

**Arkansas State University**

**State University, Arkansas**

**Basic Financial Statements  
and Other Reports**

**June 30, 2005**

LEGISLATIVE JOINT AUDITING COMMITTEE

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ARKANSAS STATE UNIVERSITY  
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JUNE 30, 2005

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BASIC FINANCIAL STATEMENTS

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Sen. Henry "Hank" Wilkins, IV  
Senate Co-Chair  
Rep. Tommy G. Roebuck  
House Co-Chair  
Sen. Randy Laverty  
Senate Co-Vice Chair  
Rep. Sandra Prater  
House Co-Vice Chair

# Arkansas



Charles L. Robinson, CPA, CFE  
Legislative Auditor

## LEGISLATIVE JOINT AUDITING COMMITTEE DIVISION OF LEGISLATIVE AUDIT

### INDEPENDENT AUDITOR'S REPORT

Arkansas State University  
Legislative Joint Auditing Committee

We have audited the accompanying basic financial statements of Arkansas State University (Institution), an Institution of Higher Education of the State of Arkansas, as of and for the year ended June 30, 2005 as listed in the table of contents. These financial statements are the responsibility of the Institution's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Arkansas State University Foundation, Inc., which represent 100% of the assets, net assets, and revenues of the discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it related to the amounts included for the Arkansas State University Foundation, Inc., is based on the report of the other auditors.

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. The financial statements of the Arkansas State University Foundation, Inc. were not audited in accordance with *Government Auditing Standards*. 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 and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Arkansas State University and of its discretely presented component unit as of June 30, 2005 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis 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 consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2005 on our consideration of the Institution's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

DIVISION OF LEGISLATIVE AUDIT

A handwritten signature in blue ink, appearing to read "Charles L. Robinson".

Charles L. Robinson, CPA, CFE  
Legislative Auditor

Little Rock, Arkansas  
November 21, 2005  
EDHE12505

Sen. Henry "Hank" Wilkins, IV  
Senate Co-Chair  
Rep. Tommy G. Roebuck  
House Co-Chair  
Sen. Randy Laverty  
Senate Co-Vice Chair  
Rep. Sandra Prater  
House Co-Vice Chair

# Arkansas



Charles L. Robinson, CPA, CFE  
Legislative Auditor

## LEGISLATIVE JOINT AUDITING COMMITTEE DIVISION OF LEGISLATIVE AUDIT

### 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

Arkansas State University  
Legislative Joint Auditing Committee

We have audited the financial statements of Arkansas State University, an Institution of Higher Education of the State of Arkansas, as of and for the year ended June 30, 2005, and have issued our report thereon dated November 21, 2005, which included a reference to the report of other auditors. 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. The financial statements of the Arkansas State University Foundation, Inc., were not audited in accordance with *Government Auditing Standards*.

#### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Institution'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. Our consideration of the internal control over financial reporting 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 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

#### Compliance and Other Matters

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

We also noted certain additional matters that we reported in a separate management letter dated November 21, 2005.

These reports are intended solely for the information and use of the Legislative Joint Auditing Committee, the governing board, institution management, state executive and oversight management, and other parties as required by Arkansas Code, and are not intended to be and should not be used by anyone other than these specified parties. However, pursuant to Arkansas Code Annotated §10-4-417, all reports presented to the Legislative Joint Auditing Committee are matters of public record and distribution is not limited.

DIVISION OF LEGISLATIVE AUDIT

*William R. Baum*

William R. Baum, CPA, CFE  
Deputy Legislative Auditor

Little Rock, Arkansas  
November 21, 2005

Sen. Henry "Hank" Wilkins, IV  
Senate Co-Chair  
Rep. Tommy G. Roebuck  
House Co-Chair  
Sen. Randy Lavery  
Senate Co-Vice Chair  
Rep. Sandra Prater  
House Co-Vice Chair

# Arkansas



Charles L. Robinson, CPA, CFE  
Legislative Auditor

## LEGISLATIVE JOINT AUDITING COMMITTEE DIVISION OF LEGISLATIVE AUDIT

### MANAGEMENT LETTER

Arkansas State University  
Legislative Joint Auditing Committee

As a management service, we would like to bring to your attention the following other items that came to our attention during this audit. The purpose of such comments is to provide constructive feedback and guidance, in an effort to assist management to maintain a satisfactory level of compliance with the state constitution, laws and regulations and achieve adequate internal controls. These matters were discussed previously with institution officials during the course of our audit fieldwork and at the exit conference.

Our follow-up of the prior years' audits of the Institution's data center, Human Resources System (HRS), Financial Reporting System (FRS), Loan Management System (LMS) and Student Information System (SIS) applications revealed the following:

1. Access Security Controls are again not adequate.

Access security privileges assigned to users appear to be excessive in some cases.

We recommend the Institution develop and implement a formal review process to establish adequate, yet not excessive, security access privilege needs by job role and or specific employee, and a process be established for comparing those needs to actual security access privileges granted.

2. Program Change Controls are again not adequate.

The following weaknesses were noted:

- There is no automated system being used to monitor changes to source code. Currently, the Information and Technology Services Department depends on manual procedures to monitor changes to source code but there are no safeguards or controls to ensure that source code is in sync with compiled code or that a copy of source is saved prior to modification.
- There are no restrictions in place to prevent Programmers from accessing, modifying and moving source code changes into production.
- Although the Program Change Control process in place does require testing of source code changes and appears to be adequate, the procedure is not documented and there are no documented test results by which to gauge adequacy of source code change tests.

#### Recommendation

We recommend the following corrective action for the above-mentioned points as follows:

- Implement a system to track and monitor source code changes.
- Implement controls to prevent Programmers from accessing source code in the production environment (to include checking out their own version of source code) and from moving their own code modifications into the production environment.
- The Program Change Control process be modified to require standard testing of application source code changes and those tests be documented for proof of diligent and adequate testing efforts.

3. Disaster Recovery or Business Continuity Plans are again not adequate:

The following weaknesses were noted:

- There is no formal, documented and approved Disaster Recovery Plan. This situation could cause the University to be without computer-processing abilities for an extended period of time in the event of a disaster or major interruption; no disaster recovery testing has been done, without adequate testing of the plan, there is no way to insure the plan will work as designed.
- There is no formal, documented and approved Business Continuity Plan. Application users have no manual procedures to activate in a disaster situation. Without manual procedures, operations could not continue after a disaster.

Recommendation

We recommend the following corrective action for the above-mentioned points as follows:

- A formal Disaster Recovery Plan be developed, documented, approved by management and tested on a periodic basis. A copy of this plan should also be stored at a secure off-site location. At a minimum, the plan should:
  - a. Identify critical applications that must be restored.
  - b. Identify software and data file backups needed to restore these applications. Backup retention periods and a secure off-site storage location should be identified and utilized.
  - c. Address the acquisition of replacement hardware should it be needed.
  - d. Identify an alternate processing site should it be needed.
  - e. Identify alternate procedures the users can use to cope with the unavailability of the computer application during the recovery period.
- A formal Business Continuity Plan be developed, documented, approved by management and tested on a periodic basis. A copy of this plan should also be stored at a secure off-site location. Each application's user department should develop, test and document manual procedures to be used in lieu of their respective computerized application in the event the application can no longer be utilized.

STUDENT ENROLLMENT DATA - In accordance with Ark. Code Ann. 6-60-209, we performed tests of the student enrollment data for the year ended June 30, 2005, as reported to the State Department of Higher Education, to provide reasonable assurance that the data was properly reported. Our testing was limited to the fall and spring terms of the year. The combined enrollment data reported for all of the Institution's campuses was as follows:

	<u>Fall Term</u> <u>2004</u>	<u>Spring Term</u> <u>2005</u>
Student Headcount	16,894	16,079
Student Semester Credit Hours	185,103	172,591

During our review, we noted the following item:

Four (4) students at the Arkansas State University–Newport campus were not enrolled in the reported truck-driving training classes as of the eleventh class day. This matter has been reported in the previous two (2) audits.

These reports are intended solely for the information and use of the Legislative Joint Auditing Committee, the governing board, institution management, state executive and oversight management, and other parties as required by Arkansas Code, and are not intended to be and should not be used by anyone other than these specified parties. However, pursuant to Arkansas Code Annotated §10-4-417, all reports presented to the Legislative Joint Auditing Committee are matters of public record and distribution is not limited.

