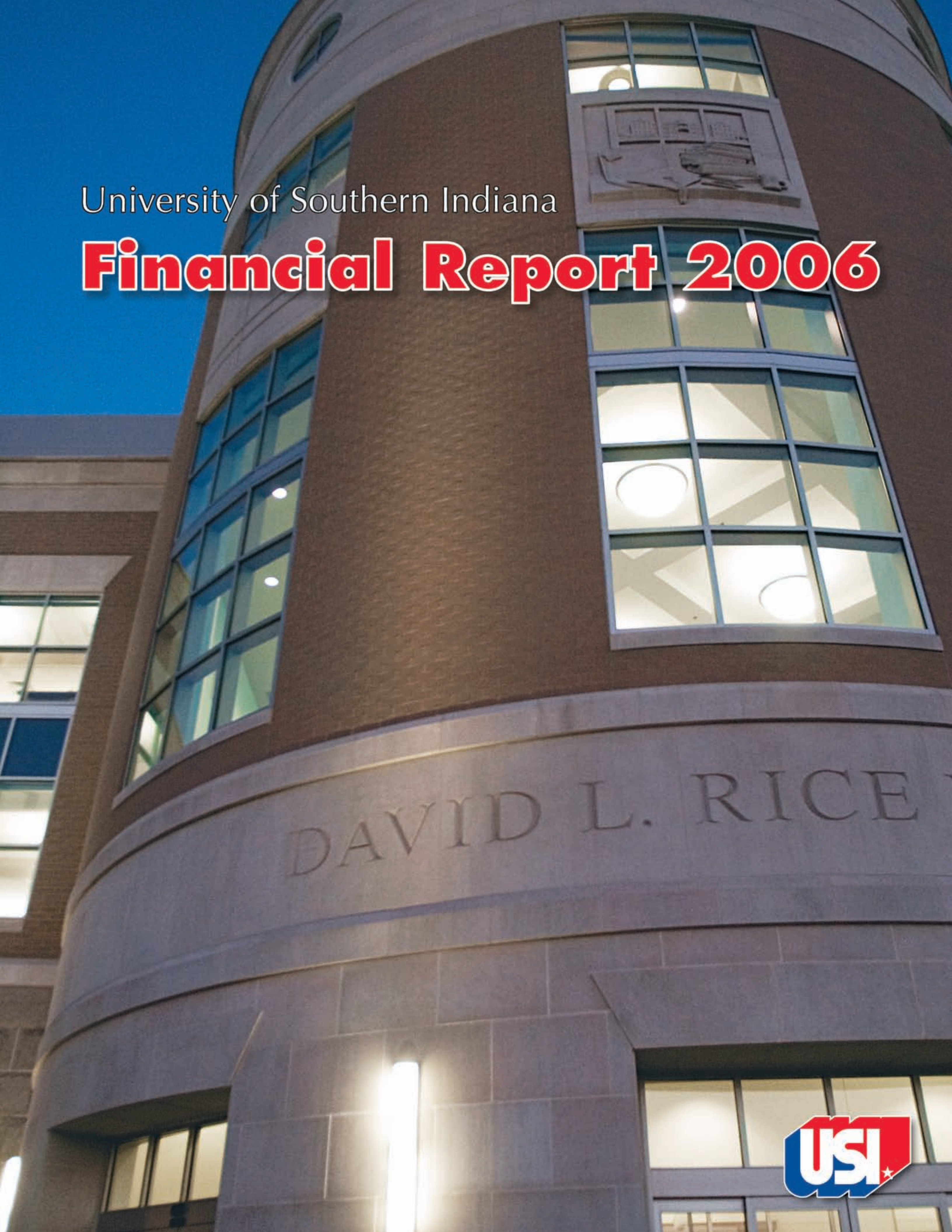
University of Southern Indiana

Financial Report 2006



ON THE COVER

A night view of the new Rice Library

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Supplementary Information

Additional copies of this report may be obtained from:

Office of the Vice President for Business Affairs and Treasurer
Byron C. Wright Administration Building
University of Southern Indiana
8600 University Boulevard
Evansville, Indiana 47712
Telephone: 812/464-8600
or from the Web site at www.usi.edu/busoff/annualreport.asp

Board of Trustees 2005-2006

Trustees of the University gather before the 2005 Commencement ceremony. They are (from left) Harolyn G. Torain, Mark Day, Frank F. McDonald II, J. David Huber, G. Patrick Hoehn, James L. Will Sr., President H. Ray Hoops, Bruce H. Baker, and Lauren C. Fultz.

University Officers 2005-2006

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Message From The President

Dr. H. Ray Hoops
President

Dear Friends,

There is no question that the highlight of this past year was the completion and grand opening of the new David L. Rice Library. I continue to believe that this facility will be a transforming one for our University. The new library is a place that brings people together—from its grand reading rooms and its abundant group study areas to its coffee shop. In so many ways it is symbolic of the collaboration and foresight that has been the hallmark of this institution's development.

The vision of the library staff, based on the needs of the faculty and student body, interpreted by the architects, and executed by the construction staff has given us a library to serve the academy of today and the learners of tomorrow. And as beautiful as the building alone is, it has been enhanced by the exterior limestone relief commissioned by arts patron Dorothea Schelecte and designed by USI art professors John McNaughton and Katie Waters. Inside the library is even more art, donated to the University or commissioned by the USI Art Collection Committee with private support. Every building project on our campus has been enhanced by friends and donors who share our commitment to public higher education.

At the ribbon-cutting ceremony, I was reminded once again what a deeply committed group of legislators we have in the southern Indiana delegation, and how responsive the entire Indiana General Assembly has been to our needs for instructional facilities so critically needed by a growing campus. Since I came to USI in 1994, we have opened the Liberal Arts Center, the Art Studio, the Education Center and Torrington Wing of the Science Center, and the Rice Library, but our instructional space per student still lags behind that of other Indiana public universities. We look forward to completing the plans for a new College of Business and General Classroom Building, for which we also will need support from the private sector.

We thank our elected officials and our friends in the private sector for helping us achieve our goal of providing an excellent, affordable education to Hoosier students and for helping close the gap between state resources and our very real needs.

