

MOREHEAD STATE UNIVERSITY

**Single Audit Reports Under
OMB Circular A-133**

*As of and for the Years Ended
June 30, 2006 and 2005
with Independent Auditors' Report Thereon*



DEAN, DORTON & FORD

CPAs • Business & Financial Advisors

November 16, 2006

To the Board of Regents
Morehead State University

We have audited the financial statements of Morehead State University (the "University") for the year ended June 30, 2006, and have issued our report thereon dated November 2, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and *Government Auditing Standards*

As stated in our engagement letter dated May 5, 2006, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the University. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the University's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the University are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2006. We posted an investment restatement adjustment disclosed in Note 2. We noted no transactions entered into by the University during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.



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Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Significant estimates within the University's financial statements relate to:

The depreciable and amortizable lives of the University's fixed assets
The valuation of the University's accounts, loans and pledges receivable

We evaluated the key factors and assumptions used by management to develop the accounting estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the University's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the University, either individually or in the aggregate, indicate matters that could have a significant effect on the University's financial reporting process.

In addition, the attached schedule summarizes passed audit adjustments of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the University's financial

statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the University's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

The completion of the audit was delayed because of the following reasons: (1) Datatel conversion and related training, (2) time associated with management discussing the investment restatement adjustment, and (3) change in timelines requested by management.

This information is intended solely for the use of the Board of Regents and management of Morehead State University and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

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

DEAN, DORTON, AND FORD, PSC

Morehead State University

Year End: June 30, 2006

Passed Audit Adjustments

Date: 7/1/2005 To 6/30/2006

Prepared by	Reviewed by	Reviewed by	Reviewed by
CWC 11/1/2006			

H-2

Number	Date	Name	Account No	Reference	Annotation	Debit	Credit
24	6/30/2006	Government Grants & Contracts - Federal	410 RESTRI	14-1			296,031.00
24	6/30/2006	Unearned Rev- Restr.	11-20301 RESTRI	14-1		296,031.00	
To properly report deferred revenue from grant activity as of June 30, 2006.							
						296,031.00	296,031.00

Net Income (Loss) 1,782,039.94



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, 2006. 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

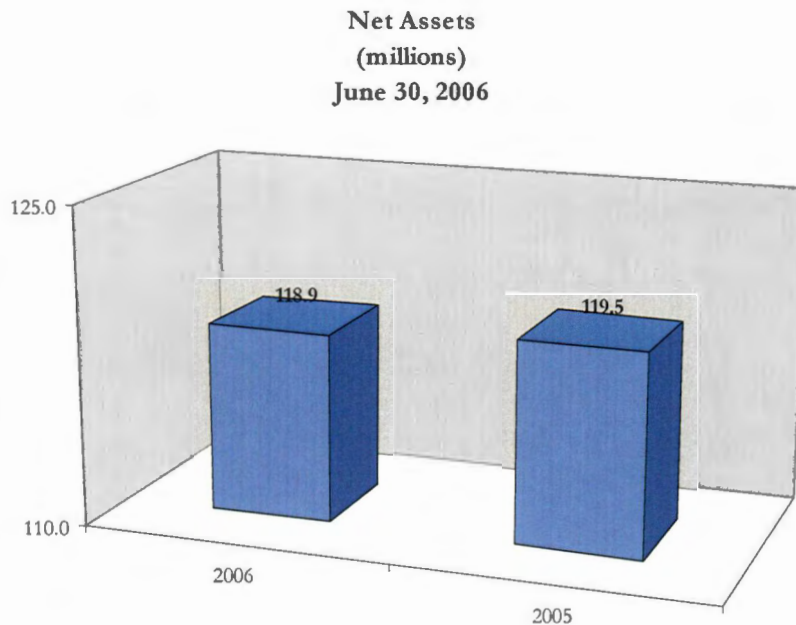
- The financial statements indicate that the University's financial condition remained stable at June 30, 2006. Financial operations were conducted in accordance with the approved budget plan.
- Total assets were \$168 million versus \$174 million at June 30, 2005. Significant components of the assets include \$20 million in cash, \$17 million in investments and \$121 million in capital assets net of depreciation.
- Total liabilities were \$49 million versus \$55 million at June 30, 2005. The significant components of the liabilities were \$33 million in bonds, notes, and capital lease obligations,

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

\$8 million in accounts payable and accrued liabilities, \$5 million in refundable grants, and \$3 million in deferred revenue and other liabilities.

- Total net assets were \$119 million at June 30, 2006 and \$120 million at June 30, 2005. Significant components of net assets include \$89 million invested in capital assets, net of depreciation and related debt, \$6 million in expendable restricted net assets, \$12 million of non-expendable restricted net assets, and \$12 million in unrestricted net assets.



- Operating revenues were \$70 million at June 30, 2006 and June 30, 2005. Operating expenses were \$118 million versus \$113 million at June 30, 2005. This created an operating loss of \$48 million versus an operating loss of \$43 million for the year ended June 30, 2005.
- Net nonoperating revenues were \$44 million for the year ended June 30, 2006, and \$42 million for the year ended June 30, 2005. Nonoperating revenues were comprised primarily of state appropriations. The combination of the net loss from operations, the net nonoperating revenues, and capital appropriations of \$4 million, resulted in a decrease in net assets of \$.7 million.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

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.

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:

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

These statements present financial information of the

University in a format similar to that used by corporations, and presents 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 29 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 Financial Statements in order to get a complete understanding.



MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

The Statement 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 Statement 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 nonoperating. GASB 35 requires State appropriations and gifts to be classified as nonoperating revenues. Accordingly, the University will generate a net operating loss prior to the addition of nonoperating revenues. The utilization of long-lived assets, referred to as Capital Assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The Statement 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

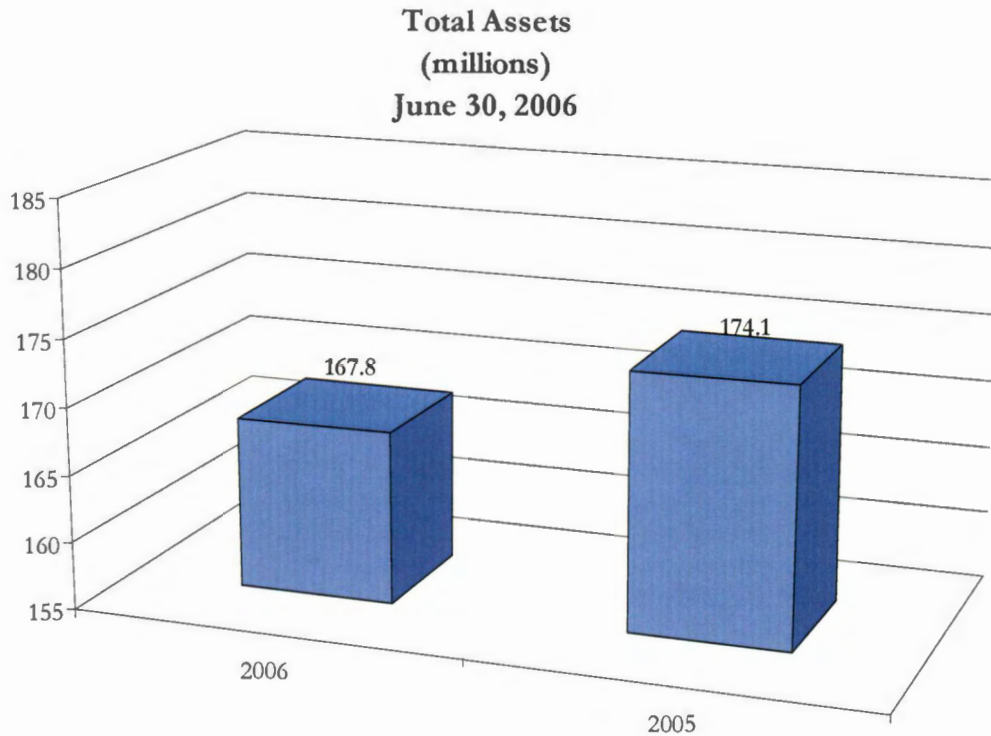
Management's Discussion and Analysis, continued

Condensed Financial Information Statement of Net Assets (in thousands)

	<u>2006</u>	<u>2005</u>
<u>Assets</u>		
Current assets	\$ 26,250	\$ 30,969
Capital assets	121,166	123,081
Other noncurrent assets	<u>20,425</u>	<u>20,047</u>
Total assets	167,841	174,097
 <u>Liabilities</u>		
Current liabilities	15,007	17,478
Noncurrent liabilities	<u>33,942</u>	<u>37,072</u>
Total liabilities	48,949	54,550
 <u>Net Assets</u>		
Invested in capital assets, net of related debt	88,653	87,308
Restricted, expendable	6,277	7,258
Restricted, nonexpendable	11,746	11,706
Unrestricted	<u>12,216</u>	<u>13,275</u>
Total net assets	<u>\$ 118,892</u>	<u>\$ 119,547</u>

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

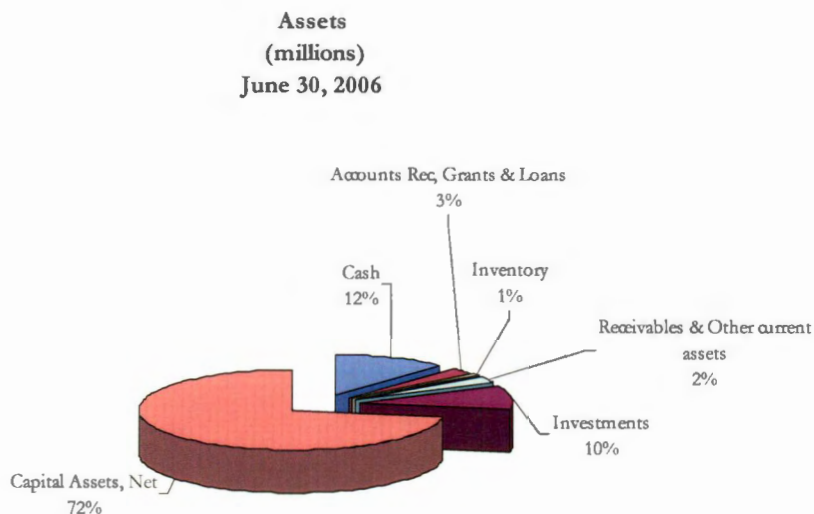


Assets

As of June 30, 2006, the University's total assets amount to approximately \$168 million versus \$174 million at June 30, 2005. Investment in capital assets, net of depreciation, represented the University's largest asset, totaling \$121 million compared to \$123 million at June 30, 2005. Cash and investments, totaling \$37 million at June 30, 2006 and \$39 million at June 30, 2005, were the University's next largest asset.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued



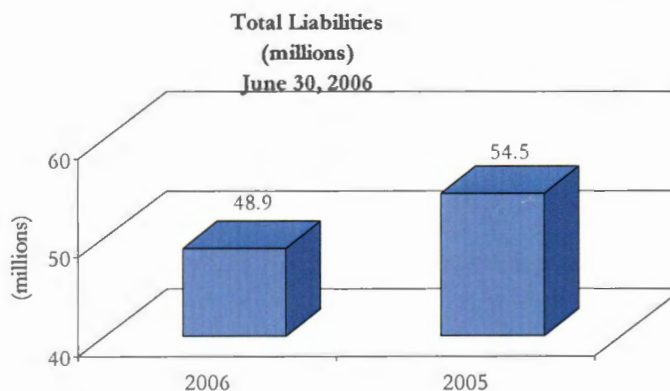
Total assets decreased by \$6.3 million during the year ended June 30, 2006. The principal areas of change were:

- cash and cash equivalents decreased approximately \$2.7 million,
- accounts, grants, and loans receivable, net decreased approximately \$1 million,
- capital assets, net of accumulated depreciation, decreased approximately \$1.9 million,
- investments and other receivables decreased approximately \$1 million.