DIVISION OF LEGISLATIVE AUDIT

*William R. Baum*

William R. Baum, CPA, CFE  
Deputy Legislative Auditor

Little Rock, Arkansas  
November 21, 2005

# **Arkansas State University**

## **Consolidated Management's Discussion and Analysis**

### **Financial Statement Presentation**

**This section of the Arkansas State University (The University) annual financial report presents discussion and analysis of the University's financial performance during the fiscal year ended June 30, 2005. This discussion and analysis is prepared by the University's financial administrators and is intended to provide information on the financial activities of the University that is both relevant and easily understandable. Information is also provided on the University's financial position as of June 30, 2005 as further explanation of the results of the year's financial activities.**

**The statements have been prepared using the format specified in Governmental Accounting Standards Board (GASB) Statements Number 34 and 35. GASB Statement Number 34 requires the presentation of comparative information from the previous fiscal year and a discussion of any significant changes in the University's financial position or the results of its operations.**

**The University's financial statements for the year ended June 30, 2005 have been audited and the Arkansas Division of Legislative Audit has rendered an audit opinion contained herein. This represents the first time an audit opinion has been issued for the consolidated financial statements of the Arkansas State University system. Prior to this fiscal year, the annual financial reports of the individual ASU campuses were audited and separate opinions and audit reports issued for each campus. Since the consolidated financial information for the fiscal year ended June 30, 2004 has not been audited, the University's annual financial report for the year ended June 30, 2005 does not include comparative information for the fiscal year ended June 30, 2004. In accordance with Governmental Accounting Standards Board requirements, however, this analysis includes a discussion of the significant changes between the two fiscal years where appropriate.**

### **Fiscal Year 2005 Highlights**

**The following events or activities of financial significance occurred during the fiscal year ended June 30, 2005.**

## **Fiscal Year 2005 Highlights (Continued)**

- **The University completed and dedicated the Arkansas Bioscience Institute on the Jonesboro campus. This building will serve as the focal point for the University's increased activities in research and sponsored programs. Funding for this project was provided through bonds issued by the Arkansas Development Finance Authority (ADFA) under the terms of Arkansas's participation in the national master tobacco settlement. The debt service for these bonds is a liability of the Authority rather than the University; accordingly, no provision for this is recognized on the University's financial statements. The capitalized value of this building is \$20,351,278.**
- **The University completed construction projects totaling \$21,830,861. Projects in progress but not yet completed totaled \$60,436,117 at June 30, 2005.**
- **The net assets of the University grew from \$174,960,827 at June 30, 2004 to \$176,434,471 at June 30, 2005, an increase of \$1,473,644 or 0.84%. University revenues and other additions from all sources during the year ended June 30, 2005 amounted to \$183,145,118 while expenses and other deductions amounted to \$181,671,476.**

## **Statement Discussion**

### *Statement of Net Assets*

**The Statement of Net Assets is intended to display the financial position of the University. Its purpose is to present to the reader of the financial statements a benchmark from which to analyze the financial stability of the University. It is a "snapshot" of the University's assets, liabilities, and net assets (assets minus liabilities) as of June 30, 2005, the last day of the fiscal year. Assets and liabilities are presented in two categories: current and noncurrent. Net assets are presented in three categories: capital assets net of related debt, restricted assets, and unrestricted assets. A more detailed explanation of these categories is found in the notes that accompany the financial statements.**

**Readers of the Statement of Net Assets can determine answers to the following key questions as of June 30, 2005:**

**Did the University have sufficient assets available to meet its existing obligations and continue operation?**

**How much did the University owe to external parties including vendors and lending institutions?**

**What resources did the University have available to make future investments and expenditures?**

## Statement Discussion (Continued)

### Condensed Statement of Net Assets

	2005	2004	Percent Change
<b>Assets:</b>			
Current Assets	\$ 40,331,876	\$ 37,230,804	8.33%
Capital Assets, Net	214,689,564	188,155,787	14.10%
Other Noncurrent Assets	53,737,257	80,138,381	-32.94%
<b>Total Assets</b>	<u>\$ 308,758,697</u>	<u>\$ 305,524,972</u>	1.06%
<b>Liabilities:</b>			
Current Liabilities	\$ 18,700,388	\$ 17,409,823	7.41%
Noncurrent Liabilities	113,623,838	113,154,322	0.41%
<b>Total Liabilities</b>	<u>\$ 132,324,226</u>	<u>\$ 130,564,145</u>	1.35%
<b>Net Assets:</b>			
Invested in Capital Assets, Net of Debt	\$ 129,359,062	\$ 122,191,582	5.87%
Restricted, Nonexpendable	9,528,813	9,017,859	5.67%
Restricted, Expendable	9,972,495	11,307,662	-11.81%
Unrestricted	27,574,101	32,443,724	-15.01%
<b>Total Net Assets</b>	<u>\$ 176,434,471</u>	<u>\$ 174,960,827</u>	0.84%
<b>Total Liabilities and Net Assets</b>	<u>\$ 308,758,697</u>	<u>\$ 305,524,972</u>	1.06%

The University's total assets increased from \$305,524,972 at June 30, 2004 to \$308,758,697 at June 30, 2005, an increase of \$3,233,725 or 1.06%. Net Capital Assets increased from \$188,155,787 at June 30, 2004 to \$214,689,564 at June 30, 2005, an increase of \$26,533,777 or 14.10% while Deposits with Trustees (Combined Current and Noncurrent) decreased from \$47,910,633 at June 30, 2004 to \$29,847,674 at June 30, 2005, a decrease of \$18,062,959 or 37.70%. The combined net decrease in the University's other assets amounted to \$5,237,093.

The University's total liabilities increased from \$130,564,145 at June 30, 2004 to \$132,324,226 at June 30, 2005, an increase of \$1,760,081 or 1.35%. This is largely attributable to increases in current bond, notes, and leases payable and the current portion of the University's compensated absences liability of \$786,629 and \$416,512, respectively.

## Statement Discussion (Continued)

The University's total net assets increased from \$174,960,827 at June 30, 2004 to \$176,434,471 at June 30, 2005, an increase of \$1,473,644 or 0.84%. This is largely attributable to the net effect of an increase in the University's net assets invested in capital assets, net of debt of \$7,167,480 and a decrease in the University's net assets expendable for debt service of \$1,483,679 and a decrease in the University's unrestricted net assets of \$4,869,625. This is reflective of the University's continued emphasis on the acquisition and construction of capital assets.

### *Statement of Revenues, Expenses and Changes in Net Assets*

The total net assets as presented on the Statement of Net Assets are based in part on the financial activities that occurred during the fiscal year as presented in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement's purpose is to present the revenues generated and received by the University, both operating and nonoperating, the expenses incurred by the University, both operating and nonoperating, and all other financial gains or losses experienced by the University during the fiscal year ended June 30, 2005.

Generally, revenues from operations are received in exchange for the University providing services or products to students and other constituencies. Operating expenses are those costs paid or incurred in producing those services or products or in carrying out the mission of the University. Nonoperating revenues are financial inflows to the University resulting from nonexchange transactions; that is, the University does not provide a specific service or product in exchange for them. For example, appropriations from the state are considered nonoperating revenue because the legislature does not receive a direct and commensurate benefit from the University in exchange for providing the appropriation.

### Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	2005	2004	Percent Change
Operating Revenues	\$ 97,254,523	\$ 92,629,333	4.99%
Operating Expenses	175,584,788	169,506,430	3.59%
Operating Income (Loss)	<u>\$ (78,330,265)</u>	<u>\$ (76,877,097)</u>	1.89%
Nonoperating Revenues (Expenses)	\$ 75,369,692	\$ 76,747,040	-1.79%
Income (Loss) before Other Revenues, Expenses, Gains, or Losses	\$ (2,960,573)	\$ (130,057)	2176.37%
Other Revenues, Expenses Gains or Losses	\$ 4,434,215	\$ 5,187,859	-14.53%
Increase (Decrease) in Net Assets	<u>\$ 1,473,642</u>	<u>\$ 5,057,800</u>	-70.86%

## Statement Discussion (Continued)

### Condensed Statement of Revenues, Expenses, and Changes in Net Assets (Continued)

	2005	2004	Percent Change
Net Assets, Beginning of the Year, Restated	\$ 174,960,829	\$ 169,903,027	2.98%
Net Assets, End of Year	\$ 176,434,471	\$ 174,960,827	0.84%

Highlights from the information presented in the Statement of Revenues, Expenses, and Changes in Net Assets for the fiscal year ended June 30, 2005 include the following:

- Tuition and Fees, Net of Scholarship Allowance amounted to \$30,468,657 or 31.33% of Total Operating Revenues.
- Personal Services expenses totaled \$108,217,482 or 61.63% of Total Operating Expenses. Expenses for Supplies and Services totaled \$39,770,753 or 22.65% of Total Operating Expenses.
- Scholarships and Fellowships expenses totaled \$7,441,160 or 4.24% of Total Operating Expenses. Scholarships and Fellowship expenses amounted to 24.42% of Tuition and Fees revenue.
- The University's Loss from Operations amounted to \$78,330,265. State Appropriations, which are reported as Nonoperating Revenues totaled \$73,637,882. Revenues and gains from all other sources amounted to \$12,252,713. Nonoperating Expenses amounted to \$6,086,688.

