Note 8 – Pension Plans and Accrued Compensated Absences

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

a. Defined Contribution Plan

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

b. Defined Benefit Plan

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

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

c. Deferred Compensation Plans

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

All compensation deferred under Section 457, all property and rights purchased with that compensation and all income attributable to that compensation, property or rights belong solely to the Commonwealth and the University until paid to the employee or beneficiary, subject only to the claims of the Commonwealth's and University's general creditors. Participants' rights under the plan are equal to those of general creditors of the Commonwealth and the University in an amount equal to the fair market value of the deferred account for each participant. The market value of the University's share of the Section 457 plan assets, as of June 30, 2004 and 2003, were $1,208,000 and $1,089,000, respectively. All compensation deferred under Section 401(k) and resultant assets belong to the plan participants.

d. Retirement Incentive Program

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

e. Compensated Absences

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

Note 9 – Operating Expenses By Natural Classification

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

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

Note 10 – Risk Management

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

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

Note 11 – Contingencies and Commitments

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

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

Note 12 – Segment Information

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

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

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

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

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

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

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

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

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

Note 1 – Summary of Significant Accounting Policies

a. Scope of Statements

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

b. Basis of Presentation

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

Net assets and changes therein are classified as follows:

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

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

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

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

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

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

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

c. Cash and Cash Equivalents

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

d. Investments

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

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

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

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

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

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

e. Fixed Assets and Depreciation

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

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

f. Net assets Released from Restrictions

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

g. Use of Estimates in the Preparation of Financial Statements

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

h. Other Significant Accounting Policies

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

Note 2 – Notes Payable

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

Note 3 – Unconditional and Conditional Promises to Give

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

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

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

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

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

Note 4 – Pension Plan

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

Note 5 – Contingent Liabilities

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

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