Sincerely yours,

H. Ray Hoops

H. Ray Hoops
President

Message From The Vice President

Mark Rozewski
Vice President for
Business Affairs
and Treasurer

To the President and the Board of Trustees of the University of Southern Indiana

I am pleased to present the University of Southern Indiana's audited financial report for the fiscal year ended June 30, 2006. The financial report has been prepared and presented in accordance with generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB) for public colleges and universities. The University is regarded as a special-purpose government entity engaged only in business-type activities. As such, the financial report consists of the following basic statements: Management's Discussion and Analysis (MD&A); the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In addition, in compliance with GASB 39, the financial results of the USI Foundation have been incorporated into the 2005-2006 report as a component unit of the University.

The FY 2005-2006 report fulfills a new requirement set out in GASB Statement No. 47, *Accounting for Termination Benefits*. This GASB requires recognition of a liability and an expense for voluntary termination benefits, such as early-retirement incentives. Full disclosure can be found in Note 8 of the Notes to the Financial Statements.

The financial statements provide a summary of the flow of economic resources during the fiscal year, the University's financial position at fiscal year end, comparative data from the previous fiscal year, and the net assets available for future use. The statements and the accompanying notes have been audited by the Indiana State Board of Accounts. Their opinion appears on the following page.

This report is a complete and permanent record of the financial status of the University of Southern Indiana for the period stated therein.

Mark Rozewski
Vice President for Business Affairs
and Treasurer

STATE OF INDIANA

AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
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INDEPENDENT AUDITORS' REPORT

TO: THE OFFICIALS OF UNIVERSITY OF SOUTHERN INDIANA, EVANSVILLE, INDIANA

We have audited the accompanying basic financial statements of University of Southern Indiana, a component unit of the State of Indiana, as of and for the years ended June 30, 2006 and 2005. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of the component unit of the University as discussed in Note 17, which represents 100% of the assets and revenues of the discretely presented component unit. The financial statements of this component unit were audited by another auditor whose report thereon has been furnished to us and our opinion, insofar as it relates to this unit, is based upon the report of the other auditor.

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

In our opinion, based on our audit and the report of the other auditor, the financial statements referred to above present fairly, in all material respects, the financial position of University of Southern Indiana, as of June 30, 2006 and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated November 15, 2006, on our consideration of University of Southern Indiana's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. The 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. This report will be issued in the University's Single Audit report prepared in accordance with OMB Circular A-133.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

STATE BOARD OF ACCOUNTS

State Board of Accounts

November 15, 2006

Management's Discussion and Analysis

Management's discussion and analysis reviews the financial performance of the University during the fiscal year ended June 30, 2006, and compares that performance with data from prior fiscal periods. It is designed to focus on current activities, resulting changes, and currently known facts. It is intended to answer questions that may result from the review of the information presented in the financial statements and to better explain the financial position of the University. The information presented in the financial statements, the notes to the financial statements, and the discussion and analysis are the responsibility of management.

Using the Annual Report

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

A key question to ask about the University's finances is whether the institution as a whole improved or declined as a result of the financial activities from the fiscal year. The answer is found in the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. Discussion and analysis of each of these statements are presented in the following pages.

Statement of Net Assets

The Statement of Net Assets presents the value of the assets, liabilities, and net assets at the end of the fiscal year. It is prepared under the accrual basis of accounting: revenues and expenses, and their impact on assets and liabilities, are recognized when service is provided or received by the University, regardless of when cash is exchanged. Assets and liabilities are classified as current (accessible or payable in one year or less) or non-current (accessible or payable beyond one year); net assets are invested in capital assets, restricted for specific purposes, or unrestricted.

Net assets are one indicator of current financial health. The increases or decreases in net assets that occur over time indicate improvements or deterioration of the University's financial condition.

STATEMENT OF NET ASSETS June 30 (in thousands)	2006	2005	2004
Current Assets	$ 55,907	$ 45,939	$ 78,565
Noncurrent Assets:			
Capital assets, net of depreciation	137,447	131,078	124,685
Other noncurrent	25,852	42,667	14,099
Total Assets	**$219,206**	**$ 219,684**	**$217,349**
Current Liabilities	$ 15,849	$15,246	$ 13,387
Noncurrent Liabilities	120,453	125,688	131,202
Total Liabilities	**$136,302**	**$140,934**	**$144,589**
Net Assets:			
Invested in capital assets, net of debt	$ 24,386	$ 25,008	$ 25,517
Restricted–expendable	1,486	214	1,489
Unrestricted	57,031	53,528	45,539
Total Net Assets	**$ 82,903**	**$ 78,750**	**$ 72,545**

Assets

Current assets at June 30, 2006, consist predominantly of cash and cash equivalents, short-term investments, and receivables. Also included are prepaid expenses, deposits with trustees, and inventories. Non-current assets include capital assets net of depreciation, long-term investments, and receivables from the state. Both current and non-current assets include lesser-valued resources that are grouped together and listed under the term *Other*.

Total assets decreased $0.4 million (.21 percent) in 2006 compared to a $2.6 million (1.2 percent) increase in 2005. This decrease over 2005 is explained by the following fiscal year events:

- Deposits with bond trustees decreased $19.4 million in 2006 as funds were expended on construction of the David L. Rice Library project. In 2005, $21.5 million remained on deposit with trustees from the proceeds of the 2004 bond issue for this project. At 2006 fiscal year end, only $2.1 million remains for finishing the project and the debt service.
- Cash and cash equivalents, short-term investments, and long-term investments increased $10.3 million dollars, or 15.4 percent. The prior fiscal year increase was $10.5 million, or 22.6 percent. The increase in 2006 is almost exclusively in certificates of deposit and repurchase agreements. In 2005, there was a shift from money markets and repurchase agreements to certificates of deposit and U.S. Treasury notes.
- Accounts receivable decreased $1.4 million compared to a $2.5 million decrease in 2005. Accounts receivable in 2005 included a non-current receivable from the State of Indiana for the twelfth-month appropriation payment of $2.9 million. During the 2006 legislative session, Senate Bill 345 appropriated funds to reduce the accrued delayed payment. These funds are to be used for general repair and rehabilitation and are collectible during FY 2007. This legislative action effectively reclassified $1.2 million from non-current to current receivables. The State Budget Agency deemed another $20,000 not payable, leaving $1.6 million in non-current receivables in 2006.
- The University's fine art collection, consisting of both donated and purchased items and valued at more than $580,000, was inventoried and recorded as capital assets in 2006.