Liabilities

At June 30, 2006, the University's liabilities totaled

approximately \$49 million versus \$55 million the previous year. Bonds, notes payable, and capital lease obligations for capital assets represented \$33 million versus \$36 million at June 30, 2005.

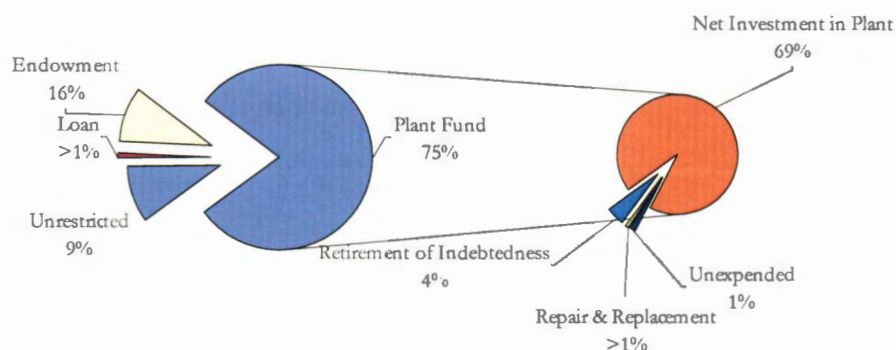


MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Total liabilities decreased by \$5.6 million during the year ended June 30, 2006. This decrease was due primarily due to a \$3 million decrease in accounts payable and accrued liabilities, and a \$3.1 million decrease in bonds, notes and capital lease obligations, and an increase of \$.7 million in deferred revenue and other liabilities.

Net Assets June 30, 2006



Net Assets

Net assets at June 30, 2006 totaled approximately \$119 million compared to \$120 million at June 30, 2005. Net assets invested in capital assets, net of related debt, totaled \$89 million at June 30, 2006 versus \$87 million at June 30, 2005. Restricted net assets totaled \$18 million at June 30, 2006 compared to \$19 million at June 30, 2005. Unrestricted net assets accounted for \$12 million at June 30, 2006 versus \$13 million at June 30, 2005. Total net assets decreased by \$.7 million during the year ended June 30, 2006.

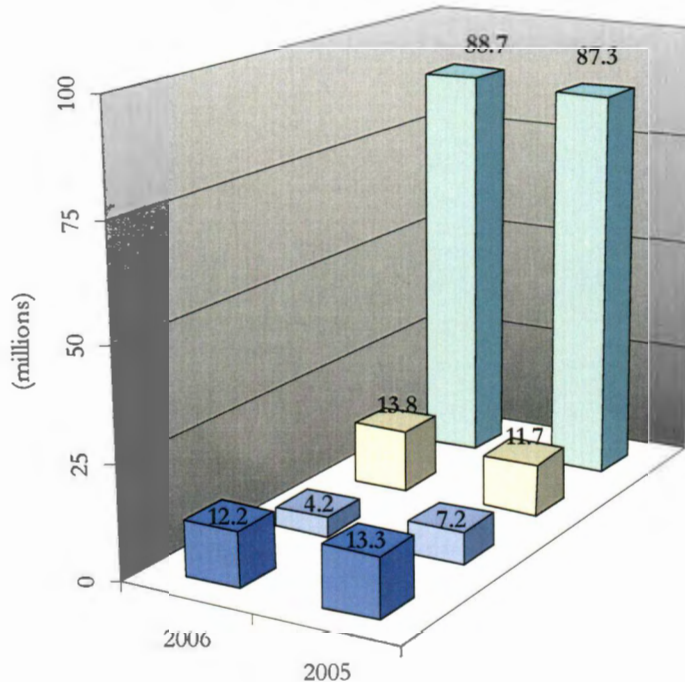
MOREHEAD STATE UNIVERSITY

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, increased by \$1.3 million. Increases in net assets invested in capital assets were primarily due to a \$10.3 million increase in capital appropriations for buildings versus an increase of \$2.6 million at June 30, 2005, a decrease of \$8.6 million for capital construction versus an increase of \$3.3 million last year.; net increases in other capital assets of \$4 million at June 30, 2006 versus \$9.6 million at June 30, 2005. Also \$3.6 million in payments of principal on debt compared to \$7.8 million during fiscal year 2005. Decreases in net assets invested in capital assets (net) were from current year depreciation of \$6.9 million compared to \$5.8 for the year ended June 30, 2005, new debt issued of \$.3 million versus \$5.7 million last year, as well as disposals and sales of \$.7 million compared to \$.72 million during fiscal year 2005.

**Total Net Assets
June 30, 2006**



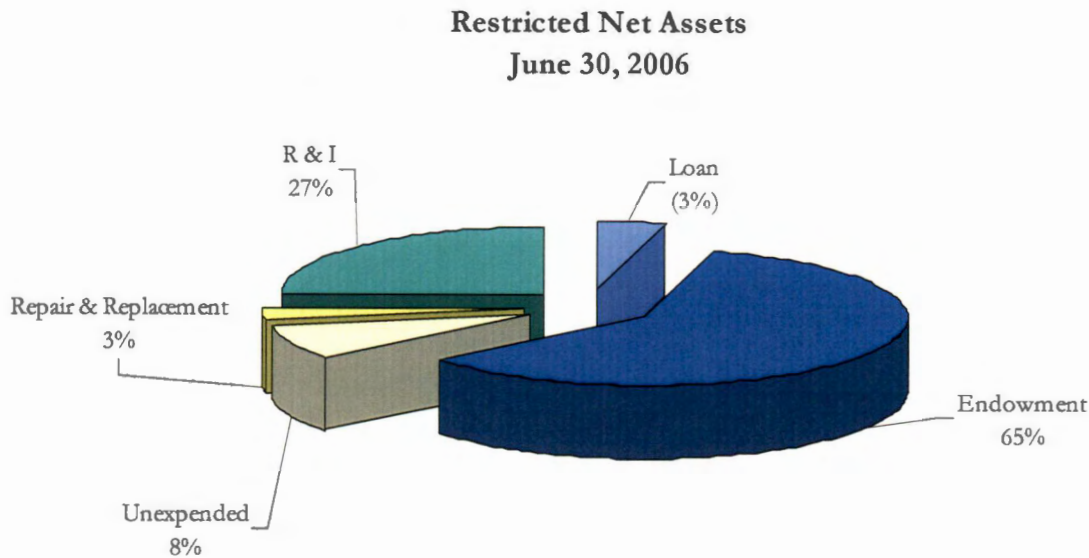
■ Unrestricted
 ■ Expendable
 ■ Non Expendable
 ■ Invested in capital assets, net of related debt

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 decreased by \$.9 million from the previous year to \$18 million. Major components of the decrease include a \$1.1 million decrease in unexpended restricted net assets, and an increase of \$.2 million primarily in the plant fund.



Unrestricted Net Assets

Unrestricted net assets decreased by \$1 million from the previous year to \$12 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, 2006 is as follows:

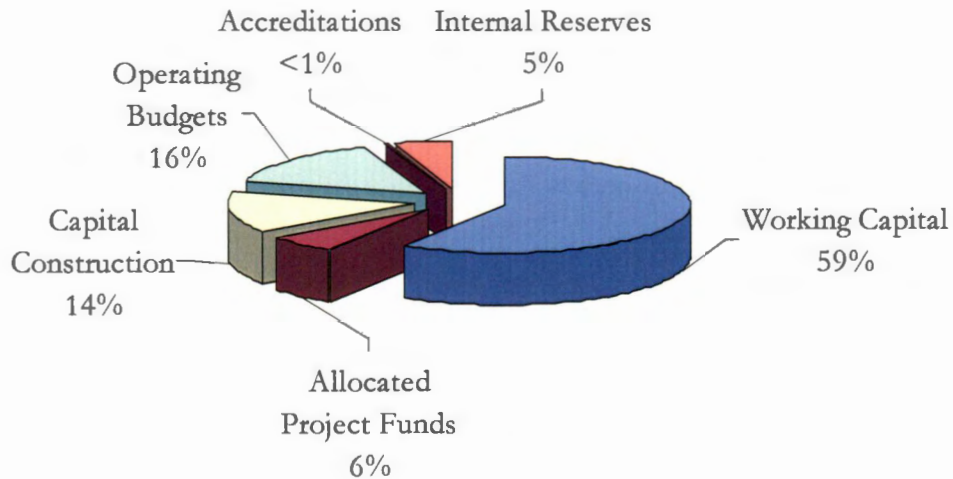
MOREHEAD STATE UNIVERSITY

Management’s Discussion and Analysis, continued

Allocation of Unrestricted Net Assets (in thousands)

	<u>2006</u>	<u>2005</u>
Working capital	\$ 7,196	\$ 6,695
Allocated project funds	778	468
Capital construction	1,683	1,816
Operating budgets	1,917	2,223
Accreditations	15	15
Internal reserves	627	2,058
Unrestricted net assets	<u>\$12,216</u>	<u>\$ 13,275</u>

**Allocation of Unrestricted Net Assets
June 30, 2006**



MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

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

	<u>2006</u>	<u>2005</u>
<u>Operating Revenues</u>		
Student tuition and fees, net	22,326	\$ 22,554
Federal grants and contracts	20,714	20,868
State and local grants and contracts	9,882	10,318
Nongovernmental grants and contracts	902	901
Sales and services of educational activities	1,984	1,630
Auxiliary enterprises	11,408	11,356
Other operating revenue	<u>2,680</u>	<u>2,413</u>
Total operating revenue	<u>69,896</u>	<u>70,040</u>
<u>Operating Expenses</u>		
Educational and general	101,269	97,422
Auxiliary enterprises	9,401	9,549
Depreciation	6,939	5,794
Other operating expenses	<u>89</u>	<u>78</u>
Total operating expenses	<u>117,698</u>	<u>112,843</u>
Operating loss	<u>(47,802)</u>	<u>(42,803)</u>
<u>Nonoperating Revenues (Expenses)</u>		
State appropriations	44,902	42,678
Investment income, net	255	297
Interest on capital assets – debt related	<u>(1,589)</u>	<u>(1,091)</u>
Net nonoperating revenues	<u>43,568</u>	<u>41,884</u>
(Loss) income before other revenues, expenses, gains or losses	<u>(4,234)</u>	<u>(919)</u>
Capital appropriations	<u>3,579</u>	<u>1,818</u>
Increase in net assets	(655)	899
Net assets, beginning of year	<u>119,547</u>	<u>118,648</u>
Net assets, end of year	<u>\$ 118,892</u>	<u>\$ 119,547</u>

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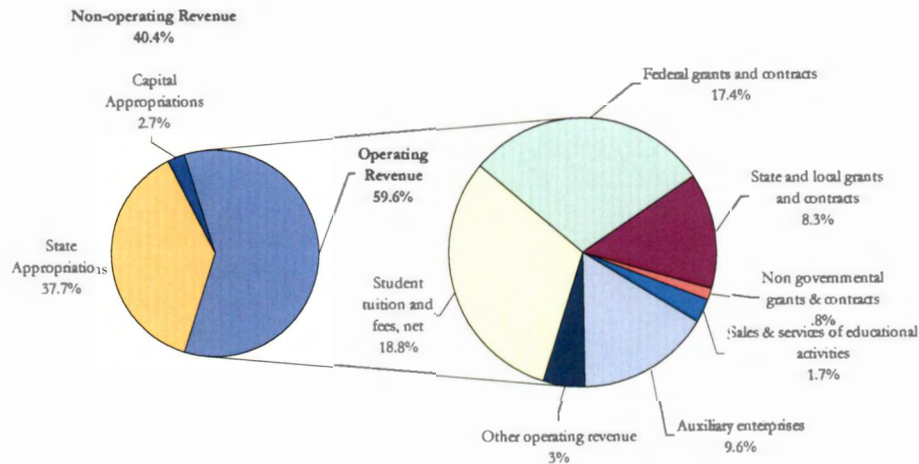
MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Revenues

Total operating revenues were approximately \$70 million for the year ended June 30, 2006 and June 30, 2005. The most significant sources of operating revenue for the University are net student fees \$22 million, federal grants and contracts \$20 million, auxiliary enterprises \$11 million, state and local grants \$10 million, and other revenues including, private grants, and sales and services of educational activities, \$7 million.

