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Kansas State University
Management's Discussion and Analysis
For the Year Ended June 30, 2004

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial performance of Kansas State University (University) based on currently known facts, decisions and conditions. Readers are encouraged to consider this information in conjunction with the statements and footnotes. The financial statements, footnotes, and this discussion are the responsibility of management.

USING THE FINANCIAL STATEMENTS

This report consists of the three financial statements. The Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, as amended by GASB Statements 37 and 38. These statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis to focus on the University as a whole.

STATEMENT OF NET ASSETS

The Statement of Net Assets presents the assets, liabilities, and net assets of the University at a point in time (at the end of the fiscal year). The Statement of Net Assets includes all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector institutions. Under the accrual basis of accounting all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

Within the Statement of Net Assets, assets and liabilities are further classified as current or non-current. The current classification distinguishes those assets that are highly liquid and available for immediate and unrestricted use by the University, and those liabilities likely to be settled in the next 12 months.

Net assets are divided into three categories:

1. **Invested in capital assets, net of debt**, indicates the university's equity in property, plant, and equipment owned by the University.
2. **Restricted net assets** are further divided into two subcategories, non-expendable and expendable. The corpus of non-expendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the University but must be spent for purposes as determined by donors and/or external entities who have placed time or purpose restrictions on the use of the assets.
3. **Unrestricted net assets** are available to the University for any lawful purpose of the institution.

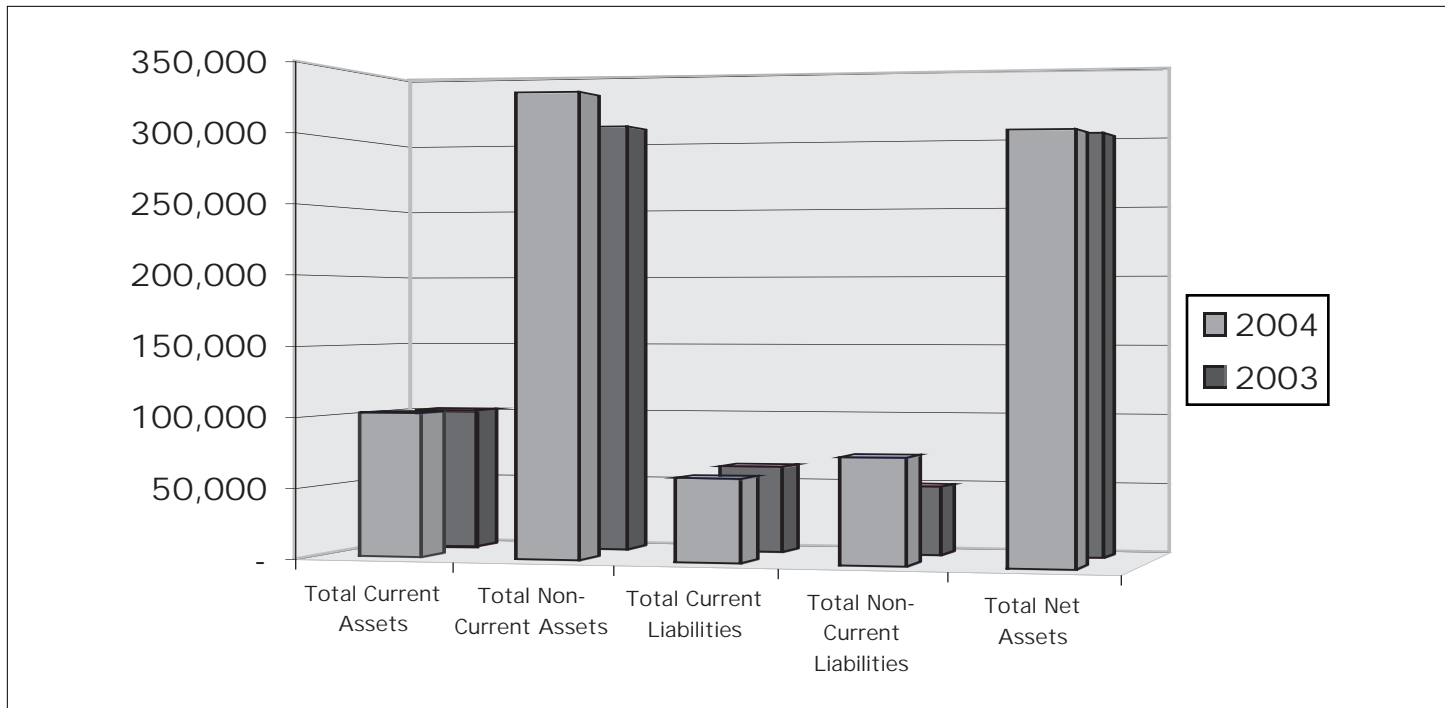
Total assets at June 30, 2004 were \$428.6 million, an increase of \$19 million (4.7%). Capital assets, net of depreciation, comprised 62%, or \$266.1 million of the total assets.

Total liabilities were \$132.3 million at June 30, 2004, an increase of \$22.5 million (20.5%), compared to \$109.8 million at June 30, 2003. Long-term liabilities comprised 60%, or \$74 million of the total liabilities.

Total net assets at June 30, 2004 were \$296.3 million, a \$3 million decrease over the prior year, or a 1% decrease in net assets. The breakout of net assets is shown below:

Capital assets, net of related debt	\$192,146,024
Restricted net assets	58,084,541
Unrestricted net assets	46,066,676
Total net assets	\$296,297,241

The composition of current and non-current assets and liabilities and net assets is displayed below for both the 2003 and 2004 fiscal year ends (in thousands):



STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses and Changes in Net Assets presents the total revenues earned and expenses incurred by the University for operating, non-operating and other related activities during a period of time. Its purpose is to assess the University's operating results.

Revenues

Operating revenues at the University as of June 30, 2004 increased by 6.4% over the previous fiscal year. The following is a brief summary of the significant changes:

- Student fee revenues, after scholarship allowances, were \$79.7 million in 2004, compared to \$68.4 million in 2003. This increase is a direct result of a tuition increase approved by the Kansas Board of Regents for fiscal year 2004. The goal of the tuition increase, which was the result of collaboration between University Administration and University students, was to provide additional funds to the University to improve or enhance student education while State appropriations decreased significantly. The increase was used for specific expenses including faculty salary increases, instructional and technological upgrades, and additional scholarships.
- Grants and contracts (federal, state and local, and non-governmental) increased \$8.1 million over the previous fiscal year. This category of revenue includes funds received from the federal government for financial aid as well as other sponsored research revenue. In conjunction with this increase in grants and contracts revenue, the revenue from the University's facilities and administrative overhead reimbursement also increased from the prior year.

- Sales and services of educational activities increased \$.5 million from the previous fiscal year. These revenues are generated by activities that are related incidentally or exist primarily to afford hands on experience related to providing instruction, research, and public service.
- Auxiliary enterprises decreased \$1.6 million from the previous fiscal year. Auxiliary enterprises include Housing, Parking, University health services, and a variety of other smaller services.