Liabilities

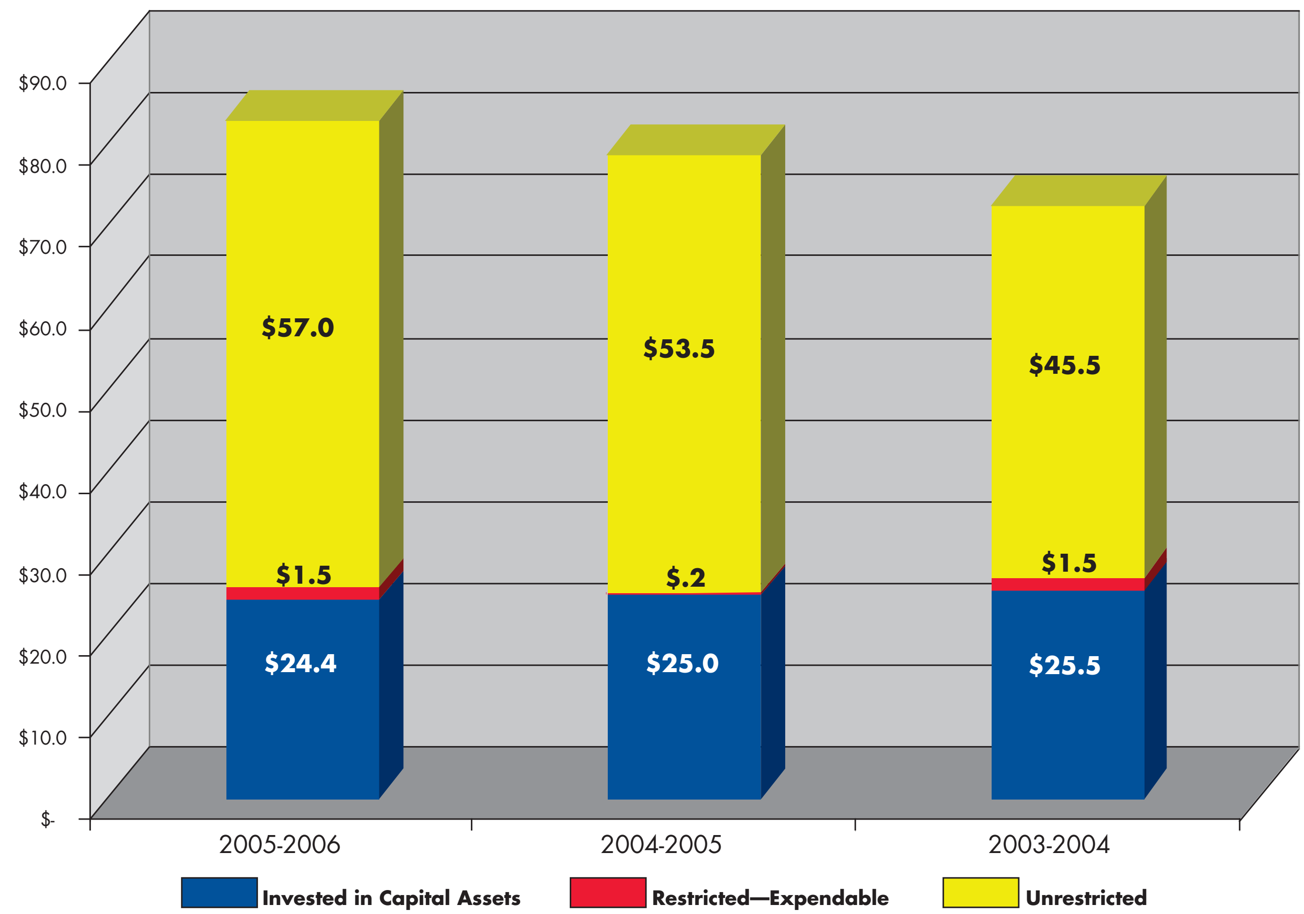
Current liabilities at June 30, 2006, are primarily composed of accrued payroll and related benefits and deductions and the current portion of bonds payable. Also included are accounts payable, debt interest payable, and miscellaneous other liabilities. Non-current liabilities are predominately bonds payable. Also included are compensated absences, an unamortized bond premium, and miscellaneous other long-term liabilities. Total liabilities decreased $4.6 million (3.3 percent) in 2006 compared to a decrease of $3.7 million (2.5 percent) in 2005. Activities during the year that influenced this change include the following:

- Accrued payroll and related benefits and deductions increased 12.7 percent this year compared to 12.3 percent in FY 2005. A new governmental accounting standard that requires recognition of voluntary termination benefits accounted for nearly $900,000 of the total increase. The new accounting standard, GASB 47, is explained in Note 8 of the notes to the financial statement.
- Paying down the existing debt created a decrease of $5.6 million in bonds payable, debt interest payable, and unamortized bond premium for 2006 compared to $4.6 million in FY 2005. A new bond issue in June 2006 acts as a line of credit until December 31 by allowing draws against the approved amount of $7.25 million. At June 30, only $50,000 had been drawn and that liability is included in the current bonds payable balance. See Note 6 for more information on the bond issue.

Net Assets
Net assets at June 30, 2006, were $4.2 million greater than on June 30, 2005. Restricted expendable assets increased $1.3 million reflecting the state appropriation funds that are restricted to general repair and rehabilitation. Unrestricted assets increased $3.5 million and comprise 69 percent of total net assets. Of the $57 million in unrestricted net assets, $51.7 million have been internally designated as follows:

- $19.2 million reserve for auxiliary operations equipment and facilities maintenance and replacement
- $16.2 million reserve for special construction-related projects
- $5.2 million reserve for working capital and outstanding encumbrances
- $3.8 million reserve for academic operations and initiatives
- $3.5 million reserve for equipment and facilities maintenance and replacement
- $2.0 million reserve for replacement of computer hardware and software
- $1.8 million reserve for employee benefit claims

ANALYSIS OF NET ASSETS (in millions)



Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and the expenses incurred during the fiscal year. This statement tells the reader to what extent the results of operations, non-operating revenues, and capital funding have had on the net assets of the University.