### *Statement of Cash Flows*

The third and final statement presented is the Statement of Cash Flows. This statement presents detailed information about the University's financial activities from the perspective of their effect on cash. The information is presented in five components. The first presents cash inflows and outflows resulting from the University's normal operating activities. The second component presents cash flows from noncapital financing activities, that is, cash received from or spent for activities that do not result from normal operations, capital financing activities, or investing. The third component presents cash inflows and outflows resulting from capital and related financing activities such as debt issuance, lease agreements, and capital appropriations, grants, or gifts. The fourth component presents cash flows resulting from investing activities such as purchases and liquidations of investments and interest, gains, and losses generated by these activities. The fifth component of the Statement of Cash Flows is a reconciliation of the net operating revenues (expenses) for the fiscal year as reported on the Statement of Revenues, Expenses, and Changes in Net Assets to the net cash provided (used) by operating activities as presented in component one of the Statement of Cash Flows.

*Statement of Cash Flows* (Continued)

**Condensed Statement of Cash Flows for the Year Ended June 30, 2005**

<b>Cash Provided (Used) by:</b>	
<b>Operating Activities</b>	<b>\$ (67,668,138)</b>
<b>Noncapital Financing Activities</b>	<b>80,185,245</b>
<b>Capital and Related Financing Activities</b>	<b>(15,826,244)</b>
<b>Investing Activities</b>	<b>4,581,860</b>
<b>Net Increase (Decrease) in Cash</b>	<b>\$ 1,272,723</b>
<b>Cash – Beginning of the Year</b>	<b>\$ 15,692,201</b>
<b>Cash – End of the Year</b>	<b>\$ 16,964,924</b>

*Capital Assets and Debt Administration*

The University continued its emphasis on the acquisition and construction of capital assets during the fiscal year ended June 30, 2005. As a result, the University's investment in capital assets, net of related debt, increased from \$122,191,582 at June 30, 2004 to \$129,359,062 at June 30, 2005, an increase of \$7,167,480, or 5.87%. This was achieved primarily through the application of proceeds from previously issued debt and the allocation of other University resources to this effort.

*Economic Outlook*

The net assets of the University grew from \$174,960,827 at June 30, 2004 to \$176,434,471 at June 30, 2005 an increase of \$1,473,644 or 0.84%. This is indicative of the University's continuing full consumption of the resources provided to it in the furtherance of its mission and the ongoing narrowness of its financial margins.

Economic conditions at the state and national level continue to improve; however, the likelihood of significant new resources being appropriated for the operation of University is remote. Additionally, the ability of the University to raise significant new amounts of revenue through tuition and fee assessment is increasingly constrained by regional and state demographics and competition between Arkansas' institutions of higher education. Continued emphasis on cost containment and resource reallocation will be required as necessary means of providing resources for new initiatives, maintaining the University's financial position, and continuing its mission.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED STATEMENT OF NET ASSETS  
JUNE 30, 2005

Exhibit A

**ASSETS**

Current Assets:

Cash and cash equivalents	\$ 15,568,377
Short-term investments	8,619,352
Accounts receivable (less allowances of \$617,952)	8,072,085
Notes and deposits receivable (less allowances of \$114,908)	1,249,638
Accrued interest and late charges	430,192
Inventories	1,259,819
Deposits with trustee	5,042,440
Prepaid expenses	89,973
Total Current Assets	40,331,876

Noncurrent Assets:

Restricted cash and cash equivalents	1,396,547
Endowment investments	9,640,136
Other long-term investments	11,908,979
Accrued interest	313
Deposits with trustee	24,805,234
Notes and deposits receivable (less allowances of \$537,730)	5,986,048
Capital assets (net of accumulated depreciation of \$154,799,115)	214,689,564
Total Noncurrent Assets	268,426,821

TOTAL ASSETS	<b>308,758,697</b>
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**LIABILITIES**

Current Liabilities:

Accounts payable and accrued liabilities	5,775,144
Bonds, notes and leases payable	5,536,276
Compensated absences	3,495,218
Deferred revenues	596,374
Funds held in trust for others	1,809,788
Deposits	133,574
Interest payable	1,342,509
Other liabilities	11,505
Total Current Liabilities	18,700,388

Noncurrent Liabilities:

Bonds, notes and leases payable	105,879,630
Compensated absences	300,367
Deposits	133,183
Refundable federal advances	7,310,658
Total Noncurrent Liabilities	113,623,838

TOTAL LIABILITIES	132,324,226
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ARKANSAS STATE UNIVERSITY  
CONSOLIDATED STATEMENT OF NET ASSETS  
JUNE 30, 2005

Exhibit A

**NET ASSETS**

Invested in capital assets, net of related debt	\$ 129,359,062
Restricted for:	
Nonexpendable:	
Scholarships and fellowships	5,758,856
Loans	888,896
Other	2,881,061
Expendable:	
Scholarships and fellowships	390,435
Research	191,434
Loans	10,000
Capital projects	4,364,601
Debt service	1,862,568
Renewal and replacement	50,279
Quasi-endowments	122,597
Other	2,980,581
Unrestricted	<u>27,574,101</u>
TOTAL NET ASSETS	<u><u>\$ 176,434,471</u></u>

The accompanying notes are an integral part of these financial statements.

ARKANSAS STATE UNIVERSITY FOUNDATION, INC.  
STATEMENT OF FINANCIAL POSITION  
JUNE 30, 2005

Exhibit A-1

**ASSETS**

Cash	\$	385,889
Certificate of deposit		566,216
Repurchase agreements		4,800,000
Accrued interest receivable		74,741
Prepaid expenses		5,163
Unconditional promises to give, net		2,282,381
Mortgage receivable		21,977
Lease purchase receivable		341,289
Short-term investments		5,476
Long-term investments		24,809,556
Property and equipment, net		66,203
Other assets		1,500
		<hr/>
Total Assets	\$	<u><u>33,360,391</u></u>

**LIABILITIES**

Accounts payable	\$	6,592
Notes payable		26,719
Annuities payable		73,675
		<hr/>
Total Liabilities		<u>106,986</u>

**NET ASSETS**

Unrestricted		410,467
Temporarily restricted		6,371,590
Permanently restricted		26,471,348
		<hr/>
Total Net Assets		<u>33,253,405</u>
		<hr/>
Total Liabilities and Net Assets	\$	<u><u>33,360,391</u></u>

ARKANSAS STATE UNIVERSITY  
 CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS  
 FOR THE YEAR ENDED JUNE 30, 2005

Exhibit B

<b>OPERATING REVENUES</b>	
Student tuition and fees (net of scholarship allowances of \$21,832,166)	\$ 30,468,657
Grants and contracts	35,393,907
Sales and services of educational departments	395,710
Auxiliary enterprises (net of scholarship allowances of \$3,404,603)	19,032,736
Self-insurance	9,243,663
Other operating revenues	2,719,850
<b>TOTAL OPERATING REVENUES</b>	<b>97,254,523</b>
 <b>OPERATING EXPENSES</b>	
Personal services	108,217,482
Scholarships and fellowships	7,441,160
Supplies and services	39,770,753
Self-insurance	8,850,553
Depreciation	11,191,206
Other	113,634
<b>TOTAL OPERATING EXPENSES</b>	<b>175,584,788</b>
<b>OPERATING INCOME (LOSS)</b>	<b>(78,330,265)</b>
 <b>NON-OPERATING REVENUES (EXPENSES)</b>	
State appropriations	73,637,882
Federal appropriations	14,195
Sales and use taxes	2,018,258
Property taxes	910,623
Gifts	1,622,464
Investment income (net of investment expense of \$12,687)	2,496,693
Interest on capital asset - related debt	(5,037,584)
Other revenue/(expense)	(292,839)
<b>NET NON-OPERATING REVENUES (EXPENSES)</b>	<b>75,369,692</b>
<b>INCOME BEFORE OTHER REVENUES, EXPENSES, GAINS OR LOSSES</b>	<b>(2,960,573)</b>
 Capital appropriations	
	2,021,802
Capital grants and gifts	2,624,948
Additions to endowments	4,685
Adjustment to prior year capital assets	426,746
Refunds to grantors	(622,366)
Gain or loss on disposal of capital assets	(127,969)
Capitalization of library holdings at rate per volume	109,375
Adjustments to prior year revenues and expenses	2,924
Other	(5,930)
<b>INCREASE (DECREASE) IN NET ASSETS</b>	<b>1,473,642</b>
 <b>NET ASSETS - BEGINNING OF YEAR</b>	 <b>174,960,829</b>
 <b>NET ASSETS - END OF YEAR</b>	 <b>\$ 176,434,471</b>

The accompanying notes are an integral part of these financial statements.