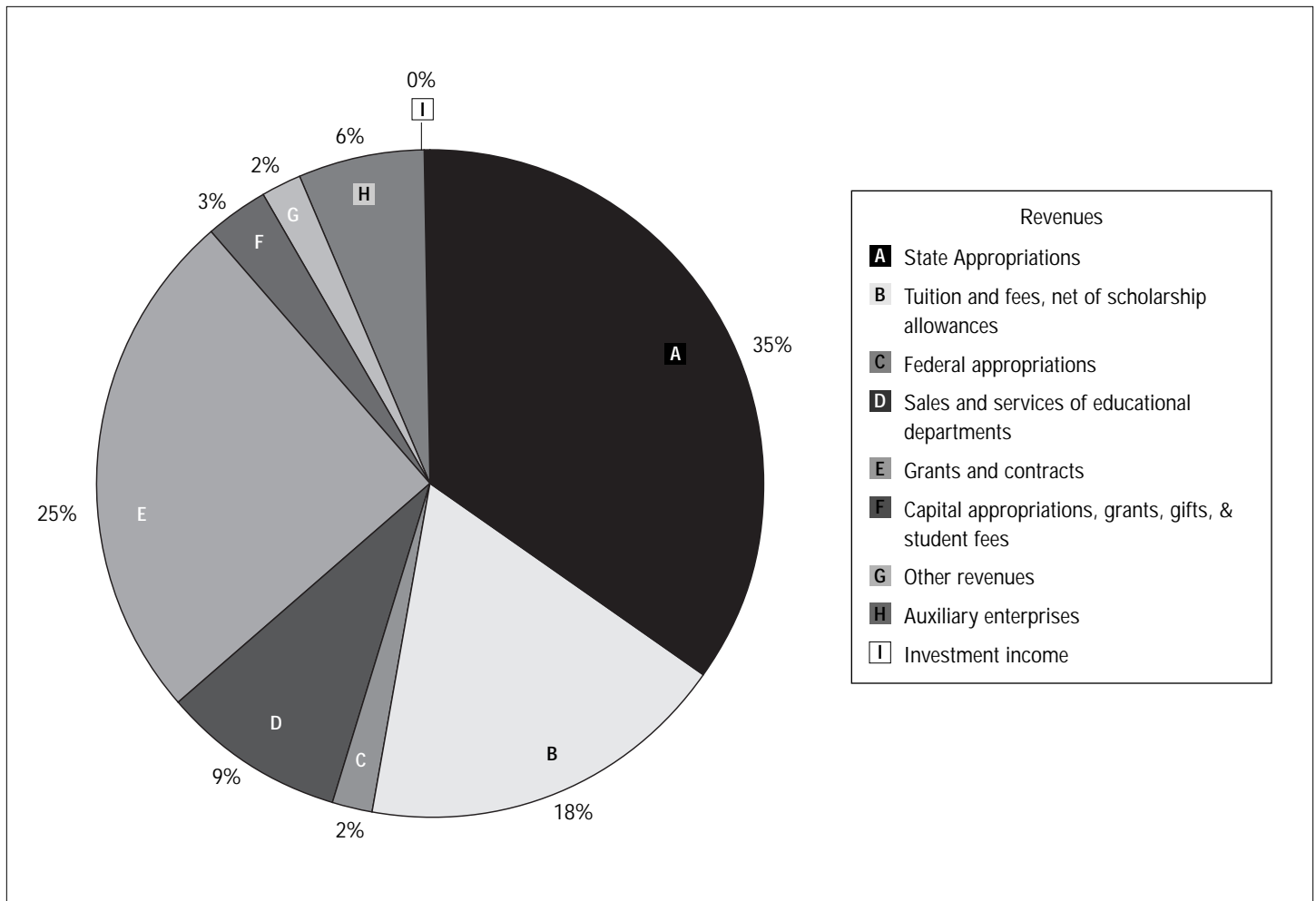
Total non-operating revenues were down 1.8% from the prior year from \$160.9 million to \$158 million. The following is a brief summary of the significant changes:

- State appropriations, the largest single source of revenue at the University, increased from \$156.8 million to \$157.8 million.
- There was no recorded gain on disposal of assets in 2004 compared to \$2.8 million in 2003.

Other revenues included the following:

- Capital appropriations and grants and gifts decreased from \$13.3 million to \$11.5 million.
- Additions to permanent endowments decreased over the prior year due to a reduction in gas and oil royalties.

In summary, total revenues increased by \$13.1 million, from \$437.1 million to \$450.2 million, an overall increase of 3%. The compositions of these revenues are displayed in the following graph:



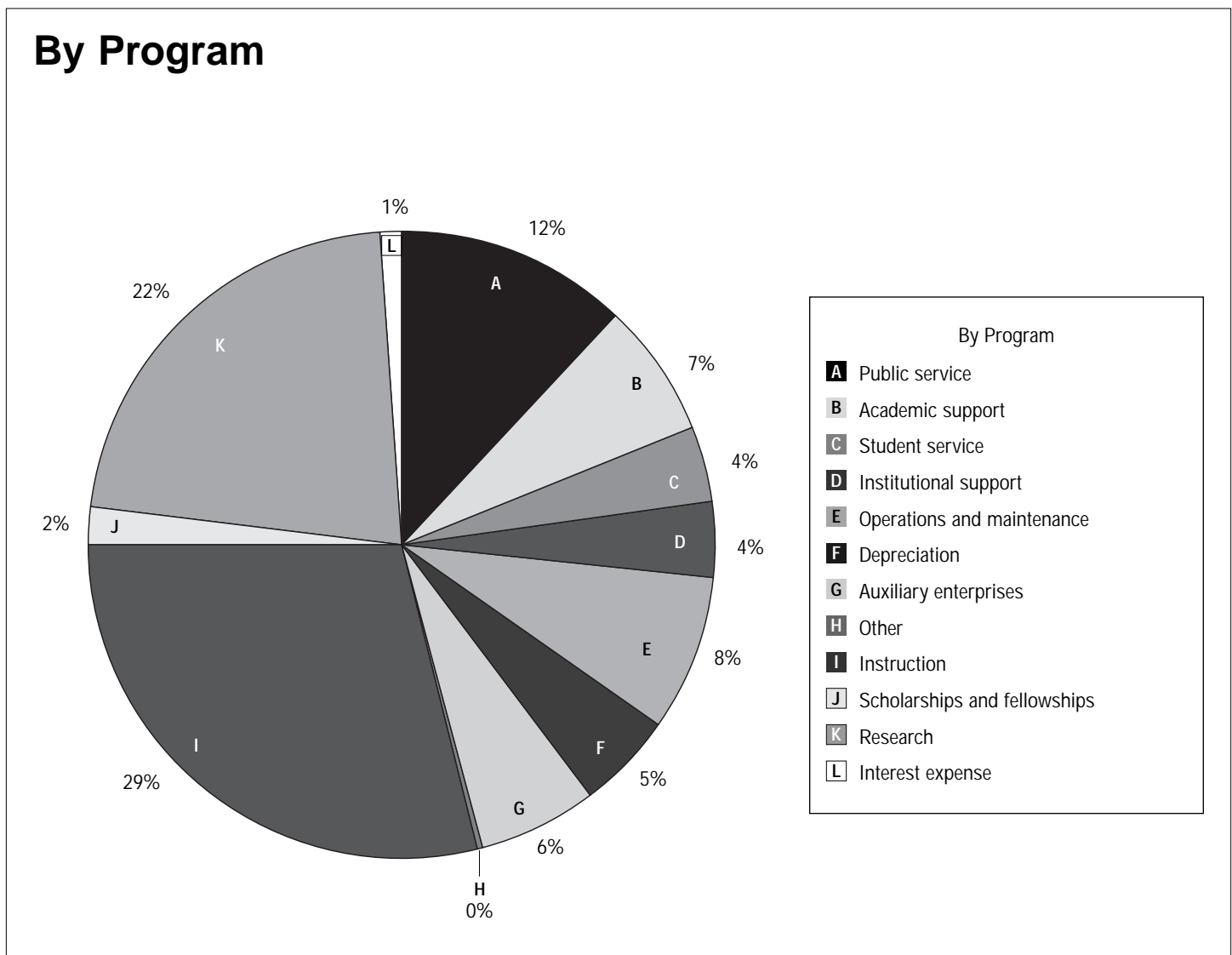
Expenses

Operating expenses were \$450.1 million for the 2004 fiscal year. This was an increase over the prior year of \$15.7 million, or 3.6%. The following is a brief summary of the significant changes:

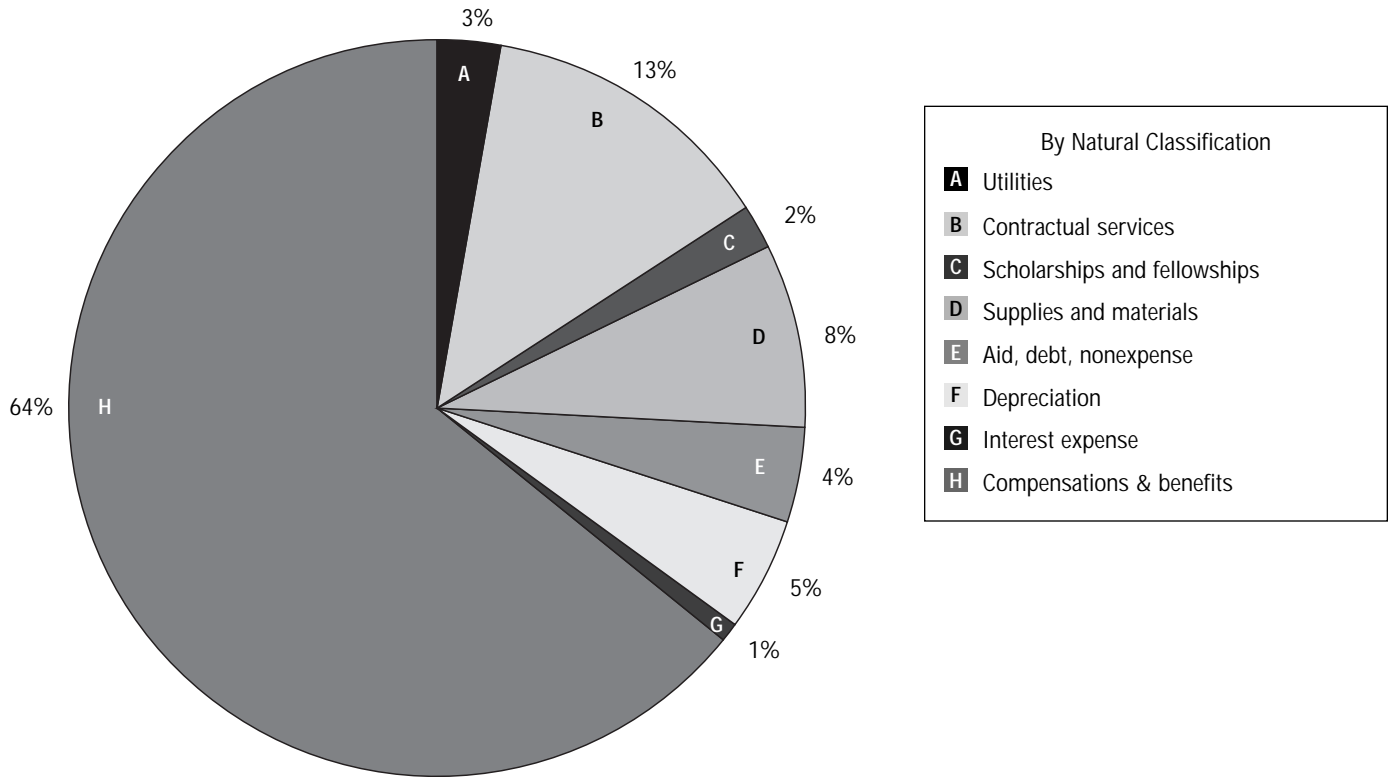
- Expenses related to the University's mission of instruction, research and public service increased \$4.3 million in 2004. This increase is directly related to the University's tuition increase earmarked for faculty salaries and the increase in grant and contract revenue.
- Operation and maintenance expenses increased by \$8 million. This increase is directly related to the University's energy conservation repair and maintenance projects.

Non-operating expenses are represented primarily by interest expense. This amount increased by \$1.6 million from the prior year as a result of the issuance of additional capital debt during the year.

The composition of total expenses, including operating and non-operating are displayed below:



By Natural Classification



Extraordinary Items

The University did not have any special and extraordinary items in 2004.

Net Assets

Net assets decreased by \$3 million compared to the previous fiscal year. This decrease in net assets can be attributed to the decrease in capital appropriations and capital gifts and grants, as well as the increase in interest expense during 2004.

STATEMENT OF CASH FLOWS

The Statement of Cash Flows presents cash receipts and payments of the University during a period of time. Its purpose is to assess the University's ability to generate future net cash flows and meet its obligations as they come due.

SUMMARY OF THE STATEMENT OF CASH FLOWS (in thousands of dollars):

	June 30, 2004	June 30, 2003
Net cash provided (used) by:		
Operating activities	\$ (145,463)	\$ (137,284)
Non-capital financing activities	158,639	158,820
Capital and related financing/appropriations	2,048	8,435
Investing activities	792	344
Net increase in cash	16,016	30,315
Beginning cash and cash equivalent balances	105,268	80,193
Prior Period Restatement	–	(5,240)
Ending cash and cash equivalent balances	\$ 121,284	\$ 105,268

Cash provided by operating activities includes tuition and fee and grant and contract revenues. Cash used for operating activities includes payments to employees and suppliers. Cash provided by non-capital financing/appropriations includes state appropriations and the receipt and disbursement of the federal direct student loan program. Cash provided for capital and related financing activities represents proceeds from debt, the principal and interest payments towards debt, capital appropriations and grants, and the purchase and construction of capital assets. Cash provided by investing activities includes purchases and sales of investments as well as investment income earnings and losses realized.

The University's overall liquidity increased by \$16 million consisting primarily of the issuance of capital debt during the fiscal year.

CAPITAL ASSETS

The University made significant investments in capital during the 2003-2004 fiscal year. Detailed information regarding capital asset additions, retirements & depreciation is available in Note 3 to the financial statements.

The following is a brief summary of the construction projects that were completed during the current fiscal year:

- The Grain Science Center Complex's Biological and Industrial Value-Added Program (BIVAP) building was completed at a cost of approximately \$6.5 million. This project was funded with state funds and a loan from the State's Pooled Money Investment Board (PMIB). The loan repayment will be made with university revenue funds.
- The Grain Science Center Complex's International Grains Program Conference Center was completed at a cost of approximately \$3.5 million and was funded entirely with private gifts.
- Two Bio Safety Level 3 laboratories were completed, one in Mosier Hall and one in Throckmorton Hall. The costs were approximately \$450,000 and \$300,000 respectively and were funded with state funds.
- Renovations to the English/Counseling Services building, formerly Lafene Student Health Center, were completed at an approximate cost of \$650,000 and funded with state funds.
- The R. V. Christian Track System received new artificial turfgrass and a rubberized track system at a cost of approximately \$1.4 million. This project was funded by the Intercollegiate Athletic Council revenue bonds with future repayment of the bonds coming from ticket revenue and/or private gifts.

