

MOREHEAD STATE UNIVERSITY

Single Audit Reports Under OMB Circular A-133

*As of and for the Years Ended June 30, 2012 and 2011
with Independent Auditors' Report Thereon*

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MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis



MANAGEMENT'S DISCUSSION AND ANALYSIS

Morehead State University's (the University) Management Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial performance of the University for the year ended June 30, 2012. Management has prepared this discussion, along with the financial statements and related footnotes, to provide summary financial information. MD&A should be read in conjunction with the accompanying financial statements and footnotes.

Financial Highlights

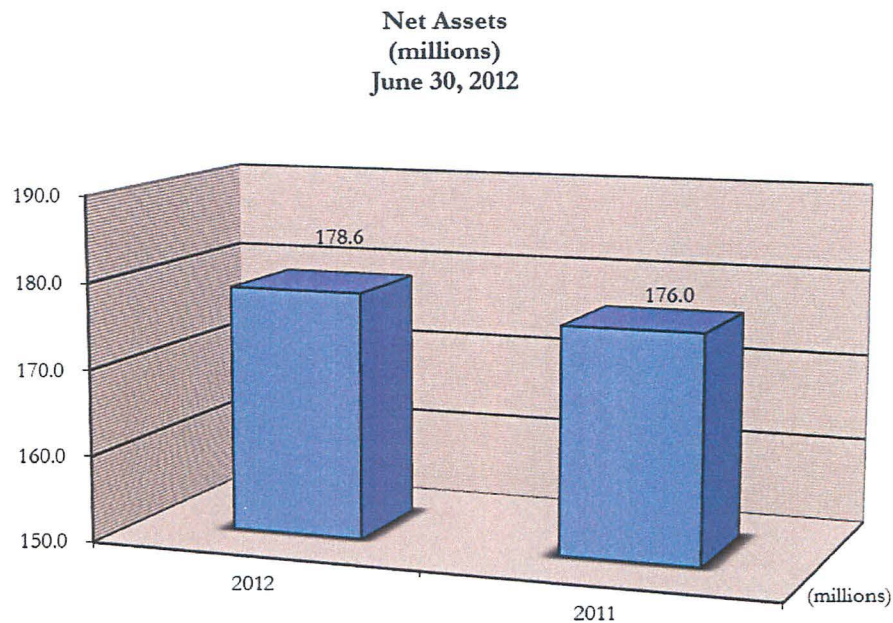
- The financial statements indicate that the University's financial condition remained stable at June 30, 2012. Financial operations were conducted in accordance with the approved budget plan.
- Total assets were \$265 million versus \$247 million at June 30, 2011. Significant components of the assets include \$40 million in cash, \$16 million in accounts, grants and loans receivable, net, \$14 million in investments and \$194 million in capital assets net of depreciation.
- Total liabilities were \$86 million versus \$71 million at June 30, 2011. The significant components of the liabilities were \$69 million in bonds, notes and capital lease obligations, \$8 million in accounts payable

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

and accrued liabilities, \$3 million in refundable grants and \$6 million in deferred revenue and other liabilities.

- Total net assets were \$179 million at June 30, 2012 and \$176 million at June 30, 2011. Significant components of net assets include \$125 million invested in capital assets, net of depreciation and related debt, \$20 million in expendable restricted net assets, \$13 million of non-expendable restricted net assets and \$21 million in unrestricted net assets.



- Net non-operating revenues were \$64 million for the year ended June 30, 2012 and \$65 million for the year ended June 30, 2011. Non-operating revenues were comprised primarily of state appropriations. The combination of the net loss from operations, the net non-operating revenues and capital appropriations of \$6 million, resulted in an increase in net assets of \$3 million.

Using the Annual Report

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

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

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. The information needed to answer this question can be found in:

- Statements of Net Assets,
- the Statements of Revenues, Expenses and Changes in Net Assets and
- the Statements of Cash Flows.

These statements present financial information of the University in a format similar to that used by corporations and present a long-term view of the University's



finances. To get a full understanding of the University's financial condition these statements should be reviewed as a whole and not individually. Further important information can be found in the Notes to the Financial Statements, beginning on page 28 of the Financial Statements. The Notes to the Financial Statements contain policies, explanations and schedules that should be reviewed before, during and after reviewing the Statements in order to get a complete understanding.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

The Statements of Net Assets

This statement 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. The University's net assets (the difference between assets and liabilities) are one indicator of the University's financial health. Over time, increases or decreases in net assets can indicate improvement or erosion of the University's financial health. Changes in net assets should be considered in conjunction with non-financial factors such as enrollment levels and conditions of facilities.

The Statements of Revenues, Expenses and Changes in Net Assets

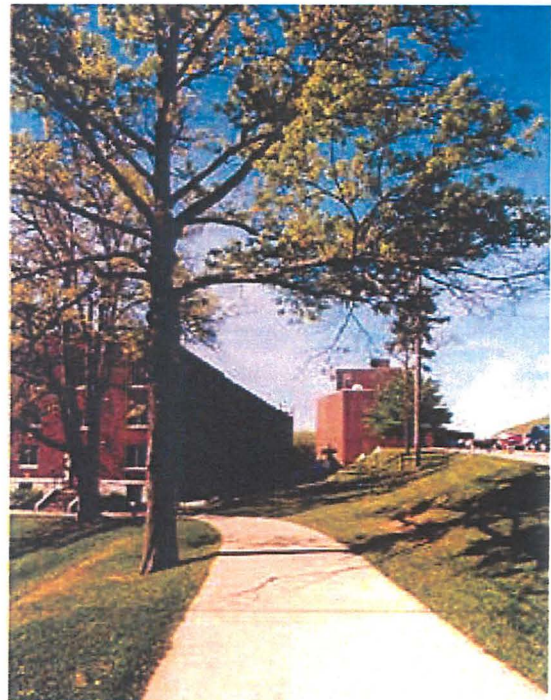
This statement presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or non-operating. GASB 35 requires state appropriations and gifts to be classified as non-operating revenues. Accordingly, the University will generate a net operating loss prior to the addition of non-operating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The Statements of Cash Flows

This statement presents information related to cash inflows and outflows, summarized by operating, non-capital financing, capital financing and investing activities. An important factor to consider when evaluating financial viability is the University's ability to meet financial obligations as they mature.

Reporting Entity

Morehead State University is a component unit of the Commonwealth of Kentucky.



MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

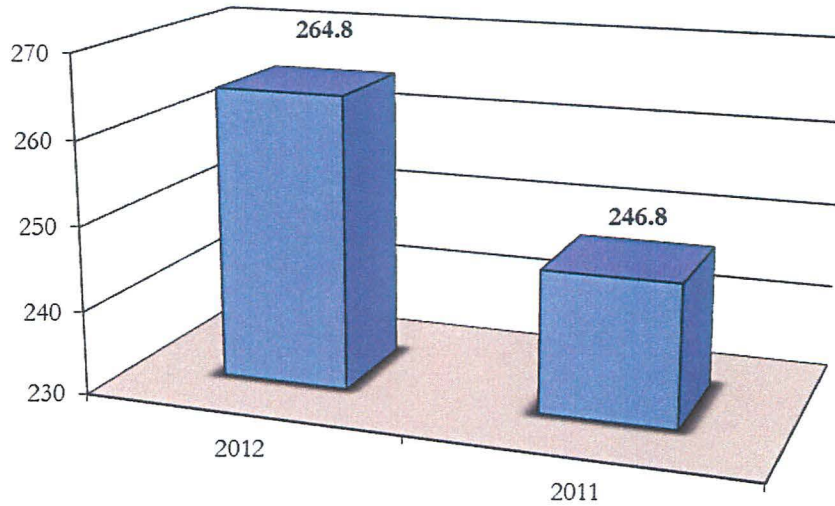
Condensed Financial Information
Statement of Net Assets (in thousands)

	<u>2012</u>	<u>2011</u>
<u>Assets</u>		
Current assets	\$ 53,631	\$ 41,325
Capital assets	193,629	187,797
Other noncurrent assets	<u>17,551</u>	<u>17,670</u>
Total assets	<u>264,811</u>	<u>246,792</u>
<u>Liabilities</u>		
Current liabilities	17,760	17,769
Noncurrent liabilities	<u>68,443</u>	<u>52,998</u>
Total liabilities	<u>86,203</u>	<u>70,767</u>
<u>Net Assets</u>		
Invested in capital assets, net of related debt	124,871	134,593
Restricted, expendable	20,173	10,121
Restricted, nonexpendable	12,409	12,427
Unrestricted	<u>21,155</u>	<u>18,884</u>
Total net assets	<u>\$ 178,608</u>	<u>\$ 176,025</u>

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

**Total Assets
(millions)
June 30, 2012**

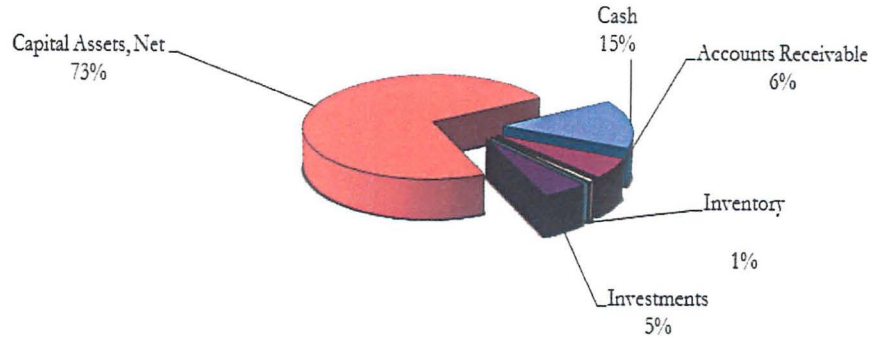


As of June 30, 2012, the University's total assets amount to approximately \$265 million versus \$247 million at June 30, 2011. Investment in capital assets, net of depreciation, represented the University's largest asset, totaling \$194 million compared to \$188 million at June 30, 2011. Cash and investments, totaling \$54 million at June 30, 2012 and \$42 million at June 30, 2011, were the University's next largest asset.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Assets
(millions)
June 30, 2012



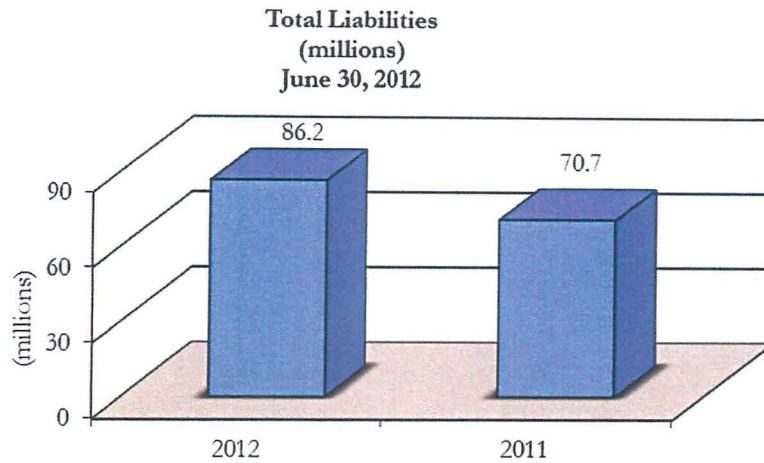
- accounts, grants and loans receivable, net increased approximately \$0.5 million,
- capital assets, net of accumulated depreciation, increased approximately \$5.8 million,
- investments and other assets decreased approximately \$0.1 million

Liabilities

At June 30, 2012, the University's liabilities totaled approximately \$86 million versus \$71 million the previous year. Bonds, notes payable and capital lease obligations for capital assets represented \$69 million versus \$54 million at June 30, 2011.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued



Total liabilities increased by \$15.4 million during the year ended June 30, 2012. This increase was primarily due to a \$15.4 million increase in bonds, notes and capital lease obligations.

Net Assets

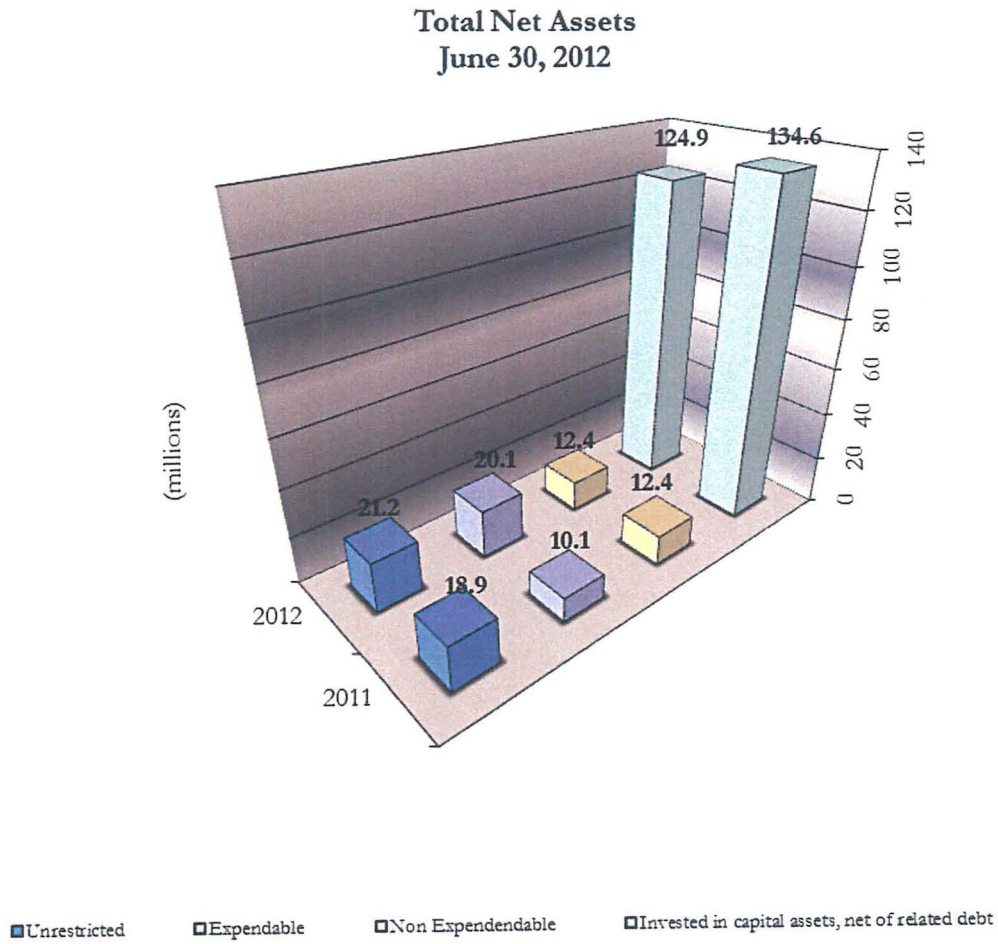
Net assets at June 30, 2012 totaled approximately \$179 million compared to \$176 million at June 30, 2011. Net assets invested in capital assets, net of related debt, totaled \$125 million versus \$135 million at June 30, 2011. Restricted net assets totaled \$32 million compared to \$22 million at June 30, 2011. Unrestricted net assets totaled \$21 million versus \$19 million at June 30, 2011. Total net assets increased by \$3 million during the year ended June 30, 2012.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Net Assets Invested in Capital Assets, Net of Related Debt

Net assets invested in capital assets, net of related debt, decreased by \$9.7 million.