Activities are reported as either operating or non-operating. Student fees, financial aid revenue from grants and scholarships, and revenues from auxiliary enterprises are the major sources of operating income. Operating income is reduced by discounts and allowances for scholarships, room, and board. Discounts and allowances are institutional resources provided to students as financial aid up to and equal the amounts owed by the students to the institution.

An important point to recognize on this financial statement is that state appropriations are required to be classified as non-operating revenues. This creates large operating deficits for public universities which rely heavily on state funding to meet their missions and goals. A truer measure of fiscal year net income is the amount shown on the statement as “Income/(expenses) before other revenues, expenses, gains, or losses”.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS Year Ended June 30 (in thousands)	2006	2005	2004
Total operating revenues	$67,951	$64,276	$60,105
Total operating expenses	(103,454)	(96,112)	(91,139)
Operating losses	(35,503)	(31,836)	(31,035)
Net nonoperating revenues/(expenses)	39,589	37,838	35,633
Income/(expenses) before other revenues, expenses, gains, or losses	4,086	6,002	4,599
Capital gifts, grants, and appropriations	67	203	991
Increase (decrease) in net assets	**$ 4,153**	**$ 6,205**	**$ 5,590**

Revenues

Operating revenues increased $3.7 million (5.7 percent) this fiscal year compared to a $4.2 million (6.9 percent) increase in the previous fiscal year. This increase is explained by the following significant fiscal year activities:

- Net student fee revenue increased from $30.0 million in 2005 to $32.4 million in 2006. This 8.1 percent increase was due to increases in FTE enrollment growth of 0.75 percent and student fee rates of 5.6 percent. The previous year's increase of 5.9 percent reflected a 1.6 percent FTE enrollment growth and 5.0 percent student fee rate increase.
- Grants and contracts from federal and nongovernmental agencies decreased $0.7 million, or 8.7 percent; state grants increased $18,000, or 0.3 percent. The University received 50 percent from federal agencies, 45 percent from state and local agencies, and 5 percent from nongovernmental entities. Of the total grant revenue, 87.3 percent provided financial aid to the University's students.
- Auxiliary enterprises revenue, after room and board allowances, increased $1.2 million, or 5.8 percent, in 2006. The prior fiscal year increased $1.4 million, or 7.8 percent. The primary sources of auxiliary revenue come from student housing rentals and the bookstore operation, $8.6 million and $5.9 million respectively for FY 2006.

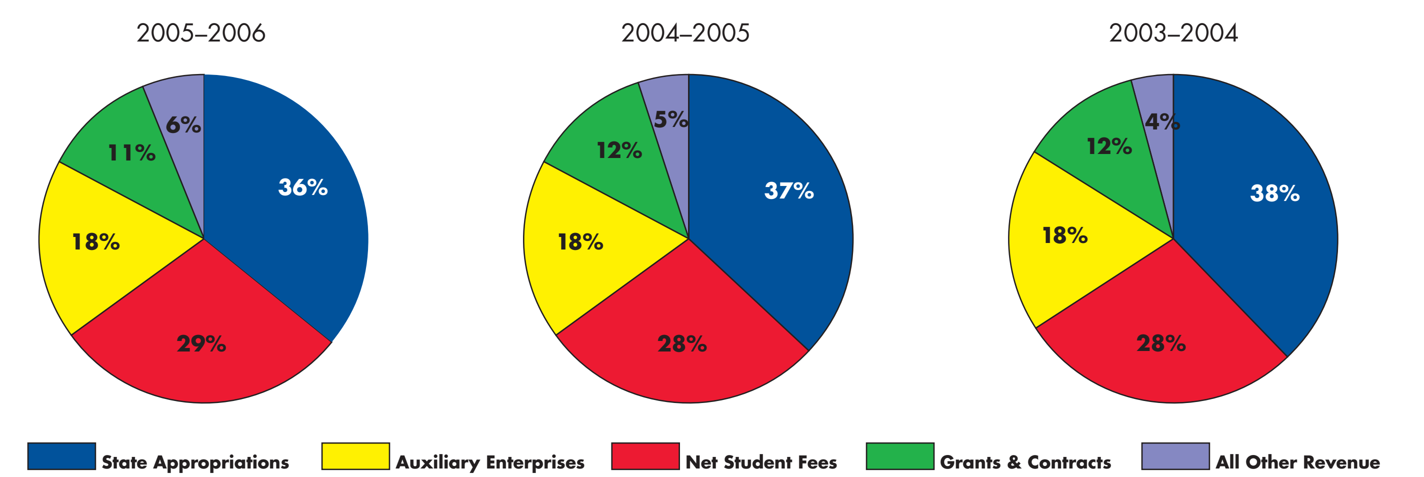
Non-operating revenues experienced a net increase of 3.9 percent for the fiscal year ended June 30, 2006, compared to a 5.8 percent increase in the prior fiscal year:

- State appropriations for general operating support increased 2.8 percent, from $39.8 million in 2005 to nearly $41.0 million in 2006.
- Gift revenues increased 11.8 percent and 17.6 percent for 2006 and 2005 respectively. Of the $1.9 million gifts received in 2006, more than 96.5 percent came from the USI Foundation for scholarships, educational grants, academic enhancements, athletics, and other University support.
- Investment income increased 18.2 percent, from $2.1 million to $2.4 million, this fiscal year. The University had $10.3 million more dollars invested during the current fiscal year than the previous year which accounts for the increase in this income.

Other revenues include capital gifts from the USI Foundation. Capital gifts of $67,167 in 2006 and $202,879 in 2005 were received for purchase of classroom equipment, major renovation, and new construction projects.