Sources of Revenue
June 30, 2006



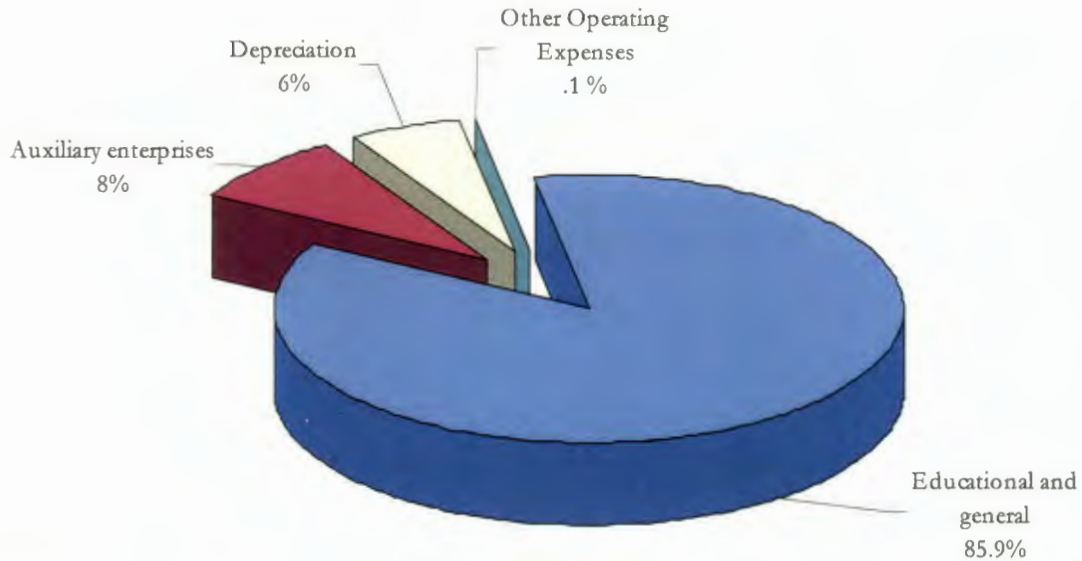
Expenses

Operating expenses totaled approximately \$118 million compared to \$113 million at June 30, 2005. Of this amount, approximately \$101 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

Operating Expenses June 30, 2006



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.



MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Statement of Cash Flows (In Thousands) Year ended June 30, 2006

	<u>2006</u>	<u>2005</u>
Cash Provided/Used By:		
Operating activities	\$ (41,334)	\$ (33,022)
Noncapital financing activities	44,891	42,730
Capital and related financing activities	(6,382)	(14,274)
Investing activities	<u>132</u>	<u>2,853</u>
Net decrease in cash	(2,693)	(1,713)
Cash, beginning of the year	<u>22,660</u>	<u>24,373</u>
Cash, end of the year	<u>\$ 19,967</u>	<u>\$ 22,660</u>

Major sources of funds included in operating activities are student tuition and fees, \$22.3 million versus \$22.6 million the previous year, and grants and contracts, \$31.1 million compared to \$31.6 million at June 30, 2005. The largest cash payments for operating activities were made to employees \$56.2 million versus \$64.7 million the previous year, and suppliers \$54.1 million compared to \$37.8 million at June 30, 2005.



The largest cash receipt in the noncapital financing activities group is the operating appropriation from the Commonwealth of Kentucky of \$44.9 million versus \$42.7 million the previous year and Cash used by capital and related financing activities is

primarily expended on the construction and acquisition of capital assets.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation (but not of related debt), totaled approximately \$121 million at June 30, 2006 versus \$123 million at June 30, 2005. This represents a net decrease of \$1.9 million over June 30, 2005. Significant changes to capital assets during fiscal 2005 - 2006 included:

Buildings and structures	\$10.3	million
Library additions, equipment and vehicles	2.7	million
Net change in construction in progress	(8.6)	million
Increase in accumulated depreciation, net	(6.3)	million

Capital Projects Approved

At June 30, 2006, The University had the following Capital Projects approved but not started:

- Space Science Center building-Architects have been selected and the design process has been started. The project scope is \$15.6 million.
- Health Sciences Building-The University received \$1.5 million for planning this building. The scope of the project is \$24.5 million

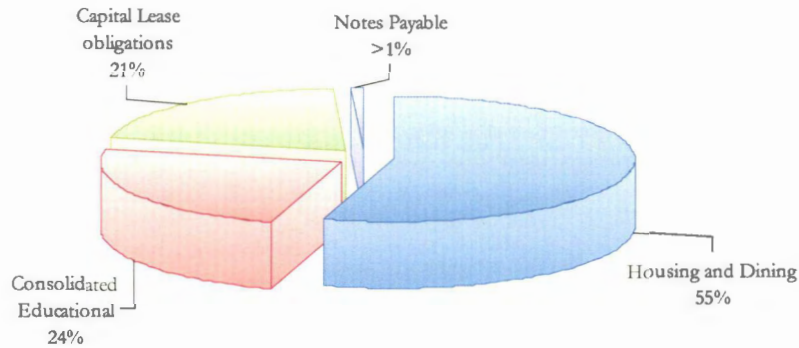
Debt

At year-end, the University had some \$32.5 million in outstanding debt versus \$35.8 million the previous year. This includes \$25.5 million in bonds payable compared to \$28.3 million at June 30, 2005. In addition, the University had capital lease obligations of \$6.8 million compared to \$7.1 million the previous year-end. The University had \$.2 million in notes payable at June 30, 2006.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

Outstanding Debt June 30, 2006



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

	June 30,	
	<u>2006</u>	<u>2005</u>
Housing and Dining System revenue bonds	\$ 17,820	\$ 19,430
Consolidated Educational buildings revenue bonds	7,665	8,875
Capital lease obligations	6,787	7,118
Notes payable	<u>240</u>	<u>350</u>
	<u>\$ 32,512</u>	<u>\$ 35,773</u>

Debt outstanding decreased approximately \$3.2 million from the end of the prior year.

In September 2005 the University entered into an agreement known as the "Blair Property Lease" in the amount of \$327,764 for the purchase of property adjacent to the campus.

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, 2007 totaling \$109 million.
- Tuition rates for FY 2006-07 will increase approximately 12.8% for resident and nonresident undergraduate and graduate students.

MOREHEAD STATE UNIVERSITY

Management's Discussion and Analysis, continued

- At June 30, 2006, grants and contracts of approximately \$23.4 million had been awarded to the University, but not expended. These contracts will provide grant revenue to future periods.
- The University's budgeted enrollment for the year ending June 30, 2007 is 9,300 students; Fall 2006 enrollment is currently tracking approximately 8,800-9,000 students.



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, 2006, and for the year 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 audit. The financial statements of the University, as of and for the year ended June 30, 2005, were audited by other auditors whose opinion dated September 26, 2005, on those statements was unqualified. As discussed in Note 2, the University has restated its 2005 financial statements during the current year to correctly state its investments in conformity with accounting principles generally accepted in the United States of America. The other auditors reported on the 2005 financial statements before the restatement.

We conducted our audit 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 audit provides 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, 2006, and the respective changes in its net assets and, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

(continued)



2006 Winner
**Best Places to Work
in Kentucky**

In accordance with *Government Auditing Standards*, we have also issued our report dated November 2, 2006, 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 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.

The management's discussion and analysis on pages 1 through 18 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the University's basic financial statements. The supplemental information contained on pages 57 through 60 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards 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 also not a required part of the basic financial statements of the University. The supplemental information and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

November 2, 2006
Lexington, Kentucky

Dean, Dartm^t Fund, PSC

MOREHEAD STATE UNIVERSITY

Statement of Net Assets

June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 19,967,069	\$ 22,659,951
Accounts, grants and loans receivable, net	4,290,485	5,195,587
Other receivables	-	1,155,241
Inventories	1,861,638	1,836,607
Other current assets	<u>131,278</u>	<u>121,278</u>
Total current assets	<u>26,250,470</u>	<u>30,968,664</u>
Noncurrent assets:		
Accounts, grants and loans receivable, net	3,828,058	3,583,072
Investments	16,596,696	16,463,820
Capital assets, net	<u>121,165,679</u>	<u>123,081,511</u>
Total noncurrent assets	<u>141,590,433</u>	<u>143,128,403</u>
 Total assets	 <u>167,840,903</u>	 <u>174,097,067</u>
Liabilities & Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	8,114,113	11,199,777
Deferred revenue	2,720,271	1,997,712
Other current liabilities	736,637	713,279
Bonds, notes and capital lease obligations, current portion	<u>3,435,914</u>	<u>3,567,149</u>
Total current liabilities	<u>15,006,935</u>	<u>17,477,917</u>
Long-term liabilities:		
Bond, notes and capital lease obligations, noncurrent portion	29,076,275	32,205,910
Advances from federal government for student loans	<u>4,865,694</u>	<u>4,865,694</u>
Total long-term liabilities	<u>33,941,969</u>	<u>37,071,604</u>
 Total liabilities	 <u>48,948,904</u>	 <u>54,549,521</u>
Net assets:		
Invested in capital assets, net of related debt	88,653,490	87,308,452
Restricted:		
Expendable	6,276,627	7,258,403
Nonexpendable	11,746,002	11,705,625
Unrestricted	<u>12,215,880</u>	<u>13,275,066</u>
 Total net assets	 <u>\$118,891,999</u>	 <u>\$ 119,547,546</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY FOUNDATION, INC.

Statement of Financial Position

June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets		
Current assets:		
Cash	\$ 383,236	\$ 148,341
Accrued interest receivable	13,871	11,687
Pledges receivable, net	734,304	720,654
Lease financing receivable, current	<u>120,690</u>	<u>115,547</u>
Total current assets	<u>1,252,101</u>	<u>996,229</u>
Noncurrent assets:		
Investments	26,228,479	24,216,048
Cash surrender value – life insurance	85,443	86,538
Property and equipment, net	292,334	587,824
Pledges receivable, net	236,987	787,021
Lease financing receivable	<u>1,457,995</u>	<u>1,252,748</u>
Total noncurrent assets	<u>28,301,238</u>	<u>26,930,179</u>
Total assets	<u>\$29,553,339</u>	<u>\$27,926,408</u>
Liabilities & Net Assets		
Current liabilities:		
Accounts payable	\$ 4,259	\$ 16,232
Annuities payable	64,200	56,400
Due to Morehead State University	<u>36,900</u>	<u>13,450</u>
Total current liabilities	<u>105,359</u>	<u>86,082</u>
Long-term liabilities:		
Funds held in trust for Morehead State University	11,329,598	11,329,598
Annuities payable	267,979	233,942
Due to Morehead State University	<u>80,700</u>	<u>95,225</u>
Total long-term liabilities	<u>11,678,277</u>	<u>11,658,765</u>
Total liabilities	<u>11,783,636</u>	<u>11,744,847</u>
Net assets:		
Unrestricted	593,553	783,094
Temporarily restricted	4,641,913	3,036,006
Permanently restricted	<u>12,534,237</u>	<u>12,362,461</u>
Total net assets	<u>17,769,703</u>	<u>16,181,561</u>
Total liabilities and net assets	<u>\$29,553,339</u>	<u>\$27,926,408</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY

Statement of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Student tuition and fees (net of scholarship allowances of \$17,045,818 and \$14,933,364)	\$ 22,326,469	\$ 22,553,579
Federal grants and contracts	20,714,214	20,868,400
State and local grants and contracts	9,882,341	10,318,105
Nongovernmental grants and contracts	901,812	900,476
Sales and services of educational activities	1,983,614	1,630,422
Auxiliary enterprises:		
Residence halls (net of scholarship allowances of \$92,287 and \$116,137)	6,903,165	6,639,380
Bookstore	3,831,364	3,837,288
Other auxiliaries	673,028	879,644
Other operating revenues	<u>2,679,744</u>	<u>2,412,911</u>
Total operating revenues	69,895,751	70,040,205
Operating expenses:		
Education and general:		
Instruction	43,057,250	40,397,806
Research	1,727,586	1,577,469
Public service	8,561,048	9,699,827
Library	2,881,181	2,823,898
Academic support	8,219,687	6,945,656
Student services	9,125,819	8,199,004
Institutional support	12,461,158	11,213,543
Operation and maintenance of plant	7,205,714	6,246,177
Depreciation	5,551,621	4,635,467
Student aid	8,029,346	10,434,550
Auxiliary enterprises:		
Residence halls	4,812,739	4,496,905
Bookstore	3,674,966	3,469,643
Other auxiliaries	913,283	1,466,207
Depreciation	1,387,905	1,158,866
Other operating expenses	<u>88,882</u>	<u>78,089</u>
Total operating expenses	<u>117,698,185</u>	<u>112,843,107</u>
Operating loss	(47,802,434)	(42,802,902)

MOREHEAD STATE UNIVERSITY**Statement of Revenues, Expenses and Changes in Net Assets, continued**

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Nonoperating revenues (expenses):		
State appropriations	44,901,703	42,678,310
Investment income (net of investment expense of \$7,177 and \$4,440)	255,299	297,005
Interest on capital asset - related debt	<u>(1,588,821)</u>	<u>(1,091,191)</u>
Net nonoperating revenues	<u>43,568,181</u>	<u>41,884,124</u>
Loss before capital appropriations	(4,234,253)	(918,778)
Capital appropriations	<u>3,578,706</u>	<u>1,818,195</u>
(Decrease) increase in net assets	(655,547)	899,417
Net assets, beginning of year	<u>119,547,546</u>	<u>118,648,129</u>
Net assets, end of year	<u>\$ 118,891,999</u>	<u>\$ 119,547,546</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY FOUNDATION, INC.

Statement of Activities

Year ended June 30, 2006

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues and other support:				
Contributions	\$ 90,971	\$ 1,813,971	\$ 171,776	\$ 2,076,718
Other revenue and gains (losses):				
Investment income:				
Interest and dividend income, net	25,340	1,224,293	-	1,249,633
Realized and unrealized gains	18,069	757,106	-	775,175
In-kind contributed services	63,628	-	-	63,628
Other income	734	370,289	-	371,023
Annuities payable adjustment	(53,486)	-	-	(53,486)
Net assets released from restrictions:				
Restrictions satisfied by payments	<u>2,559,752</u>	<u>(2,559,752)</u>	<u>-</u>	<u>-</u>
 Total revenues and other support	 2,705,008	 1,605,907	 171,776	 4,482,691
 Expenses:				
Program expenses:				
Contributions to Morehead State				
University for:				
Academic programs	1,322,909	-	-	1,322,909
Athletics	293,846	-	-	293,846
University support:				
Operations and materials	123,698	-	-	123,698
Student financial aid	913,978	-	-	913,978
Athletics	<u>25,837</u>	<u>-</u>	<u>-</u>	<u>25,837</u>
 Total program expenses	 2,680,268	 -	 -	 2,680,268
 General and administrative	 148,238	 -	 -	 148,238
Fundraising	<u>66,043</u>	<u>-</u>	<u>-</u>	<u>66,043</u>
 Total expenses	 <u>2,894,549</u>	 <u>-</u>	 <u>-</u>	 <u>2,894,549</u>
 Change in net assets	 (189,541)	 1,605,907	 171,776	 1,588,142
 Net assets, beginning of year	 <u>783,094</u>	 <u>3,036,006</u>	 <u>12,362,461</u>	 <u>16,181,561</u>
Net assets, end of year	<u>\$ 593,553</u>	<u>\$ 4,641,913</u>	<u>\$ 12,534,237</u>	<u>\$ 17,769,703</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY FOUNDATION, INC.

Statement of Activities

Year ended June 30, 2005

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues and other support:				
Contributions	\$ 159,142	\$ 953,534	\$ 1,498,791	\$ 2,611,467
Other revenue and gains (losses):				
Investment income:				
Interest and dividend income, net	16,096	713,603	-	729,699
Realized and unrealized gains	-	889,991	-	889,991
In-kind contributed services	59,407	-	-	59,407
Other income	1,845	341,574	-	343,419
Annuities payable adjustment	(48,571)	-	-	(48,571)
Net assets released from restrictions:				
Restrictions satisfied by payments	<u>1,394,893</u>	<u>(1,394,893)</u>	<u>-</u>	<u>-</u>
Total revenues and other support	1,582,812	1,503,809	1,498,791	4,585,412
Expenses:				
Program expenses:				
Contributions to Morehead State				
University for:				
Academic programs	839,044	-	-	839,044
Athletics	249,841	-	-	249,841
University support:				
Operations and materials	110,621	-	-	110,621
Student financial aid	286,821	-	-	286,821
Athletics	21,056	-	-	21,056
Bad debt	<u>286,783</u>	<u>-</u>	<u>-</u>	<u>286,783</u>
Total program expenses	1,794,166	-	-	1,794,166
General and administrative	135,270	-	-	135,270
Fundraising	<u>39,034</u>	<u>-</u>	<u>-</u>	<u>39,034</u>
Total expenses	<u>1,968,470</u>	<u>-</u>	<u>-</u>	<u>1,968,470</u>
Change in net assets	(385,658)	1,503,809	1,498,791	2,616,942
Net assets, beginning of year	<u>1,168,752</u>	<u>1,532,197</u>	<u>10,863,670</u>	<u>13,564,619</u>
Net assets, end of year	<u>\$ 783,094</u>	<u>\$ 3,036,006</u>	<u>\$12,362,461</u>	<u>\$16,181,561</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY

Statement of Cash Flows

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Tuition and fees	\$22,260,932	\$ 22,627,651
Grants and contracts	31,184,058	31,684,326
Payments to suppliers	(54,108,690)	(37,750,076)
Payments to employees	(56,230,983)	(64,745,437)
Loans issued to students	(1,162,429)	(600,411)
Collection of loans issued to students	655,777	626,193
Auxiliary enterprises:		
Residence halls	6,905,033	6,644,339
Bookstore	3,824,298	3,584,093
Other auxiliaries	674,024	864,163
Sales and services of educational activities	1,983,614	1,630,422
Other receipts	<u>2,679,744</u>	<u>2,412,911</u>
Net cash used in operating activities	<u>(41,334,622)</u>	<u>(33,021,826)</u>
Cash flows from noncapital financing activities:		
State appropriations	44,901,703	42,678,310
Student organization agency receipts	2,479,198	2,265,610
Student organization agency disbursements	<u>(2,489,651)</u>	<u>(2,213,683)</u>
Net cash provided by noncapital financing activities	44,891,250	42,730,237
Cash flows from capital and related financing activities:		
Capital appropriations	3,578,706	1,818,195
Purchase of capital assets	(4,783,637)	(7,200,865)
Principal paid on capital debt and leases	(3,588,634)	(7,800,243)
Interest paid on capital debt and leases	<u>(1,588,821)</u>	<u>(1,091,191)</u>
Net cash flows used in capital and related financing activities	<u>(6,382,386)</u>	<u>(14,274,104)</u>
Cash flows from investing activities:		
Interest received on investments, net	255,299	297,005
Changes in investments, net	<u>(122,423)</u>	<u>2,556,140</u>
Net cash flows provided by investing activities	<u>132,876</u>	<u>2,853,145</u>
Net decrease in cash and cash equivalents	<u>(2,692,882)</u>	<u>(1,712,548)</u>
Cash and cash equivalents, beginning of year	<u>22,659,951</u>	<u>24,372,499</u>
Cash and cash equivalents, end of year	<u>\$ 19,967,069</u>	<u>\$ 22,659,951</u>

MOREHEAD STATE UNIVERSITY

Statement of Cash Flows, continued

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (47,802,434)	\$(42,802,902)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	6,939,526	5,813,405
Loss on disposal of capital assets	87,707	15,479
Changes in assets and liabilities:		
Receivables, net	1,815,357	(1,262,281)
Inventories	(25,031)	(206,120)
Other current assets	(10,000)	53,227
Accounts payable and accrued liabilities	(3,085,664)	5,076,229
Deferred revenue	722,559	290,417
Other current liabilities	<u>23,358</u>	<u>720</u>
Net cash used in operating activities	<u>\$ (41,334,622)</u>	<u>\$ (33,021,826)</u>
 Supplemental disclosures of cash flow information:		
Noncash investing and financing transactions:		
Purchase of capital assets with capital lease obligations	\$ 327,764	\$ 5,698,519

See accompanying notes.

MOREHEAD STATE UNIVERSITY

Notes to 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 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

Inventories representing approximately 61% and 59% of total inventories at June 30, 2006 and 2005, respectively, are stated at the lower of cost (retail inventory method) or market. The remainder of the inventories are 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 of 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 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
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.

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 nonoperating 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.

Recent Accounting Pronouncements

For the year ended June 30, 2005, the University implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment of GASB Statement No. 3. This new standard revises the existing requirements regarding disclosure of custodial credit risk and establishes requirements regarding disclosure of credit risk, concentration of credit risk, interest rate risk and foreign currency risk. It has no impact on the reported amounts of investments, net assets or changes in net assets. See also Note 2.

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement establishes standards for the measurement, recognition, and display of other postemployment benefit expenses/expenditures and related assets/liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of employers subject to governmental accounting standards. The provisions of this statement are effective for financial statements for fiscal periods beginning after December 15, 2006. The University has not yet evaluated the impact that the adoption of this statement will have on its financial statements.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

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.

Restatements and Reclassifications

Since the inception of the Regional University Excellence Trust Fund (RUETF) and other similar state-matching trust funds, the University and the Foundation have both recorded the corpus, state match and related earnings thereon from such funds. However, the Foundation records a liability called "Funds held in trust for Morehead State University" consisting of only the state match leaving the corpus and related earnings thereon on the Foundation's books. Thus, the University and the Foundation were including a portion of the same investments on their respective books (corpus and related earnings thereon). Upon discussions with management of both entities, it was decided that the University would only include the state match on its books that correlated with the Foundation's "Funds held in trust for Morehead State University." Moreover, these investments had previously been reported as expendable when they should have been nonexpendable, as in accordance with the underlying trust agreements. Accordingly, the financial statements have been restated to reflect these changes. Ending net assets as of June 30, 2004 have been decreased by \$3,521,948 to correctly state the effect of the investments adjustment as of June 30, 2004. As of and for the year ended June 30, 2005, investments and nonexpendable net assets have been decreased an additional \$3,864,736. Investment income, net of investment expenses, decreased \$1,200,152, and capital appropriations decreased \$2,664,584, resulting in the increase in net assets being reduced by \$3,864,736.

Certain other 2005 amounts have been reclassified to conform to 2006 presentation with no effect on total assets, liabilities, net assets, or change in net assets.

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

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

2. Cash, Cash Equivalents and Investments, continued

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

At June 30, 2006 and 2005, the University had petty cash funds totaling \$116,501 and \$109,419, respectively, and deposits as reflected by bank balances as follows:

	<u>2006</u>	<u>2005</u>
Insured, commercial banks	\$ 217,326	\$ 241,111
Uninsured, commercial banks; collateral held by pledging institution's agent in the University's name	15,646,784	19,578,675
Maintained by Commonwealth of Kentucky	<u>3,799,054</u>	<u>7,499,316</u>
	<u>\$ 19,663,164</u>	<u>\$ 27,319,102</u>

The difference in the cash carrying amount per the statement of net assets and the above bank balances represented items in transit.