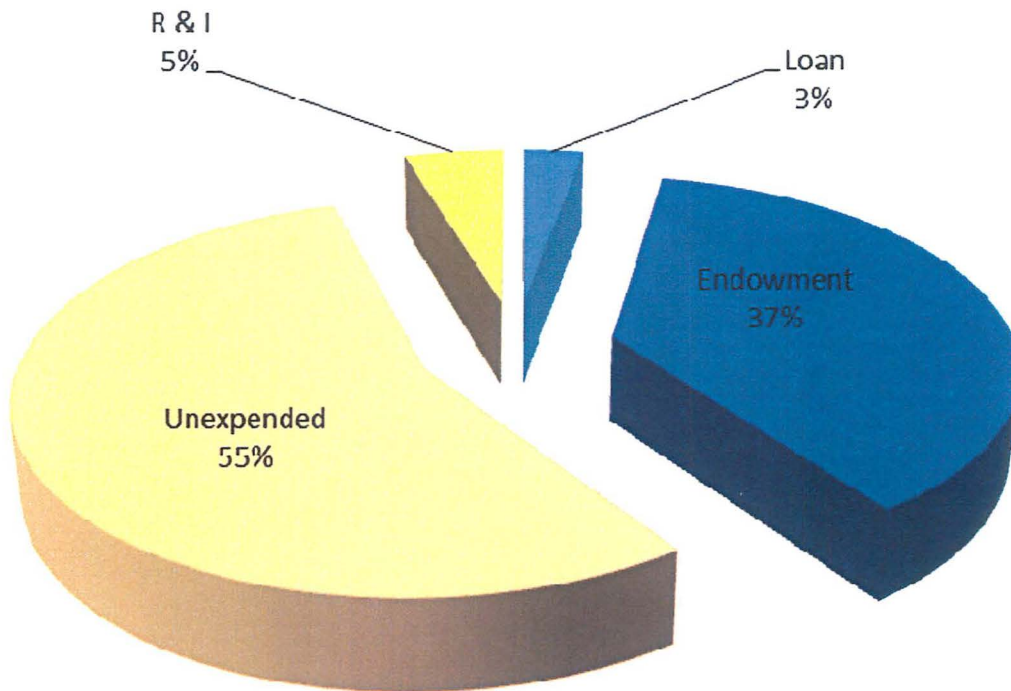
MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Restricted Net Assets

Restricted net assets are subject to stipulations made by entities external to the University that govern the use of these funds. Restricted net assets increased by \$10 million from the previous year to \$32 million. This was primarily due to the issuance of new bonds.

Restricted Net Assets June 30, 2012



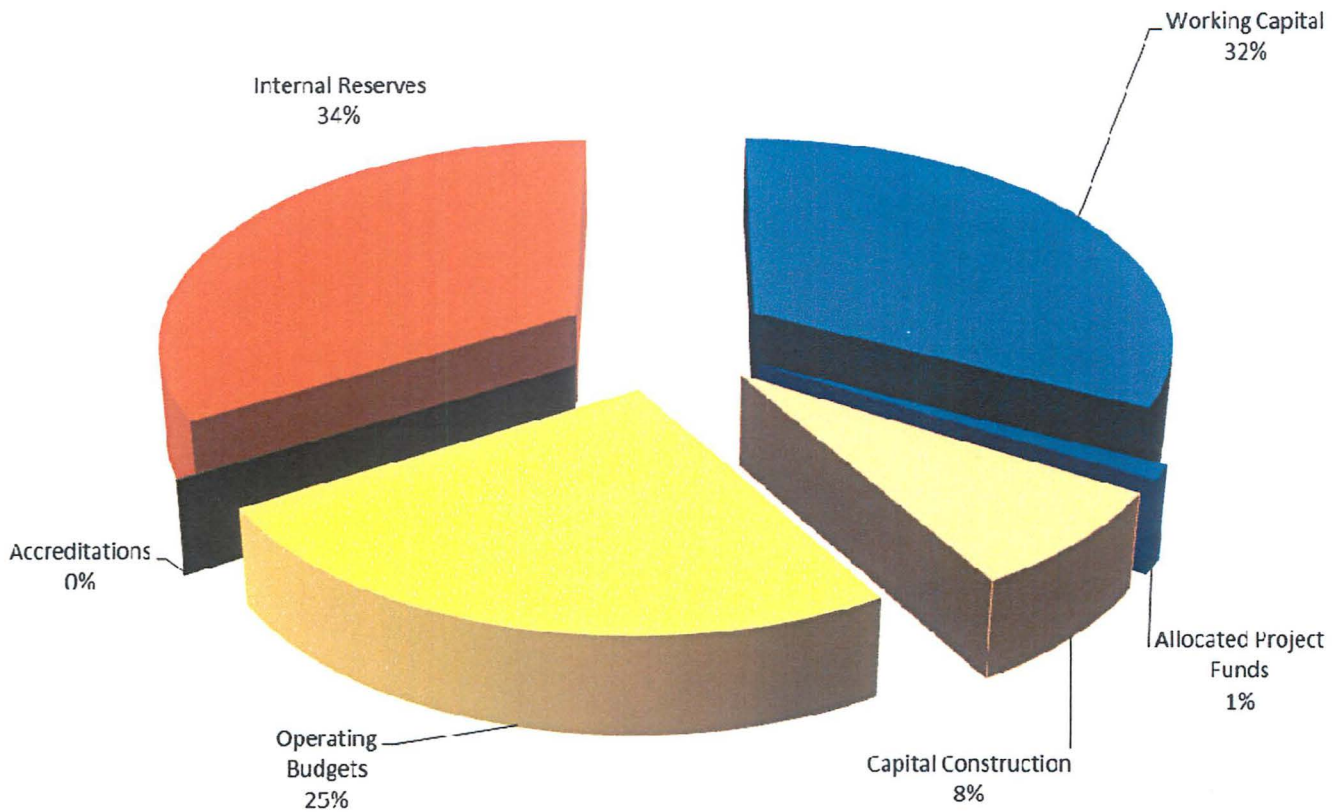
Unrestricted Net Assets

Unrestricted net assets increased by \$2.2 million from the previous year to \$21.1 million. Unrestricted net assets are not subject to externally imposed restrictions. However, substantially all of the unrestricted net asset balance has been allocated for the support of academic programs and other initiatives, the completion of capital projects, or working capital requirements. The allocation of unrestricted net assets as of June 30, 2012 is as follows:

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

**Allocation of Unrestricted Net Assets
June 30, 2012**



Allocation of Unrestricted Net Assets (in thousands)

	<u>2012</u>	<u>2011</u>
Working capital	\$ 6,896	\$ 6,829
Allocated project funds	241	371
Capital construction	1,656	4,222
Operating budgets	5,238	4,874
Accreditations	25	30
Internal reserves	<u>7,099</u>	<u>2,558</u>
Unrestricted net assets	<u>\$ 21,155</u>	<u>\$ 18,884</u>

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

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

	<u>2012</u>	<u>2011</u>
<u>Operating Revenues</u>		
Student tuition and fees, net	\$ 39,040	\$ 36,597
Federal grants and contracts	12,199	16,730
State and local grants and contracts	2,035	1,714
Nongovernmental grants and contracts	845	610
Sales and services of educational activities	2,281	2,354
Auxiliary enterprises	15,510	13,269
Other operating revenue	<u>4,729</u>	<u>5,402</u>
Total operating revenue	<u>76,639</u>	<u>76,676</u>
<u>Operating Expenses</u>		
Educational and general	120,915	123,498
Auxiliary enterprises	12,584	12,331
Depreciation	9,876	9,122
Other operating expenses	<u>94</u>	<u>98</u>
Total operating expenses	<u>143,469</u>	<u>145,049</u>
Operating loss	<u>(66,830)</u>	<u>(68,373)</u>
<u>Non-operating Revenues (Expenses)</u>		
Grants and contracts	22,001	22,067
State appropriations	44,149	44,634
Investment income, net	284	571
Interest on capital assets – debt related	<u>(2,744)</u>	<u>(2,624)</u>
Net non-operating revenues	<u>63,690</u>	<u>64,648</u>
Loss before capital appropriations	(3,140)	(3,725)
Capital appropriations	<u>5,722</u>	<u>11,389</u>
Increase in net assets	2,582	7,664
Net assets, beginning of year	<u>176,026</u>	<u>168,362</u>
Net assets, end of year	<u>\$ 178,608</u>	<u>\$ 176,026</u>

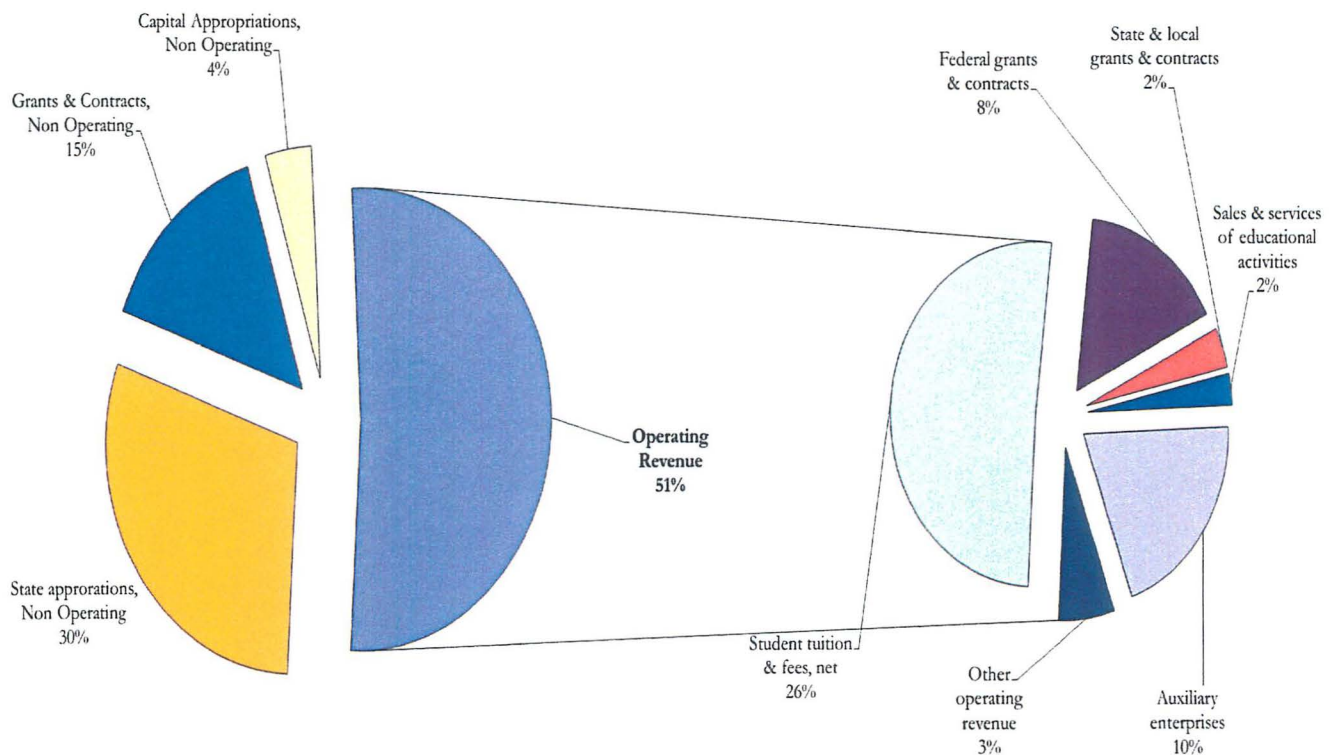
MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Revenues

Total operating revenues were approximately \$77 million for the year ended June 30, 2012 and approximately \$77 million for the year ended June 30, 2011. The most significant sources of operating revenue for the University are net student fees \$39 million, federal grants and contracts \$12 million, auxiliary enterprises \$16 million, state and local grants \$2 million and other revenues including, private grants and sales and services of educational activities, \$8 million.

Sources of Revenues
June 30, 2012

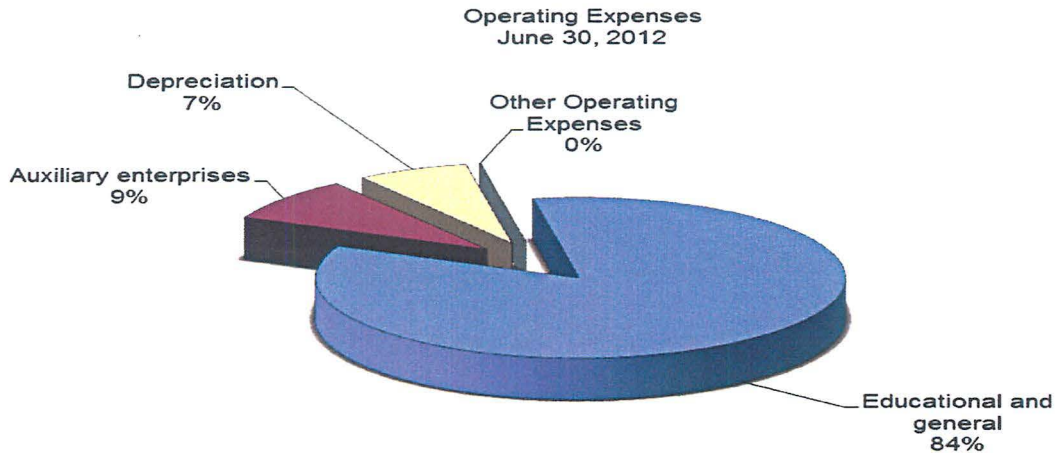


Expenses

Operating expenses totaled approximately \$143 million compared to \$145 million at June 30, 2011. Of this amount, approximately \$121 million was used for educational and general expenses related to functions such as instruction, research and public service.

MOREHEAD STATE UNIVERSITY

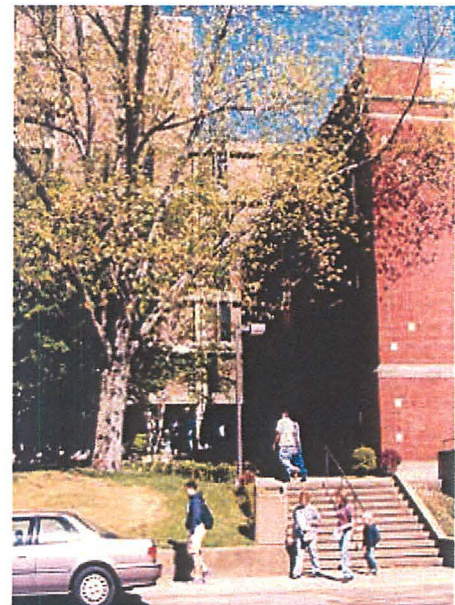
Management's Discussion and Analysis, continued



Cash Flows

Another way to assess the financial health of an institution is to look at the Statement of Cash Flows. The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the University during the period. The Statement of Cash Flows also helps financial statement readers assess:

- the University's ability to generate future net cash flows
- the University's ability to meet obligations as they become due and
- the University's need for external financing.



Statement of Cash Flows (In Thousands)
Year ended June 30,

	<u>2012</u>	<u>2011</u>
Cash Provided By (Used In):		
Operating activities	\$ (57,169)	\$ (55,713)
Noncapital financing activities	66,150	66,701
Capital and related financing activities	2,504	(20,741)
Investing activities	<u>296</u>	<u>179</u>
Net increase (decrease) in cash	11,781	(9,574)
Cash, beginning of the year	<u>28,085</u>	<u>37,659</u>
Cash, end of the year	<u>\$ 39,866</u>	<u>\$ 28,085</u>

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Major sources of funds included in operating activities are student tuition and fees, \$38.8 million versus \$30.7 million the previous years, and grants and contracts, \$14.2 million compared to \$19.1 million the previous year. The largest cash payments for operating activities were made to suppliers, \$71.8 million versus \$64.9 million the previous year, and employees \$62.1 million compared to \$62 million the previous year.



The largest cash receipt in the noncapital financing activities group is the operating appropriation from the Commonwealth of Kentucky of \$44.1 million versus \$44.6 million the previous year and cash used by capital and related financing activities is primarily expended on the construction and acquisition of capital assets.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation (but not of related debt), totaled approximately \$193.6 million at June 30, 2012 versus \$187.8 million at June 30, 2011. This represents a net increase of \$5.8 million over June 30, 2011. Significant changes to capital assets during fiscal 2011 - 2012 included:

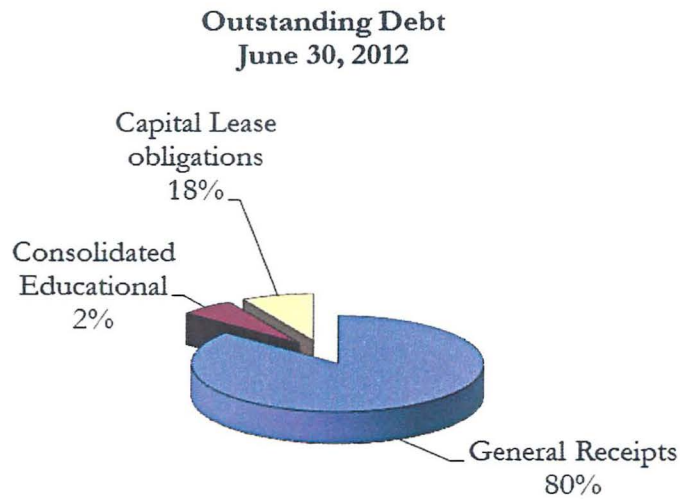
Buildings and structures	\$ 3.9	million
Library additions, equipment and vehicles	2.8	million
Net change in construction in progress	8.3	million
Increase in accumulated depreciation, net	(9.2)	million

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Debt

At year-end, the University had \$68.9 million in outstanding debt versus \$53.6 million the previous year. This includes \$56.3 million in bond payable compared to \$49.8 million at June 30, 2011. In addition, the University had capital lease obligations of \$12.6 million compared to \$3.8 million the previous year-end.