Additionally, the University was involved in several construction projects that were in physical construction or planning and design phases at year-end:

- Phase III of the Ackert Hall Addition will complete the lower level and first floor of the addition, providing much needed space for the Departments of Biochemistry and Chemistry. The estimated cost is \$3 million and will be provided through state funds.

- The Grain Science Center Biological and Industrial Value-Added Program Complex project which commenced in FY2003, continues with plans for completing the remaining three buildings: a flour mill, a feed mill, and a teaching/research/administration building. The project budget for the remaining buildings is approximately \$31 million.
- The Biosecurity Research Institute is a \$40 million project that will enable investigation of infectious diseases and provide for safe handling of biotechnology products. The majority of the funding is being provided through the issuance of revenue bonds, with future repayment of the bonds coming from state appropriations and various university revenue funds.
- Renovations to Ford Hall, which is a part of the Department of Housing and Dining Services, began in Spring 2003. The renovation project is estimated at \$4.7 million, to be funded by Housing Operation revenues. The newly renovated facility will consist of a variety of suite arrangements. This project also includes various smaller updates to Marlatt, Putnam and Goodnow Halls.
- In Spring 2002, Kansas State University engaged Viron Energy Services to conduct an investment grade energy audit of the campus for the purpose of identifying energy conservation projects. The audit identified over 100 energy savings measures, which include new windows, plumbing and lighting retrofits, boiler replacements, and many others. The result will be an average annual utility and maintenance savings of \$1.7 million, at a cost of approximately \$19.3 million to implement. The project is being funded through an Energy Performance Bond issued by the State of Kansas. At the end of the project, the University will be responsible for repaying the State with the annual utility and maintenance savings. This project is scheduled for completion in FY2005.
- The Jardine Terrace Apartments renovation is a \$102 million Department of Housing and Dining Services project scheduled to begin in Spring 2005. The project will be funded through a 30-year series of bond agreements with future repayment of the bonds coming from Housing Operation revenues.

DEBT ADMINISTRATION

At June 30, 2004, the University had \$77 million in debt outstanding. Revenue bonds were issued by the Kansas Board of Regents in the amount of \$21,020,000 for the benefit of Kansas State University to finance an energy conservation project. The University paid \$4,998,284 in principal and interest payments related to all outstanding revenue bonds.

Moody's Investors Service currently rates the University "Aa3". More detailed information about the University's long-term liabilities is available in Notes 7, 8, and 9 to the financial statements.

ECONOMIC OUTLOOK

The State of Kansas revenues stabilized in FY 2004 and revenues for FY 2005 are coming in slightly higher than estimated. Budget reductions will be made during FY 2005, in accordance with the State's review of administrative processes, based on the expectation that efficiencies and therefore budget savings will be realized. The budget callback will be approximately \$4.2 million. Future increases in State funding are likely to be moderate. Thirty-five percent of the total resources for the University, during a fiscal year, are provided by the State. Appropriations for fiscal year 2005 are currently set at \$167.8 million, which is an increase of 2.5% from fiscal year 2004.

The University is not aware of any additional currently known facts, decisions, or conditions that are expected to have significant effect on the financial position or results of operations during this fiscal year beyond those unknown variations having a global effect on virtually all types of business operations.

Overall, the financial position of the University continues to be strong. Enrollment for the academic 2004–2005 year is expected to be relatively consistent with academic 2003–2004 year.

Kansas State University
Statement of Net Assets
For the Year Ended June 30, 2004

	University Funds		Component Units	
	2004	2003	2004	2003
ASSETS				
Current Assets				
Cash and cash equivalents	\$ 80,258,793	\$ 73,873,538	\$ 18,568,123	\$ 15,908,948
Accounts receivable, net	16,878,290	19,070,018	2,356,859	1,830,776
Pledges receivable	-	-	520,335	538,875
Investments	-	-	1,411,664	1,139,536
Loans to students, net	1,330,687	3,286,375	201,394	-
Inventories	3,003,354	3,676,397	245,322	156,327
Prepaid expenses	197,498	659,410	-	250,356
Total Current Assets	<u>101,668,622</u>	<u>100,565,738</u>	<u>23,303,697</u>	<u>19,824,818</u>
Noncurrent Assets				
Restricted cash and cash equivalents	41,024,987	31,394,368	11,638,853	10,167,357
Pledges receivable	-	-	12,265	9,047
Investments	4,029,882	3,962,453	2,038,624	2,568,734
Loans to students, net	15,763,755	15,003,522	-	-
Other assets—	-	-	968,707	818,774
Capital assets, net	266,112,910	258,253,180	5,092,899	4,929,036
Total Noncurrent Assets	<u>326,931,534</u>	<u>308,613,523</u>	<u>19,751,348</u>	<u>18,492,948</u>
TOTAL ASSETS	<u>428,600,156</u>	<u>409,179,261</u>	<u>43,055,045</u>	<u>38,317,766</u>
LIABILITIES				
Current Liabilities				
Accounts payable and accrued liabilities	22,838,321	20,921,692	5,932,435	4,920,693
Deferred revenue	19,021,764	23,213,985	13,029,733	12,211,222
Loan payable	212,521	193,204	100,000	33,206
Revenue bonds payable	2,560,000	2,245,000	778,054	889,960
Accrued compensated absences	11,323,874	10,656,037	793,477	738,800
Other liabilities	1,144,171	3,055,714	644,805	-
Capital lease payable	1,133,617	1,026,542	165,417	144,341
Total Current Liabilities	<u>58,234,268</u>	<u>61,312,174</u>	<u>21,443,921</u>	<u>18,938,222</u>
Noncurrent Liabilities				
Other liabilities	5,611,016	3,123,237	-	-
Revenue bonds payable	60,220,000	41,760,000	16,142,836	16,805,929
Other loan payable	4,007,989	879,717	250,000	50,000
Accrued compensated absences	1,317,127	-	-	-
Capital lease payable	2,031,233	2,005,133	96,123	124,398
Deposits held in custody for others	881,282	745,895	446,277	464,514
Total Noncurrent Liabilities	<u>74,068,647</u>	<u>48,513,982</u>	<u>16,935,236</u>	<u>17,444,841</u>
TOTAL LIABILITIES	<u>132,302,915</u>	<u>109,826,156</u>	<u>38,379,157</u>	<u>36,383,063</u>
NET ASSETS				
Invested in capital assets, net of related debt	192,146,024	205,628,500	(12,087,730)*	(13,031,826)*
Restricted for:				
Nonexpendable	2,437,574	2,364,689	7,166,212	6,108,062
Expendable				
Scholarships, research, instruction, public service, & other	(6,081,562)	(5,153,458)	4,007,822	4,005,919
Loans	19,922,275	21,275,484	-	-
Capital projects	33,894,647	24,443,223	18,542	53,376
Debt service	7,911,607	7,169,740	3,653,261	4,078,509
Unrestricted	46,066,676	43,624,927	1,917,781	720,163
TOTAL NET ASSETS	<u>\$ 296,297,241</u>	<u>\$ 299,353,105</u>	<u>\$ 4,675,888</u>	<u>\$ 1,934,203</u>

*See accompanying Note 14.