As of June 30, 2006 and 2005, investments consisted of:

	<u>2006</u>	<u>2005</u>
Insured and registered, with securities held by the counter party or by its trust department or agent, in the University's name:		
Money market funds – restricted for capital purposes	\$ 4,850,695	\$ 4,758,196
Equity mutual funds	296,874	305,329
Money market funds	<u>33,645</u>	<u>697</u>
	5,181,214	5,064,222
Certificate of deposit	85,884	70,000
Restricted assets held by the Morehead State University Foundation, Inc.	<u>11,329,598</u>	<u>11,329,598</u>
Total investments	<u>\$ 16,596,696</u>	<u>\$ 16,463,820</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

2. Cash, Cash Equivalents and Investments, continued

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 MSU Foundation, Inc. (Foundation) are comprised of the Regional University Excellence Trust Fund endowment and other similar endowments (see Note 14). Assets held by the Foundation are invested primarily in an investment pool managed by the Foundation and are carried at fair value.

The assets in the Foundation investment pool at June 30, 2006 and 2005, are invested as follows:

	<u>2006</u>	<u>2005</u>
Percentage of pool invested in:		
Registered investment companies equity funds	61%	64%
Registered investment companies fixed income funds	<u>39%</u>	<u>36%</u>
Total	<u><u>100%</u></u>	<u><u>100%</u></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>2006</u>	<u>2005</u>
Student tuition and fees	\$ 774,594	\$ 672,576
Student loans	3,911,375	3,609,064
Grants and contracts	3,044,081	4,083,119
Auxiliary enterprises	919,775	915,573
Other	<u>131,278</u>	<u>128,413</u>
	8,781,103	9,408,745
Allowance for doubtful accounts	<u>(662,560)</u>	<u>(630,086)</u>
	8,118,543	8,778,659
Current portion	<u>(4,290,485)</u>	<u>(5,195,587)</u>
Noncurrent portion	<u>\$ 3,828,058</u>	<u>\$ 3,583,072</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

4. Capital Assets, Net

Capital assets as of June 30, 2006, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land and improvements	\$ 12,541,402	\$ 546,993	\$ -	\$ 13,088,395
Buildings	158,395,223	10,377,361	-	168,772,584
Library books	17,245,514	1,015,280	-	18,260,794
Vehicles	2,068,682	121,463	66,975	2,123,170
Equipment and livestock	32,397,054	1,596,718	620,109	33,373,663
Datatel	3,817,294	47,075	-	3,864,369
Art collection	66,075	-	-	66,075
Construction in progress	<u>12,820,855</u>	<u>2,608,948</u>	<u>11,202,437</u>	<u>4,227,366</u>
	239,352,099	16,313,838	11,889,521	243,776,416
<u>Accumulated Depreciation</u>				
Land improvements	4,291,738	290,837	-	4,582,575
Buildings	70,573,253	3,517,569	-	74,090,822
Library books	13,172,768	837,976	-	14,010,744
Vehicles	1,517,631	174,675	43,421	1,648,885
Datatel	91,903	765,264	-	857,167
Equipment and livestock	<u>26,623,295</u>	<u>1,353,205</u>	<u>555,956</u>	<u>27,420,544</u>
	<u>116,270,588</u>	<u>6,939,526</u>	<u>599,377</u>	<u>122,610,737</u>
Capital assets, net	<u>\$ 123,081,511</u>	<u>\$ 9,374,312</u>	<u>\$ 11,290,144</u>	<u>\$ 121,165,679</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

4. Capital Assets, Net, continued

Capital assets as of June 30, 2005, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land and improvements	\$ 11,718,989	\$ 822,413	\$ -	\$ 12,541,402
Buildings	155,730,257	2,664,966	-	158,395,223
Library books	16,272,598	972,916	-	17,245,514
Vehicles	1,885,797	241,818	58,933	2,068,682
Equipment and livestock	32,004,551	1,054,218	661,715	32,397,054
Datatel		3,874,520	57,226	3,817,294
Art collection	66,075		-	66,075
Construction in progress	<u>9,552,322</u>	<u>3,268,533</u>	-	<u>12,820,855</u>
	227,230,589	12,899,384	777,874	239,352,099
 <u>Accumulated Depreciation</u>				
Land improvements	3,986,169	305,569	-	4,291,738
Buildings	67,560,245	3,013,008	-	70,573,253
Library books	12,376,335	796,433	-	13,172,768
Vehicles	1,410,228	150,507	43,104	1,517,631
Datatel		91,903	-	91,903
Equipment and livestock	<u>25,810,304</u>	<u>1,455,985</u>	<u>642,994</u>	<u>26,623,295</u>
	<u>111,143,281</u>	<u>5,813,405</u>	<u>686,098</u>	<u>116,270,588</u>
 Capital assets, net	 <u>\$116,087,308</u>	 <u>\$ 7,085,979</u>	 <u>\$ 91,776</u>	 <u>\$123,081,511</u>

5. Accounts Payable and Accrued Liabilities

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

	<u>2006</u>	<u>2005</u>
Payable to vendors and contractors	\$ 2,433,031	\$ 5,029,172
Accrued vacation	1,787,101	1,701,333
Accrued salaries and other liabilities	<u>3,893,981</u>	<u>4,469,272</u>
	<u>\$ 8,114,113</u>	<u>\$ 11,199,777</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

6. Long-Term Liabilities

Long-term liabilities at June 30, 2006, 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>
Housing and Dining System Revenue Bonds	\$ 19,430,000	\$ -	\$ 1,610,000	\$ 17,820,000	\$ 1,490,000	\$ 16,330,000
Consolidated Educational Building Revenue Bonds	8,875,000	-	1,210,000	7,665,000	1,250,000	6,415,000
Capital lease obligations	7,118,059	327,764	658,634	6,787,189	585,914	6,201,275
Notes payable	<u>350,000</u>	<u>-</u>	<u>110,000</u>	<u>240,000</u>	<u>110,000</u>	<u>130,000</u>
Total bonds, notes and capital lease obligations	35,773,059	327,764	3,588,634	32,512,189	3,435,914	29,076,275
Federal refundable grants	<u>4,865,694</u>	<u>-</u>	<u>-</u>	<u>4,865,694</u>	<u>-</u>	<u>4,865,694</u>
Total long-term Liabilities	<u>\$ 40,638,753</u>	<u>\$ 327,764</u>	<u>\$ 3,588,634</u>	<u>\$ 37,377,883</u>	<u>\$ 3,435,914</u>	<u>\$ 33,941,969</u>

Long-term liabilities at June 30, 2005, 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>
Housing and Dining System Revenue Bonds	\$ 21,065,000	\$ -	\$ 1,635,000	\$ 19,430,000	\$ 1,610,000	\$ 17,820,000
Consolidated Educational Building Revenue Bonds	14,460,000	-	5,585,000	8,875,000	1,210,000	7,665,000
Capital lease obligations	1,889,783	5,698,519	470,243	7,118,059	637,149	6,480,910
Notes payable	<u>460,000</u>	<u>-</u>	<u>110,000</u>	<u>350,000</u>	<u>110,000</u>	<u>240,000</u>
Total bonds, notes and capital lease obligations	37,874,783	5,698,519	7,800,243	35,773,059	3,567,149	32,205,910
Federal refundable grants	<u>4,843,063</u>	<u>22,631</u>	<u>-</u>	<u>4,865,694</u>	<u>-</u>	<u>4,865,694</u>
Total long-term liabilities	<u>\$ 42,717,846</u>	<u>\$ 5,721,150</u>	<u>\$ 7,800,243</u>	<u>\$ 40,638,753</u>	<u>\$ 3,567,149</u>	<u>\$ 37,071,604</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>2006</u>	<u>2005</u>
2.75 – 5.75% Housing and Dining System Revenue Bonds, Series N, O, P, Q, and R repayable in annual installments with the final installment due May, 2020	\$ 17,820,000	\$ 19,430,000
2.00 – 5.75% Consolidated Educational Building Revenue Bonds, Series L and M repayable in annual installments with the final installment due May, 2024	7,665,000	8,875,000
5.00% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due February, 2019	178,642	187,780
5.04% Capital lease obligation with a finance corporation, repayable in semi-annual installments with the final installment due January, 2006	1,190	101,757
9.50% Note payable to an individual, repayable in annual installments with the final installment due January, 2008	200,000	300,000
9.50% Note payable to an individual, repayable in annual installments with the final installment due January, 2008	40,000	50,000
5.75% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due February, 2012	635,049	730,477
9.40% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due March, 2023	433,496	443,822
4.19% Capital lease obligation with a finance corporation in semi-annual payments with final installment due October, 2019	1,688,308	1,779,704
3.58% Capital lease obligation with a finance corporation in semi-annual payments with final installment due June, 2015	3,545,955	3,874,519
4.47% Capital lease obligation with the Foundation, repayable in monthly installments with the final installment due August, 2015	<u>304,549</u>	<u>-</u>
	<u>\$ 32,512,189</u>	<u>\$ 35,773,059</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, 2006 and 2005, the reserve requirements have been fully funded. The revenue bonds are subject to several non-financial covenants, all of which management has asserted were met as of June 30, 2006 and 2005.

The revenue bonds are collateralized by various buildings. The revenues derived from student registration fees and residence hall rental fees are pledged as collateral on the revenue bond issues.

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

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

	<u>2006</u>	<u>2005</u>
Equipment	\$ 7,722,742	\$ 11,531,463
Less: accumulated depreciation	<u>975,193</u>	<u>3,667,138</u>
	<u>\$ 6,747,549</u>	<u>\$ 7,864,325</u>

The following is a schedule by years of future minimum payments required for the capital lease obligations as of June 30, 2006:

Year Ending June 30,				
2007		\$	871,842	
2008			870,653	
2009			870,653	
2010			870,653	
2011			870,653	
Thereafter			<u>4,247,028</u>	
Total minimum lease payments			8,601,482	
Less: amounts representing interest			<u>(1,814,293)</u>	
Present value of minimum lease payments		\$	<u>6,787,189</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 and notes payable at June 30, 2006, are as follows:

Year ending June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 2,850,000	\$ 1,037,251	\$ 3,887,251
2008	2,575,000	925,067	3,500,067
2009	2,555,000	819,046	3,374,046
2010	2,655,000	718,570	3,373,570
2011	2,420,000	620,240	3,040,240
2012-2024	<u>12,670,000</u>	<u>2,838,285</u>	<u>15,508,285</u>
	<u>\$ 25,725,000</u>	<u>\$ 6,958,459</u>	<u>\$ 32,683,459</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 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 6.16% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 13.84% 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, 2006 and 2005 were \$3,423,175 and \$3,897,045 respectively, equal to the required contributions for each year.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

7. Pension Plan, continued

Kentucky Employee 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 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 employees who contribute 5.00% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 5.89% of current eligible 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 ending June 30, 2006, and 2005 were \$314,391 and \$345,384 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 Aetna Life Insurance and Annuity Company. Under these plans the employee's contribution is 6.16% of their gross salary and the University's contribution is 7.23% to the retirement company and 6.16% to Kentucky Teachers Retirement System. The University's contributions under these plans for the years ending June 30, 2006 and 2005 were \$561,275 and \$720,501 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 \$356,000 and \$344,000 in 2006 and 2005, respectively.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

9. Contingencies and Commitments

The University is defendant in several 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 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, 2006.

The University has made certain commitments related to the completion of various construction projects in progress totaling approximately \$2,800,000. 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, 2006 and 2005 totaled \$265,947 and \$217,038, respectively.