The University's debt is summarized by type of debt instrument as follows (in thousands):

	June 30,	
	<u>2012</u>	<u>2011</u>
General Receipts bonds	\$ 54,695	\$ 47,130
Consolidated Educational buildings revenue bonds	1,650	2,670
Capital lease obligations	<u>12,639</u>	<u>3,755</u>
	<u>\$ 68,984</u>	<u>\$ 53,555</u>

Debt outstanding increased approximately \$15.4 million from the end of the prior year.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

FACTORS IMPACTING FUTURE PERIODS

The following are known facts and circumstances that could affect future financial results:

- The University's Board of Regents has approved an operating budget for the fiscal year ending June 30, 2013 totaling \$135.7 million.
- Under the 2012-13 tuition model, all students will be assessed tuition on a per credit hour basis. The 2012-13 tuition rates include a 5% increase in the undergraduate resident per credit hour rate with a 60% discount on undergraduate hours enrolled above 12.

DEAN || DORTON || ALLEN || FORD_{PLC}

Independent Auditors' Report

Members of the Board of Regents and
Dr. Wayne D. Andrews, President
Morehead State University
Morehead, Kentucky

Secretary of Finance and
Administration Cabinet of the
Commonwealth of Kentucky

We have audited the accompanying financial statements of Morehead State University (the "University") and its discretely presented component unit as of June 30, 2012 and 2011, and the related statements of revenues, expenses, and changes in net assets, and statements of cash flows for the years then ended, which collectively comprise the University's basic financial statements as listed on 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 conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University and its discretely presented component unit as of June 30, 2012 and 2011, and the respective changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 17, 2012, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 17 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the University's financial statements. The supplemental information contained on pages 62 and 63 is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying schedule of expenditures of federal awards information on pages 64 – 74 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental information, including the schedule of expenditures of federal awards information, is fairly stated in all material respects in relation to the financial statements as a whole.

October 17, 2012
Lexington, Kentucky



MOREHEAD STATE UNIVERSITY

Statements of Net Assets

June 30, 2012 and 2011

Assets	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	\$ 39,866,034	\$ 28,085,016
Accounts, grants and loans receivable, net	12,007,850	11,489,241
Prepaid interest	124,649	124,649
Inventories	1,571,687	1,550,106
Other current assets	<u>60,948</u>	<u>75,512</u>
Total current assets	53,631,168	41,324,524
Noncurrent assets:		
Accounts, grants and loans receivable, net	3,696,930	3,681,658
Prepaid interest, noncurrent portion	102,191	226,840
Investments	13,751,313	13,762,812
Capital assets, net	<u>193,629,289</u>	<u>187,797,068</u>
Total noncurrent assets	<u>211,179,723</u>	<u>205,468,378</u>
Total assets	<u>264,810,891</u>	<u>246,792,902</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	7,992,272	7,526,310
Deferred revenue	4,824,398	5,042,812
Other current liabilities	876,832	892,637
Bonds, notes and capital lease obligations, current portion	<u>4,066,315</u>	<u>4,307,643</u>
Total current liabilities	17,759,817	17,769,402
Long-term liabilities:		
Bonds, notes and capital lease obligations, noncurrent portion	64,918,592	49,247,480
Advances from federal government for student loans	3,233,892	3,460,284
Deferred revenue, noncurrent portion	<u>290,235</u>	<u>290,235</u>
Total long-term liabilities	<u>68,442,719</u>	<u>52,997,999</u>
Total liabilities	<u>86,202,536</u>	<u>70,767,401</u>
Net assets:		
Invested in capital assets, net of related debt	124,871,223	134,593,433
Restricted:		
Expendable	20,173,298	10,120,842
Nonexpendable	12,408,359	12,427,343
Unrestricted	<u>21,155,475</u>	<u>18,883,883</u>
Total net assets	<u>\$ 178,608,355</u>	<u>\$ 176,025,501</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY FOUNDATION, INC.

Statements of Financial Position

June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets		
Current assets:		
Cash	\$ 844,976	\$ 2,495,337
Accounts receivable	-	1,250
Accrued interest receivable	5,712	7,752
Current portion of pledges receivable	756,191	520,139
Current portion of investment in capital leases	<u>186,638</u>	<u>178,910</u>
Total current assets	<u>1,793,517</u>	<u>3,203,388</u>
Noncurrent assets:		
Investments, at fair value	34,917,391	33,895,166
Cash surrender value – life insurance	115,716	108,629
Property and equipment, net	220,787	203,741
Pledges receivable, net of current portion	1,729,018	1,574,990
Net investment in capital leases, net of current portion	<u>503,362</u>	<u>690,000</u>
Total noncurrent assets	<u>37,486,274</u>	<u>36,472,526</u>
 Total assets	 <u>\$ 39,279,791</u>	 <u>\$ 39,675,914</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ -	\$ 75,512
Accrued liabilities	23,954	-
Current portion of annuities payable	201,948	175,241
Due to Morehead State University	<u>60,948</u>	<u>-</u>
Total current liabilities	<u>286,850</u>	<u>250,753</u>
Long-term liabilities:		
Funds held in trust for Morehead State University	12,014,828	12,014,828
Annuities payable, net of current portion	<u>1,103,652</u>	<u>936,770</u>
Total long-term liabilities	<u>13,118,480</u>	<u>12,951,598</u>
 Total liabilities	 <u>13,405,330</u>	 <u>13,202,351</u>
Net assets:		
Unrestricted	(1,727,219)	189,514
Temporarily restricted	10,199,948	9,401,972
Permanently restricted	<u>17,401,732</u>	<u>16,882,077</u>
Total net assets	<u>25,874,461</u>	<u>26,473,563</u>
 Total liabilities and net assets	 <u>\$ 39,279,791</u>	 <u>\$ 39,675,914</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY

Statements of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Student tuition and fees (net of scholarship allowances of \$26,063,738 and \$24,551,510)	\$ 39,039,988	\$ 36,597,058
Federal grants and contracts	12,199,360	16,730,415
State and local grants and contracts	2,035,319	1,713,790
Nongovernmental grants and contracts	845,269	609,803
Sales and services of educational activities	2,280,687	2,354,345
Auxiliary enterprises:		
Residence halls (net of scholarship allowances of \$454,597 and \$662,367)	9,074,062	7,479,142
Bookstore	4,568,260	4,421,534
Other auxiliaries	1,867,502	1,367,415
Other operating revenues	<u>4,728,587</u>	<u>5,402,419</u>
Total operating revenues	<u>76,639,034</u>	<u>76,675,921</u>
Operating expenses:		
Education and general:		
Instruction	45,591,539	46,295,191
Research	2,033,009	2,025,681
Public service	6,138,702	6,906,939
Library	3,350,368	3,258,718
Academic support	11,857,698	12,414,159
Student services	16,704,430	15,050,339
Institutional support	13,599,198	15,039,387
Operation and maintenance of plant	8,812,954	9,222,653
Depreciation	9,876,079	9,122,062
Student aid	12,826,208	13,284,719
Auxiliary enterprises:		
Residence Halls	6,694,111	7,350,493
Bookstore	4,054,650	3,729,888
Other auxiliaries	1,835,704	1,251,018
Other operating expenses	<u>93,675</u>	<u>97,975</u>
Total operating expenses	<u>143,468,325</u>	<u>145,049,222</u>
Operating loss	<u>(66,829,291)</u>	<u>(68,373,301)</u>

MOREHEAD STATE UNIVERSITY

Statements of Revenues, Expenses and Changes in Net Assets, concluded

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Nonoperating revenues (expenses):		
Grants and contracts	22,001,090	22,066,903
State appropriations	44,148,933	44,633,605
Investment income, net	284,405	571,172
Interest on capital asset-related debt	<u>(2,744,349)</u>	<u>(2,623,868)</u>
Net nonoperating revenues	<u>63,690,079</u>	<u>64,647,812</u>
 Loss before capital appropriations	 (3,139,212)	 (3,725,489)
 Capital appropriations	 <u>5,722,066</u>	 <u>11,388,908</u>
 Increase in net assets	 2,582,854	 7,663,419
 Net assets, beginning of year	 <u>176,025,501</u>	 <u>168,362,082</u>
 Net assets, end of year	 <u>\$ 178,608,355</u>	 <u>\$ 176,025,501</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY FOUNDATION, INC.

Statements of Activities

Year ended June 30, 2012

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues and other support:				
Contributions	\$ 14,111	\$ 2,359,367	\$ 519,655	\$ 2,893,133
Other revenue and gains:				
Investment income:				
Interest and dividend income, net	26,712	806,801	-	833,513
Realized and unrealized gains (losses)	(37,608)	297,153	-	259,545
In-kind contributed services	100,228	-	-	100,228
Other income	267,923	319,430	-	587,353
Annuities payable adjustment	(56,468)	-	-	(56,468)
Net assets released from restrictions:				
Restrictions satisfied by payments	<u>2,984,775</u>	<u>(2,984,775)</u>	<u>-</u>	<u>-</u>
Total revenues and other support	<u>3,299,673</u>	<u>797,976</u>	<u>519,655</u>	<u>4,617,304</u>
Expenses:				
Program expenses:				
Contributions to Morehead State University for:				
Academic programs	3,365,409	-	-	3,365,409
Athletics	272,287	-	-	272,287
University support:				
Operations and materials	849,550	-	-	849,550
Student financial aid	443,763	-	-	443,763
Athletics	<u>80,180</u>	<u>-</u>	<u>-</u>	<u>80,180</u>
Total program expenses	<u>5,011,189</u>	<u>-</u>	<u>-</u>	<u>5,011,189</u>
General and administrative	185,792	-	-	185,792
Fundraising	<u>19,425</u>	<u>-</u>	<u>-</u>	<u>19,425</u>
Total expenses	<u>5,216,406</u>	<u>-</u>	<u>-</u>	<u>5,216,406</u>
Change in net assets	(1,916,733)	797,976	519,655	(599,102)
Net assets, beginning of year	<u>189,514</u>	<u>9,401,972</u>	<u>16,882,077</u>	<u>26,473,563</u>
Net assets, end of year	<u>\$ (1,727,219)</u>	<u>\$ 10,199,948</u>	<u>\$ 17,401,732</u>	<u>\$ 25,874,461</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY FOUNDATION, INC.

Statements of Activities, concluded

Year ended June 30, 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues and other support:				
Contributions	\$ 299,697	\$ 3,032,067	\$ 3,292,341	\$ 6,624,105
Other revenue and gains (losses):				
Investment income:				
Interest and dividend income, net	31,999	1,000,690	-	1,032,689
Realized and unrealized gains	47,710	3,347,577	-	3,395,287
In-kind contributed services	97,051	-	-	97,051
Other income	420,637	261,518	-	682,155
Annuities payable adjustment	(301,052)	-	-	(301,052)
Net assets released from restrictions:				
Restrictions satisfied by payments	<u>2,494,400</u>	<u>(2,494,400)</u>	<u>-</u>	<u>-</u>
Total revenues and other support	3,090,442	5,147,452	3,292,341	11,530,235
Expenses:				
Program expenses:				
Contributions to Morehead State				
University for:				
Academic programs	1,293,274	-	-	1,293,274
Athletics	131,960	-	-	131,960
University support:				
Operations and materials	587,922	-	-	587,922
Student financial aid	422,028	-	-	422,028
Athletics	<u>86,176</u>	<u>-</u>	<u>-</u>	<u>86,176</u>
Total program expenses	2,521,360	-	-	2,521,360
General and administrative	180,479	-	-	180,479
Fundraising	<u>43,987</u>	<u>-</u>	<u>-</u>	<u>43,987</u>
Total expenses	<u>2,745,826</u>	<u>-</u>	<u>-</u>	<u>2,745,826</u>
Change in net assets	344,616	5,147,452	3,292,341	8,784,409
Net assets, beginning of year	<u>(155,102)</u>	<u>4,254,520</u>	<u>13,589,736</u>	<u>17,689,154</u>
Net assets, end of year	<u>\$ 189,514</u>	<u>\$ 9,401,972</u>	<u>\$16,882,077</u>	<u>\$26,473,563</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY

Statement of Cash Flows

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Tuition and fees	\$ 38,821,201	\$ 30,700,041
Grants and contracts	14,224,894	19,109,395
Payments to suppliers	(71,820,289)	(64,889,216)
Payments to employees	(62,107,031)	(62,055,389)
Loans issued to students	(412,017)	(236,920)
Collection of loans issued to students	448,220	633,276
Auxiliary enterprises:		
Residence halls	9,074,062	7,479,631
Bookstore	4,690,793	4,419,407
Other auxiliaries	1,864,304	1,370,436
Sales and services of educational activities	2,295,250	2,354,345
Other receipts	<u>5,751,921</u>	<u>5,402,419</u>
Net cash used in operating activities	(57,168,692)	(55,712,575)
Cash flows from noncapital financing activities:		
Nonoperating grants and contracts	22,001,090	22,066,903
State appropriations	<u>44,148,933</u>	<u>44,633,605</u>
Net cash provided by noncapital financing activities	66,150,023	66,700,508
Cash flows from capital and related financing activities:		
Capital appropriations	5,722,066	11,388,908
Purchase of capital assets	(15,801,975)	(25,053,135)
Decrease in advances from federal government for student loan	(226,392)	(352,816)
Issuance of new bonds	10,150,000	-
Proceeds from new debt	9,671,127	-
Principal paid on capital debt and leases	(4,391,343)	(4,224,982)
Interest paid on capital debt and leases	<u>(2,619,700)</u>	<u>(2,499,220)</u>
Net cash provided by (used in) capital and related financing activities	2,503,783	(20,741,245)
Cash flows from investing activities:		
Interest received on investments, net	284,405	571,172
Changes in investments, net	<u>11,499</u>	<u>(392,212)</u>
Net cash provided by investing activities	<u>295,904</u>	<u>178,960</u>
Net increase (decrease) in cash and cash equivalents	11,781,018	(9,574,352)
Cash and cash equivalents, beginning of year	<u>28,085,016</u>	<u>37,659,368</u>
Cash and cash equivalents, end of year	<u>\$ 39,866,034</u>	<u>\$ 28,085,016</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY

Statement of Cash Flows, concluded

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (66,829,291)	\$ (68,373,301)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	9,876,079	9,122,062
Loss on disposal of capital assets	93,675	97,975
Bad debt expense	911,287	958,747
Changes in assets and liabilities:		
Receivables, net	(1,445,168)	2,449,733
Inventories	(21,581)	(145,330)
Other current assets	14,564	(68,594)
Accounts payable and accrued liabilities	465,962	(538,730)
Deferred revenue	(218,414)	865,244
Other current liabilities	<u>(15,805)</u>	<u>(80,381)</u>
Net cash used in operating activities	<u>\$ (57,168,692)</u>	<u>\$ (55,712,575)</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements

1. Organization and Summary of Significant Accounting Policies

Organization

Morehead State University (the University) is a regional, coeducational, public institution of higher education offering general and liberal arts programs and pre-professional and professional training in education and various other fields at both the undergraduate and graduate levels. Located in Morehead, Kentucky, the University has provided educational service to the Commonwealth of Kentucky (the Commonwealth) since 1887.

Reporting Entity

The University is a component unit of the Commonwealth of Kentucky and is included in the general-purpose financial statements of the Commonwealth. The Morehead State 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 the resources the Foundation holds and invests are restricted by the donors to the activities of the University. 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.