ARKANSAS STATE UNIVERSITY FOUNDATION, INC.  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2005

Exhibit B-1

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Support</b>				
Support and Reclassifications				
Contributions	\$ 27,807	\$ 3,249,116	\$ 962,916	\$ 4,239,839
Use of contributed facilities	3,400			3,400
Contributed services	145,914			145,914
Contributed supplies	4,888			4,888
Investment return	159,807	53,163	2,323,043	2,536,013
Other income	146,893	133,604	2,905	283,402
Net assets released from restrictions	4,102,869	(3,601,476)	(501,393)	
<b>Total Support</b>	<b>4,591,578</b>	<b>(165,593)</b>	<b>2,787,471</b>	<b>7,213,456</b>
<b>Expenses and Losses</b>				
Program services:				
Academic activities	720,323			720,323
Administrative	207,798			207,798
Student activities	22,249			22,249
Supporting services:				
Management and general	263,483			263,483
Fundraising	136,316			136,316
Transfers to Arkansas State University	3,083,531			3,083,531
<b>Total Expenses and Losses</b>	<b>4,433,700</b>			<b>4,433,700</b>
Increase (Decrease) in net assets	157,878	(165,593)	2,787,471	2,779,756
Net assets at beginning of year as previously reported	396,605	6,377,281	23,026,562	29,800,448
Prior period adjustments	(58,592)	189,498	542,295	673,201
Balance at beginning of year, as restated	338,013	6,566,779	23,568,857	30,473,649
Reclassification and internal transfers	(85,424)	(29,596)	115,020	
Total after reclassification and internal transfers	252,589	6,537,183	23,683,877	30,473,649
Net assets at end of year	\$ 410,467	\$ 6,371,590	\$ 26,471,348	\$ 33,253,405

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 2005

Exhibit C

<b>CASH FLOW FROM OPERATING ACTIVITIES</b>	
Student tuition and fees	\$ 29,312,878
Grants and contracts	35,239,266
Auxiliary enterprises revenues	19,094,175
Sales and services of educational departments	355,201
Self-insurance	9,239,624
Collection of principal and interest related to student loans	1,430,317
Collection of employee travel loans	388,389
Other receipts	3,042,707
Payments to employees	(84,867,059)
Payments for employee benefits	(22,303,567)
Payments to suppliers	(40,687,865)
Scholarships and fellowships	(7,441,160)
Self-insurance	(8,894,212)
Loans issued to students	(1,183,476)
Travel loans issued to employees	(393,356)
Net cash provided (used) by operating activities	<u>(67,668,138)</u>
 <b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>	
Federal appropriations	14,195
State appropriations	75,639,094
Private gifts and grants	1,627,149
Sales and use taxes	2,015,543
Property taxes	910,623
Other agency funds - net	273,820
Refunds to grantors	(136,371)
Other	(158,808)
Net cash provided (used) by noncapital financing activities	<u>80,185,245</u>
 <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>	
Capital appropriations	2,021,802
Capital gift and grants	2,338,461
Proceeds from sale of capital assets	4,255
Received from bond trustees	13,666,412
Payments to bond trustees	(5,318,081)
Purchases of capital assets	(25,032,537)
Principal paid on capital debt and leases	(2,810,309)
Interest paid on capital debt and leases	(694,997)
Other	(1,250)
Net cash provided (used) by capital and related financing activities	<u>(15,826,244)</u>
 <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Proceeds from sales and maturities of investments	12,479,184
Interest on investments	924,294
Purchases of investments	(8,821,618)
Net cash provided (used) by investing activities	<u>4,581,860</u>
Net increase (decrease) in cash and cash equivalents	1,272,723
Cash and cash equivalents - beginning of year	<u>15,692,201</u>
Cash and cash equivalents - end of year	<u>\$ 16,964,924</u>

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 2005

Exhibit C

Reconciliation of net operating revenues (expenses)  
to net cash provided (used) by operating activities:

Operating income (loss)	\$ (78,330,265)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:	
Depreciation expense	11,191,206
Change in assets and liabilities:	
Receivables, net	(585,683)
Inventories	29,561
Deposits with trustee	142,608
Accrued interest receivable	(38,702)
Prepaid expenses	(23,632)
Accounts and salaries payable	(628,098)
Deferred revenues	42,512
Deposits	40,769
Refundable federal advances	120,914
Compensated absences	205,242
Other liabilities	<u>165,430</u>
Net cash provided (used) by operating activities	<u>\$ (67,668,138)</u>

NONCASH CAPITAL FINANCING ACTIVITIES

The University acquired capital assets of \$6,687,944 through significant capital leases and notes payable.

The accompanying notes are an integral part of these financial statements.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 1: Summary of Significant Accounting Policies

Reporting Entity

Arkansas State University (“the University”), an Institution of Higher Education of the State of Arkansas, developed from one of four (4) State agricultural schools established in 1909 by an act of the Arkansas General Assembly.

The University opened as a vocational high school in 1910 and was reorganized as a junior college in 1918. The name was changed to State Agricultural and Mechanical College by an act of the Legislature in 1925. Authority to extend the curriculum, offer senior college work, and grant degrees were granted in 1931. In 1933, the Legislature changed the name of the College to Arkansas State College. In January 1967, the Legislature passed an act authorizing a change in the name of Arkansas State College to Arkansas State University, effective July 1, 1967.

A branch campus at Beebe, Arkansas was added to Arkansas State College by an act of the General Assembly of the State of Arkansas in 1955. The branch campus was designated as Arkansas State College – Beebe Branch. Under the provisions of Ark. Code Ann. 6-53-405, White River Technical College was consolidated with Arkansas State University – Beebe campus effective July 1, 1992 and named Arkansas State University – Newport. Act 90 of 2001 eliminated the word “branch” from the references to campuses of Arkansas State University. Subsequently, the Newport campus separated itself from Beebe to become a stand-alone campus. ASU – Heber Springs, a Center of ASU – Beebe, was officially established by Act 426 of 1999 in response to the community’s desire to have a two-year college presence in Cleburne County. Effective July 1, 2003, Foothills Technical Institute in Searcy merged with ASU – Beebe to become ASU – Searcy, a Technical Campus of ASU – Beebe.

Effective July 1, 1992, Arkansas State University began administrative operations at a Mountain Home campus. On October 19, 1993, the voters of Baxter County authorized the levy of a two (2) mill tax to support operations at the Arkansas State University – Mountain Home campus.

Effective July 1, 2001, Delta Technical Institute was merged to the University to become the Arkansas State University Technical Center.

The governing body of the University is the Board of Trustees comprised of five (5) members.

The Arkansas State University Foundation, Inc. (“the Foundation”) is a legally separate, tax-exempt component unit of Arkansas State University (“the University”). The Foundation acts primarily as a fund-raising and asset management organization to develop and supplement the resources that are available to the University in support of its mission and programs. The 33 member board of the Foundation is self-perpetuating and consists of graduates and friends of the University. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources or income thereon that the Foundation holds and invests are restricted to the activities of the University by donors. Because these restricted resources held by the Foundation may only be used by, or for the benefit of the University, the Foundation is considered a component unit of the University under the guidelines established by Governmental Accounting Standards Board (GASB) Statement Number 39, *Determining Whether Certain Organizations are Component Units*. Accordingly, the financial statements of the Foundation are discretely presented in the University’s financial statements in accordance with the provisions of GASB Statement Number 39.