Total revenues (operating, non-operating, and other) increased $5.2 million in fiscal year 2006 compared to a $5.8 million increase in 2005. The graph below shows the composition of the University's revenue for the fiscal years 2004–2006:

REVENUE CHARTS



Expenses

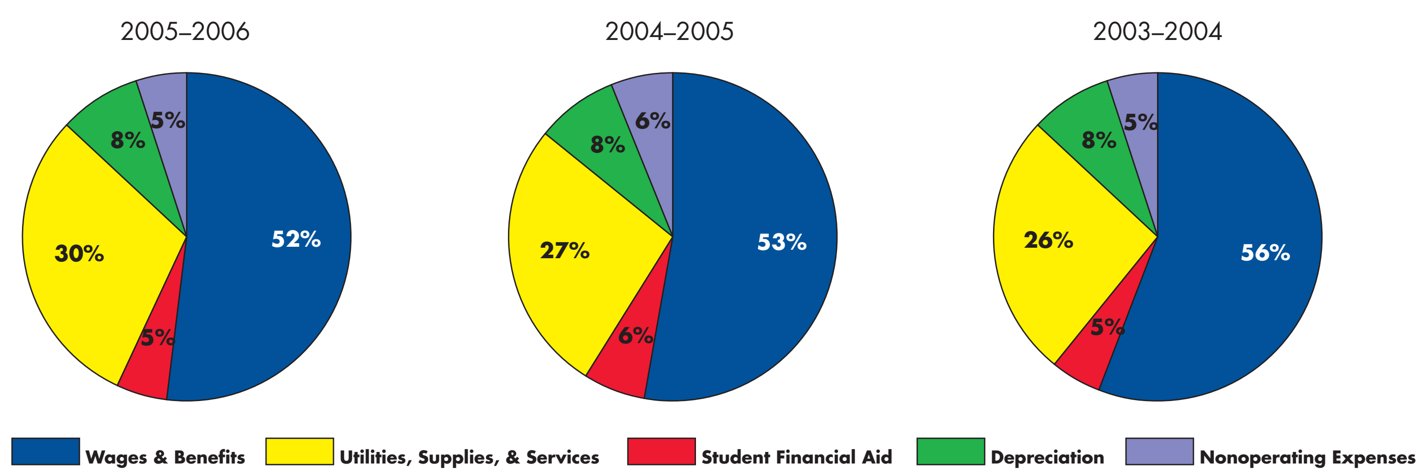
Operating expenses for fiscal year 2006 were $103.5 million, an increase of $7.3 million, or 7.6 percent, over the previous fiscal year. Except as noted otherwise, the increase in operating expenses is generally a result of enrollment growth, staffing increases, and an increase in campus plant facilities. Changes in expense categories were as follows:

- Compensation (salaries, wages, and benefits) comprise 54.7 percent of total operating expenses and increased 3.8 percent. This is down from the 5.7 percent increase in the prior fiscal year. Staffing increases caused by enrollment growth, promotions, and annual raises in salary contributed to this change in both years.
- Student financial aid increased from $5.6 million to $5.7 million, or 1.7 percent. This is less than the prior year increase of $0.6 million, or 13.3 percent. Both the Federal and State governments changed their funding formulas which caused smaller awards to fewer students.
- Utilities increased $0.8 million, or 26.7 percent, compared to the prior year's increase of $0.6 million or 24.7 percent. This reflects the continuing rising cost of natural gas and other commodities coupled with the increased size of the plant facilities.
- Supplies and other services increased $4.2 million, or 17.4 percent, compared to last year's decrease of $1.0 million. Much of this increase was due to supplies and moveable equipment purchases in preparation of the opening of the new David L. Rice library. Deferred maintenance expenditures also contributed significantly to this increase.
- Depreciation increased only $0.1 million, or 1.45 percent, in FY 2006 compared to $1.7 million, or 26.5 percent in FY 2005. Last year's large depreciation increase was due to the addition of a new classroom building and residence facility. No significant additions were made to capitalized assets this year that were subject to depreciation.

Non-operating expenses consist of interest on capital asset-related debt and other costs associated with issuing bonds and refinancing debt. These expenditures decreased $66,000 this year compared to $190,000 increase in 2005. The University issued one new revenue bond in FY 2006 which increased bond issuance costs insignificantly. The overall decrease is reflected in less interest on capital debt expense having been incurred in FY 2006.

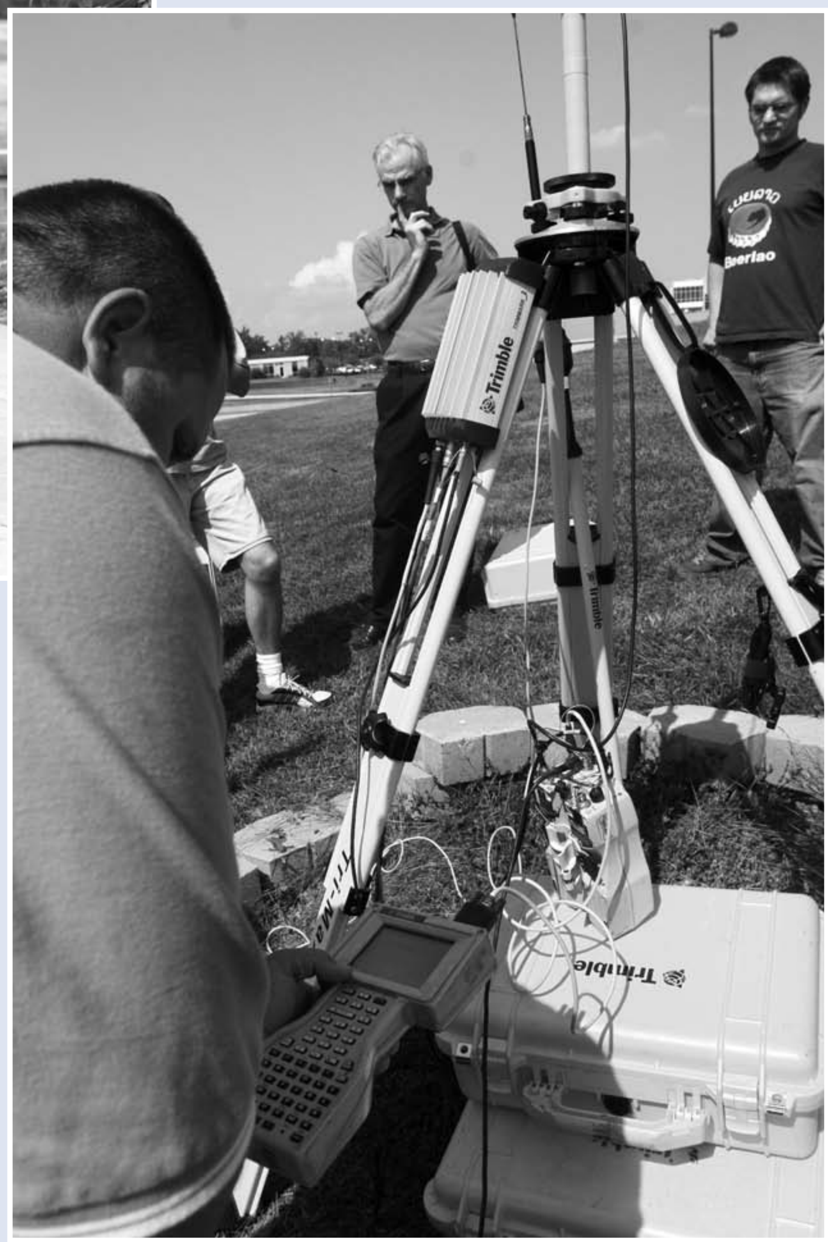
Total expenses (operating and non-operating) increased $7.3 million in fiscal year 2006 compared to a $5.2 million increase in 2005. The composition of total expenses for both years is depicted by major category in the graph below:

EXPENSE CHARTS



Change in Net Assets

The difference between revenues and expenses results in an increase or decrease in net assets. For fiscal year ending June 30, 2006, net assets increased $4.2 million compared to a $6.2 million increase for fiscal year ending June 30, 2005. Total expenses increased at a greater rate than total revenues during fiscal year 2006.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Statement of Cash Flows

The Statement of Cash Flows provides additional information about the financial health of the University by helping the user assess the ability to generate future cash flows, the ability to meet obligations as they come due, and the need for external financing.

This statement identifies the sources and uses of cash and equivalents throughout the fiscal year and informs the user how much cash was used by or provided by the following activities: operating, noncapital financing, capital financing, and investing. The chart below shows the University's sources, uses, and changes in cash and cash equivalents for 2006, 2005, and 2004:

STATEMENT OF CASH FLOWS Year ended June 30 (in thousands)	2006	2005	2004
Net cash (used) provided by			
Operating activities	($27,461)	($22,713)	($25,230)
Noncapital financing activities	43,036	41,548	40,682
Capital financing activities	(6,914)	(11,290)	(10,258)
Investing activities	(13,193)	(6,867)	(3,253)
Net increase (decrease) in cash	**($ 4,532)**	**$ 678**	**$ 1,941**

Operating activities

- Cash used by operating activities increased $4.8 million over the prior fiscal year compared to a $2.5 million decrease from 2004 to 2005.
- Student fees and auxiliary enterprises provided the largest inflow in cash for all fiscal years.
- Payments to employees (wages and benefits) and suppliers caused the largest outflow of cash for all fiscal years.

Noncapital financing activities

- Cash provided by noncapital financing activities increased $1.5 million over the prior fiscal year compared to a $0.9 million increase from 2004 to 2005.
- State appropriations provided the largest cash inflow in all fiscal years.

Capital financing activities

- Cash used for capital financing activities decreased $4.4 million in 2006 compared to a $1.1 million increase in 2005.
- Deposits with bond trustees generated the largest cash inflow for fiscal year 2006 and in 2005 as bond proceeds were held for the David L. Rice Library construction project.
- Purchase of capital assets generated the largest cash outflow in both 2006 and 2005 as funds were expended on the David L. Rice Library project.
- Principal paid on capital debt in 2005 used $5.7 million compared to $4.9 used in 2005.

Investing activities

- Cash used by investing activities increased $6.3 million during 2006 compared to a $3.6 million decrease in 2005.
- Proceeds from sales and maturities of investments increased $10.3 million in 2006 compared to a $0.8 decrease in 2005.
- Cash used for purchases of investments increased $15.9 million in 2006 compared to a $4.9 million increase in 2005.

Summary of Statement of Cash Flows

- For the year ended June 30, 2006, more cash was used for operating activities, more cash was provided by noncapital financing activities, less cash was used by capital financing activities, and more cash was used by investing activities. As a result of these activities, the University decreased its cash position by $4.5 million, ending the fiscal year with a cash balance of $17.4 million.

Factors Impacting Future Periods

The Indiana General Assembly granted USI $14.0 million in bonding authority only (no student fee replacement) for renovation and expansion of the University Center (UC), which will provide additional and/or renovated space for the bookstore, food service, student activities, and student organizations. The UC will expand into the former library building now that the new library is open, providing additional conference and meeting spaces and a range of student amenities. This project is currently in the planning stage. The State Budget Committee and the Indiana Commission for Higher Education must approve this project and the financing plan before USI can proceed further.

Bonding authorization was received by the 2005 legislature for completion of the lower level of the Education Center, expansion of the physical plant facility, and architectural planning and design for a new College of Business/General Classroom Building. Interim debt of $6.6 million will be issued during calendar year 2007 for these three interrelated projects.