Basis of Presentation

The accompanying financial statements 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). 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. In accordance with GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities* (GASB No. 35) and subsequent standards issued by GASB, the University reports as a Business Type Activity (BTA). BTAs are those activities that are financed in whole or in part by fees charged to external parties for goods and services.

GASB No. 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 asset 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.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Basis of Presentation, continued

- **Restricted:**

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.

Nonexpendable– Net assets subject to externally imposed stipulations that they be maintained permanently by the University. Such assets include the University's permanent endowment funds.

- **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 Regents or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation required by GASB No. 35 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.

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the University has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989 and do not conflict with or contradict GASB pronouncements.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is established through a provision for doubtful accounts charged to expense. The allowance represents an amount which, in management's judgment, will be adequate to absorb probable losses on existing accounts that may become uncollectible.

Inventories

University store inventories representing approximately 56% and 53% of total inventories at June 30, 2012 and 2011, respectively, are stated at the lower of cost (retail inventory method) or market. The remainder of the inventories is stated at the lower of moving-average-cost or market.

Investments

The University values investments at fair value based on quoted market prices.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Investments, continued

Investment income consists of interest and dividend income and the net change for the year in the fair value of investments carried at fair value.

Capital Assets

Capital assets are stated at cost for purchased assets and at fair value at date of donation in the case of gifts. Expenditures which increase values or extend useful lives of the respective assets are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation of assets is computed using the straight-line method over the assets estimated useful lives. The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research and public service. Estimated lives used for depreciation purposes are as follows:

<u>Classification</u>	<u>Estimated Life</u>
Land improvements	20 years
Buildings	50 years
Building improvements	20 years
Vehicles	5-9 years
Equipment	5-15 years
Library books	10 years

Accrued Vacation Pay

Accrued vacation pay is included in accounts payable and accrued liabilities in the statement of net assets and represents earned vacation available to employees at current compensation rates.

Deferred Revenue

Deferred revenue includes amounts received from grant and contract sponsors that have not yet been earned. Deferred revenue also includes tuition billed on or before June 30th for future terms.

Advances from Federal Government for Student Loans

Funds provided by the United States Government under the Federal Perkins Loan program are loaned to qualified students and may be reloaned after collections. These funds are ultimately refundable to the United States Government and, therefore, are recorded as a liability in the accompanying financial statements. Federally funded financial aid programs are subject to special audits. Such audits could result in claims against the resources of the University.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

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.

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 non-operating revenues, in accordance with GASB No. 35.

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 and the reported revenues and expenditures during the reporting period. Actual results could differ from the estimated amounts.

Income Taxes

As a state institution of higher education, the income of the University is generally exempt from federal and state income taxes under Section 115(1) of the Internal Revenue Code, as amended and a similar provision of state law. However, the University is subject to federal income tax on any unrelated business taxable income.

Reclassifications

Certain 2011 amounts have been reclassified to conform to the 2012 presentation with no effect on total assets, liabilities, net assets or changes in net assets.

Recent Accounting Pronouncements

In June 2012, the GASB approved Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement 68 requires governments providing defined

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements, continued

benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits.

Governmental employers participating in a cost-sharing plan will also be required to report a net pension liability, pension expense and pension-related assets and liabilities based on their proportionate share of the collective amounts for all governments in the plan. All governments participating in the defined benefit pension plan would also have the following in their note disclosures:

- Descriptions of the plan and benefits provided
- Significant assumptions employed in the measurement of the net pension liability
- Descriptions of benefit changes and changes in assumptions
- Assumptions related to the discount rate and impact on the total pension liability of a 1 percentage point increase and decrease in the discount rate
- Net pension assets and liabilities

The provisions of this Statement are effective for fiscal years beginning after June 15, 2014. The University is currently evaluating the effects of this statement on its financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections-2012-an amendment of GASB Statements No. 10 and No. 62*. This Statement amends Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. This Statement also amends Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. The University does not expect this statement to have a significant impact on its financial statements.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The provisions of this statement are effective for financial statements for periods

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements, continued

beginning after December 15, 2012. The University is currently evaluating the effects of this statement on its financial statements.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53*. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. The University does not expect this statement to have a significant impact on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this statement is to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The University is currently evaluating the effects of this statement on its financial statements.

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this statement is to improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. It eliminates the need for financial statement preparers to determine which accounting principles apply to state and local governments. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The University does not expect this statement to have a significant impact on its financial statements.

In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*. The objective of this statement is to improve financial reporting for a governmental financial reporting entity. The requirements of statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. This statement modifies certain requirement for inclusion of component units in the financial reporting entity. This statement also amends the criteria for reporting component units as if they were part of the primary government (i.e. blending) in certain circumstances. The provisions of this Statement are effective for financial statements for

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements, continued

periods beginning after June 15, 2012. The University does not expect this statement to have a significant impact on its financial statements.

In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. The objective of this statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. As used in this statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The University does not expect this statement to have a significant impact on its financial statements.

In June 2010, the GASB issued Statement No. 59, *Financial Instruments Omnibus*. The objective of this statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. It amended various GASB statements to improve financial reporting by providing more complete information, by improving consistency of measurements and by providing clarifications of existing standards. The provisions of this statement were effective for financial statements for periods beginning after June 15, 2010. This statement did not significantly affect the University's financial statements.

2. Cash, Cash Equivalents and Investments

The statement of net assets classification "cash and cash equivalents" includes all readily available sources of cash such as petty cash, demand deposits, deposits with the Commonwealth of Kentucky, certificates of deposit and temporary investments in marketable securities with original maturities less than three months.

The state treasurer requires that all state funds be insured by Federal Deposit Insurance Corporation (FDIC), collateralized by securities held by the cognizant Federal Reserve Bank or invested in U.S. Government obligations. The University's deposits with the state treasurer are pooled with funds of other state agencies and then, in accordance with statutory limitations, placed in financial institutions or invested as the state treasurer may determine, in the state's name.

The University requires that balances on deposit with financial institutions be insured by FDIC or collateralized by securities held by the cognizant Federal Reserve Bank, in the University's name.

Custodial credit risk for deposits is the risk that, in the event of a bank failure, the University's deposits may not be returned to the University. As a means of limiting its exposure to losses from

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

2. Cash, Cash Equivalents and Investments, continued

custodial credit risk, the University's deposits and investments are held by the state treasurer, collateralized by securities in the University's name, or insured by the FDIC.

At June 30, 2012 and 2011, the University had petty cash funds totaling \$39,540 and \$44,576, respectively and deposits as reflected by bank balances as follows:

	<u>2012</u>	<u>2011</u>
Insured, commercial banks	\$ 22,766,515	\$ 265,357
Uninsured, commercial banks; collateral held by pledging institution's agent in the University's name	-	14,432,530
Maintained by Commonwealth of Kentucky	<u>17,059,979</u>	<u>13,342,553</u>
	<u>\$ 39,826,494</u>	<u>\$ 28,040,440</u>

As of June 30, 2012 and 2011, investments consisted of:

	<u>2012</u>	<u>2011</u>
Insured and registered, with securities held by the counterparty or by its trust department or agent, in the University's name:		
Money market funds - restricted for capital purposes	\$ 1,342,952	\$ 1,335,469
Equity mutual funds	282,637	303,061
Money market funds	<u>703</u>	<u>703</u>
	1,626,292	1,639,233
Certificate of deposit	110,193	108,751
Restricted assets held by Morehead State University Foundation, Inc.	<u>12,014,828</u>	<u>12,014,828</u>
Total investments	<u>\$ 13,751,313</u>	<u>\$ 13,762,812</u>

Restricted investments for capital purposes are comprised of amounts invested for sinking fund and debt service reserves. The University may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest to a limited extent in equity securities.

University investments held by the Foundation are comprised of the Regional University Excellence Trust Fund endowment and other similar endowments (see Note 13). Assets held by the Foundation are invested primarily in an investment pool managed by the Foundation and are carried at fair value.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

2. Cash, Cash Equivalents and Investments, continued

The assets in the Foundation investment pool at June 30, 2012 and 2011 are invested as follows:

	<u>2012</u>	<u>2011</u>
Percentage of pool invested in:		
Registered investment companies fixed income funds	33%	56%
Registered investment companies equity fund	35%	29%
Registered investment companies alternative investments	<u>32%</u>	<u>15%</u>
Total	<u>100%</u>	<u>100%</u>

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The University does not have a formal policy to specifically limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The University does not have a formal policy for concentration of credit risk.

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The University does not have a formal policy for custodial credit risk.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

3. Accounts, Grants and Loans Receivable

Accounts, grants and loans receivable consist of the following as of June 30:

	<u>2012</u>	<u>2011</u>
Student tuition and fees	\$ 5,347,367	\$ 4,464,797
Laptop lease	1,104,400	1,455,500
Financing and interest	1,110,000	2,158,415
Student loans	3,778,457	3,767,496
Grants and contracts	5,612,852	4,253,649
Auxiliary enterprises	283,526	387,603
Other	<u>573,829</u>	<u>400,183</u>
	17,810,431	16,887,643
Allowance for doubtful accounts	<u>(2,105,651)</u>	<u>(1,716,744)</u>
	15,704,780	15,170,899
Current portion	<u>(12,007,850)</u>	<u>(11,489,241)</u>
Noncurrent portion	<u>\$ 3,696,930</u>	<u>\$ 3,681,658</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

4. Capital Assets, Net

Capital assets as of June 30, 2012, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land and improvements	\$ 19,633,615	\$ 459,577	\$ 80,331	\$ 20,012,861
Buildings	247,528,350	3,559,311	-	251,087,661
Library books	23,761,208	1,153,735	-	24,914,943
Vehicles	1,960,593	105,612	74,941	1,991,264
Equipment and livestock	23,663,810	2,254,357	578,808	25,339,359
Datatel	4,203,490	-	-	4,203,490
Art collection	845,205	47,140	6,790	885,555
Construction in progress	<u>462,270</u>	<u>9,970,101</u>	<u>1,714,689</u>	<u>8,717,682</u>
	322,058,541	17,549,833	2,455,559	337,152,815
<u>Accumulated Depreciation</u>				
Land improvements	6,755,814	523,744	-	7,279,558
Buildings	89,326,336	5,568,397	-	94,894,733
Library books	18,732,131	1,004,221	-	19,736,352
Vehicles	1,675,012	119,406	74,941	1,719,477
Equipment and livestock	13,633,048	2,608,885	539,085	15,702,848
Datatel	<u>4,139,132</u>	<u>51,426</u>	-	<u>4,190,558</u>
	<u>134,261,473</u>	<u>9,876,079</u>	<u>614,026</u>	<u>143,523,526</u>
Capital assets, net	<u>\$ 187,797,068</u>	<u>\$ 7,673,754</u>	<u>\$ 1,841,533</u>	<u>\$ 193,629,289</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

4. Capital Assets, Net, continued

Capital assets as of June 30, 2011, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land and improvements	\$ 18,628,615	\$ 1,005,000	\$ -	\$ 19,633,615
Buildings	218,887,808	28,640,542	-	247,528,350
Library books	22,670,271	1,090,937	-	23,761,208
Vehicles	1,991,753	123,161	154,321	1,960,593
Equipment and livestock	19,923,703	4,406,940	666,833	23,663,810
Datatel	4,197,690	5,800	-	4,203,490
Art collection	824,570	20,635	-	845,205
Construction in progress	<u>10,702,150</u>	<u>17,141,663</u>	<u>27,381,543</u>	<u>462,270</u>
	297,826,560	52,434,678	28,202,697	322,058,541
<u>Accumulated Depreciation</u>				
Land improvements	6,249,247	506,567	-	6,755,814
Buildings	84,297,872	5,028,464	-	89,326,336
Library books	17,746,728	985,403	-	18,732,131
Vehicles	1,704,421	124,912	154,321	1,675,012
Datatel	11,805,188	2,396,718	568,858	13,633,048
Equipment and livestock	<u>4,059,134</u>	<u>79,998</u>	<u>-</u>	<u>4,139,132</u>
	<u>125,862,590</u>	<u>9,122,062</u>	<u>723,179</u>	<u>134,261,473</u>
Capital assets, net	<u>\$ 171,963,970</u>	<u>\$ 43,312,616</u>	<u>\$ 27,479,518</u>	<u>\$ 187,797,068</u>

5. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of June 30, are as follows:

	<u>2012</u>	<u>2011</u>
Payable to vendors and contractors	\$ 1,068,183	\$ 808,124
Accrued vacation	2,397,522	2,636,694
Accrued salaries and other liabilities	<u>4,526,567</u>	<u>4,081,492</u>
	<u>\$ 7,992,272</u>	<u>\$ 7,526,310</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

6. Long-Term Liabilities

Long-term liabilities at June 30, 2012, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Long-Term Portion</u>
Consolidated Educational Building Revenue Bonds	\$ 2,670,000	\$ -	\$ 1,020,000	\$ 1,650,000	\$ 570,000	\$ 1,080,000
General Receipts Bonds	47,130,000	10,150,000	2,585,000	54,695,000	2,850,000	51,845,000
Capital lease obligations	3,755,123	-	786,343	2,968,780	646,315	2,322,465
Energy savings capital lease	<u>-</u>	<u>9,671,127</u>	<u>-</u>	<u>9,671,127</u>	<u>-</u>	<u>9,671,127</u>
Total bonds, notes and capital lease obligations	53,555,123	19,821,127	4,391,343	68,984,907	4,066,315	64,918,592
Federal refundable grants	<u>3,460,284</u>	<u>-</u>	<u>226,392</u>	<u>3,233,892</u>	<u>-</u>	<u>3,233,892</u>
Total long-term Liabilities	<u>\$ 57,015,407</u>	<u>\$ 19,821,127</u>	<u>\$ 4,617,735</u>	<u>\$ 72,218,799</u>	<u>\$ 4,066,315</u>	<u>\$ 68,152,484</u>

Long-term liabilities at June 30, 2011, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Long-Term Portion</u>
Consolidated Educational Building Revenue Bonds	\$ 3,660,000	\$ -	\$ 990,000	\$ 2,670,000	\$ 1,020,000	\$ 1,650,000
General Receipts Bonds	49,695,000	-	2,565,000	47,130,000	2,585,000	44,545,000
Capital lease obligations	<u>4,425,105</u>	<u>-</u>	<u>669,982</u>	<u>3,755,123</u>	<u>702,643</u>	<u>3,052,480</u>
Total bonds, notes and capital lease obligations	57,780,105	-	4,224,982	53,555,123	4,307,643	49,247,480
Federal refundable grants	<u>3,813,100</u>	<u>-</u>	<u>352,816</u>	<u>3,460,284</u>	<u>-</u>	<u>3,460,284</u>
Total long-term Liabilities	<u>\$ 61,593,205</u>	<u>\$ -</u>	<u>\$ 4,577,798</u>	<u>\$ 57,015,407</u>	<u>\$ 4,307,643</u>	<u>\$ 52,707,764</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

6. Long-Term Liabilities, continued

The following is a summary of bonds, capital lease obligations and notes payable at June 30:

	<u>2012</u>	<u>2011</u>
2.00 – 4.50% Consolidated Educational Building Revenue Bonds, Series L and M repayable in semi-annual installments with the final installment due May, 2024	\$ 1,650,000	\$ 2,670,000
4.00% General Receipts Bonds, 2007 Series A, repayable in semi-annual installments with the final installment due November, 2027	4,975,000	5,365,000
3.00 – 3.80% General Receipts Bonds, 2008 Series A, payable in semi-annual installments with the final installment due November, 2022	7,385,000	8,060,000
4.00 – 4.50% General Receipts Bonds, 2008 Taxable Series B, repayable in semi-annual installments with the final installment due May, 2013	90,000	175,000
2.00 – 6.00% General Receipts Bonds, 2009 Taxable Series A, repayable in semi-annual installments with the final installment due November, 2028	26,570,000	27,760,000
1.27 – 5.75% General Receipts Bonds, 2010 Taxable Series A, repayable in semi-annual installments with the final installment due November, 2029	5,525,000	5,770,000
2.00-4.125% General Receipts Bonds, 2011 Series A Improvement Bonds, repayable in semi-annual installments with the final installment due November, 2030	5,090,000	-
2.00-3.625% General Receipts Bonds, 2012 Series A Tax Exempt Bonds, repayable in semi-annual installments with the final installment due November, 2031	5,060,000	-
5.00% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due February, 2019	107,122	120,333
5.25% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due May, 2013	33,221	230,138
9.40% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due March, 2023	346,415	364,524
4.19% Capital lease obligation with a finance corporation in semi-annual payments with final installment due October, 2019	1,052,685	1,169,900
3.58% Capital lease obligation with a finance corporation in semi-annual payments with final installment due June, 2015	1,309,796	1,716,314
4.47% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due August, 2015	119,541	153,914
2.65% Energy savings capital lease obligation with JP Morgan/Chase, repayable in quarterly installments beginning in September 2013, with the final installment due June, 2025	<u>9,671,127</u>	<u>-</u>
	<u>\$ 68,984,907</u>	<u>\$ 53,555,123</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

6. Long-Term Liabilities, continued

In order to retire the revenue bonds, the University is required to make deposits to sinking funds in annual amounts sufficient to meet the principal and interest payments due within the next twelve months. As of June 30, 2012 and 2011, all reserve requirements have been fully funded (\$1,121,008 and \$1,126,385, respectively). The revenue bonds are subject to several non-financial covenants, all of which management has asserted were met as of June 30, 2012 and 2011.