During the year ended June 30, 2005, the Foundation transferred property, equipment and funds of \$3,083,531 to the University for proper accountability and academic support. Complete financial statements for the Foundation may be obtained from the Foundation at P. O. Box 1990, State University, AR 72467-1990.

The Foundation reports under Financial Accounting Standards Board (FASB) standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation’s financial information in the University’s financial statements.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 1: Summary of Significant Accounting Policies (Continued)

Financial Statement Presentation

In June 1999, the Governmental Accounting Standards Board issued Statement No. 34, *Basic Financial Statements - and Management Discussion and Analysis - for State and Local Governments*. GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*, followed this in November 1999. The financial statement presentation required by GASB No. 34 and No. 35 provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

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 focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation is incurred.

The consolidated University financial statements were prepared from the separate statements of the four (4) campuses. Other than the receipt and disbursement of student financial aid between the campuses, financial transactions among the campuses were not considered material in amount or consequence and, accordingly, were not eliminated from the consolidated statements.

The University may choose whether to apply pronouncements of the FASB issued after November 30, 1989 unless those pronouncements conflict with pronouncements of the GASB. The University has elected to not apply pronouncements of the FASB issued after November 30, 1989.

Capital Assets and Depreciation

Land, buildings, improvements and infrastructure, equipment, audiovisual holdings and construction in progress are recorded at cost at the date of acquisition or fair market value at the date of donation in the case of gifts. Livestock held for educational purposes is recorded at cost or estimated fair value. Library holdings are recorded at cost or a stated rate per volume. Library holdings that are capitalized do not include periodicals, microfilm, microfiche and government documents. The University's capitalization policy for equipment is to record, as assets, any items with a unit cost of more than \$2,500 and an estimated useful life greater than one year. Improvements to buildings, infrastructure, and land that significantly increase the value or extend the useful life of the asset are capitalized. Routine repairs and maintenance are charged to operating expense when incurred.

Depreciation is calculated using the straight-line method over the estimated lives of the assets, generally 15 to 30 years for buildings, 15 years for improvements and infrastructure, 10 years for library and audiovisual holdings, and 3 to 20 years for equipment. Capital assets are presented net of accumulated depreciation where applicable.

Operating and Nonoperating Revenues

Revenues of the University are classified as either operating or nonoperating according to the following criteria:

Operating Revenues – Operating revenues result from activities that have characteristics of exchange transactions; that is the University receives payment in exchange for providing services or products to students or other constituencies. Student tuition and fees, net of scholarship discounts and allowances, sales and services of auxiliary operations, net of scholarship discounts and allowances, and most federal, state, local and private grants are the main categories of operating revenues for the University.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 1: Summary of Significant Accounting Policies (Continued)

Operating and Nonoperating Revenues (Continued)

Nonoperating Revenues – Nonoperating revenues are those revenues that result from nonexchange transactions or from activities specifically defined as nonoperating by the GASB. Examples of nonoperating revenues include state appropriations, sales and use taxes, property taxes and investment income. State appropriations from the state are considered nonoperating under the definitions set forth by the GASB because the University does not provide a direct and commensurate benefit to the legislature in exchange for them.

Cash Equivalents

For 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.

Accounts Receivable

Accounts receivable consists of assets the University is legally entitled to, but for which payment has not been received as of the close of the fiscal year at June 30, 2005. The various sources of the University's receivables are detailed in a subsequent note. Receivables are presented net of any estimated uncollectible amounts in accordance with generally accepted accounting principles.

Investments

The University accounts for its investments, except for nonparticipating contracts, at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment 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. Nonparticipating contracts are reported at cost.

It is the University's policy to report all endowment funds, administered by other parties for investment purposes, as investments in the financial statements.

Inventories

Inventories are valued at cost with cost being generally determined on a first-in, first out or average basis.

Noncurrent Cash and Investments

Cash and investments that are externally restricted for endowment scholarships and other purposes or to purchase or construct capital assets, are classified as noncurrent assets in the Statement of Net Assets. Additionally, this classification includes other long-term investments with original maturity dates greater than one year.

Restricted/Unrestricted Resources

The University has no formal policy addressing which resources to use when both restricted and unrestricted net assets are available for the same purpose. University personnel decide which resources to use at the time expenses are incurred.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 1: Summary of Significant Accounting Policies (Continued)

Deferred Revenues

Deferred revenues consist primarily of amounts received prior to the end of the fiscal year for tuition and fees and certain auxiliary activities that relate to a subsequent accounting period. For example, payments for tuition and fees for the second summer term or season football tickets for the upcoming fall season received prior to June 30, 2005 are treated as deferred revenues. They are considered liabilities of the University until earned.

Compensated Absences Payable

Employee vacation pay earned, but not paid, and related matching costs are recorded as a liability and expense on the University's financial statements as required by generally accepted accounting principles. An estimate is made to allocate this liability between its current and noncurrent components.

Deposits with Trustees

Deposits with trustees are externally restricted and held by various banks for the University. They are maintained in order to make debt service payments, to maintain sinking or reserve funds as required by bond covenants, or to purchase or construct capital assets.

Noncurrent Liabilities

Noncurrent liabilities include (1) principal amounts of bonds payable, notes payable, and capital lease obligations with contractual maturities greater than one year; (2) estimated amounts for accrued compensated absences and related matching costs and other liabilities that will not be paid within the next fiscal year; and (3) the refundable federal portion of the Perkins Loan Program.

Property Taxes

Property taxes are levied in November based on property assessment made between January 1 and May 31 and are an enforceable lien on January 1 for real property and June 1 for personal property. The tax records are opened on the first business day of March of the year following the levy date and are considered delinquent after October 10 of the same calendar year.

Sales and Use Taxes

Effective January 2003, the electors of Jackson County, by a majority vote, approved the levy of a one-half of one percent (1/2%) sales and use tax for the ASU – Newport campus. This tax will be utilized for capital improvements and operation and maintenance. Additionally, the electors of Cleburne County approved the levy of a one-half of one percent (1/2%) sales and use tax for the Heber Springs campus. The tax will also be utilized for capital improvements and operation and maintenance.

Funds Held in Trust for Others

The University holds deposits as custodian or fiscal agent for students, student organizations, and certain other organized activities related to the University.

Net Assets

The University's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt – This classification represents the University's total investment in capital assets, net of outstanding debt obligations related to those assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included in this category.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 1: Summary of Significant Accounting Policies (Continued)

Net Assets (Continued)

Restricted Net Assets – Within this classification there are two (2) categories of net assets:

Restricted, expendable – Restricted expendable net assets include resources for which the University is legally or contractually obligated to spend only in accordance with restrictions imposed by external parties.

Restricted, nonexpendable – Nonexpendable restricted net assets consist of endowment and similar type funds for which donors or other external parties have stipulated that the principal or corpus is to be maintained inviolate and in perpetuity and invested only for the purpose of producing income which may either be expended in accordance with the donors' or external parties' stipulations or added to the principal.

Unrestricted Net Assets – Unrestricted net assets represent resources of the University that are unrelated to capital items and not externally restricted. These resources may be expended at the discretion of the University's governing board in the educational and general operations of the University and in furtherance of its mission.

Scholarship Discounts and Allowances

Student tuition and fees, and certain other revenues received 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 University's stated rates and charges and the amount actually paid by students and/or third parties making payments on behalf of the students. Under this approach, scholarships awarded by the University are considered as reductions in tuition and fee revenues rather than as expenses. Additionally, certain governmental grants, such as Pell grants, and payments from other federal, state or nongovernmental programs, are required to be recorded as either operating or nonoperating revenues in the University's financial statements. To the extent that revenues from such programs are applied to tuition, fees, and other student charges, the University has reported a corresponding scholarship discount or allowance.