Kansas State University
Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2004

	University Funds		Component Units	
	2004	2003	2004	2003
Operating Revenues:				
Tuition and fees, net of scholarship allowances of \$ 11,697,307	\$ 79,726,016	\$ 68,428,803	\$ 2,339,890	\$ 2,240,990
Federal appropriations	7,670,522	8,720,429	-	-
Federal grants and contracts	84,027,706	75,829,593	-	-
State and local grants and contracts	8,580,657	8,512,146	-	-
Nongovernmental grants and contracts	21,398,742	21,593,872	10,780,382	8,781,970
Sales and services of educational activities	39,218,732	38,727,304	18,937,990	18,650,126
Auxiliary enterprises				
Housing revenues (revenues are pledged as security for bonds)	21,152,745	22,368,199	-	-
Parking revenues (revenues are pledged as security for bonds)	1,565,797	2,114,959	-	-
Student health revenues	5,423,568	5,361,742	-	-
Other auxiliary revenues	517,855	445,699	-	-
Interest earned on loans to students	307,349	377,194	-	-
Other operating revenues	8,171,305	8,554,593	5,898,616	4,498,893
Contributions	-	-	7,015,469	8,566,724
Total Operating Revenues	277,760,994	261,034,533	44,972,347	42,738,703
Operating Expenses:				
Instruction	128,759,116	129,310,319	-	-
Research	98,761,511	93,957,342	-	-
Public Service	54,915,585	54,837,137	891,789	755,478
Academic Support	30,995,516	28,712,966	-	-
Student Service	17,988,933	17,540,848	2,796,808	2,835,998
Institutional Support	20,249,498	18,736,212	31,159,592	29,674,901
Operations & Maintenance of Plant	37,045,887	29,089,178	-	-
Depreciation	21,559,712	24,675,603	892,979	861,419
Scholarships & Fellowships	10,452,316	10,683,134	4,285,076	3,727,756
Auxiliary Enterprises	28,172,878	26,429,207	-	-
Other Expenses	1,207,613	408,483	1,776,935	1,101,094
Total Operating Expenses	450,108,565	434,380,429	41,803,179	38,956,646
Operating Income (Loss)	(172,347,571)	(173,345,896)	3,169,168	3,782,057
Nonoperating Revenues (Expenses)				
State appropriations	157,784,459	156,880,717	1,262,072	1,273,303
Investment income	778,645	316,766	-	248,373
Interest expense	(2,814,838)	(1,204,936)	1,149,037	(1,061,160)
Gain on disposal of assets	-	2,846,463	(1,158,476)	-
Student fees for capital projects	2,274,231	2,057,359	-	-
Net Nonoperating Revenues	158,022,497	160,896,369	1,252,633	460,516
Income (Loss) Before Other Revenues, Expenses, Gains and Losses	(14,325,074)	(12,449,527)	4,421,801	4,242,573
Capital appropriations	6,063,027	7,231,040	-	-
Capital grants and gifts	5,424,151	6,081,696	-	-
Additions to permanent endowment	94,620	106,792	1,021,106	(295,956)
Other additions, net	(312,588)	541,591	(2,701,222)	(1,524,173)
Increase (Decrease) in Net Assets	(3,055,864)	1,511,592	2,741,685	2,422,444
Net Assets				
Net Assets—Beginning of Year, as previously reported	299,353,105	298,723,238	1,934,703	(527,431)
Prior Period Restatement	-	(881,725)	(500)	39,690
Net Assets, Beginning of Year, as restated	299,353,105	297,841,513	1,934,203	(487,741)
Net Assets—End of Year	\$ 296,297,241	\$ 299,353,105	\$ 4,675,888	\$ 1,934,703

Kansas State University
Statement of Cash Flows
For the Year Ended June 30, 2004

	University Funds	
	2004	2003
Cash Flows from Operating Activities		
Tuition and fees	\$ 91,052,157	\$ 76,750,483
Endowment income	94,304	138,954
Sales and services of educational activities	39,674,801	38,532,601
Auxiliary enterprise charges		
Housing	21,438,754	22,093,659
Parking	2,099,096	2,032,017
Student Health	5,385,504	5,341,570
Other	512,227	484,077
Grants and contracts	111,301,053	105,707,166
Federal appropriations	7,670,522	8,720,429
Payments to suppliers	(159,507,758)	(138,709,613)
Compensation & benefits	(288,906,226)	(282,713,250)
Loans issued to students and employees	(6,032,839)	(6,129,280)
Collections on loans issued to students and employees	5,505,663	5,404,238
Other receipts (payments)	24,249,983	25,063,002
	(145,462,759)	(137,283,947)
Net Cash Flows from Operating Activities		
Cash Flows from Noncapital Financing Activities		
State appropriations	157,784,459	156,880,717
Disposal of intangible asset		1,500,000
Direct lending receipts	82,592,605	74,024,756
Direct lending payments	(82,214,613)	(74,291,865)
Funds held for others	135,387	(98,043)
Other	341,241	804,768
	158,639,079	158,820,333
Net Cash Flows from Noncapital Financing Activities		
Cash Flows from Capital and Related Financing Activities		
Proceeds from capital debt	24,375,000	22,485,000
Capital appropriations	4,067,346	3,183,667
Capital Grants and gifts	3,169,509	2,513,255
Student fees for capital projects	2,274,231	2,057,359
Purchases of capital assets	(26,301,546)	(19,839,456)
Principal paid on capital debt and leases	(2,452,411)	(2,327,973)
Interest paid on capital debt and leases	(2,771,544)	(1,199,298)
Disposal of asset		1,424,988
Other	(312,588)	137,119
	2,047,997	8,434,661
Net Cash Flows from Capital and Related Financing Activities		
Cash Flows from Investing Activities		
Investment income	885,217	433,635
Purchase of investments	(93,660)	(89,901)
	791,557	343,734
Net Cash Flows from Investing Activities		
Net change in cash and cash equivalents	16,015,874	30,314,781
Cash and cash equivalents—beginning of year	105,267,906	80,192,847
Prior Period Restatement		(5,239,722)
Cash and cash equivalents—beginning of year	105,267,906	74,953,125
Cash and cash equivalents—end of year	\$ 121,283,780	\$ 105,267,906

Kansas State University
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2004

	University Funds	
	2004	2003
Reconciliation		
Operating income (loss)—SRECNA	\$ (172,347,571)	\$ (173,345,896)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	21,559,712	24,675,603
Changes in assets and liabilities:		
Accounts receivable, net	2,206,007	1,421,119
Loans to students, net	(527,176)	(871,771)
Inventories	673,043	(700,088)
Prepaid expenses	461,912	(59,201)
Accounts payable and accrued liabilities	4,718,571	3,503,342
Deferred revenue	(4,192,221)	(1,684,825)
Accrued compensated absences	1,984,964	9,777,770
	\$ (145,462,759)	\$ (137,283,947)
Net cash used in operating activities—Cash Flow		

Kansas State University
Notes to Financial Statements
For the Year Ended June 30, 2004

Note 1—Organization and Summary of Significant Accounting Policies

Organization. Kansas State University (University) is a comprehensive, research, federal land grant institution governed by the Kansas Board of Regents and is an agency of the State of Kansas. Accordingly, for financial reporting purposes, the University is included in the financial report of the State of Kansas.

The University is currently classified as a Doctoral/Research University—Extensive under the Carnegie Classification system and is accredited by the North Central Association of Colleges and Schools. Undergraduate, graduate and post-graduate degrees are available from nine colleges: Agriculture, Architecture, Planning & Design, Arts & Sciences, Business Administration, Education, Engineering, Human Ecology, Veterinary Medicine, and Technology & Aviation.