The Consolidated Educational Building Revenue Bonds are collateralized by various buildings. The revenues derived from student registration fees are pledged as collateral on the Consolidated Educational Building Revenue Bond issues.

The capital leases consist of leases of real estate and equipment. The leased equipment includes items related to a new computer system.

The following equipment is held under capital lease obligations at June 30:

	<u>2012</u>	<u>2011</u>
Equipment	\$ 7,722,742	\$ 7,722,742
Less: accumulated depreciation	<u>(4,687,289)</u>	<u>(4,579,705)</u>
	<u>\$ 3,035,453</u>	<u>\$ 3,143,037</u>

The University entered into an energy saving capital lease agreement in order to improve the energy efficiency of the University's infrastructure. Proceeds from the agreement are in an escrow account and are being used to fund the improvement project. As of June 30, 2012, total costs related to this project were \$2,534,310, all of which are reported as construction in progress. The remaining \$7,136,817 is in an escrow account.

The following is a schedule by years of future minimum payments required for the capital lease obligations as of June 30, 2012:

Year ending June 30,	
2013	\$ 774,333
2014	1,714,928
2015	1,714,928
2016	1,216,777
2017	1,210,018
Thereafter	<u>8,530,300</u>
Total minimum lease payments	15,161,284
Less: amounts representing interest	<u>(2,521,377)</u>
Present value of minimum lease payments	<u>\$ 12,639,907</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

6. Long-Term Liabilities, continued

The principal and interest repayment requirements relating to the outstanding bonds at June 30, 2012, are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30,			
2013	3,420,000	2,401,874	5,821,874
2014	3,440,000	2,316,080	5,756,080
2015	2,965,000	2,200,772	5,165,772
2016	3,055,000	2,095,976	5,150,976
2017	3,130,000	1,983,237	5,113,237
2018-2030	<u>40,335,000</u>	<u>12,722,343</u>	<u>53,057,343</u>
	<u>\$ 56,345,000</u>	<u>\$ 23,720,282</u>	<u>\$ 80,065,282</u>

7. Pension Plan

Kentucky Teachers Retirement System

All faculty and exempt employees required to hold a degree and occupying full-time positions, defined as seven-tenths (7/10) of normal full-time service on a daily or weekly basis, are required by state law to participate in the Kentucky Teachers Retirement System (KTRS). KTRS, a cost sharing, multiple-employer, public employee retirement system, provides retirement benefits based on an employee's final average salary and number of years of service. Benefits are subject to certain reductions if the employee retires before reaching age sixty, unless the employee has twenty-seven or more years of participation in the plan. The plan also provides for disability retirement, death and survivor benefits and medical insurance.

The Kentucky Teachers Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Teachers Retirement System, 479 Versailles Road, Frankfort, Kentucky 40601-3868 or by calling (502) 573-5120.

Funding for the plan is provided from eligible employees who contribute 7.16% for members after September 1, 2008 or 6.50% for members prior to September 1, 2008 of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 14.84% for members after September 1, 2008 and 14.18% for members prior to September 1, 2008 of currently eligible employees' salaries to the KTRS through appropriations to the University. Contribution requirements of the plan members and the University are established by Kentucky Revised Statute and the KTRS Board of Trustees. The University's contributions to KTRS for the years ending June 30, 2012 and 2011 were \$4,615,755 and \$4,521,516, respectively, equal to the required contributions for each year.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

7. Pension Plan, continued

Kentucky Employees Retirement System

Substantially all other full-time University employees are required by law to participate in the Kentucky Employees Retirement System (KERS), a cost sharing multiple-employer, public employee retirement system. KERS provides retirement benefits based on an employee's final average salary and number of years of service. Benefits are subject to certain reductions if the employee retires before reaching age sixty-five, or has less than twenty-seven years of service. The plan also provides for disability retirement, death and survivor benefits and medical insurance.

The Kentucky Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Employees Retirement System, 1260 Louisville Road, Perimeter Park West, Frankfort, Kentucky 40601 or by calling (502) 564-4646.

Funding for the plan is provided from eligible hazardous and non-hazardous employees who contribute 8.00% and 5.00% for nonhazardous members prior to September 1, 2008 and 6.00% for nonhazardous members after September 1, 2008, respectively, of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 28.98% and 19.82%, respectively of current eligible hazardous and non-hazardous employees' salaries to the KERS through appropriations to the University. University contribution rates are determined by the Kentucky Revised Statute and the Board of Trustees of the Kentucky Retirement Systems each biennium.

The University's contributions to KERS for the years ended June 30, 2012 and 2011 were \$2,273,787 and \$1,966,670 respectively, equal to the required contributions for each year.

Optional Retirement Plans

Optional retirement plans (ORP's) are available to employees hired on or after January 1, 1997, who would otherwise be participants in the Kentucky Teachers' Retirement System. The ORP is established as a 403(b) defined contribution plan under the Internal Revenue Code guidelines. The providers of the University's ORP's are the Teachers Insurance and Annuity Association-College Retirement Equities Fund, Variable Annuity Life Insurance Company and International Netherlands Group. Under these plans the employee's contribution is 6.50% of their gross salary and the University's contribution is 8.74% to the retirement company and 5.10% to Kentucky Teachers Retirement System. The University's contributions under these plans to Kentucky Teachers Retirement System for the years ended June 30, 2012 and 2011 were \$1,446,897 and \$1,364,273 respectively, equal to the required contributions for each year.

8. Operating Leases

The University has operating lease agreements for use of equipment and various parcels of real estate cancelable annually with the option to renew. The University recognizes the expenditures related to those obligations as lease payments are made. Total rent expenses under operating type leases were approximately \$660,000 and \$696,000 in 2012 and 2011, respectively.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

9. Contingencies and Commitments

The University is a defendant in various lawsuits; however, University management is of the opinion, based on advice of legal counsel, that the ultimate resolution of these litigation matters will not have a material effect on the future operations or financial position of the University.

The University receives financial assistance from federal and state agencies in the form of grants and awards. The expenditure of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the applicable fund. The University has had no disallowed claims in the past. In the opinion of management, such potential disallowed claims, if any, would not have a material adverse effect on the overall financial position of the University at June 30, 2012.

The University has made certain commitments related to the completion of various construction projects in progress totaling approximately \$9,287,000. Such construction is principally financed by appropriations from the Commonwealth of Kentucky and proceeds from bonds.

10. Self-Insurance Program

The University maintains a self-insurance program for employees' dental insurance. The University funds the plan at the single rate for all permanent full-time employees with the employees paying the difference between the single plan and the family plan, if applicable. Expenses incurred to cover claims paid by the University under the plan for fiscal year ending June 30, 2012 and 2011 totaled \$318,199 and \$317,955, respectively.

The University maintains a fully insured health plan. The University pays a sliding percentage of premiums for all permanent full-time employees. Depending on the level of coverage, this amount ranges from a low of \$358 per month to a high of \$606. Payments for employee health insurance for fiscal years ending June 30, 2012 and 2011 were \$6,459,164 and \$6,987,264 respectively.

11. Risk Management

The University is exposed to various risks of loss from torts; theft of, damage to, destruction of assets; business interruption; employee injuries and illnesses; natural disasters; and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from theft of, damage to, destruction of assets; business interruption; natural disasters; and employee health and accident benefits. Settled claims have not exceeded this commercial coverage in any of the three preceding years. As a sovereign entity of the Commonwealth of Kentucky, the Kentucky Board of Claims handles tort claims on behalf of the University.

The Commonwealth of Kentucky operates a public entity risk pool operating as a common risk management and insurance program for its members. The pool's governing agreement specifies that the pool will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of specified stop loss amounts.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

11. Risk Management, continued

The University operates a self-insurance program for worker's compensation for its employees. The University purchases reinsurance through commercial carriers for claims in excess of specified stop loss amounts.

12. Friends of Kentucky Folk Art Center, Inc.

The Friends of Kentucky Folk Art Center, Inc. (KFAC) provides educational opportunities, benefits and programs to the public to enhance the awareness of and foster an appreciation and understanding of contemporary folk art. Under an operating agreement, the University provides office space and certain administrative services to the KFAC at no charge. For the fiscal year ended June 30, 2012, state appropriations in the amount of \$176,554 were allocated to KFAC, an affiliate of the University. KFAC is an affiliated corporation in accordance with the provisions of KRS 164A.610. The financial statements of this affiliated corporation are reported upon separately. However, the assets, liabilities and net assets of KFAC have been included in the University's financial statements.

13. Endowment Trust Funds

The Foundation holds endowment investments for the University, the majority of which are associated with the Regional University Excellence Trust Fund (RUETF). The RUETF was created by the Kentucky General Assembly with the passage of the Postsecondary Education Improvement Act of 1997 ("House Bill 1"). The RUETF Endowment Match Program, also known as "Bucks for Brains", provides state funds on a dollar-for-dollar basis. Funds are endowed for the purposes of supporting endowed chairs and professorships.

The Foundation also holds endowment investments for the University which are associated with the Technology Endowment Program. The University will provide matching funds of at least one dollar for every dollar of grant funds. At the end of twenty years, both the principal and the income derived will be used to upgrade and/or replace software/hardware of the University's Information Management System.

The fair market value of Morehead State University endowment funds held by the Foundation as of June 30, 2012 and 2011 was \$35,222,926 and \$34,305,649, respectively. The portion of the endowments representing the value of the funding received from the Kentucky General Assembly was \$11,724,599 as of both June 30, 2012 and 2011, and is included in investments held by the Foundation. The portion of the endowments representing the value of the funding received from the Technology Endowment Program was \$290,229 for the years ended June 30, 2012 and 2011, and is included in investments held by the Foundation.

14. Related Parties

The University and the Foundation are related parties. The Foundation's purpose is to assist in the development, growth, expansion and progress of the student programs of Morehead State University. The University authorizes the Foundation to solicit contributions on its behalf. In the absence of donor

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

14. Related Parties, continued

restrictions, the Foundation has discretionary control over the amounts and timing of its distributions to the University.

Related party transactions and funds held by the Foundation on behalf of the University are as follows during 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Funds disbursed by the University on behalf of the Foundation for employee salaries and benefits	\$ 100,228	\$ 97,051
Funds held by the Foundation on behalf or for the benefit of the University	12,014,828	12,014,828
Funds due to the University by the Foundation	60,948	-

The University entered into an agreement with the Foundation where the University will provide personnel, office space, support equipment and other services that may be necessary to the operation of the Foundation. The Foundation reimburses the University for these services at an annual rate determined mutually by the two entities, \$81,709 and \$79,908 for the years ended June 30, 2012 and 2011 respectively. Amounts disclosed above as funds disbursed by the University on behalf of the Foundation for employee salaries and benefits are net of the annual rate for the fiscal years ended June 30, 2012 and 2011.

The University has also entered into several direct financing capital leases of real estate with the Foundation as disclosed in Note 15I.

15. Morehead State University Foundation, Inc.

A. Description of Organization

The Morehead State University Foundation, Inc. (the Foundation) is a corporation formed for educational, charitable and public purposes in accordance with the provisions of KRS 273.0010. The Foundation is a component unit of Morehead State University (the University). Specifically, it was founded to cooperate with the University and its Board of Regents in the promotion of the educational, civic and charitable purposes of the University in any lawful manner deemed appropriate by the Foundation's Board of Trustees. This purpose includes the encouragement of scholarship and research and the promotion of the prestige, expansion and development of the University's physical plant and faculty and the assistance of its students and alumni.

B. Summary of Significant Accounting Policies

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) which require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The following is a summary of the significant accounting policies consistently followed by the Foundation in the preparation of its financial statements.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

Basis of Presentation

The Foundation's financial statements are presented in accordance with GAAP. Under these standards net assets and revenues, expenses, gains and losses are classified based upon the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Foundation and changes therein are classified and reported as follows:

Unrestricted net assets: Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Trustees.

Temporarily restricted net assets: Net assets whose use by the Foundation is subject to donor-imposed stipulations that can be fulfilled by actions of the Foundation pursuant to those stipulations or that expire by the passage of time.

Permanently restricted net assets: Net assets subject to donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed. Generally, donors of these assets permit the Foundation to use all or part of the income earned on related investments for general or specific purposes.

Cash

The Foundation maintains its cash balances in financial institutions, which at times, may exceed federally insured limits. The Foundation has not experienced any losses on such accounts. The Foundation believes it is not exposed to any significant credit risk related to its cash balances.

Revenue Recognition

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.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

Pledges Receivable

Pledges receivable of amounts greater than \$500, less an appropriate allowance amount, are recorded at the net present value of estimated future cash flows using a discount rate commensurate with the risks involved. Net present value was computed using a discount rate of .72% and 1.76% for the years ended June 30, 2012 and 2011, respectively.

The allowance for doubtful accounts is established through a provision for doubtful accounts charged to expense. The allowance represents an amount, which, in management's judgment, will be adequate to absorb probable losses on existing pledges that may become uncollectible.

Investments

Investments in equity securities having a readily determinable fair value and all debt securities are carried at fair value. Investment returns include dividend, interest and other investment income and realized and unrealized gains and losses on investments carried at fair value. Investment returns that are initially restricted by donor stipulation and for which the restriction will be satisfied in the same year are included as unrestricted net assets. Other investment returns are reflected in the statement of activities as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

Property and Equipment

Property and equipment is stated at cost at the date of acquisition or fair value at date of donation. Expenditures with a cost greater than \$1,000, which increase values or extend useful lives of the respective assets, are capitalized, whereas expenditures for maintenance and repairs are charged to expense as incurred. Depreciation of assets is computed using the straight-line method over the estimated useful lives of the respective assets.

Annuities Payable

The Foundation pays stipulated amounts periodically to individuals (annuitants) who have given to the Foundation certain assets and who have entered into agreements that such payments cease at the death of the annuitant. Total annuity payments for the years ended June 30, 2012 and 2011 were \$187,241 and \$148,723, respectively.

The June 30, 2012 and 2011 annuity liability balances of \$1,305,600 and \$1,112,011, respectively are the present values of the monthly, quarterly, or semiannual payments to the annuitants based on the life expectancies of the annuitants and interest rates ranging from .69% to 4.39%. The estimated remaining life expectancies of the annuitants ranged from 4.5 to 19.6 years and 5.2 to 21.0 years for the years ended June 30, 2012 and 2011, respectively.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

Due to Morehead State University

Contributions were made to the Foundation related to a program that the University has prefunded. The Foundation and the University have agreed that contributions made to the Foundation on behalf of this program will be remitted to the University annually. In accordance with GAAP, the contributions have been included as a liability on the Foundation's statements of financial position.

Funds Held in Trust for Morehead State University

The Foundation is the custodian of funds owned by the University for the purpose of establishing certain endowment funds as authorized by the Kentucky Council on Postsecondary Education and the Kentucky General Assembly. The Foundation invests the principal with a portion of the income derived from the principal to be remitted annually to the University. For the years ended June 30, 2012 and 2011, the Foundation held \$12,014,828 for the University's investment purposes.