NOTE 2: Public Fund Deposits and Investments

Cash deposits are carried at cost. The University's cash deposits at year-end are shown below:

	Carrying Amount	Bank Balance
Insured (FDIC)	\$ 2,172,386	\$ 2,232,319
Collateralized:		
Collateral held by the pledging bank or pledging bank's trust department in the University's name	23,743,517	25,561,166
Collateral held by the pledging bank or pledging bank's trust department not in the University's name	140,009	140,009
Total Deposits	\$ 26,055,912	\$ 27,933,494

The above deposits do not include cash on deposit in the state treasury, cash on hand maintained by the University and cash equivalents in the amounts of \$1,797,318, \$99,016 and \$1,107,679 for the year ended June 30, 2005, respectively. Cash equivalents primarily consisted of the short-term Common Fund account. The above total deposits include certificates of deposits of \$10,602,848 reported as investments and classified as nonparticipating contracts. Additionally, the deposits include certificates of deposit and money market checking accounts of \$1,492,153 reported as deposits with trustee.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 2: Public Fund Deposits and Investments (Continued)

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. It is the University's policy to require full collateralization above the Federal Deposit Insurance Corporation (FDIC) insurance limits. As of June 30, 2005, \$140,009 of the University's bank balance of \$27,933,494 was exposed to custodial credit risk as follows:

Uninsured and collateral held by the pledging bank or pledging bank's trust department not in the University's name	<u>\$140,009</u>
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Short-Term Common Fund Account

The University had \$1,107,628 invested in the Short-Term Common Fund account at June 30, 2005. The Short-Term Common Fund account is subject to regulation by the Comptroller of the Currency.

Credit risk – The Short-Term Common Fund is restricted to investments in U.S. Treasury and government agency securities, high quality corporate securities, mortgage-backed and asset-backed securities, and commercial and bank paper. The average credit quality rating of the investment portfolio of this fund is AAA.

Interest rate risk – The portfolio of the Short-Term Common Fund had an effective duration of 2.58 years.

Deposits with Trustee

At June 30, 2005, the University's deposits with trustee, excluding nonnegotiable certificates of deposit, of \$28,355,521 were primarily invested in the Federated Treasury Obligations Fund, a money market treasury. The money market fund was rated AAAM by Standard and Poor's and Aaa by Moody's Investors Service and consisted of short-term repurchase agreements and U.S. Treasuries. The effective average maturity was ten (10) days.

The deposits with trustee consisted of funds either obligated as debt reserves for the University's bond issues or earmarked for specific capital projects.

University Investments (Excluding Endowment Funds)

At June 30, 2005, the University's investments, excluding endowment funds, consisted of corporate bonds of \$2,825,017 and U.S. agencies of \$7,218,212. The corporate bonds will mature as follows:

Less than one year - \$450,905
1-5 years - \$1,533,585
6-10 years - \$840,527

The U.S. agencies will mature as follows:

Less than one year - \$149,325
1-5 years - \$5,595,037
6-10 years - \$1,325,304
Greater than 10 years - \$148,546

Credit risk – The credit quality ratings of the corporate bonds ranged from BB to AAA by Standard and Poor's and Baa3 to Aaa by Moody's Investors Service. The credit quality ratings of the U.S. agencies were AAA by Standard and Poor's and Aaa by Moody's Investors Service.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 2: Public Fund Deposits and Investments (Continued)

University Investments (Excluding Endowment Funds) (Continued)

Interest rate risk - The corporate bonds had an estimated weighted average maturity of 3.84 years at June 30, 2005. The U.S. agencies had an estimated weighted average maturity of 4.23 years. The University's investment policy does not specifically limit operating investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The investment policy states the portfolio shall be designed to attain an above market rate of return throughout budgetary and economic cycles, taking into account investment risk constraints and cash flow requirements.

Concentration of credit risk – The University does not limit the amount of operating funds invested in any one issuer. More than five percent of the University's investments were in the Federal Home Land Bank (FHLB) and the Federal National Mortgage Association (FNMA). These investments were 19.9% and 9% of the University's total investments, respectively.

Endowment Investments

Except for the endowment investments at the Beebe campus, which consisted of nonnegotiable certificates of deposit of \$117,746 and the investments of the R.E. Lee Wilson, Sr. Trust, all remaining endowment funds are included in an investment pool administered by the Arkansas State University Foundation, Inc. The University's portion of the investment pool was 18.24% or \$6,126,638 and consisted of the following types of investments:

- Mutual funds under the direction of the Common Fund and TIAA/CREF investment asset managers - \$5,947,681
- Real estate investments - \$83,149
- Endowment Energy Partners III, LP - \$10,054
- Cash equivalents - \$85,754

Credit risk – Applicable investments of the Common Fund portfolio had an average quality rating of AA+, while applicable investments of the TIAA/CREF portfolio had an average quality rating of B1 to AA1.

Interest rate risk – Applicable investments of the Common Fund portfolio had a weighted average maturity of 6.67 years and an effective duration of 3.5 years. Applicable investments of the TIAA/CREF portfolio had a weighted average maturity of 6.75 to 7.71 years and an effective duration of 4.4 to 5.37 years. The University's investment policy does limit endowment investment maturities to 30 years and requires interest on cash equivalents to be benchmarked to the 90 day Treasury bill index.

R.E. Lee Wilson, Sr. Trust Investments

The R.E. Lee Wilson, Sr. Trust of \$3,395,752 consisted of the following types of investments held in trust by a third party:

- Mutual funds - \$2,119,853
- Cash equivalents - \$904,704
- U.S. Treasury bond - \$364,945
- Stock - \$6,250

Interest rate risk – The trust portfolio consists of one U.S. Treasury bond that will mature on May 15, 2016.

NOTE 3: Income Taxes

The Institution is tax exempt under Internal Revenue Service code. It is also exempt from state income taxes under Arkansas law. Accordingly, no provision for income taxes is made in the financial statements.

ARKANSAS STATE UNIVERSITY  
CONSOLIDATED NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005

NOTE 4: Capital Assets

Following are the changes in capital assets for the year ended June 30, 2005:

	Balance July 1, 2004	Additions	Transfers	Retirements	Balance June 30, 2005
Nondepreciable capital assets:					
Land and improvements	\$ 11,706,961	\$ 35,144	\$ 193,739		\$ 11,935,844
Livestock for educational purposes	104,805	21,050		\$ (5,930)	119,925
Construction-in-progress	53,992,446	28,329,560	(21,830,861)	(55,028)	60,436,117
<b>Total nondepreciable capital assets</b>	<b>\$ 65,804,212</b>	<b>\$ 28,385,754</b>	<b>\$ (21,637,122)</b>	<b>\$ (60,958)</b>	<b>\$ 72,491,886</b>
Other capital assets:					
Improvements and infrastructure	\$ 18,633,331	\$ 2,966,281	\$ 1,137,986		\$ 22,737,598
Buildings	206,470,931	650,890	20,499,136	\$ (948,964)	226,671,993
Equipment	31,784,903	2,951,360		(1,170,893)	33,565,370
Library/audiovisual holdings	13,503,754	529,686		(11,608)	14,021,832
<b>Total other capital assets</b>	<b>270,392,919</b>	<b>7,098,217</b>	<b>21,637,122</b>	<b>(2,131,465)</b>	<b>296,996,793</b>
Less accumulated depreciation for:					
Improvements and infrastructure	5,909,420	1,108,953			7,018,373
Buildings	108,218,655	6,413,680		(909,998)	113,722,337
Equipment	20,138,810	3,141,921		(1,078,930)	22,201,801
Library/audiovisual holdings	11,301,843	557,650		(2,889)	11,856,604
<b>Total accumulated depreciation</b>	<b>145,568,728</b>	<b>11,222,204</b>	<b>*</b>	<b>(1,991,817)</b>	<b>154,799,115</b>
<b>Other capital assets, net</b>	<b>\$ 124,824,191</b>	<b>\$ (4,123,987)</b>	<b>\$ 21,637,122</b>	<b>\$ (139,648)</b>	<b>\$ 142,197,678</b>
Capital Asset Summary:					
Nondepreciable capital assets	\$ 65,804,212	\$ 28,385,754	\$ (21,637,122)	\$ (60,958)	\$ 72,491,886
Other capital assets, at cost	270,392,919	7,098,217	21,637,122	(2,131,465)	296,996,793
<b>Total cost of capital assets</b>	<b>336,197,131</b>	<b>35,483,971</b>		<b>(2,192,423)</b>	<b>369,488,679</b>
Less accumulated depreciation	145,568,728	11,222,204		(1,991,817)	154,799,115
<b>Capital Assets, net</b>	<b>\$ 190,628,403</b>	<b>\$ 24,261,767</b>	<b>\$ 0</b>	<b>\$ (200,606)</b>	<b>\$ 214,689,564</b>

\*Includes prior year adjustment to accumulated depreciation of \$30,998 at the ASU-Beebe campus.