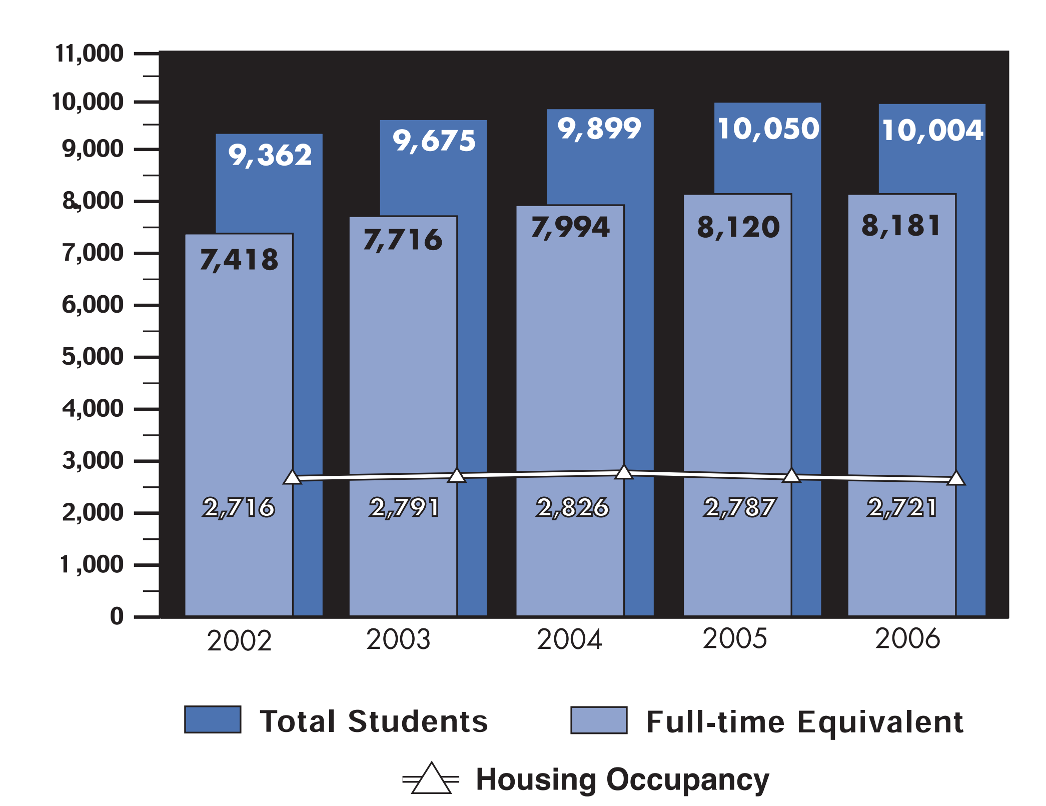
The University issued debt in June 2006 in the amount of $7.25 million, secured by a demand on student fees, to construct and equip an addition to the Recreation and Fitness Center. The University is seeking an additional $29.9 million in bonding authorization from the 2007 General Assembly to proceed with the construction of the College of Business/General Classroom Building.

The State of Indiana will make available during FY 2007 a portion of the twelfth-monthly appropriation payment that had been deferred indefinitely in FY 2005. The funds were reclassified from general operating support and are to be used for general repair and rehabilitation. USI will collect $1.2 million of the total receivable; $1.6 million remains deferred indefinitely.

Moody's Investors Service assigned an A2 rating to the University's debt obligations in November 2001. In July 2003, Moody's reviewed and rated the auxiliary system bonds as A3. Moody's staff visited the USI campus in May 2004 and reaffirmed these ratings.

The University's total enrollment for academic years ending 2002 through 2006 has increased 6.9 percent; full-time equivalents for the same period have increased 10.3 percent. Full-time students now represent 77 percent of the total student population. The University is maturing as a residential campus and its rate of growth is beginning to stabilize. Housing occupancy also has stabilized. The occupancy rate increased slightly (0.18 percent) over the same five-year period. The following graph illustrates the enrollment growth and housing occupancy for the five-year period, 2002 to 2006.

ENROLLMENT FOR YEAR ENDING JUNE 30



Statement of Net Assets

As of June 30	2006	2005 Reclass*
ASSETS		
Current Assets		
Cash and cash equivalents (Note 2)	$ 17,365,826	$ 21,897,420
Short-term investments (Note 2)	22,577,553	16,431,898
Accounts Receivable (Note 3)	5,623,008	4,207,024
Due from the State of Indiana (Note 4)	1,225,670	—
Inventories	1,828,716	1,794,797
Deposit with bond trustee	396,499	659,741
Other current assets	1,890,111	947,995
Total current assets	$ 55,907,383	$ 45,938,875
Noncurrent Assets		
Long-term investments (Note 2)	22,242,477	18,543,125
Deposit with bond trustee	1,751,332	20,889,816
Capital assets, net (Note 14 and 15)	137,446,496	131,078,182
Due from the State of Indiana (Note 4)	1,612,030	2,857,580
Other noncurrent assets	245,794	376,473
Total noncurrent assets	$ 163,298,129	$173,745,176
Total Assets	**$ 219,205,512**	**$219,684,051**
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	$ 1,106,591	$ 1,352,378
Accrued payroll, benefits, and deductions	5,906,618	5,538,293
Notes and bonds payable (Notes 5 and 6)	5,656,434	5,631,308
Debt interest payable	1,731,688	1,742,186
Other current liabilities	1,447,968	982,130
Total current liabilities	$ 15,849,299	$ 15,246,296
Noncurrent Liabilities		
Notes and bonds payable (Notes 5 and 6)	$116,044,487	$121,746,723
Unamortized bond premium	1,673,521	1,771,963
Compensated absences and termination benefits (Notes 7 and 8)	2,308,976	1,752,518
Other noncurrent liabilities	426,033	416,559
Total noncurrent liabilities	$120,453,017	$125,687,763
Total Liabilities	**$136,302,316**	**$140,934,058**
NET ASSETS		
Invested in capital assets, net of related debt	$ 24,386,113	$ 25,008,003
Restricted		
Expendable		
Scholarship, research, and other	40,191	9,970
Capital projects	220,577	204,525
Repairs and rehabilitation	1,225,670	—
Unrestricted	57,030,645	53,527,494
Total Net Assets	**$ 82,903,196**	**$ 78,749,992**

*See note 18 in the Notes to Financial Statements

Component Unit

University of Southern Indiana Foundation
Statement of Financial Position
June 30, 2006

Assets

Cash	$ 24,595
Accounts and interest receivable	125,487
Contributions receivable, net	4,172,695
Investments	49,172,402
Beneficial interest in perpetual trusts	3,325,119
Beneficial interest in Community Foundation	68,183
Real estate held for investment	359,147
Land	120,883
Buildings and leasehold improvements, net of accumulated depreciation; 2006 – $103,976; 2005 – $92,119	715,232
Property management deposits	3,000
Cash value of life insurance	146,273
Prepaid expenses	3,251
Total assets	$58,236,267

Liabilities and Net Assets

Liabilities	
Accounts payable	$ 89,424
Notes payable	164,988
Annuities payable	1,012,639
Deposits	2,000
Payable to related parties	819,076
Total liabilities	2,088,127
Net Assets	
Unrestricted	11,461,869
Temporarily restricted	20,865,337
Permanently restricted	23,820,934
Total net assets	56,148,140
Total liabilities and net assets	$58,236,267