Income Taxes

The Foundation is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Except for tax on any unrelated business income activities, no provision for income taxes has been made.

The Foundation has evaluated the tax positions taken on all income tax returns that remain open to examination by the respective taxing authorities (those returns filed for the years 2008 through 2011) and does not believe there are any uncertain positions on those returns that should impact the financial statements.

Contributions

Gifts of cash and other assets received without donor stipulations are reported as unrestricted revenue and net assets. Gifts received with donor stipulations that limit their use are reported as temporarily or permanently restricted revenue and net assets. When a donor-stipulated time restriction ends or the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions. Gifts and investment income that are originally restricted by the donor and for which the restriction is met in the same time period are included in unrestricted net assets.

Gifts of land, buildings, equipment, and other long-lived assets are reported as unrestricted revenue and net assets unless explicit donor stipulations specify how such assets must be used, in which case the gifts are reported as temporarily or permanently restricted revenue and net assets. Absent explicit donor stipulations for the time long-lived assets must be held, expirations of restrictions

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

Contributions, continued

resulting in the reclassification of temporarily restricted net assets to unrestricted net assets are reported when the long-lived assets are placed in service.

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are recorded at the present value of estimated future cash flows. The resulting discount is computed using risk-free interest applicable to the years in which the promises are received. Amortization using the level-yield method is included in contribution revenue. Conditional gifts are not included as support until the conditions are substantially met.

Donated Materials and Property

Donated materials and property are recorded at their estimated fair value when received. The statements of activities for the years ended June 30, 2012 and 2011 include in-kind contributions of \$538,084 and \$351,423, respectively.

Functional Allocation of Expenses

The costs of supporting the various programs and other activities have been summarized on a functional basis in the statements of activities. Certain costs have been allocated among the functional categories based on their relationship to various direct costs in those functions.

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through October 17, 2012, the date the financial statements were available to be issued.

Reclassifications

Certain amounts in the 2011 financial statements have been reclassified to conform to the 2012 presentation with no impact on net assets or change in net assets.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

C. Investments

Investments held as of June 30, 2012 and 2011 are summarized as follows:

	<u>2012</u>	<u>2011</u>
Certificates of deposit	\$ 619,853	\$ 989,871
Mutual funds	34,123,420	32,725,809
Corporate bonds and stocks	37,043	48,340
Annuity investment	<u>137,075</u>	<u>131,146</u>
Total investments at fair value	<u>\$ 34,917,391</u>	<u>\$ 33,895,166</u>

Investment management fees were approximately \$63,000 and \$43,000 during the years ended June 30, 2012 and 2011, respectively.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

D. Fair Value Measurements

The Foundation has determined the fair value of certain assets and liabilities through application of GAAP.

<u>June 30, 2012</u>	<u>Fair Value</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Certificates of deposit	\$ 619,853	\$ 619,853	\$ -	\$ -
Mutual funds:				
Equity				
U.S. Large Cap	6,031,470	6,031,470	-	-
U.S. Small Cap	1,118,500	1,118,500	-	-
International	3,601,300	3,601,300	-	-
Global	1,481,400	1,481,400	-	-
Fixed income and cash:				
Cash	1,947,235	1,947,235	-	-
Core	5,329,900	5,329,900	-	-
Non-core/tactical	3,408,300	3,408,300	-	-
Alternative investments:				
Hedge funds	7,639,015	-	-	7,639,015
Real assets	3,366,300	-	-	3,366,300
Private equity	200,000	-	-	200,000
Corporate bonds and stocks	37,043	37,043	-	-
Annuity investment	137,075	137,075	-	-
Total assets	<u>\$34,917,391</u>	<u>\$ 23,712,076</u>	<u>\$ -</u>	<u>\$ 11,205,315</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

D. Fair Value Measurements, continued

June 30, 2011	Fair Value	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Certificates of deposit	\$ 989,871	\$ 989,871	\$ -	\$ -
Mutual funds:				
Equity				
U.S. Large Cap	4,856,854	4,856,854	-	-
U.S. Small Cap	1,221,790	1,221,790	-	-
International	2,809,893	2,809,893	-	-
Global	1,063,411	1,063,411	-	-
Fixed income and cash:				
Cash	653,059	653,059	-	-
Core	12,861,917	12,861,917	-	-
Non-core/tactical	4,256,648	4,256,648	-	-
Alternative investments:				
Hedge funds	1,705,058	-	-	1,705,058
Real assets	3,297,179	-	-	3,297,179
Corporate bonds and stocks	48,340	48,340	-	-
Annuity investment	131,146	131,146	-	-
Total assets	\$33,895,166	\$ 28,892,929	\$ -	\$ 5,002,237

Financial assets and liabilities valued using level 1 inputs are based on unadjusted quoted market prices within active markets. Financial assets and liabilities valued using level 2 inputs are based primarily on quoted prices for similar assets or liabilities in active or inactive markets. Financial assets and liabilities valued using level 3 inputs are primarily valued based on valuations determined by the investment managers using Net Asset Values as of their most recent statements, adjusted for cash receipts, cash disbursements, and other anticipated income or loss. There have been no changes in the methodology used to determine the fair market value at June 30, 2012 and 2011.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

D. Fair Value Measurements, continued

The table below presents information about the changes in the fair value of assets based on significant unobservable inputs (Level 3):

	<u>Hedge Funds</u>	<u>Real Assets</u>	<u>Private Equity</u>	<u>Total</u>
Beginning balance, June 30, 2011	\$ 1,705,058	\$ 3,297,179	\$ -	\$ 5,002,237
Additional investment	5,700,000	1,575,285	200,000	7,475,285
Funds sold	-	(2,006,455)	-	(2,006,455)
Realized gains	-	456,924	-	456,924
Unrealized gains	245,116	48,660	-	293,776
Fees	<u>(11,159)</u>	<u>(5,293)</u>	-	<u>(16,452)</u>
Ending balance, June 30, 2012	<u>\$ 7,639,015</u>	<u>\$ 3,366,300</u>	<u>\$ 200,000</u>	<u>\$ 11,205,315</u>

Donor-Designated Endowments

The Foundation has adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The Foundation follows UPMIFA and its own governing documents. The Foundation has interpreted UPMIFA as maintaining historical dollar value and to retain in endowment funds a portion of the investment return to support the increasing cost of benefits in the future, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations made pursuant to an applicable gift agreement. The Foundation has determined that the balance of its endowments includes funds that require that the income and net appreciation be restricted to certain uses for the benefit of participants.

The Foundation, on the advice of legal counsel, has determined that the majority of contributions are subject to the terms of its governing documents. Certain contributions are received subject to other gift instruments, or are subject to specific agreements with the Foundation. Under the terms of the Foundation's governing documents, the Foundation has the ability to distribute as much of the original principal of any trust or separate gift, devise, bequest, or fund as the Foundation in its sole discretion shall determine. As a result of the ability to distribute the original principal, all contributions not classified as temporarily restricted or permanently restricted are classified as unrestricted net assets for financial statement purposes.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

D. Fair Value Measurements, continued

Donor-Designated Endowments, continued

The Foundation has established a financial management and investment policy for endowment assets that provides general guidelines for the prudent investment management of the endowment fund assets. The investment policy is established with the objective to preserve the real purchasing power of endowment assets as well as generate capital appreciation, after accounting for endowment spending, inflation, and costs of the portfolio and fund management, both internal and external.

The current financial management and investment policy establishes an annual maximum approved spending goal for distributions of up to 3.5% of endowment assets, a management fee used to support the annual operating budget which shall not exceed 1%, the costs of managing the portfolio shall not be greater than 1% of the portfolio value, and therefore the long-term target minimum annual return shall be 5.5%. In order to achieve a prudent level of portfolio diversification, the securities of any one company should not exceed more than 10% of total, and no more than 25% of total should be invested in any one sector.

The Foundation's investments include endowment investments for the University associated with the Technology Endowment Program and RUETF Endowment Match Program, also known as "Bucks for Brains". Funds held for the Technology Endowment Program are matched by the University of at least one dollar for every dollar of grant funds. As of both June 30, 2012 and 2011, the amount of funds included in the Foundation's investments held for the Technology Endowment Program was \$290,229. Funds held for the RUETF Endowment Match Program are endowed for the purposes of supporting endowed chairs and professorships, scholarships, fellowships, research funds, and mission support funds. As of June 30, 2012 and 2011, the amount of funds included in the Foundation's investments held for the RUETF Endowment Match Program was \$11,724,599 each year. These amounts are shown as funds held in trust for Morehead State University on the statements of financial position and are therefore not included in donor-designated endowment net assets.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

D. Fair Value Measurements, continued

Donor-Designated Endowments, continued

Endowment net asset composition by fund type and changes in endowment net assets by fund type as of June 30, 2012 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Endowment net assets,				
beginning of year	\$ -	\$ 5,408,744	\$ 16,882,077	\$ 22,290,821
Contributions	-	-	519,655	519,655
Interest and dividend				
income	-	778,143	-	778,143
Net appreciation	-	212,700	-	212,700
Amounts appropriated				
for expenditure	-	(593,221)	-	(593,221)
Endowment net assets,				
end of year	<u>\$ -</u>	<u>\$ 5,806,366</u>	<u>\$ 17,401,732</u>	<u>\$ 23,208,098</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

D. Fair Value Measurements, continued

Donor-Designated Endowments, continued

Endowment net asset composition by fund type and changes in endowment net assets by fund type as of June 30, 2011 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets,				
beginning of year	\$ -	\$ 2,283,110	\$ 13,589,736	\$ 15,872,846
Contributions	-	25,277	3,292,341	3,317,618
Interest and dividend income	-	999,816	-	999,816
Net appreciation	-	3,347,577	-	3,347,577
Amounts appropriated for expenditure	-	(1,247,036)		(1,247,036)
Endowment net assets, end of year	\$ -	\$ 5,408,744	\$ 16,882,077	\$ 22,290,821

E. Pledges Receivable

Pledges receivable have been designated to be paid by donors as follows:

Year ended June 30,	
2013	\$ 1,067,405
2014	770,142
2015	737,683
2016	231,308
2017	205,598
Thereafter	95,000
	3,107,136
Less: present value discount	(311,213)
Less: allowance for uncollectible pledges	(310,714)
Pledges receivable, net	2,485,209

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

E. Pledges Receivable, continued

Less: current pledges receivable	(756,191)
Noncurrent pledges receivable	\$ 1,729,018

F. Property and Equipment

Property and equipment as of June 30, 2012 and 2011 consists of the following:

	<u>2012</u>	<u>2011</u>
Land	\$ 53,000	\$ 53,000
Furniture and equipment	126,907	122,538
Buildings	175,000	175,000
	354,907	350,358
Less: accumulated depreciation	(134,120)	(146,797)
	\$ 220,787	\$ 203,741

Depreciation expense was \$7,954 and \$13,589 for the years ended June 30, 2012 and 2011, respectively.

G. Deferred Giving Program

The Foundation established a life insurance deferred giving program during 1983. The program consists of donors designating the Foundation as the owner and beneficiary of life insurance policies. There are twenty deferred giving programs with life insurance in effect totaling \$685,000 for both years ending June 30, 2012 and 2011, respectively. The cash surrender value of these policies as of June 30, 2012 and 2011 is \$115,716 and \$108,629, respectively.

H. Support for Morehead State University

The Foundation's purpose is to assist in the development, growth, expansion and progress of the student programs of Morehead State University. All support to the University has been disclosed separately on the statements of activities as University support.

I. Net Investment in Capital Leases

The Foundation's net investment in direct financing capital leases of real estate with the University as of June 30 is as follows:

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

I. Net Investment in Capital Leases, continued

	<u>2012</u>	<u>2011</u>
Total minimum lease payments to be received	\$ 930,945	\$ 1,172,225
Less: unearned income	<u>(240,945)</u>	<u>(303,315)</u>
 Net investment in capital leases	 <u>\$ 690,000</u>	 <u>\$ 868,910</u>

The following is a schedule of future minimum lease payments due from direct financing capital leases as of June 30:

2013	\$ 234,029
2014	111,495
2015	111,495
2016	77,700
2017	70,941
Thereafter	<u>325,285</u>
	 <u>\$ 930,945</u>

J. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available at June 30 for the following purposes:

	<u>2012</u>	<u>2011</u>
Funds restricted for specific purposes	\$ 9,775,303	\$ 9,278,618
Scholarships	92,023	87,429
Athletics	<u>332,622</u>	<u>35,925</u>
	 <u>\$ 10,199,948</u>	 <u>\$ 9,401,972</u>

Permanently restricted net assets at June 30, 2012 and 2011 consist of endowment funds.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Morehead State University Foundation, Inc., continued

J. Temporarily and Permanently Restricted Net Assets, continued

Temporarily restricted net assets consist of the following as of June 30:

	<u>2012</u>	<u>2011</u>
Cash	\$ 700,363	\$ 600,000
Pledges receivable	2,230,889	1,861,705
Investments	6,556,367	6,158,744
Buildings	139,251	142,752
Net investment in capital leases	<u>573,078</u>	<u>638,771</u>
	<u>\$ 10,199,948</u>	<u>\$ 9,401,972</u>

Permanently restricted net assets consist of the following as of June 30:

	<u>2012</u>	<u>2011</u>
Pledges receivable	\$ 200,383	\$ 192,114
Investments	17,031,427	16,406,824
Land	53,000	53,000
Net investment in capital leases	<u>116,922</u>	<u>230,139</u>
	<u>\$ 17,401,732</u>	<u>\$ 16,882,077</u>

K. Related-Party Transactions

The University entered into an agreement with the Foundation where the University will provide personnel, office space, support equipment and other services that may be necessary to the operation of the Foundation. The Foundation reimburses the University for these services at a rate determined mutually by the two entities, \$81,709 and \$79,908 for the years ended June 30, 2012 and 2011 respectively. GAAP requires recognition of professional services received if those services (a) create long-lived assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Those services in excess of \$79,908 per year are considered in-kind contributed services and are treated as both revenue and expense to the Foundation.

Transactions with the University include direct financing capital leases and support for the University as disclosed in Notes H and I.