Beginning this year, the University switched from a self-insured health plan to a fully insured health plan. 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 \$248 per month to a high of \$600 per month. Payments for employee health insurance for the fiscal year ending June 30, 2006 were \$5,646,461, including \$3,239,182 paid for claims on the behalf of employees, and \$2,407,279 paid for insurance premiums. Expenses paid to cover claims incurred under the former self-insured health plan at June 30, 2005 were \$4,144,873.

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; employee injuries and illnesses; natural disasters; and employee health and accident benefits. Settled claims have not exceeded this commercial coverage in any of the three

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

11. Risk Management, continued

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 University pays an annual premium to the pool for its workers' compensation insurance coverage. 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.

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. As a result of the 1998 General Assembly's legislative decision to appropriate \$200,000 annually to KFAC as an affiliate of the University, the KFAC became 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. Segment Information

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds are outstanding. A segment has a specifically identifiable revenue stream pledged in support of revenue bonds and has related expenses, gains and losses, assets, and liabilities, that are required by an external party to be accounted for separately. The University has one segment that meets the reporting requirements of GASB No. 35, which is the University Housing and Dining System.

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

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Segment Information, continued

Condensed Statement of Net Assets at June 30:

	2006	2005
	<u>Housing</u>	<u>Housing</u>
	<u>and Dining</u>	<u>and Dining</u>
Assets		
Current assets	\$ 665,394	\$ 1,178,091
Noncurrent assets	3,267,828	3,927,482
Capital assets, net	<u>23,925,146</u>	<u>24,764,955</u>
Total assets	<u>27,858,368</u>	<u>29,870,528</u>
Liabilities		
Current liabilities	1,490,000	1,610,000
Noncurrent liabilities	<u>16,330,000</u>	<u>17,820,000</u>
Total liabilities	<u>17,820,000</u>	<u>19,430,000</u>
Net assets		
Invested in capital, net of related debt	6,105,146	5,334,955
Restricted, expendable	<u>3,933,222</u>	<u>5,105,573</u>
Total net assets	<u>\$10,038,368</u>	<u>\$10,440,528</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30:

	2006	2005
	<u>Housing</u>	<u>Housing</u>
	<u>and Dining</u>	<u>and Dining</u>
Operating revenues	\$ 6,815,320	\$ 6,710,673
Operating expenses	(4,905,026)	(4,613,042)
Depreciation expense	<u>(1,687,861)</u>	<u>(841,022)</u>
Operating income	222,433	1,256,609
Nonoperating revenue	180,131	44,844
Nonoperating expenses	<u>(804,724)</u>	<u>(866,229)</u>
(Deficiency) excess of revenues over expenses	(402,160)	435,224
Net assets, beginning of year	<u>10,440,528</u>	<u>10,005,304</u>
Net assets, end of year	<u>\$10,038,368</u>	<u>\$10,440,528</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Segment Information, continued

Condensed Statement of Cash Flows for the years ended June 30:

	2006	2005
	<u>Housing and Dining</u>	<u>Housing and Dining</u>
Net cash flows from operating activities	\$1,910,294	\$2,097,631
Net cash flows from investing activities	839,785	506,657
Net cash flows from capital and related financing activities	<u>(3,262,776)</u>	<u>(2,017,191)</u>
Net (decrease) increase in cash and cash equivalents	(512,697)	587,097
Cash and cash equivalents, beginning of year	<u>1,178,091</u>	<u>590,994</u>
Cash and cash equivalents, end of year	<u>\$ 665,394</u>	<u>\$1,178,091</u>

14. 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 fair market value of Morehead State University endowment funds held by the Foundation as of June 30, 2006 and 2005 was \$20,857,833 and \$18,716,277, respectively. The portion of the endowments representing the value of the funding received from the Kentucky General Assembly was \$11,329,598 for both the years ended June 30, 2006 and 2005, and is included in investments held by the Foundation.

15. 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 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 2006 and 2005:

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

15. Related Parties, continued

	<u>2006</u>	<u>2005</u>
Funds disbursed by the University on behalf of the Foundation for employee salaries and benefits	\$ 63,628	\$ 59,407
Funds held by the Foundation on behalf or for the Benefit of the University as of June 30	11,329,598	11,329,598
Funds due to the University by the Foundation	117,600	108,675

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 of \$30,000 per year. Amounts disclosed above as funds disbursed by the University on behalf of the Foundation for employee salaries and benefits are net of the \$30,000 per year.

The University has also entered into several direct financing capital leases of real estate with the Foundation as disclosed in Note 16H.

16. 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 preparation of financial statements prepared in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. The following is a summary of the significant

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

accounting policies consistently followed by the Foundation in the preparation of its financial statements.

Basis of Presentation

The Foundation's financial statements are presented in accordance with Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. 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 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.

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 5.25 percent and 4 percent for the years ended June 30, 2006 and 2005, 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

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

Investments, continued

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.

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 there from to be remitted annually to the University. As of both June 30, 2006 and 2005, the Foundation held \$11,329,598 for the University's investment purposes.

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, 2006 and 2005 were \$63,807 and \$57,283, respectively.

The June 30, 2006 and 2005 annuity liabilities balances of \$332,179 and \$290,342 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 7.8% to 9.4%. The estimated remaining life expectancies of the annuitants range from 7.1 to 10.1 years and 6.7 to 7.5 years for the years ended June 30, 2006 and 2005, respectively.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

Due to Morehead State University

A gift was pledged to the Foundation that the donor stipulated was specifically for the University. In accordance with SFAS No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, the gift has been included as a liability on the Foundation's Statement of Financial Position.

Contributions

Gifts of cash and other assets received without donor stipulations are reported as unrestricted revenue and net assets. Gifts received with a donor stipulation that limits 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 statement 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 resulting in reclassification of temporarily restricted net assets as 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 Statement of Activities for the years ended June 30, 2006 and 2005 include in-kind contributions of \$583,130 and \$320,513, respectively.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

B. Summary of Significant Accounting Policies, continued

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.

Tax Exempt Status

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.

Restatements and Reclassifications

As disclosed in Annuities Payable, the Foundation has been the recipient of several gift annuities which require future payments to the donor (annuitant). During fiscal 2006, the Foundation became aware that its annuities payable had not been adjusted for the life expectancies of the annuitants. Accordingly, ending unrestricted net assets as of June 30, 2004 have decreased \$66,678. The annuities payable adjustment for the year ended June 30, 2005 was also restated, resulting in a decrease in the change in net assets of \$53,956.

Upon further review of the Foundation's contributions received during the year ended June 30, 2005, management has determined that a portion of its contributions and related investment income previously reported as unrestricted should have been reported as temporarily restricted. The Statement of Financial Position and Statement of Activities as of and for the year ended June 30, 2005 have been changed to reflect management's determination. There was no effect on total assets, total liabilities and net assets, or change in net assets.

Certain other 2005 amounts have been reclassified to conform to 2006 presentation with no effect on total assets, liabilities, net assets, or change in net assets.

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

C. Investments

Investments held at June 30, 2006 and 2005 are summarized as follows:

	<u>2006</u>	<u>2005</u>
Money market funds	\$ 515,845	\$ 389,231
Certificates of deposit	1,059,386	1,033,805
Mutual funds	24,503,653	22,647,057
Corporate bonds and stocks	36,394	36,394
Annuity investment	<u>113,201</u>	<u>109,561</u>
 Total investments at fair value	 <u>\$26,228,479</u>	 <u>\$24,216,048</u>

Investment management fees were approximately \$7,000 and \$4,000 for the years ending June 30, 2006 and 2005, respectively.

D. Pledges Receivable

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

Year ended June 30	
2007	\$ 734,304
2008	221,050
2009	137,550
2010	54,551
2011	22,447
Thereafter	<u>35,400</u>
	1,205,302
 Less: present value discount	 (105,972)
Less: allowance for uncollectible pledges	<u>(128,039)</u>
 Pledges receivable, net	 971,291
 Less: current pledges receivable	 <u>(734,304)</u>
 Noncurrent pledges receivable	 <u>\$ 236,987</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

E. Property and Equipment

Property and equipment as of June 30, 2006 and 2005 consist of the following:

	<u>2006</u>	<u>2005</u>
Land	\$ 53,000	\$ 327,560
Furniture and equipment	133,223	81,275
Buildings	<u>175,000</u>	<u>228,204</u>
	361,223	637,039
Less: accumulated depreciation	<u>(68,889)</u>	<u>(49,215)</u>
	<u>\$ 292,334</u>	<u>\$ 587,824</u>

Depreciation expense was \$19,674 and \$13,048 for the years ended June 30, 2006 and 2005, respectively.

F. 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 \$640,000 and \$665,000 for the years ended June 30, 2006 and 2005. The cash surrender value of these policies as of June 30, 2006 and 2005 is \$85,443 and \$86,538, respectively.

G. 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 Statement of Activities as "University support".

H. Net Investment in Capital Leases

The Foundation's net investment in the direct financing capital leases of real estate as of June 30, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Total minimum lease payments to be received	\$2,378,620	\$2,063,265
Less: unearned income	<u>(799,935)</u>	<u>(694,970)</u>
Net investment in capital leases	<u>\$1,578,685</u>	<u>\$1,368,295</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

H. Net Investment in Capital Leases, continued

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

2007	\$ 241,279
2008	241,279
2009	241,279
2010	241,279
2011	241,279
Thereafter	<u>1,172,225</u>
	<u>\$2,378,620</u>

I. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available at June 30, 2006 and 2005 for the following purposes:

	<u>2006</u>	<u>2005</u>
Funds restricted for specific purposes	\$2,686,272	\$ 2,059,997
Scholarships	1,182,546	494,718
Athletics	<u>773,095</u>	<u>481,291</u>
	<u>\$4,641,913</u>	<u>\$ 3,036,006</u>

Permanently restricted net assets at June 30, 2006 and 2005 consist of endowment funds.

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

	<u>2006</u>	<u>2005</u>
Pledges receivable	\$ 166,493	\$ 164,603
Investments	<u>4,475,420</u>	<u>2,871,403</u>
	<u>\$ 4,641,913</u>	<u>\$ 3,036,006</u>

MOREHEAD STATE UNIVERSITY

Notes to the Financial Statements, continued

16. Morehead State University Foundation, Inc., continued

I. Temporarily and Permanently Restricted Net Assets, continued

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

	<u>2006</u>	<u>2005</u>
Pledges receivable	\$ 760,145	\$ 1,291,844
Investments	<u>11,774,092</u>	<u>11,070,617</u>
	<u>\$12,534,237</u>	<u>\$ 12,362,461</u>

J. 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 of \$30,000 per year.

SFAS No. 116, *Accounting for Contributions Received and Contributions Made*, 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 \$30,000 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 G and H.

K. Concentration of Credit Risk

The Foundation has a concentration of credit risk in that it maintains cash deposits in a single financial institution which, at times, exceeds federally insured limits. Cash deposits in excess of the federally insured limits total \$965,049 and \$641,325 as of June 30, 2006 and 2005, respectively. The Foundation has not experienced any losses in such accounts and does not believe it is not exposed to any significant credit risk related to the accounts.