Other major operating units of the University are the Agricultural Experiment Station and a statewide Cooperative Extension Service. The main campus covers 668 acres in the cities of Manhattan and Salina, Kansas. Additional University sites include 18,000 acres of the Agricultural Experiment Station (AES) located in research centers at Hays, Garden City, Colby, and Parsons and 8,600 acres in the Konza Prairie Research Natural Area, jointly operated by the AES and the Division of Biology.

Financial Reporting Entity. As required by the accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB), these financial statements present the financial position and financial activities of the University and its component units: the Kansas State University Research Foundation (KSURF), The IDEA Center, Inc., The K-State Union Corporation, the Intercollegiate Athletic Council of Kansas State University, Inc., and the Kansas State University Student Financial Assistance Foundation, Inc. Component unit financial activities and balances have been discretely presented

The Kansas State University Foundation accounts are not included in the University's financial statements.

Basis of Accounting. For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant intra-agency transactions have been eliminated.

The University has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The University has elected to not apply FASB pronouncements issued after the applicable date.

Cash Equivalents. For the purposes of the Statement of Cash Flows, the University considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Investments. The University accounts for its investments at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses, and Changes in Net Assets.

Accounts Receivable. Accounts receivable consists of tuition and fee charges to students and auxiliary enterprise services provided to students, faculty, and staff. Accounts receivable also include amounts due from the Federal, state and local governments or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's grants and contracts. Accounts receivable are recorded net of estimated uncollectible amounts.

Inventories. Inventories are stated at cost.

Kansas State University

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2004

Noncurrent Cash and Investments. Cash and investments that are externally restricted to make debt service payments, maintain sinking or reserve funds, or to purchase or construct capital or other noncurrent assets, are classified as noncurrent in the Statement of Net Assets.

Capital Assets. Capital assets are recorded at cost at the date of acquisition, or fair market value at the date of donation in the case of gifts. For equipment, the University's capitalization policy includes all items with a unit cost of \$5,000 or more, and an estimated useful life of greater than one year. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the structure are capitalized if the related project cost is \$100,000 or greater. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred.

Depreciation is computed using the straight-line method and half-year convention over the estimated useful lives of the assets, generally 40 years for buildings, 25 years for infrastructure and land improvements, 8 years for equipment, and 5 to 40 years for componentized buildings and building improvements.

Deferred Revenue. Deferred revenues consist primarily of summer school tuition not earned during the current year and amounts received from grant and contract sponsors that have not yet been earned.

Compensated Absences. Employee vacation and sick pay is accrued at year-end for financial statement purposes. The liability and expense incurred are recorded as accrued compensated absences in the Statement of Net Assets, and as a component of compensation and benefit expense in Note 13 Operating Expenses by Natural Classification.

Noncurrent Liabilities. Noncurrent liabilities include principal amounts of revenue bonds and loans payable, capital lease obligations with contractual maturities greater than one year, and other liabilities that are to be paid from funds that are classified as noncurrent assets.

Net Assets. The University's net assets are classified as follows:

Invested in capital assets, net of related debt: This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted net assets—nonexpendable: Restricted nonexpendable net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

Restricted net assets—expendable: Restricted expendable net assets include resources in which the University is legally or contractually obligated to spend resources in accordance with restrictions imposed by external third parties.

Unrestricted net assets: Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments. These resources are used for transactions relating to the educational and general operations of the University, and may be used at the discretion of the governing board to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for students, faculty and staff.

Tax Status. As a state institution of higher education, the income of the University is generally exempt from federal and state income taxes under Section 115(a) of the Internal Revenue Code; however, income generated from activities unrelated to the University's exempt purpose is subject to income taxes under Internal Revenue Code Section 511(a)(2)(B).

Kansas State University

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2004

Classification of Revenues. The University has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues: Operating revenues include activities that have the characteristics of exchange transactions, such as 1) student tuition and fees, net of scholarship discounts and allowances, 2) sales and services of auxiliary enterprises or educational activities, 3) most Federal, state and local grants and contracts, and 4) interest on institutional student loans.

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting* and GASB Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*, such as state appropriations and investment income.

Scholarship Discounts and Allowances. Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the Statement of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University, and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants, and other Federal, state or nongovernmental programs, are recorded as either operating or nonoperating revenues in the University's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

Summer Session. Revenues and expenses for the summer session are reported within the fiscal year in which the summer session is predominately conducted. Accordingly, only revenues and expenses for the 2003 summer session are reported in the Statement of Revenues, Expenses, and Changes in Net Assets. For the 2004 summer session, revenues received prior to June 30, 2004 are reported as deferred revenues in the Statement of Net Assets while expenses paid prior to June 30, 2004 are reported as prepaid expenses. Kansas Board of Regents officials determined this methodology and believe the departure from generally accepted accounting principles will not have a material effect on the University's financial position.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles require management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

Note 2—Cash, Cash Equivalents, and Investments

Cash and Cash Equivalents. The carrying amount of the University's deposits with the State Treasurer and other financial institutions at June 30, 2004 were \$121,283,780. The University's deposits with the State Treasurer are pooled with the funds of other State Agencies and then, in accordance with statutory limitations, placed in short-term investments with the exception of the bond funds. All bond proceeds are invested in conjunction with specifications stated in the bond resolutions.

Investments. The University's investments are categorized as to credit risk as either (1) insured or registered, or securities held by the University or its agent in the University's name, (2) uninsured and unregistered, with securities held by the counter party's trust department or agent in the University's name, or (3) uninsured and unregistered, with securities held by the counter party, or by its trust department or agent, but not in the University's name. At June 30, 2004, the University's investments consisted of the following:

	Categories			Fair Value
	1	2	3	
U. S. Government Securities	\$ 14,882	\$ --	\$ --	\$ 14,882
Certificates of Deposits	2,360,000	--	--	2,360,000
Guaranteed Investment Contracts	1,655,000	--	--	1,655,000
Total Investments	\$ 4,029,882	\$ --	\$ --	\$ 4,029,882

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2004

Note 3—Capital Assets

Capital asset activity for the University for the year ended June 30, 2004 is summarized as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Capital Assets (not depreciated)				
Land and Improvements	7,395,878	1,895	-	7,397,773
Art Collections	1,919,000	-	-	1,919,000
Construction in Progress	5,532,366	15,253,215	12,002,386	8,783,195
Capital Assets (being depreciated)				
Buildings & Improvements	372,332,747	15,689,531	35,700	387,986,578
Land Improvements	12,959,240	2,754,396	-	15,713,636
Infrastructure	6,585,361	-	-	6,585,361
Equipment and Furnishings	142,900,170	10,579,768	9,958,158	143,521,780
Vehicles	21,283,982	769,754	520,166	21,533,570
Total Capital Assets	570,908,744	45,048,559	22,516,410	593,440,893
Accumulated Depreciation				
Buildings & Improvements	184,470,497	9,425,994	20,527	193,875,964
Land Improvements	5,241,011	555,266	-	5,796,277
Infrastructure	3,787,364	191,299	-	3,978,663
Equipment and Furnishings	101,892,845	9,354,455	6,326,027	104,921,273
Vehicles	17,199,721	2,032,698	476,613	18,755,806
Total Depreciation	312,591,438	21,559,712	6,823,167	327,327,983
Capital Assets, net	258,317,306	23,488,847	15,693,243	266,112,910

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2004

Note 4—Accounts Receivable

Accounts receivable are shown net of allowances for doubtful accounts in the accompanying Statement of Net Assets. At June 30, 2004, accounts receivable consisted of the following:

	June 30, 2004
Student tuition and fees	\$ 2,988,823
Auxiliary enterprises and other operating activities	2,119,406
Federal, state, and private grants and contracts	12,476,396
Interest	91,007
	\$17,675,632
Less allowance for doubtful accounts	797,342
Net accounts receivable	\$16,878,290

Note 5—Loans Receivable

Student loans made through the Federal Perkins Loan Program and the Health Profession Student Loan Program comprise approximately 98% of the June 30, 2004 loan balances. The Programs provide for cancellation of a loan at rates of 10% to 30% per year up to a maximum of 100%, if the participant complies with certain provisions. The federal government reimburses the University for amounts cancelled under these provisions.