SUPPLEMENTAL INFORMATION

MOREHEAD STATE UNIVERSITY

Schedule of Bonds, Notes and Capital Lease Obligations

June 30, 2012

	<u>Issue Date</u>	<u>Net Amount of Issue</u>	<u>Interest Cost</u>	<u>Outstanding June 30, 2011</u>	<u>Payments 2011-12</u>	<u>New Issues</u>	<u>Outstanding June 30, 2012</u>	<u>Interest Paid 2011-12</u>	<u>Debt Service Requirements 2012-13</u>	
									<u>Principal</u>	<u>Interest</u>
Consolidated Educational Building Revenue Bonds:										
Series L	12/01/01	\$ 4,875,000	2.25-4.30	\$ 475,000	\$ 475,000	\$ -	\$ -	\$ 20,425	\$ -	\$ -
Series M	01/01/04	<u>5,620,000</u>	2.00-4.50	<u>2,195,000</u>	<u>545,000</u>	-	<u>1,650,000</u>	<u>80,573</u>	<u>570,000</u>	<u>62,588</u>
Total educational buildings		10,495,000		2,670,000	1,020,000	-	1,650,000	100,998	570,000	62,588
General Receipts:										
2007 Series A Bonds	08/14/07	6,445,000	4.00	5,365,000	390,000	-	4,975,000	206,800	405,000	190,900
2008 Series A Bonds	06/10/08	10,000,000	3.00-3.80	8,060,000	675,000	-	7,385,000	265,373	690,000	244,035
2008 Series B Bonds	06/10/08	1,875,000	4.00-4.50	175,000	85,000	-	90,000	7,875	90,000	4,050
2009 Series A Bonds	07/29/09	28,930,000	2.00-6.00	27,760,000	1,190,000	-	26,570,000	1,397,674	1,210,000	1,367,049
2010 Series A Bonds	06/29/10	5,770,000	1.27-5.75	5,770,000	245,000	-	5,525,000	247,830	245,000	244,119
2011 Series A Bonds	07/25/11	5,090,000	2.00-4.125	-	-	5,090,000	5,090,000	129,533	210,000	166,856
2012 Series A Bonds	06/15/12	<u>5,060,000</u>	2.00-3.625	-	-	<u>5,060,000</u>	<u>5,060,000</u>	-	-	<u>122,278</u>
Total General Receipts		\$63,170,000		\$47,130,000	\$2,585,000	10,150,000	\$54,695,000	\$2,255,085	\$2,850,000	\$2,339,287

MOREHEAD STATE UNIVERSITY

Schedule of Bonds, Notes and Capital Lease Obligations, concluded

June 30, 2012

	<u>Issue Date</u>	<u>Net Amount of Issue</u>	<u>Interest Cost</u>	<u>Outstanding June 30, 2011</u>	<u>Payments 2011-12</u>	<u>New Issues</u>	<u>Outstanding June 30, 2012</u>	<u>Interest Paid 2011-12</u>	<u>Debt Service Requirements 2012-13</u>	
									<u>Principal</u>	<u>Interest</u>
Lease Purchase Agreements:										
MSU Foundation, Inc.	03/01/99	240,000	5.0	120,333	13,211	-	107,122	5,717	13,887	5,041
MSU Foundation, Inc.	07/15/02	990,000	5.25	230,138	196,917	-	33,221	(67,134)	33,221	243
MSU Foundation, Inc.	10/21/02	466,457	9.4	364,524	18,109	-	346,415	33,904	19,887	32,126
Citi Mortgage, Inc.	03/31/05	1,824,000	4.19	1,169,900	117,215	-	1,052,685	47,804	122,177	42,841
Suntrust Bank, Inc	06/15/05	3,874,522	3.58	1,716,314	406,518	-	1,309,796	57,837	421,202	43,154
MSU Foundation, Inc.	09/01/05	327,764	4.47	153,914	34,373	-	119,541	6,181	35,941	4,613
JP Morgan/Chase	03/31/12	<u>9,671,127</u>	2.65	<u>-</u>	<u>-</u>	<u>9,671,127</u>	<u>9,671,127</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total lease purchase		<u>17,393,870</u>		<u>3,755,123</u>	<u>786,343</u>	<u>9,671,127</u>	<u>12,639,907</u>	<u>84,309</u>	<u>646,315</u>	<u>128,018</u>
Total		<u>\$ 91,058,870</u>		<u>\$ 53,555,123</u>	<u>\$ 4,391,343</u>	<u>\$ 19,821,127</u>	<u>\$ 68,984,907</u>	<u>\$ 2,440,392</u>	<u>\$ 4,066,315</u>	<u>\$ 2,529,893</u>

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Education:			
Direct Programs:			
Student Financial Aid Cluster:			
FEDERAL WORK STUDY		84.033	\$ 774,003
FEDERAL PELL GRANT PROGRAM		84.063	15,315,246
FEDERAL SUPPLEMENTAL EDUCATIONAL OPPORTUNITY GRANT PROGRAM		84.007	286,577
FEDERAL PERKINS LOAN PROGRAM		84.038	412,017
FEDERAL DIRECT LOAN PROGRAM		84.268	45,727,214
TEACHER EDUCATION ASSISTANCE FOR COLLEGE AND HIGHER EDUCATION GRANT		84.405	89,166
			<hr/> 62,604,223
TRIO Cluster:			
CEOC - SE 07-10		84.066	296,192
CEOC - NE 09/14	PO66090058	84.066	364,031
STUDENT SUPPORT SERVICES 10.15		84.042	332,884
TALENT SEARCH 07-11		84.044	75,593
TALENT SEARCH II 7-11		84.044	60,490
TALENT SEARCH II 11/16	P044A110127	84.044	209,446
TALENT SEACH 11/16	P044A110123	84.044	328,218
UPWARD BOUND MATH-SCIENCE 08-12		84.047	241,632
UPWARD BOUND EAST 07-11		84.047	237,182
UPWARD BOUND CENTRAL 09/10		84.047	548,822
			<hr/> 2,694,490
GEAR-UP IRAPP 08-14	P334A080059	84.334	1,668,192
KY GEAR UP II 10/11	PO2 415 1100000130 1	83.334	87,810
ODDIS-MAGNETS 09/10		84.116	14,165
RATLIFF-ENTREPRENEUR-CEE 10/11		84.215	742
			<hr/> 1,770,909
Passed through Kentucky Education and Workforce Development Cabinet - Department for Workforce Investment:			
STUBBS-CARRY FORWARD 11		84.048	1,865
STUBBS-TITLE IC-IS 11/12	PON2 531 1100003047 1	84.048	17,884
STUBBS TITLE IC-NURSING 11/12	PON2 531 1100003047 1	84.048	22,643
STUBBS TITLE IC-AS 11/12	PON2 531 1100003047 1	84.048	21,044
STUBBS TITLE IC-DEAN 11/12	PON2 531 1100003047 1	84.048	2,970

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
STUBBS USED-FIELD BASED 11/12	PON2 531 1100002449 1	84.051	16,186
STUBBS-USED-CTE-FACULTY 11/12	PON2 531 1100002460 1	84.051	5,470
MATTINGLY-CDP REHAB 10/11	PO2 531 0800016952 1	84.346	711,383
MICULINICH-USED-TEACH 11	PON2 531 1100001984 1	84.243A	1,145
			<hr/> 800,590
 Passed through Kentucky Council on Postsecondary Education:			
GUNN-CPE-MATH & SCIENCE II 10/11		84.367	31,615
WYMER-USED-KDE-COBRA 12/13	PON2-540-1200001684	84.366B	23,102
HENRIX-POWELL ADULT LC 11/12		84.002	161,637
BOWERSOCK-WL ADULT LC 11/12		84.002	166,697
HENDERSON-USED-CPE-PILOT 11/12		84.002	10,286
ACKERMAN-ADULT ED ACAD 11/12		84.002	289,509
BARTON-USED-CPE-MATH 11/12	PO2 415 1100002583 1	84.367	117,899
BARTON-USED-CPE-READINESS 10/11		84.367	29,814
BARTON-ACTIVE MATH-USED-CPE 11/12		84.367	26,436
BARTON-USED-CPE-READING 12/13	PO2 415 1200003615 1	84.367	18,415
BARTON-USED-CPE-READINESS 11/12	PO2 415 1100002589 1	84.367	131,152
ACKERMAN-ADULT ED ACAD 10/11		84.002	6,078
CONNELL-POWELL ADULT LC 10/11	PO2 415 1100001830 1	84.002	1,815
CONNELL-MONTGOMERY-LC11/12	PO2 415 1200002909	84.002	98,670
CONNELL-MONTGOMERY RESULTS 12	PO2 415 1200002910	84.002	9,303
TOBIN-WL ADULT LC 10/11	PO2 415 1100001859 1	84.002	82
TOBIN-WL ADULT LC-RESULTS	PO2 415 1100001859 2	84.002	11,061
HARR-CPE-FISCAL AGENT 10/12	PO2 415 1200000373 1	84.002	67,608
HENDERSON-MSU ADULT LC RESULTS	PO2 415 1100001823 2	84.002	13,999
HENDERSON-MSU ADULT LC 11/12	PO2 415 1200001313 1	84.002	150,024
			<hr/> 1,365,202
 Passed through National Writing Project Corporation:			
NWP #13 05-06	94-KY07	84.928	48,773
			<hr/> 48,773
 Total U.S. Department of Education			 <hr/> 69,284,187

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
U.S Department of Health and Human Services:			
Direct Programs:			
BLUNT-HHS-RURAL HEALTH 08/11		93.912	(26)
HARDMAN-MARTIN COUNTY-HSA 09/10	1 D1ARH16063-01-00	93.888	33,856
COOPER-HHS-SCHOLARSHIPS 11/12	T08HP22564-01-00	93.925	18,051
SEELIG-MARTIN COUNTY HHS 10/12		93.888	120,285
			<hr/> 172,166
Passed through Eastern Kentucky University:			
SLOAN-TRAINING RESOURCE 10/11	452129-11-165	93.658	112
HESTERBERG-PCWCP-PRESTON 11/12	452312-12-111	93.658	4,080
HESTERBERG-PCWCP-ASHLAND 11/12	452312-12-112	93.658	3,798
SLOAN-MSU TRAINING 11/12	452314-12-110	93.658	91,530
GEURIN-PCWCP-MOREHEAD 10/11	452312-12-114	93.658	6,037
GEURIN-PCWCP-MT. STERLING 10/11	452312-12-113	93.658	5,977
			<hr/> 111,534
Passed through Louisville Metro Community Action Project:			
WILLIAMS-CAPACITY BUILDING 10/11		93.048	15,023
JUDD-HHS-LMG-KY MEDICARE 12/13		93.048	1,197
JUDD-KY MEDICARE 11/12	09SRSKY004	93.048	18,456
JUDD-HHS-CAPACITY-BUILDING 11/12		93.048	10,578
WILLIAMS-KY MEDICARE 10/11	90AM3133/05	93.048	1
			<hr/> 45,255
Passed through Volunteers of America of Los Angeles:			
SHANNON-VOL-REENTRY 11/12		93.243	24,095
SHANNON-HHS-ADULT 10/11		93.243	12,002
SHANNON-VOL-SAFE HAVENS 11/12		93.243	16,902
SHANNON-HHS-VETERANS 10/11		93.243	12,470
SHANNON-HHS-REENTRY 10/11		93.243	14,871
			<hr/> 80,340
Passed through Administration Office of Courts:			
SHANNON-HHS-DAVISS 10/11	PON2-025-11*1372	93.243	11,127
SHANNON-HHS-FAYETTE 10/11	PON2-025-11*1371	93.243	15,499
SHANNON-HHS-STATEWIDE 11/12	PON2-025-1200001315	93.243	12,534
SHANNON-HHS-CLARK MADISON 11/12		93.243	5,852

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
SHANNON-HHS-CLARK HOPKINS 11/12	PON2-025-1200000785	93.243	26,630
SHANNON-HHS-COURTS-DAVISS 11/12	PON2 025-1100001372	93.243	25,132
SHANNON-HHS-COURTS-CHRISTIAN 11/12	PON2-025-1200000606	93.243	17,134
SHANNON-HHS-COURTS-FLOYD 11/12	PON2-025-1200000761	93.243	29,858
SHANNON-HHS-COURTS-PERRY 11/12	5H79TI020019-03	93.243	27,294
SHANNON-HHS-COURTS-HARDIN 11/12	PON2 025-1200000784	93.243	39,202
SHANNON-HHS-KNOT-MAGOFFIN 11/12	PON2-025-1200002084	93.243	4,544
SHANNON-HHS-MUHLENBERG 11/12	PON2-025-1200001314	93.243	3,500
SHANNON-HHS-KNOX-LAUREL 11/12	PON2-025-1200000787	93.243	40,529
SHANNON-HHS-COURTS-FAYETTE 11/12	PON2-025-1100001371	93.243	43,005
			<hr/> 301,840
 Passed through KY Cabinet for Health and Family Services:			
MCBRIDE-STEPS-CHFS 10/11	PON 2736 1000036271	93.558	34,038
			<hr/> 34,038
 Passed through University of Kentucky Research Foundation:			
SHANNON-HHS-CHRISTIAN 10/11	3048106655-11-303	93.243	575
SHANNON-HHS-FLOYD/PERRY 10/11	3048105484-11-302	93.243	1,696
SHANNON-HHS-HOPKINS 10/11	3048106848-11-306	93.243	1,871
SHANNON-HHS-HARDIN 10/11	3048106847-11-305	93.243	3,945
SHANNON-HHS-KNOX/LAUREL 10/11	3048106847-11-304	93.243	3,944
ALBERT-HHS-UKRF 11/12	UKRF3049024112-11-406	93.718	5,000
			<hr/> 17,031
 Total U.S. Department of Health and Human Services			<hr/> 762,204
 U.S. Department of Homeland Security:			
Direct Programs:			
LANGE-NIHS STUIDY 10/11		97.000	389,787
			<hr/> 389,787
 Passed through to University of Kentucky Research: Foundation			
HAIL-DHS-NIHS-DAMS 10/12	3048106906-11-420	97.000	76,158
			<hr/> 76,158

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
Total U.S. Department of Homeland Security			<u>465,945</u>
U.S. Department of Defense			
Direct Programs			
MALPHRUS DOD 10/11		12.000	208,245
Passed through Radiance Technologies	W9113M-08-D-0001	43.000	<u>102,752</u>
Total Department of Defense			<u>310,997</u>
National Science Foundation:			
Direct Programs:			
XU-NFS-MRI 09/11		47.041	319
DENNIS-NSF-MAPPING 12/13	MCB-1052127	47.074	32,936
HARE-NFS-MAPPING 12/13	BCS-1144511	47.075	1,462
SCHACK-NSF-NUMERACY 11/12	DUE-1043656	47.076	23,001
DENNIS-NSF-MSP 08/09		47.076	<u>4,933</u>
Total National Science Foundation			<u>62,651</u>
Corporation for National and Community Service			
Direct Programs:			
JUDD-CNCS-RSVP 12/15	12SRSKY005	94.002	18,565
WILLIAMS-RSVP 09/12	09SRSKY004	94.002	<u>60,355</u>
			78,920
Passed through Kentucky Campus Compact Foundation			
COOPER-CNCS-PAY IT FORWARD 11/12		94.005	<u>4,000</u>
			4,000
Passed through Western Kentucky University Research Foundation			
HAIGHT-KUPEE 09/12	528101-10-001	94.005	<u>63,808</u>
			63,808
Passed through CNCS			
MSU CORP CNCS 10/11	PO2 703 1000003914	94.006	31,388
MSU CORP-10 MONTH CNCS-11/12		94.006	<u>340,390</u>
			371,778

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
Total Corporation for National and Community Service			<u>518,506</u>
 Corporation for Public Broadcasting			
Direct Programs:			
HITCHCOCK-CPB 09/11		11.550	16
HITCHCOCK-CPB 11/12	0014161222011A2, B2	11.550	95,513
HITCHCOCK-CPB-RLAIF-BONUS 11/12		11.550	20,962
HITCHCOCK-CPE-RADIO 11/13			26,722
HITCHCOCK-CPE BONUS 10/11		11.550	<u>758</u>
Total Corporation for Public Broadcasting			<u>143,971</u>
 Small Business Administration:			
Passed through University of Kentucky Research Foundation:			
SBDC Federal UKRF 10/11	1-603001-Z-0018-30	59.037	29,133
MORLEY-SBA-UKRF-SBDC EXPORT 12	3046356600-12-587	59.037	321
SBDC -SBA-UKRF-FEDERAL 11/12	2-603001-Z-0018	59.037	<u>104,857</u>
Total Small Business Administration			<u>134,311</u>
 U.S. Department of Justice:			
Passed through Kentucky State Police:			
WILBURN-DOJ-RESPONSE 10	VAWA-2010-MOREHEAD-00141	16.588	7,761
WEBB-KSP-JUSTICE 10/12	2010-AH-FX-0093-MS	16.727	<u>18,553</u>
Total U.S. Department of Justice			<u>26,314</u>
 Appalachian Regional Commission:			
Direct Programs:			
KY-AHED-Duvall 04-09		23.001	424,939
DEMOSS-ARC Dental 11/12		23.001	<u>199,000</u>
			623,939
 Passed through East Tennessee State			
MCMICHAEL -ETS-ATP 11/12	220011-05	23.001	<u>3,942</u>
			3,942

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
Total Appalachian Regional Commission			<u>627,881</u>
U.S. Department of Labor			
Passed Through U.S. Department of Housing and Urbana Development			
SLOAN-HUD YOUTHBUILD II 09/12	YB-18972-09-60-A-21	17.274	204,428
SLOAN-YOUTHBUILD-DOL-HUD 09/10	YB-18972-09-60-A-21	17.274	<u>50</u>
			204,478
Passed through Buffalo Trace Area Development District:			
REYNOLDS-TODAY'S YOUTH 11/12	FY 12-5245	17.259	<u>110,624</u>
			110,624
Total U.S. Department of Labor			<u>315,102</u>
National Aeronautics and Space Administration:			
Passed through Western Kentucky University:			
MALPHRUS—NASA-KSGC SBAND 11	3048107336-11-168	43.001	12,512
PANNUTI-NASA-KSGC 11	3048107336-11-184	43.001	10,596
BROWN-NASA-UKRF-CXBN 12	3048107336-12-485	43.001	2,927
THOMAS-NASA-KSGC-WORKSHOP 12	3048107336-12-486	43.001	1,830
THOMAS-NASA-KSGC-STEM 11	3048107336-11-190	43.001	<u>2,043</u>
Total National Aeronautics and Space Administration			<u>29,908</u>
U.S. Department of Agriculture:			
Direct Programs:			
MORLEY-ENERGY AUDIT 10/12		10.769	54,261
MORLEY-USDA 08/10		10.769	<u>42,280</u>
			96,541
Passed Through to Kentucky Department of Education			
Cady- Summer Food Program 11	103-X30-999SU	10.558	16,858
Cady- Summer Food Program 12		10.558	<u>9,418</u>
			26,276