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NOTE 5: Long-Term Liabilities

A summary of long-term debt is as follows:

<u>Date of Issue</u>	<u>Date of Final Maturity</u>	<u>Rate of Interest</u>	<u>Amount Authorized and Issued</u>	<u>Debt Outstanding June 30, 2005</u>	<u>Maturities To June 30, 2005</u>
10/1/67	10/1/05	3%	\$ 270,000	\$ 4,000	\$ 266,000
10/1/69	10/1/09	4.5%	2,250,000	560,000	1,690,000
4/1/92	10/1/08	4.3-4.55%	1,410,000	615,000	795,000
10/1/92	10/1/12	6.2-6.6%	400,000	225,000	175,000
2/1/96	11/1/05	3.8-4.75%	5,380,000	685,000	4,695,000
12/1/98	12/1/23	3.85-5%	3,900,000	3,300,000	600,000
3/1/99	3/1/24	3.4-5.05%	9,460,000	8,200,000	1,260,000
4/21/99	2/10/16	5.85%	567,296	426,466	140,830
5/1/99	4/1/24	3.5-5.1%	17,000,000	14,365,000	2,635,000
8/1/99	4/10/19	4.8%	1,032,704	817,823	214,881
4/1/00	4/1/25	4.5-6.125%	5,500,000	4,895,000	605,000
3/1/01	3/1/31	3.6-5.25%	7,000,000	6,490,000	510,000
3/1/01	3/1/31	3.6-5.25%	3,000,000	2,780,000	220,000
11/15/02	12/1/27	1.6-5%	6,105,000	5,720,000	385,000
12/1/02	12/1/17	1.6-4.4%	5,405,000	4,815,000	590,000
2/5/03	2/5/06	3%	25,295	6,324	18,971
5/1/03	5/1/28	4.125-5%	5,000,000	4,735,000	265,000
8/11/03	9/1/08	7%	507,000	341,290	165,710
11/25/03	1/1/07	Variable	2,000,000	999,957	1,000,043
1/30/04	1/1/09	Variable	500,000	186,940	313,060
3/1/04	3/1/34	3-5%	34,000,000	34,000,000	
3/1/04	3/1/34	2-4.6%	11,555,000	11,145,000	410,000
8/28/04	2/28/09	11.25%	1,694,771	1,380,640	314,131
8/30/04	4/1/10	4.45%	4,325,881	4,099,794	226,087
10/1/04	10/1/24	6%	465,046	455,804	9,242
10/28/04	10/28/07	4.72%	53,271	41,462	11,809
10/28/04	10/28/08	5.99%	148,975	125,406	23,569
Totals			<u>\$ 128,955,239</u>	<u>\$ 111,415,906</u>	<u>\$ 17,539,333</u>

The variable rates of interest are calculated at periodic intervals. Such calculations are primarily based on the lenders' changes in the index determined by the Prime Rate or the LIBOR Rate.

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NOTE 5: Long-Term Liabilities (Continued)

The changes in long-term liabilities are as follows:

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Amounts Due Within One Year
Bonds payable	\$ 105,655,000		\$ 3,121,000	\$ 102,534,000	\$ 3,374,000
Notes payable	3,883,774	\$ 4,790,927	1,687,917	6,986,784	1,675,776
Installment contracts	50,000		50,000		
Capital leases	491,097	1,909,665	505,640	1,895,122	486,500
Compensated absences	3,590,342	3,837,496	3,632,253	3,795,585	3,495,218
<b>Totals</b>	<b>\$ 113,670,213</b>	<b>\$ 10,538,088</b>	<b>\$ 8,996,810</b>	<b>\$ 115,211,491</b>	<b>\$ 9,031,494</b>

Total long-term debt principal and interest payments are as follows:

Year ended June 30,	Principal	Interest	Total
2006	\$ 5,536,276	\$ 4,921,039	* \$ 10,457,315
2007	5,281,558	4,745,839	10,027,397
2008	5,051,550	4,574,711	9,626,261
2009	5,132,779	4,406,455	9,539,234
2010	4,715,654	4,229,871	8,945,525
2011-2015	20,052,660	18,570,809	38,623,469
2016-2020	20,680,773	14,042,271	34,723,044
2021-2025	21,144,656	8,880,474	30,025,130
2026-2030	13,480,000	4,514,759	17,994,759
2031-2034	10,340,000	1,262,602	11,602,602
<b>Totals</b>	<b>\$ 111,415,906</b>	<b>\$ 70,148,830</b>	<b>\$ 181,564,736</b>

\*Includes interest payable of \$1,342,509 recorded as a current liability at June 30, 2005.

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NOTE 6: Capital Leases

The University has acquired certain capital assets under various capital leases.

Type of Asset	Asset Amount
Telecommunications equipment	\$ 1,694,771
Print shop equipment	730,791
Public safety equipment and software	202,246
Computer equipment	32,995
Total	\$ 2,660,803

The following is a schedule of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments, as of June 30, 2005:

Fiscal Year Ending June 30,	Amount
2006	\$ 563,939
2007	557,425
2008	542,596
2009	405,301
Total Minimum Lease Payments	2,069,261
Less: Amount Representing Interest	174,139
Total Present Value of Net Minimum Lease Payments	\$ 1,895,122

NOTE 7: Commitments

The University was contractually obligated for the following at June 30, 2005:

A. Construction Contracts

Project Name	Estimated Completion Date	Contract Balance
Residence hall - Jonesboro campus	September 2006	\$ 14,769,176
Student union - Jonesboro campus	To be determined	2,582,241
Family Housing Phase II - Jonesboro campus	September 2005	1,144,375
Walton Hall renovation/addition - Newport campus	May 2006	1,123,211
Lakeport Phase II - Jonesboro campus	June 2006	541,799

B. Operating Leases (Noncapital leases with initial or remaining noncancellable lease terms in excess of 1 year)

Various leases for copiers, computers, and other office equipment with terms ranging from 24 to 60 months, four (4) real estate leases with terms of 24 to 60 months and two (2) items of heavy equipment with terms of 48 and 60 months.

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NOTE 7: Commitments (Continued)

B. (Continued)

- (a) Future minimum rental payments (aggregate) at June 30, 2005: \$673,032
- (b) Future minimum rental payments for the five (5) succeeding fiscal years:

Year Ended June 30,	Amount
2006	\$ 400,297
2007	176,149
2008	64,826
2009	28,551
2010	3,209

Rental payments for the above operating leases, for the year ended June 30, 2005, were approximately \$533,739.

C. Capital Improvement Revenue Bonds

Capital Improvement Revenue Bonds in the amount of \$2,827,229 were issued by the State Board of Vocational Education of the State of Arkansas, dated April 1, 1992 as Series A, with interest payable semiannually on April 1 and October 1 and principal payment annually on April 1. Arkansas State University - Searcy (formerly Foothills Technical Institute) is required to contribute thirteen percent (13%) of the principal and interest payments as follows:

Year Ended June 30,	Amount
2006	\$ 20,871
2007	20,871
2008	20,871
2009	20,871

NOTE 8: Retirement Plans

Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF)

**Plan Description.** The University participates in TIAA/CREF, a defined contribution plan. The plan is a 403(b) program as defined by Internal Revenue Service Code of 1986 as amended, and is administered by TIAA/CREF. TIAA is an insurance company offering participants a traditional annuity with guaranteed principle and a specific interest rate plus the opportunity for additional growth through dividends. CREF is an investment company which offers a variable annuity. Arkansas law authorizes participation in the plan.

**Funding Policy.** TIAA/CREF has contributory and non-contributory plans. Contributory members select the percentage of their gross salaries to contribute based on current regulations. The University contributes 10% of earnings for all applicable employees. The University's and participants' contributions for the year ended June 30, 2005 were \$5,416,319 and \$4,958,544, respectively.

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NOTE 8: Retirement Plans (Continued)

Arkansas Teacher Retirement System

Plan Description. The University contributes to the Arkansas Teacher Retirement System (ATRS), a cost-sharing multiple-employer defined benefit pension plan for employees who do not elect a qualified alternative retirement plan. ATRS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit and contribution provisions are established by State law and can be amended only by the Arkansas General Assembly. The Arkansas Teacher Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for ATRS. That report may be obtained by writing to Arkansas Teacher Retirement System, 1400 West Third Street, Little Rock, Arkansas 72201 or by calling 1-800-666-2877.