SUPPLEMENTAL INFORMATION

MOREHEAD STATE UNIVERSITY

Schedule of Bonds, Notes and Capital Lease Obligations

June 30, 2006

	<u>Issue Date</u>	<u>Net Amount of Issue</u>	<u>Interest Cost</u>	<u>Outstanding June 30, 2005</u>	<u>Retired Bonds 2005-06</u>	<u>New Issues</u>	<u>Outstanding June 30, 2006</u>	<u>Interest Paid 2005-06</u>	<u>Debt Service Requirements 2006-07</u>	
									<u>Principal</u>	<u>Interest</u>
Housing and Dining System Revenue Bonds:										
Series I	11/01/66	3,920,000	3.00	180,000	180,000	-	-	2,700	-	-
Series N	06/01/00	4,790,000	5.0-5.75	4,180,000	170,000	-	4,010,000	224,861	180,000	215,890
Series O	06/01/00	4,625,000	5.0-5.25	3,030,000	490,000	-	2,540,000	143,660	515,000	118,033
Series P	07/01/01	5,125,000	2.75-4.9	4,370,000	195,000	-	4,175,000	188,720	200,000	181,410
Series Q	04/16/03	4,485,000	3.25	3,725,000	405,000	-	3,320,000	110,850	425,000	98,400
Series R	06/01/03	4,270,000	3.682	3,945,000	170,000	-	3,775,000	133,933	170,000	130,533
Total housing and dining system		27,215,000		19,430,000	1,610,000	-	17,820,000	804,724	1,490,000	744,266
Consolidated Educational Building Revenue Bonds:										
Series L	12/01/01	4,875,000	5.5-5.75	3,670,000	740,000	-	2,930,000	207,969	770,000	120,763
Series M	01/01/04	5,620,000	2.0-3.3625	5,205,000	470,000	-	4,735,000	233,234	480,000	149,422
Total educational buildings		10,495,000		8,875,000	1,210,000	-	7,665,000	441,203	1,250,000	270,185
Lease Purchase Agreements:										
G.E. Capital	01/26/01	457,000	5.04	101,757	100,567	-	1,190	3,817	1,190	-
MSU Foundation, Inc.	03/01/99	240,000	5.0	187,780	9,138	-	178,642	9,789	9,878	9,050
MSU Foundation, Inc.	07/15/02	990,000	5.25	730,477	95,428	-	635,049	34,356	100,310	29,474
MSU Foundation, Inc.	10/21/02	466,457	9.4	443,822	10,326	-	433,496	41,687	11,339	40,674
Citi Mortgage, Inc.	03/31/05	1,824,000	4.19	1,779,704	91,396	-	1,688,308	73,622	95,266	69,753
Suntrust Bank, Inc.	06/15/05	3,874,522	3.58	3,874,519	328,564	-	3,545,955	135,792	340,431	123,924
MSU Foundation, Inc.	09/01/05	327,764	4.77	-	23,215	327,764	304,549	10,581	27,500	13,053
Total lease purchase agreements		8,179,743		7,118,059	658,634	327,764	6,787,189	309,644	585,914	285,928

MOREHEAD STATE UNIVERSITY

Schedule of Bonds, Notes and Capital Lease Obligations, continued

June 30, 2006

	<u>Issue Date</u>	<u>Net Amount of Issue</u>	<u>Interest Cost</u>	<u>Outstanding June 30, 2005</u>	<u>Retired Bonds 2005-06</u>	<u>New Issues</u>	<u>Outstanding June 30, 2006</u>	<u>Interest Paid 2005-06</u>	<u>Debt Service Requirements 2006-07</u>	
									<u>Principal</u>	<u>Interest</u>
Notes Payable:										
Fred White	06/01/01	\$700,000	9.5	\$300,000	\$100,000	-	\$200,000	\$28,500	\$100,000	\$19,000
Freddie White	06/01/01	90,000	9.5	50,000	10,000	-	40,000	4,750	10,000	3,800
Total housing and dining system		<u>790,000</u>		<u>350,000</u>	<u>110,000</u>	<u>-</u>	<u>240,000</u>	<u>33,250</u>	<u>110,000</u>	<u>22,800</u>
Total		<u>\$46,679,743</u>		<u>\$35,773,059</u>	<u>\$3,588,634</u>	<u>\$327,764</u>	<u>\$32,512,189</u>	<u>\$1,588,821</u>	<u>\$3,435,914</u>	<u>\$1,323,179</u>

MOREHEAD STATE UNIVERSITY

Schedules of Housing System Revenues and Expenditures

Year ended June 30, 2006

Revenues:	
Housing fees	\$ 6,815,320
Interest income	<u>180,131</u>
	6,995,451
Operating expenditures:	
Residence hall grants	92,287
Maintenance and IT allocations	2,388,350
Residence hall services	1,256,691
Student housing	715,787
Telephone	307,169
Married student housing	<u>144,742</u>
	4,905,026
Revenues in excess of operating expenditures	2,090,425
Debt service expenditures:	
Principal	1,610,000
Interest	<u>804,724</u>
	2,414,724
Deficiency of revenues over expenditures	<u>\$ (324,299)</u>

MOREHEAD STATE UNIVERSITY

Schedule of Bond Reserves

June 30, 2006

	Sinking Fund	Housing and Dining System Debt Service Reserve Fund	Repair Fund	Consolidated Educational Building Bonds	Totals
Balances, beginning of year	\$ 153,481	\$2,511,259	\$ 570,659	\$1,906,893	\$5,142,292
Receipts and other additions:					
Transfers, net	1,496,181	-	-	31,380	1,527,561
Income from investments	<u>2,758</u>	<u>38,357</u>	<u>20,544</u>	<u>64,839</u>	<u>126,498</u>
Total available funds	1,498,939	38,357	20,544	96,219	1,654,059
Disbursements and other deductions:					
Transfers, net	-	34,082	-	-	34,082
Redemption of bonds	1,210,000	-	-	-	1,210,000
Payment of interest	306,410	-	-	-	306,410
Administrative fees	<u>311</u>	<u>-</u>	<u>-</u>	<u>6,866</u>	<u>7,177</u>
Total disbursements and other deductions	<u>1,516,721</u>	<u>34,082</u>	<u>-</u>	<u>6,866</u>	<u>1,557,669</u>
Balances, end of year	<u>\$ 135,699</u>	<u>\$2,515,534</u>	<u>\$ 591,203</u>	<u>\$1,996,246</u>	<u>\$5,238,682</u>

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Education:			
Direct Programs:			
Student Financial Aid Cluster:			
Federal Work Study Program		84.033	\$ 703,426
Federal Pell Grant Program		84.063	10,251,737
Federal Supplemental Educational Opportunity Program		84.007	558,768
Federal Perkins Loan Program		84.038	3,838,994
Federal Direct Loan Program		84.268	<u>25,807,958</u>
			41,160,883
Trio Cluster:			
CEOC - NE 04-06		84.066	444,855
CEOC - SE 02-06		84.066	219,672
Student Support Services 01-06		84.042	316,754
Talent Search 02-06		84.044	389,302
Talent Search II 02-06		84.044	246,364
Upward Bound Central 05-06		84.047	604,826
Upward Bound Math/Science 04-06		84.047	207,871
Upward Bound East 03-06		84.047	315,800
Upward Bound 00-05		84.047	<u>2,050</u>
			2,747,494
Gear-up IRAPP 00-04		84.334	1,088,771
Hail-IFIR 05-06		84.116	91,800
Hail-IFIR 05-07		84.116	59,093
Patrick-SI 05-06		84.031	<u>321,597</u>
			45,469,638
Passed through Council on Postsecondary Education:			
Kentucky Gear-up 04-05	M-04577025	84.334	246,465
Kentucky Gear-up 05-06	M-05508393	84.334	<u>93,895</u>
			340,360

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
Passed through Kentucky Department of Education:			
TMP 03-07	M-04041510	84.367	217,131
Spangler-KDE 06	M-06084525	84.048	8,537
First Coach 05-06	M-05104460	84.357	193,179
TE01-IET 05-06	M-05131946	84.048	3,614
TE01-IS 05-06	M-05131946	84.048	4,213
			<hr/> 426,674
Passed through Murray State University:			
Reading River 04-05	OSP 2004-185	84.367	852
Reeder-Murray	USP 2006-016	84.215	6,261
			<hr/> 7,113
Passed through Western Kentucky University:			
Teacher Quality 04-05	WKURF 543604-05-22	84.336	13,311
Teacher Quality 05-06	WKURF 543604-06-38	84.336	91,638
			<hr/> 104,949
Passed through Kentucky Educational Development Corp.:			
Learning Comm 03-04	RCG 03-04-071	84.215	3,001
Passed through Department of Vocational Rehabilitation:			
CDP Rehab 04-06	M-04106347	84.126	571,555
Passed through Kentucky Workforce Development Cabinet:			
TE-02 Zargari 05	TE-02	84.048	9,689
TE02 - IET 05-06	M-05131946	84.048	4,681
Tech Prep-Zargari 05	M-05122282	84.048	21,411
Title 1c-ADN 05-06	M-05131946	84.048	45,361
Title 1c-IET 05-06	M-05131946	84.048	54,272
Title 1c-IS 05-06	M-05131946	84.048	30,199
Title 1c-RS 05-06	M-05131946	84.048	31,240
Title 1c-VET 05-06	M-05131946	84.048	58,478
			<hr/> 255,331

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
Passed through National Writing Project Corp.:			
NWP#15 05-07	94-KY07 (#15)	84.928	34,905
Total U.S. Department of Education			47,213,526
U.S. Department of Health and Human Services - National Institute of Health:			
Direct Programs:			
NIH - Amphetamine		93.279	16,491
Prefont Cortex 03-06		93.242	17,909
			34,400
Passed through University of Louisville Research Foundation:			
INBRE - Demoss 06-07	2P20RR016481-06	93.385	22,309
INBRE - Mattingly 06-07	2P20RR016481-06	93.385	4,844
INBRE - White 04-09	2P20RR016481-04	93.385	5,011
INBRE - White 06-07	2P20RR016481-04	93.385	20,601
INBRE - DeMoss 05-06	2P20RR016481-05	93.385	140,682
INBRE - Mattingly 05-06	2P20RR016481-05	93.385	98,927
INBRE - White 05-06	2P20RR016481-05	93.385	120,649
			413,023
Passed through Kentucky Families And Children:			
STEPS 04-05	M-04210189	93.558	36,869
Passed through Eastern Kentucky University:			
MSU Training 04-05	EKU 05-302	93.568	5
MSU Training 05-06	M-05235291	93.568	65,278
			65,283
Passed through University of Kentucky Research Foundation:			
Nurse Practitioner 04-05	UKRF 4-63922-01-284	93.247	18,932

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
Passed through National Youth Sports Program: NYSP 2005	RCG-2005-323	93.570	45,514
Passed through Johns Hopkins University: White-JHU 05-06	8512-47647-X	93.848	14,981
Passed through Kentucky Seniors Saving Medicare: KY Medicare 05-06	90AM2945	93.048	<u>39,962</u>
Total U.S. Department of Health and Human Services - National Institute of Health			<u>668,964</u>
Corporation for National and Community Service: Direct Programs: RSVP 03-06		94.002	98,201
Passed through Kentucky Cabinet for Families and Children: Promise Corps 04-05 Promise Corps 05-06	M-04185843 M-04185843	94.006 94.006	73,046 <u>414,031</u> <u>487,077</u>
Total Corporation for National and Community Service			<u>585,278</u>
National Science Foundation: Direct Programs: CSMS 03-07 NSF-Wangsaputra 04-06 NSF-Jerde 04-07		47.076 47.076 47.050	46,847 9,641 <u>20,421</u> 76,909
Passed through University of Kentucky Research Foundation: AMSP 02-06	4-66358-03-191	47.076	257,000

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
Passed through Kentucky NSF:			
Cetiner-KYNSF 05-06	3046901800-05-49	47.076	19,006
Feria-KYNSF 05-06	4-69018-05-496	47.076	<u>9,248</u>
			<u>28,254</u>
Total National Science Foundation			<u>362,163</u>
Small Business Administration:			
Direct Programs:			
Space Ctr IRAPP 01-03		59.000	162,307
Space Ctr S&T 01-03		59.000	<u>21,561</u>
			183,868
Passed through University of Kentucky:			
SBDC Federal 04-05	04-60301-20018-24	59.037	52,167
SBDC Federal 05-06	04-60301-20018-25	59.037	<u>101,757</u>
			<u>153,924</u>
Total Small Business Administration			<u>337,792</u>
U.S. Department of Agriculture:			
Direct Programs:			
Distance Learning 05		10.855	217,855
USDA 03-05		10.769	21,437
USDA 05-07		10.769	<u>31,390</u>
			270,682
Passed through Kentucky Department of Education:			
NYSP Food 05	103-Y10-999-SU	10.558	16,512
Up Bound Food 06	103-X30-999-SU	10.558	6,664
Up Bound Food 05	103-X30-999-SU	10.558	<u>22,523</u>
			<u>45,699</u>
Total U.S. Department of Agriculture			<u>316,381</u>