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
Passed Through to Louisiana State University			
MARK_USGS_LSU 11/12	2011-69005-30515	10.031	6,249
			<hr/> 6,249
 Total U.S. Department of Agriculture			<hr/> 129,066
National Endowment for the Arts:			
Direct Programs:			
COLLINSWORTH-NEA-WILLIAMS 09/11		45.024	623
			<hr/> 623
Passed Through South Arts			
TOWELL-NEA-SOUTH ARTS 11		45.024	4,342
			<hr/> 4,342
 Total National Endowment for the Arts			<hr/> 4,965
National Endowment for the Humanities:			
Direct Programs:			
DAVISON-QUESTIONS-NEH 10/12		45.163	9,070
			<hr/> 9,070
U.S. Environmental Protection Agency:			
Passed through Kentucky Environmental and Public Protection Cabinet :			
WRIGHT-LABORATORY CRT 10.12		66.468	64,009
WRIGHT-PRINCIPAL LAB 10/12		66.468	32,391
			<hr/> 96,400
Passed through Kentucky Division of Water:			
HAIGHT-TRIPLETT CREEK 08/09	C9994861-08	66.460	61,333
			<hr/> 61,333
 Total U.S. Environmental Protection Agency			<hr/> 157,733
National Institute of Health:			
Direct Programs:			
WHITE-NIH AMPHETAMINE 11/13	2R15DA015351-03	93.113	29,322
WHITE-NIH AMP 07/10		93.279	28,701

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
HARE-NIH 08/12	1R15GM085722-01A1	93.859	60,472
			<hr/> 118,495
 Passed through University of Louisville Research Foundation:			
INBRE-KBRIN-MATTINGLY 12/13		93.389	7,113
INBRE-KBRIN-CARLSON 12/13		93.389	6,472
INBRE-KBRIN-DENNIS FELLOWS 11		93.389	24,637
INBRE-KBRIN-DENNIS 11/12		93.389	60,966
INBRE-KBRIN-T HARE 11/12		93.389	12,003
INBRE-KBRIN-J HARE 11/12		93.389	61,606
IBRE-KBRIN-MATTINGLY 11/12		93.389	266,449
INBRE-KBRIN-J HARE 12/13		93.389	10,033
INBRE-KBRIN-DENNIS-LEAD 12/13		93.389	6,032
IBRE-KBRIN-T HARE 12/13		93.389	10,605
			<hr/> 465,916
 Total National Institute of Health			 <hr/> 584,411
 U.S. Geological Survey:			
Direct Programs:			
O'KEEFE USGS 10/11		15.808	6,116
PARKANSKY-USGS 07/11		15.808	23,155
			<hr/> 29,271
 Passed through America View, Inc.			
MCMICHAEL-USGS-AMVIEW 11/12	AV08-KY01	15.815	15,636
MCMICHAEL-USGS-America View 10/11	AV08-KY01	15.808	17,022
			<hr/> 32,658
 Passed through US Department of Interior			
MASON-USGS-DOI-MAPPING 12/14			<hr/> 904
			904
 Total U.S. Geological Survey			 <hr/> 62,833

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2012

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
National Highway Traffic Safety Administration:			
Passed through Kentucky Transportation Cabinet			
STIDAM-NWTSA-POSTED 11/12		20.600	2,454
JAMES-NTSA-POSTED 10/11	AL-11-28	20.600	<u>1,860</u>
Total National Highway Traffic Safety Administration			<u>4,314</u>
U.S. Department of Energy:			
Direct Programs:			
PHILLIPS-US ENEGRY 10/11		81.087	<u>67,437</u>
			67,437
Institute of Museum and Library Services			
COLLINGSWORTH OUTREACH 11/12	MA-04-11-0416-11	45.301	<u>13,655</u>
			13,655
 Total Expenditures of Federal Awards			 <u><u>\$ 73,715,461</u></u>

MOREHEAD STATE UNIVERSITY

Notes to Schedule of Expenditures of Federal Awards

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Morehead State University (the "University") and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Non-profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. Federal Student Loan Programs

Loans made by the University to eligible students under the Federal Perkins Loan Program and federal student loans issued by the Federal Direct Loan Program during the year ended June 30, 2012 are summarized as follows:

Federal Perkins Loan Program:	
Loans disbursed	\$ 412,017
Federal Direct Loan Program:	
Federal Unsubsidized Loans	\$ 22,566,295
Federal Subsidized Loans	20,876,970
Federal Plus Loans	2,283,949

As of June 30, 2012, the University had loans outstanding, in the amount of \$3,491,466 with an allowance for doubtful accounts of \$81,527 under the Federal Perkins Loan Program.

DEAN || DORTON || ALLEN || FORD^{PLLC}

**Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in Accordance
with *Government Auditing Standards***

Members of the Board of Regents and
Dr. Wayne D. Andrews, President
Morehead State University
Morehead, Kentucky

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Morehead State University (the University) as of and for the year ended June 30, 2012 which collectively comprise the University's basic financial statements and have issued our report thereon dated October 17, 2012. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the University is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Morehead State University in a separate letter dated October 17, 2012.

This report is intended solely for the information and use of the Board of Regents, audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Dean Don Allen Ford, ACC". The signature is written in a cursive style with a large initial "D".

October 17, 2012
Lexington, Kentucky

DEAN || DORTON || ALLEN || FORD^{PLLC}

**Report on Compliance with Requirements that Could
Have a Direct and Material Effect on Each Major
Program and Internal Control Over Compliance in
Accordance with OMB Circular A-133**

Members of the Board of Regents and
Dr. Wayne D. Andrews, President
Morehead State University
Morehead, Kentucky

Compliance

We have audited the compliance of Morehead State University (the University) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. The University's major federal programs are identified in the summary of auditors' results section of the accompanying *Schedule of Findings and Questioned Costs*. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the University's management. Our responsibility is to express an opinion on the University's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the University's compliance with those requirements.

In our opinion, the University complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

We did not audit the University's compliance with requirements governing the maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Perkins Loan Program. Those requirements govern functions that are performed by University Accounting Service, LLC (UAS). Since we did not apply auditing procedures to satisfy ourselves as to compliance with those requirements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance with those requirements. UAS's compliance with the requirements governing the functions that it performs for the University was examined by other accountants whose report has been furnished to us. The report of the other accountants indicates that compliance with those requirements was examined in accordance with the Department

of Education's Audit Guide, *Compliance Audits (Attestation Engagements) of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*. Based on our review of the service organization accountant's report, we have determined that all of the compliance requirements included in the *Compliance Supplement* that are applicable to the major program in which the University participates are addressed in either our report or the report of the service organization accountants. Further, based on our review of the service organization accountant's report, we have determined that it does not contain any findings of noncompliance that would have a direct and material effect on the University's major program.

Internal Control Over Compliance

Management of the University is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the University's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over compliance.

Requirements governing the maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Federal Perkins Loan Program are performed by UAS. Internal control over compliance relating to such functions was reported on by other accountants in accordance with the U.S. Department of Education's Audit Guide, *Compliance Audits (Attestation Engagements) of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*. A copy of the service organization accountant's report has been furnished to us. However, the scope of our work did not extend to internal control maintained at UAS.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Members of the Board of Regents and
Dr. Wayne D. Andrews, President
Page 3

This report is intended solely for the information and use of management, the Board of Regents, others within the entity, audit committee, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

October 17, 2012
Lexington, Kentucky

A handwritten signature in black ink that reads "Dean Doctor Allen Ford, PLLC". The signature is written in a cursive, flowing style.

MOREHEAD STATE UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended June 30, 2012

Section I – Summary of Auditors’ Results (under Section .505(d)(1) of OMB Circular A-133):

Financial Statements:

- a. The type of report issued on the financial statements: **Unqualified Opinion**
- b. Internal control over financial reporting:
Material weaknesses: **No**
Significant deficiencies identified that are not considered to be material weaknesses: **None Noted**
- c. Non-compliance which is material to the financial statements: **No**

Federal Award:

- d. Internal control over major programs:
Material weaknesses: **No**
Significant deficiencies identified that are not considered to be material weaknesses: **None Noted**
- e. The type of report issued on compliance for major programs: **Unqualified Opinion**
- f. Any audit findings which are required to be reported under Section .510(a) of OMB Circular A-133: **No**
- g. Major programs:
 - Student Financial Aid Cluster:**
 - Federal Pell Grant, CFDA 84.063**
 - Federal Work Study, CFDA 84.033**
 - Federal Supplemental Educational Opportunity Grant, CFDA 84.007**
 - Federal Perkins Loan, CFDA 84.038**
 - Federal Direct Loan Program, CFDA 84.268**
 - Teacher Education Assistance for College and Higher Education Grant, CFDA 84.405**
 - Liles Scholarship, CFDA 93.925**
 - TRIO Cluster:**
 - CEOC, CFDA 84.066**
 - Student Support Services, CFDA 84.042**
 - Talent Search, CFDA 84.044**
 - Upward Bound, CFDA 84.047**
 - Gear Up, CFDA 84.334**

MOREHEAD STATE UNIVERSITY

Schedule of Findings and Questioned Costs, continued

Year ended June 30, 2012

Section I – Summary of Auditors’ Results (under Section .505(d)(1) of OMB Circular A-133), continued:

- h. Dollar threshold used to distinguish between Type A and Type B programs: **\$333,337**
- i. Auditee qualified as a low-risk auditee: **Yes**

Section II – Financial Statement Findings (under Section .505(d)(2) of OMB Circular A-133):

Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*:
None Noted

Section III – Federal Award Findings and Questioned Costs (under Section .505(d)(3) of OMB Circular A-133):

None Noted

MOREHEAD STATE UNIVERSITY

Summary Schedule of Prior Audit Findings

Year ended June 30, 2012

Finding 11-01:

Condition:

During our audit, we noted that Morehead State University modified its employee vacation policy but did not properly account for the modification. This condition resulted in the accrued vacation account being understated at year end.

Effect:

An adjusting journal entry was required to correct the vacation accrual on the financial statements for the year ending June 30, 2011.

Recommendation:

We recommend that the University review the accounting for the vacation accrual on a regular basis to ensure that it is being calculated accurately and according to policy.

Management's Response:

Following a review of the University's employee vacation accrual policy by the Office of Human Resources in February 2011, the University modified its interpretation of the policy. The change in the interpretation was applied to all current employee vacation accrual calculation tables, resulting in additional vacation leave time being available to those current employees. Although the University had recorded a liability for accrued vacation leave as of June 30, 2011, the net effect of the change in interpretation of the policy had not been quantified at that time, and therefore could not be booked accurately. Once that additional amount was determined in September 2011, the net financial effect of the change was booked in a subsequent adjusting entry to the University's June 30, 2011 financial statements. Future accrual adjustments for vacation leave time will be determined in accordance with the new interpretation.

Current Status:

No instances of this compliance issue repeated in current year.

Finding 11-02:

Federal Program: U.S. Department of Education
Federal Pell Grant, CFDA 84.063

MOREHEAD STATE UNIVERSITY

Summary Schedule of Prior Audit Findings, continued

Year ended June 30, 2012

Finding 11-02, continued:

Condition:

During our testing of the verification requirement, we noted 3 students (out of the sample of 45) for which the verification process was not completed properly. For these 3 students the income tax return section of the Institutional Student Information Record (ISIR) was not properly reconciled to the income tax return provided by the student. The differences related primarily to "untaxed income and benefits" not being properly accounted for on the student's application for federal aid. Due to the errors noted in our original sample, we requested that MSU examine all verifications performed in the current to determine the full magnitude of this issue. MSU pulled the verification records for 2,672 students and noted that 45 of those students had similar issues regarding the untaxed income reported on the ISIR not being properly reconciled to the income tax return.

Criteria:

Per 34 CRF 668.55, schools are required to perform verification procedures to ensure that the data used to award aid to students is accurate, based on source documentation. Per 34 CRF 668.56 and 668.57, dictate the types of items that are required to be verified including untaxed income and benefits as well as what source documentation is acceptable.

Cause:

There is no internal control in place to provide a review of the verification process prior to the disbursement of the students' awards to ensure that all supporting documentation agrees to the ISIR.

Effect:

The University failed to properly verify the untaxed income for 48 students. Using the incorrect income resulted in an incorrect calculation of the expected family contribution (EFC). The incorrect EFC impacted the amount of aid that was awarded to students. Specifically, 47 students were awarded too much Pell (\$31,275) and 1 student was not awarded enough Pell (\$1,500). The net Pell overaward of \$29,775 is required to be returned to the federal government. The \$29,775 was returned on October 24, 2011.

Recommendation:

We recommend that MSU put a control in place to properly monitor the verification process that is being conducted as well as ensure that any changes that are being put into place for the year being verified are properly communicated to all members involved in the verification process.

MOREHEAD STATE UNIVERSITY

Summary Schedule of Prior Audit Findings, continued

Year ended June 30, 2012

Finding 11-02, continued:

Management Response:

The required verification data items vary from one year to the next, most often regarding untaxed income. Due to the changes, we believe some items were overlooked during times when two years overlapped. We have developed a check sheet that will be updated each year that contains all required data items to be verified. This will ensure each data item is checked. When years overlap and we are verifying two years at the same time, we now have a process in place to work on the years separately to prevent any conflicting issues. Verifications completed will be spot checked throughout the year to ensure compliance with current year requirements.

Our verification processor has participated in two Webinars and one federal training regarding verification processes in the last two months, with continued training planned. We will ensure training continues and that the director of financial aid communicates more with the verification processor regarding the processes.

Current Status:

No instances of this compliance issue repeated in current year.

Finding 11-03:

Federal Program: U.S. Department of Education
Federal Pell Grant, CFDA 84.063
Federal Direct Loan Program, CFDA 84.268

Condition:

During our audit, we encountered an error in the return of Title IV funds calculation. The error primarily related to the calculation of the Pell money that should be returned. The computer system, Datatel, was not using the actual amount of Pell that was disbursed in the return calculation. This error primarily related to students that enrolled at full time and then dropped to part time before withdrawing completely and therefore resulting in a return calculation. In four separate cases, the Datatel withdrawal calculation was not reviewed and incorrect amounts were calculated for the amount of aid earned and the amount of aid to be returned.

Criteria:

MOREHEAD STATE UNIVERSITY

Summary Schedule of Prior Audit Findings, continued

Year ended June 30, 2012

Per 34 CFR 668.22, the amount of Title IV grant or loan assistance that is earned by the student is calculated by: (1) determining the percentage of Title IV grant or loan assistance that has been earned by

Finding 11-03, continued:

the student and (2) applying this percentage to the total amount of Title IV grant or loan assistance that was disbursed for the payment period or period of enrollment as of the student's withdrawal date.

Cause:

There is no internal control in place to provide a review of the return of Title IV aid calculation to ensure that all funds are being returned timely and in the appropriate amounts.

Effect:

In all cases noted above, the amount of aid earned by the student was incorrectly calculated. As a result, in two of these cases, both the institution and the student returned more Title IV aid than was required.

Recommendation:

We recommend that an internal control be implemented to ensure that all return of Title IV aid calculations are being reviewed to ensure that the Datatel system is working properly and correct amounts of aid are being returned in a timely manner.

Management Response:

The Assistant Director for Student Services is now reviewing all Return of Title IV Fund Calculations to ensure that the Datatel system is working properly and correct amounts of aid are being returned in a timely manner.

Current Status:

No instances of this compliance issue repeated in current year.