Funding Policy. ATRS has contributory and non-contributory plans. Contributory members are required by law to contribute 6% of their salaries. Each participating employer is required by law to contribute at a rate established the by Arkansas General Assembly. The current employer rate is 14%. The University's contributions to ATRS for the years ended June 30, 2005, 2004 and 2003 were \$694,198, \$578,377 and \$439,159, respectively, equal to the required contributions for each year.

Arkansas Public Employees Retirement System

Plan Description. The University contributes to the Arkansas Public Employees Retirement System (APERS), a cost-sharing multiple-employer defined benefit pension plan. Employees may elect coverage under APERS as a qualified retirement system. APERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit and contribution provisions are established by State law and can be amended only by the Arkansas General Assembly. The Arkansas Public Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for APERS. That report may be obtained by writing to Arkansas Public Employees Retirement System, One Union National Plaza, 124 W. Capitol, Little Rock, Arkansas 72201 or by calling 1-800-682-7377.

Funding Policy. APERS has contributory and non-contributory plans. Contributory members are required by law to contribute 6% of their salaries. Each participating employer is required by law to contribute at a rate established by the Arkansas General Assembly. The current statutory employer rate is 11.09% of annual covered payroll. The University's contributions to APERS for the years ended June 30, 2005, 2004 and 2003 were \$851,549, \$771,077 and \$780,162, respectively, equal to the required contributions for each year.

Variable Annuity Life Insurance Company (VALIC)

Plan Description. The University contributes to VALIC, a defined contribution plan. The plan is a 403(b) program as defined by Internal Revenue Service Code of 1986 as amended, and is administered by VALIC. VALIC provides insurance policies that become the property of the participant when issued.

Funding Policy. VALIC has contributory and non-contributory plans. Employees select the percentage of their gross salaries to contribute based on current regulations. The University's contributory rate is 10% or 12% for all applicable employees. Vesting occurs for all participants immediately. The participants' and the University's contributions for the year ended June 30, 2005 were \$656,746 and \$773,315, respectively.

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NOTE 9: Natural Classifications by Function

The University's operating expenses by function were as follows:

	Personal Services	Scholarships and Fellowships	Supplies and Services	Self- insurance	Depreciation	Other	Total
Instruction	\$ 49,378,318	\$ 103,224	\$ 5,794,710				\$ 55,276,252
Research	4,384,772	83,911	2,152,405				6,621,088
Public service	6,531,464	114,575	3,739,904				10,385,943
Academic support	10,426,772	112,716	4,459,875				14,999,363
Student services	7,871,794	131,938	2,162,991				10,166,723
Institutional support	14,007,404	2,000	3,673,426				17,682,830
Scholarships and fellowships		6,892,796	3,114				6,895,910
Operations and maintenance of plant	9,067,562		7,660,527				16,728,089
Auxiliary enterprises	6,549,396		10,123,801				16,673,197
Self-insurance				\$ 8,850,553			8,850,553
Depreciation					\$ 11,191,206		11,191,206
Other						\$ 113,634	113,634
<b>Totals</b>	<b>\$ 108,217,482</b>	<b>\$ 7,441,160</b>	<b>\$ 39,770,753</b>	<b>\$ 8,850,553</b>	<b>\$ 11,191,206</b>	<b>\$ 113,634</b>	<b>\$ 175,584,788</b>

NOTE 10: Disaggregation of Receivable and Payable Balances

Accounts receivable from students was \$4,518,919 at June 30, 2005. This amount was reduced by an allowance for doubtful accounts of \$617,952.

Notes receivable pertain to loans awarded to students through the Federal Perkins Loan Program. Notes receivable were \$7,750,166 at June 30, 2005. This amount was reduced by an allowance for doubtful loans of \$652,638. Deposits receivable were \$138,158 at June 30, 2005.

Other receivables of \$4,171,118 at June 30, 2005 primarily consisted of reimbursements of \$1,882,366 from various agencies for grants and contracts, \$820,848 due from various state treasury accounts, \$124,715 due from sales and use tax, and auxiliary enterprises receivables of \$264,756. Other receivables also consisted of \$419,884 due from the U. S. Department of Education for cancellations pertaining to the Federal Perkins Loan Program and miscellaneous items of \$658,549.

The accounts payable and accrued liabilities of \$5,775,144 consisted of \$4,803,176 due to vendors, salaries and other payroll related items of \$970,201 and other items of \$1,767.

NOTE 11: Museum Collection

The financial statements do not include the University's museum collection, which consists of numerous historical relics, artifacts, displays and memorabilia. The total value of this collection has not been established.

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NOTE 12: Early Retirement Incentive Program

The University contributes to health and life insurance premiums (individual or family coverage) for all employees who retire between the ages of 60 and 65 with at least 10 years of service. These contributions are paid until the retiree is 65 years of age. The University also contributes to health and life insurance premiums for one year for those employees who are determined to be eligible for disability. At June 30, 2005, the number of retirees who were eligible for these benefits totaled 102. The University also pays life insurance premiums for certain retirees under a plan no longer utilized by the University. These premiums are paid until the retiree's death. At June 30, 2005, the number of retirees eligible for these benefits totaled 6. All premiums for these benefits described above were paid monthly and financed on a pay-as-you-go basis. These premiums, paid by the University and the retirees, totaled \$524,175 for the year ended June 30, 2005. Of this amount, the University's contribution was \$383,910.

NOTE 13: Arkansas Services Center

On October 8, 1968, an agreement was signed by Arkansas State University, Arkansas State Hospital, Arkansas Department of Public Welfare, Arkansas State Board of Vocational Education and Craighead County, Arkansas to raise money for the construction of the Arkansas Services Center. This project was financed from the proceeds of a bond issue by Arkansas State University, grants and legislative appropriations by the agencies. With the exception of Craighead County, Arkansas, the participants signed lease agreements for 40 years (the bond term) with rentals and revenues thereof, sufficient to maintain the facility and retire the bonds.

Arkansas State University maintains the financial records of the Arkansas Services Center. Operating revenues are derived solely from agency rentals and vending income. All financial activity relating to the Arkansas Services Center is reflected in the accompanying financial statements as auxiliary enterprises.

NOTE 14: Self-insurance Program

Beginning July 1, 1994, Arkansas State University established a self-funded health benefit plan for employees and their eligible dependents. All campuses of the University participate in the program, which is administered by USAbled and NOVA administrators.

There are three plans available to employees. These include: USAbled Classic I, USAbled Point of Service and NOVA Classic I. At June 30, 2005, approximately 3,802 active employees, their dependents, former employees and retirees were participating in the program. For those participating in the USAbled Classic and the NOVA Classic I plans, the University pays 94% of the total premium for full-time employees and early retirees, and 72% of the total premium for dependents, while former employees, through COBRA, may participate on a fully contributory basis. For those participating in the USAbled Point of Service plan, the University pays 80% of the total premium for full-time employees and early retirees, and 72% of the total premium for dependents, while former employees, through COBRA, may participate on a fully contributory basis.

The University estimates its unpaid health claims liability beyond the experience period to be \$748,677 with USAbled and \$30,099 with NOVA. This is equal to approximately 14.9% of the previous 12 months claims paid.

The University purchases specific and aggregate reinsurance to reduce its exposure to large claims. Reliance National Company of Philadelphia, Pennsylvania was chosen as the reinsurance carrier. Under the specific arrangement, the reinsurance carrier pays for claims for covered employees that exceed \$125,000.

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NOTE 15: Endowment Funds

The University has donor-restricted endowment funds. Investment income on the amount endowed is restricted for scholarships and other purposes. All endowment funds are maintained as investments. Investments reported at fair value, include U. S. Government obligations, common stock, mutual funds and other managed investments. The endowment net assets at June 30, 2005 were \$9,047,033. Of this amount, \$8,639,917 was nonexpendable and the remaining \$407,116 was expendable.

State law allows a governing board to expend a portion of the net appreciation in the fair value of the assets over the historic dollar value of the fund unless the applicable gift document states otherwise. State law stipulates that such expenses are to be for the purpose for which the endowment funds were established.

It is the University's policy for annual expenses from the endowment funds not to exceed 4.5% of the five (5) year average market value as determined at December 31. In periods with no market value appreciation, the University limits the spending to actual income generated by the endowment fund assets.

NOTE 16: Subsequent Events

- (a) On July 1, 2005, the University executed a contract of \$942,738 for the construction of a physical plant building at the Mountain Home campus.
- (b) On September 15, 2005, the University issued refunding bonds of \$19,230,000 for the Jonesboro campus and \$3,330,000 for the Beebe campus.