As the University determines that loans are uncollectible and not eligible for reimbursement by the federal government, the loans are written off and assigned to the U.S. Department of Education. The University has provided an allowance for uncollectible loans, which, in management's opinion, is sufficient to absorb loans that will ultimately be written off. At June 30, 2004, the allowance for uncollectible loans was approximately \$859,500.

Note 6—Deferred Revenue

Deferred revenues consist primarily of summer session tuition and fees and advance collections on grants and contracts. The breakdown of deferred revenues is as follows:

Tuition and fees	\$ 2,857,108
Grants and contracts	16,164,656
	\$19,021,764

Note 7—Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2004 consists of the following:

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds payable	\$44,005,000	\$21,020,000	\$ 2,245,000	\$62,780,000	\$2,560,000
Loans payable	1,072,921	3,355,000	207,411	4,220,510	212,521
Lease obligations	3,031,675	1,415,306	1,282,131	3,164,850	1,133,617
Deposits held in custody for others	745,895	5,742,907	5,607,520	881,282	-
Other liabilities	6,178,951	3,799,032	3,222,796	6,755,187	1,144,171
Total Long-Term Liabilities	\$55,034,442	\$35,332,245	\$12,564,858	\$77,801,829	\$5,050,309

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2004

Note 8—Revenue Bonds Outstanding

Revenue bonds payable consisted of the following at June 30, 2004:

	Principal Outstanding <u>6/30/04</u>
<p>Kansas Development Finance Authority Revenue Bonds-Series 2003J-1 (The Kansas Board of Regents—Kansas State University Energy Conservation Projects) issued on August 1, 2003 in the original amount of \$21,020,000. Due in annual installments beginning 8/1/05 with final maturity on 8/1/23. Interest ranging from 4.25% to 5.00% payable semi-annually.</p>	\$21,020,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 2003C (The Kansas Board of Regents—Kansas State University Research and Development Facilities Projects) issued on February 1, 2003 in the original amount of \$22,485,000. Due in annual installments beginning 10/1/22 with final maturity on 6/30/33. Interest ranging from 4.75% to 5.00% payable semi-annually.</p>	\$22,485,000
<p>Kansas Development Finance Authority Refunding Revenue Bonds-Series 2001G-1 (The Kansas Board of Regents—Kansas State University Salina Housing Project) issued on June 15, 2001 in the original amount of \$845,000. Due in annual installments with final maturity on 4/1/08. Interest ranging from 4.25% to 5.00% payable semi-annually.</p>	\$ 700,000
<p>Kansas Development Finance Authority Refunding Revenue Bonds-Series 2001G-2 (The Kansas Board of Regents—Kansas State University Recreation Project) issued on June 15, 2001 in the original amount of \$6,385,000. Due in annual installments with final maturity on 4/1/07. Interest ranging from 4.25% to 5.00% payable semi-annually.</p>	\$ 5,220,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 2000D (The Kansas Board of Regents—Kansas State University Ackert Hall Addition Project) issued on July 15, 2000 in the original amount of \$1,735,000. Due in annual installments with final maturity on 5/1/15. Interest ranging from 4.60% to 5.60% payable semi-annually.</p>	\$ 1,415,000
<p>Kansas Development Finance Authority Refunding Revenue Bonds-Series 1999F (The Kansas Board of Regents—Kansas State University Housing System, Manhattan Campus) issued on July 1, 1999 in the original amount of \$5,740,000. Due in annual installments with final maturity on 4/1/05. Interest ranging from 3.70% to 5.00% payable semi-annually.</p>	\$ 1,055,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 1998B (The Kansas Board of Regents—Kansas State University Student Union Renovation and Expansion Project) issued on April 1, 1998 in the original amount of \$9,320,000. Due in annual installments with final maturity on 4/1/18. Interest ranging from 3.90% to 5.00% payable semi-annually.</p>	\$ 7,560,000

Kansas State University

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2004

Revenue bonds payable consisted of the following at June 30, 2004:

	Principal Outstanding <u>6/30/04</u>
Kansas Development Finance Authority Refunding Revenue Bonds-Series 1995G (The Kansas Board of Regents—Kansas State University Parking System Refunding Project) issued on November 1, 1995 in the original amount of \$2,095,000. Due in annual installments with final maturity on 10/1/05. Interest ranging from 3.80% to 4.75% payable semi-annually.	\$ 450,000
Kansas Development Finance Authority Revenue Bonds-Series 1995K (The Kansas Board of Regents—Kansas State University Farrell Library Expansion Project) issued on November 1, 1995 in the original amount of \$3,835,000. Due in annual installments with final maturity on 10/1/15. Interest ranging from 3.75% to 5.40% payable semi-annually.	\$ 2,875,000

Series 2001G-2 Recreation Project, Series 1995K Farrell Library Expansion Project, and Series 1998B Student Union Renovation and Expansion Project are collateralized by a pledge of student fees. Series 2001G-1 Salina Housing Project and Series 1999F Housing System, Manhattan Campus are collateralized by a pledge of housing revenues. Series 1995G Parking System Refunding Project is collateralized by a pledge of parking fees. Series 2000D Ackert Hall Addition Project is collateralized by a pledge of sponsored research overhead revenues. Series 2003C Research and Development Facilities Projects are collateralized by a pledge of State appropriations and various university revenue funds. Series 2003J-1 Energy Conservation Projects are collateralized by the annual utility and maintenance savings realized by the implementation of the energy improvement projects.

In August and December 1985, certain bonds of the University were legally defeased through an advanced refunding by depositing sufficient funds to pay all future debt service in a special escrow trust. Therefore, neither the assets of the trust nor the related bonds payable are included in the Statement of Net Assets. The principal amount of defeased bonds outstanding at June 30, 2004 is \$309,000.

Future debt service requirements for all bonds outstanding at June 30, 2004 are as follows:

Year Ending June 30:	Principal	Interest	Total
2005	\$ 2,560,000	\$ 2,923,275	\$ 5,483,275
2006	2,620,000	2,813,123	5,433,123
2007	1,845,000	2,718,368	4,563,368
2008	1,935,000	2,648,673	4,583,673
2009	2,035,000	2,566,107	4,601,107
2010–2014	11,945,000	11,392,864	23,337,864
2015–2019	10,575,000	8,584,956	19,159,956
2020–2024	9,865,000	6,249,886	16,114,886
2025–2029	9,725,000	3,617,532	13,342,532
2030–2033	9,675,000	997,875	10,672,875
Total	\$62,780,000	\$44,512,659	\$107,292,659

Kansas State University

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2004

Note 9—Loan and Lease Obligations

In December, 1991, Kansas State University and the Pooled Money Investment Board entered into a building construction and equipment loan agreement for Throckmorton Hall in the amount of \$1,757,509.14. The loan requires annual principal and interest payments through September 10, 2007 and bears interest at a rate of 5.25% per annum. In July 2003, they entered into a construction loan agreement for the Biological and Industrial Value Added Program for a maximum amount of \$4,000,000. The loan requires annual interest payments due August 1 of each year in which a principal balance remains outstanding at a rate of 1.548% per annum. The entire principal balance is due August 1, 2007.