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Labor:			
Passed through TENCO Workforce Investment Board:			
Today's Youth 05-06	FY06-1282	17.250	<u>145,775</u>
National Oceanic and Atmospheric Administration:			
Passed through Eastern Kentucky Pride - Pride 05/07			
	RSG 2005-06-054	11.469	<u>143,517</u>
U.S. Department of Defense:			
Direct Program			
	Cetiner-DOD 05-06	12.431	<u>133,558</u>
U.S. Department of Housing/Urban Development:			
Direct Programs:			
COPC 02-05		14.551	19,596
Hail-ACRP 04-06		14.243	<u>104,883</u>
Total U.S. Department of Housing/ Urban Development			<u>124,479</u>
Appalachian Regional Commission:			
Direct Programs:			
KY AHED Duvall 04-07		23.001	60,818
Passed through East Tennessee State University:			
Bortolot ETSU 05-06	5-30773-4	23.011	<u>2,422</u>
Total Appalachian Regional Commission			<u>63,240</u>
U.S. Department of Justice:			
Direct Programs:			
COPS 02-05		16.710	39,244

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
Passed through UNITE: Krug-UNITE 06	06MH01	16.580	2,381
Passed through Kentucky Justice Cabinet: Block Grant 05	LLEP-642-04	16.592	<u>80</u>
Total U.S. Department of Justice			<u>41,705</u>
U.S. Department of the Interior: Direct Programs: Parkansky-USGS 05-09		15.808	<u>37,319</u>
U.S. Environmental Protection Agency: Direct Programs: Environ Justice 03-04		66.604	1,510
Passed through University of Louisville Research Foundation: Reeder-ULRF 03-06	ULRF G03-1016-07	66.460	17,656
Passed through Shaw Environment: Sloan-Shaw 05	88863-OP CO#501	66.439	<u>15,185</u>
Total U.S. Environmental Protection Agency			<u>34,351</u>

MOREHEAD STATE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u>	<u>Pass Through Number</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
National Aeronautics and Space Administration:			
Passed through Western Kentucky University:			
Boram-KSGC 05-06	WKU 516171-06-14	43.001	936
Doyle-NASA EPS 05-06	WKU 516140-06-15	43.001	18,519
Kentucky Earth 01-04	WKU 521751-01-01	43.001	1
KSGC-McMichaels 05-06	WKU 516171-06-06	43.001	4,657
Malphrus-KySP 06	WKU 516171-06-36	43.001	2,400
Malphrus-KSGC 05-06	WKU 516171-06-10	43.001	3,425
NASA Travel 05-06	WKU 519171-06-21	43.001	1,000
Malphrus-Scholar 06	WKU 516171-06-38	43.001	<u>1,600</u>
Total National Aeronautics and Space Administration			<u>32,538</u>
National Highway Transportation Safety Board:			
Passed through Kentucky State Police:			
Krug-HRD 06-07	2005-AH-FX-0003	20.601	<u>14,839</u>
U.S. Department of Transportation:			
Passed through University of Kentucky Research Foundation:			
Blanken-UKRF	3046962300-06-286	16.560	<u>6,172</u>
National Endowment for the Humanities:			
Direct Programs:			
Collinwor-NEA 06-08	06-4448-7108	45.024	2,364
Passed through Kentucky Humanities Council:			
Little-KHC 05-06	XT2006-002	45.129	<u>877</u>
Total National Endowment for the Humanities			<u>3,241</u>
Total Expenditures of Federal Awards			<u>\$ 50,264,838</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, 2006 are summarized as follows:

Federal Perkins Loan Program:		
Loans disbursed	\$	972,074
Federal Direct Loan Program:		
Federal Subsidized Stafford Loans	\$	13,576,800
Federal Unsubsidized Stafford Loans		10,559,357
Federal Plus Loans		1,671,801

At June 30, 2006, the University had loans outstanding, in the amount of \$3,838,994 with an allowance for doubtful accounts of \$126,895 under the Federal Perkins Loan Program.



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 Morehead State University (the "University") and its discretely presented component unit as of and for the year ended June 30, 2006 which collectively comprise Morehead State University's basic financial statements and have issued our report thereon dated November 2, 2006. We conducted our audit 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

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-01 and 06-02.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above are material weaknesses.



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We also noted certain immaterial items involving the internal control over financial reporting that we have reported to management in a separate letter dated November 2, 2006.

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*.

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.

Lexington, Kentucky
November 2, 2006

Dean, Dartm & Fund, PSC



Report on Compliance with Requirements Applicable to Each Major Program and on 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 are applicable to each of its major federal programs for the year ended June 30, 2006. 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 on the University's compliance with those requirements.

In our opinion, Morehead State University complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.



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in Kentucky

Internal Control Over Compliance

The management of Morehead State University is responsible for establishing and maintaining effective internal control over compliance with 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 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.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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.

Lexington, Kentucky
November 2, 2006

Dean, Justin S. Ford, ASL

MOREHEAD STATE UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended June 30, 2006

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. Reportable conditions in internal control over financial reporting: **Yes**
Material weaknesses: **No**
- c. Non-compliance which is material to the financial statements: **No**

Federal Award:

- d. Reportable conditions in internal control over major programs: **No**
Material weaknesses: **No**
- 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 Grants, CFDA 84.063**
 - Federal Work Study, CFDA 84.033**
 - Federal Supplemental Educational Opportunity Grants, CFDA 84.007**
 - Federal Perkins Loans, CFDA 84.038**
 - Federal Direct Loan Program, CFDA 84.268**
 - TRIO Cluster:**
 - Upward Bound, CFDA 84.047**
 - Talent Search, CFDA 84.044**
 - Educational Opportunity Center, CFDA 84.066**
 - Student Support Services, CFDA 84.042**
 - Gear-Up IRAPP 00-04, CFDA 84.334**
 - KY Gear Up 04-05, CFDA 84.334**
- h. Dollar threshold used to distinguish between Type A and Type B programs: **\$643,000**
- i. Auditee qualified as a low-risk auditee: **Yes**

MOREHEAD STATE UNIVERSITY

Schedule of Findings and Questioned Costs, continued

Year ended June 30, 2006

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: 06-01 and 06-02.

Finding 06-01:

Specific Requirement:

Bank statements for all cash accounts should be reconciled to the general ledger in a timely manner.

Condition:

During our audit we noted that several cash accounts had not been reconciled and reviewed in a timely manner.

Effect:

Could result in a financial statement misstatement not being detected in a timely manner.

Recommendation:

We recommend that the University establish more effective reconciliation and review procedures as a customary part of the accounting process. This would involve timely reconciliations of all accounts and performing more frequent reviews of the general ledger throughout the year, including making necessary adjustments.

Management's Response:

We concur. Due to the implementation of our new accounting system, our resources were strained during the setup and training functions. We anticipate gains in efficiency and productivity once the new system is fully functional, later this year. At that point we believe the cycle time on reconciliations will decline dramatically.

MOREHEAD STATE UNIVERSITY

Schedule of Findings and Questioned Costs, continued

Year ended June 30, 2006

Finding 06-02:

Specific Requirement:

A detail grant schedule should be maintained which details the revenue, expenditures, unearned revenue, and amounts receivable by grant. The total of this schedule should agree to the financial statements.

Condition:

During our audit we noted that the schedule was being maintained, but the totals did not agree to the financial statements.

Effect:

Could result in the financial statements being misstated by an amount that is more than inconsequential.

Recommendation:

We recommend that a system be implemented such that the detail schedule of grant activity is reconciled to the financial statements on a quarterly basis.

Management's Response:

We currently reconcile and adjust on a quarterly basis; we will review our use of offset accounts to ensure greater alignment with the reports generated at year end. Due to the timing of expenses and reimbursement income, quarterly balances will fluctuate, which is appropriate. We believe that uncertainties that have existed in the reporting process have been addressed and will allow the grant schedule to be maintained in a more consistent manner going forward.

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

Findings and Questioned Costs relating to Federal Awards: **None**

MOREHEAD STATE UNIVERSITY

Summary Schedule of Prior Audit Findings

Year ended June 30, 2006

U.S. Department of Education

Finding 05-01:

Federal Pell Grant Program (CFDA No. 84.063), Federal Supplemental Education Grant Program (CFDA No. 84.007), Federal Work Study Program (CFDA No. 84.033), Perkins Loan Program (CFDA No. 84.038) and Federal Direct Loan Program (CFDA No. 84.268)

Condition:

During the review of Return of Title IV calculations and inquiries with management, it was noted that the University was not preparing a return calculation if the student withdrew past the 60% point of the semester and any aid not disbursed was cancelled in the University's financial aid system. Due to the procedures currently in place at the institution, it was noted that the return calculation for one student in the sample of twenty, who officially withdrew during the current year, did not contain the loans for which he was eligible as aid that could have been disbursed. As a result, there was no post-withdrawal necessary, but the University returned too much to the federal agency than if the funds had been included.

Recommendation:

It was recommended that the University review its current procedures and make the necessary changes to ensure the accurate completion of all Return of Title IV calculations and thus leading to accurate funds submitted back to the federal agency.

Current Status:

Recommendation was adopted and no similar findings were noted in the 2006 audit.

Finding 05-02:

Federal Direct Loan Program (CFDA No. 84.268)

Condition:

During the review of exit counseling, it was noted that exit counseling for thirteen of the twenty students selected, were not provided to the student in accordance with the federal regulations. The majority of these students consisted of graduates who should have been given this counseling prior to leaving the University.

MOREHEAD STATE UNIVERSITY

Summary Schedule of Prior Audit Findings, continued

Year ended June 30, 2006

Finding 05-02, continued:

Recommendation:

It was recommended that the University review its current procedures over exit counseling and make the necessary changes to ensure the appropriate materials are provided or sent to the borrowers in accordance with the federal regulations.

Current Status:

Recommendation was adopted and no similar findings were noted in the 2006 audit.

Finding 05-03:

Federal Direct Loan Program (CFDA No. 84.268)

Condition:

While testing a sample of students who withdrew or graduated from the University during 2004-2005, it was noted that December graduates were not being reported to the NSLDS as graduates but being submitted on the first Spring semester roster as withdrawn if the student did not return to the University. It was also noted that students who unofficially withdrew during either semester were not being reported in compliance with the above regulation.

Recommendation:

It was recommended that the University review its current procedures for submitting December graduates and unofficial withdrawals to the NSLDS and make the necessary changes to ensure that all enrollment information is accurately submitted and in accordance with federal regulations.

Current Status:

Recommendation was adopted and no similar findings were noted in the 2006 audit.

MOREHEAD STATE UNIVERSITY

Summary Schedule of Prior Audit Findings, continued

Year ended June 30, 2006

Finding 05-04:

Pell Grant Program (CFDA No. 84.063)

Condition:

During the testing of Return of Title IV calculations, it was noted that four students out of the 21 selected for testing incurred a Pell overpayment that was not submitted to the Department in accordance with the regulations. It was also noted that Pell overpayments on an additional two students were not returned to the Department and two separate individuals whose funds were returned 30 days from the date the institution determined that they had withdrawn.

Recommendation:

It was recommended that the University review its current procedures over return calculations and make the necessary changes to ensure that all funds are appropriately and timely reported and returned in accordance with federal regulations.

Current Status:

Recommendation was adopted and no similar findings were noted in the 2006 audit.