The University is obligated for the purchase of certain equipment funded through the State of Kansas Equipment Lease Purchase Program in the amount of \$3,164,850 as of June 30, 2004. Payments to liquidate these obligations are scheduled as follows:

Year Ending June 30:	Total
2005	\$1,133,617
2006	972,070
2007	883,405
2008	175,758
	<u>\$3,164,850</u>

Note 10—Retirement Plans

The University participates in one cost-sharing multiple-employer defined benefit pension plan, one defined contribution pension plan, and one federal pension plan.

Defined Benefit Plan

Classified employees participate in the Kansas Public Employees Retirement System (KPERS). Benefit provisions are established by state statute and provide retirement, disability, and death benefits to benefits eligible employees. KPERS issues a publicly available annual financial report that includes its financial statements and required supplementary information and is available upon request from KPERS.

For the year ended June 30, 2004, active KPERS members were required by statute to contribute 4% and the University to contribute 4.58% of the employees' covered payroll. The Kansas Legislature establishes and may amend active plan members' and the University's contribution rates. The University contributed \$1,951,719 during fiscal year 2004 and individual employees contributed \$1,715,876. In addition, \$79,462 was contributed to KPERS by the University for prior service benefits. Payments to KPERS for death and disability coverage for all University employees totaled \$1,292.

Defined Contribution Plan

Eligible unclassified employees are required to participate in the Kansas Board of Regents (Regents) defined contribution retirement plan, which was authorized by K.S.A. 74-4925. The Regents have selected the following companies to provide investment options to participants: 1) Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF), 2) ING Financial Advisers, 3) Lincoln National Life Insurance Company, and 4) Security Benefit Life Insurance Company. Benefits under these plans depend solely on the contributed amounts and the returns earned on the investment of those contributions. All contributions are fully vested with the first contribution.

For the year ended June 30, 2004 active members were required by statute to contribute 5.5% and the University to contribute 8.5% of the employees' covered payroll. The Kansas Legislature establishes and may amend active plan members' and the University's contribution rates. The University contributed \$11,967,292 during fiscal year 2004 and individual employees contributed \$7,635,242.

Kansas State University

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2004

Federal Retirement Plan

Some Extension Service employees at Kansas State University hold Federal appointments. Prior to December 31, 1986, Federal appointees were required to participate in the Federal Civil Service Retirement System (CSRS), a defined benefit plan. CSRS employees are subject to the Hospital Insurance portion of FICA, the CSRS employee deduction of 7.0%, and the employer contribution of 7.5%.

The Federal Employees Retirement System (FERS), also a defined benefit plan, was created beginning January 1, 1987. Employees hired after December 31, 1983 were automatically converted to FERS. Other Federal employees not covered by FERS had a one-time option to transfer to FERS up to December 31, 1987. New FERS employees contribute 0.8% with an employer contribution rate of 10.7%. FERS employees contribute at the full FICA rate. They also participate in a Thrift Savings Plan with an automatic employer contribution of 1%. Employees may also contribute to this plan at variable rates up to 13%, in which case the employer contributes at a variable rate up to 5%. CSRS employees are also eligible for participation in the Thrift Savings Plan up to 8%, but without employer contributions. Acceptance of new member participation was terminated effective July 1, 1986

For the year ended June 30, 2004, the University contributed \$735,137 and individual employees contributed \$401,800 to these plans.

Voluntary Tax-Sheltered Annuity Program

Employees may also elect to participate, up to the maximum dollar amount permitted by the Internal Revenue Code, in a voluntary tax-sheltered annuity program. This voluntary plan permits employees to designate a part of their earnings into tax-sheltered investments and thus defer federal and state income taxes on their contributions and the accumulated earnings under the plan. Participation and the level of employee contributions are voluntary. The employer is not required to make contributions to the plan

Note 11—Postemployment Benefits

In addition to pension benefits, the State provides post-employment health care benefits to eligible retired employees. The benefits are provided in accordance with the rules and regulations of the Kansas State Employees Health Care Commission. The Commission is responsible for the determination of the allocation of premium costs between the participants and the State. These allocations are subject to change each contract year. The University funds the benefits on a pay-as-you-go basis.

Note 12—Commitments and Contingencies

At June 30, 2004, the University had outstanding commitments on various construction projects and contracts for repairs and renovation of facilities of approximately \$5,600,000.

The University is a defendant in several lawsuits. However, University officials are of the opinion, based on advice of in-house legal counsel, that the ultimate outcome of all litigation will not have a material effect on the future operations or financial position of the University.

As a result of legislation, the University, as an agency of the State of Kansas, is subject to the state of Kansas' self-insurance program with regard to comprehensive general liability and personal injury insurance. The University is covered by the State's umbrella insurance policies for automobile liability and property insurance. Also, the University is self-insured relative to workers' compensation, medical, and unemployment insurance. These areas include stop-loss provisions that limit the University's exposure.

In the normal course of operations, the University receives grants, contracts, and other forms of reimbursement from various federal and state agencies. These activities are subject to audit and disallowance by agents of the funding authority, the purpose of which is to ensure compliance with conditions precedent to providing such funds. University officials believe that the liability, if any, for any reimbursement that may arise as the result of audits, would not have a material effect on the University's financial position.

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2004

Note 13—Operating Expenses by Natural Classification

Year Ended June 30, 2004

	Compensation and Benefits	Contractual Services	Supplies and Materials	Utilities	Scholarships and Fellowships	Aid, Debt and Nonexpense	Depreciation	Total
Instruction	\$ 109,865,431	\$ 10,066,585	\$ 6,283,313	\$ 786	\$	\$ 2,543,001	\$	\$ 128,759,116
Research	63,914,903	12,795,067	13,472,896	256,841		8,321,804		98,761,511
Public Service	42,301,305	7,475,980	4,143,706	18,820		975,774		54,915,585
Academic Support	19,888,824	6,476,323	4,246,799	59		383,511		30,995,516
Student Service	11,907,134	2,939,528	294,882	3,858		2,843,531		17,988,933
Institutional Support	14,288,381	5,260,511	514,112			186,494		20,249,498
Operations and Maintenance of Plant	14,430,910	9,651,451	1,766,459	10,393,964		803,103		37,045,887
Scholarships & Fellowships					10,452,316			10,452,316
Auxiliary Enterprises	16,077,410	5,005,675	5,480,248	1,544,953		64,592		28,172,878
Depreciation							21,559,712	21,559,712
Other		433,518	774,095					1,207,613
Total Operating Expenses	\$ 292,674,298	\$ 60,104,638	\$ 36,976,510	\$ 12,219,281	\$ 10,452,316	\$ 16,121,810	\$ 21,559,712	\$ 450,108,565

Note 14—Component Units

Buildings and improvements purchased by The Intercollegiate Athletic Council immediately become the property of Kansas State University. This results in a negative amount being reported for Invested in Capital Assets, Net of Related Debt on the Statement of Net Assets.

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