Statement of Revenues, Expenses, and Changes in Net Assets

Fiscal Year Ended June 30	2006	2005 Reclass*
REVENUES		
Operating Revenues		
Student fees	$ 41,605,858	$ 39,352,480
Scholarship discounts and allowances	(9,196,258)	(9,373,805)
Federal grants and contracts	6,306,558	6,896,061
State and local grants and contracts	5,731,816	5,713,421
Non-governmental grants and contracts	639,909	715,408
Auxiliary enterprises	21,489,359	20,344,387
Room and board discounts and allowances	(555,423)	(560,192)
Other operating revenues	1,929,296	1,188,347
Total operating revenues	$ 67,951,115	$ 64,276,107
EXPENSES		
Operating Expenses		
Compensation:		
Salaries & Wages	$ 42,597,372	$ 41,167,363
Benefits (Notes 9, 10, and 11)	13,976,659	13,329,428
Student financial aid	5,653,167	5,560,843
Utilities	4,027,017	3,177,330
Supplies and other services	28,871,502	24,667,929
Depreciation	8,328,213	8,209,153
Total operating expenses	$103,453,930	$ 96,112,046
Operating income (loss)	$(35,502,815)	$(31,835,939)
NON-OPERATING REVENUES (EXPENSES)		
State appropriations	$ 40,951,727	$ 39,947,991
Gifts	1,948,189	1,642,281
Investment income (net of investment expense of $54,498 and $59,788 for 2006 and 2005)	2,436,686	2,060,802
Interest on capital asset-related debt	(5,547,903)	(5,595,691)
Bond issuance costs	(68,988)	(17,396)
Other non-operating revenues (expenses)	(130,862)	(200,173)
Net non-operating revenues	$ 39,588,849	$ 37,837,814
Income (Expense) before other revenues, expenses, gains, or losses	$ 4,086,037	$ 6,001,875
Capital grants and gifts	67,167	202,879
Total other revenues	67,167	202,879
Increases (Decreases) in net assets	$ 4,153,201	$ 6,204,754
NET ASSETS		
Net assets – beginning of year	$ 78,749,992	$ 72,545,237
Net assets – end of year	**$ 82,903,196**	**$ 78,749,992**

*See note 18 in the Notes to Financial Statements

Component Unit

University of Southern Indiana Foundation
Statement of Activities
Year Ended June 30, 2006

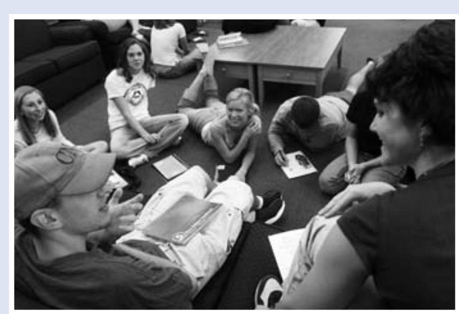
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES AND OTHER SUPPORT				
Contributions	$ 2,083,160	$ 3,177,736	$ 3,041,663	$ 8,302,559
Change in value of split-interest agreements	—	1,040,478	(24,599)	1,015,879
Rental income	47,763	—	—	47,763
Miscellaneous income	93,921	68,188	—	162,109
Reclassification of donor intent	894	(36,237)	35,343	0
Net assets released from restrictions	4,084,061	(4,084,061)	—	0
Total revenues and other support	6,309,799	166,104	3,052,407	9,528,310
EXPENSES				
Programs – University of Southern Indiana				
Scholarships and awards	1,053,888	—	—	1,053,888
Educational grants and academic enhancements	542,009	—	—	542,009
Athletic support	66,596	—	—	66,596
Other University support	584,109	—	—	584,109
Capital projects	32,302	—	—	32,302
Community outreach	54,620	—	—	54,620
Total program services	2,333,524	0	0	2,333,524
Management and general	383,023	—	—	383,023
Fundraising	184,455	—	—	184,455
Uncollectible pledge loss	—	39,441	—	39,441
Total expenses	2,901,002	39,441	0	2,940,443
OTHER CHANGES				
Investment income, net	1,056,091	2,814,749	37,815	3,908,655
Change in value of beneficial interest in trusts	—	1,824	232,832	234,656
Gain on sale of property	9,820	—	—	9,820
Gain on cash value of life insurance	—	11,358	—	11,358
Total other changes	1,065,911	2,827,931	270,647	4,164,489
Change in Net Assets	4,474,708	2,954,594	3,323,054	10,752,356
Net Assets, Beginning of Year	6,987,161	17,910,743	20,497,880	45,395,784
Net Assets, End of Year	$11,461,869	$ 20,865,337	$ 23,820,934	$ 56,148,140

Statement of Cash Flows

Fiscal Year Ended June 30	2006	2005
Cash Flows from Operating Activities		Reclass*
Tuition and fees	$ 32,316,761	$ 29,454,118
Grants and contracts	12,721,677	13,537,851
Payments to suppliers	(29,245,293)	(23,926,405)
Payments for utilities	(4,027,017)	(3,177,330)
Payments to employees	(41,944,671)	(42,542,357)
Payments for benefits	(13,704,577)	(11,596,913)
Payments for scholarships	(5,653,167)	(5,560,843)
Loans issued to students	(417,184)	(741,466)
Collection of loans to students	435,127	766,995
Auxiliary enterprises receipts	20,299,961	19,446,874
Sales and services of educational depts.	128,702	160,876
Other receipts (payments)	1,629,109	1,465,957
Net cash used by operating activities	**$(27,460,572)**	**$(22,712,643)**
Cash Flows from Noncapital Financing Activities		
State appropriations	$ 40,971,607	$ 39,864,146
Gifts and grants for other than capital purposes	1,948,189	1,642,281
Other non-operating receipts (payments)	115,941	41,477
Net cash provided by Noncapital financing activities	**$ 43,035,737**	**$ 41,547,904**
Cash Flows from Capital Financing Activities		
Proceeds from capital debt	$ 50,000	$ —
Capital grants and gifts	177,673	362,143
Bond financing costs	(199,850)	(217,569)
Purchase of capital assets	(14,696,527)	(14,816,961)
Principal paid on capital debt	(5,727,110)	(4,852,408)
Interest paid on capital debt and leases	(5,656,842)	(5,337,075)
Proceeds from deposit with trustee	19,138,484	13,572,115
Net cash used by capital financing activities	**$ (6,914,172)**	**$(11,289,755)**

*See Note 18 in the Notes to Financial Statements





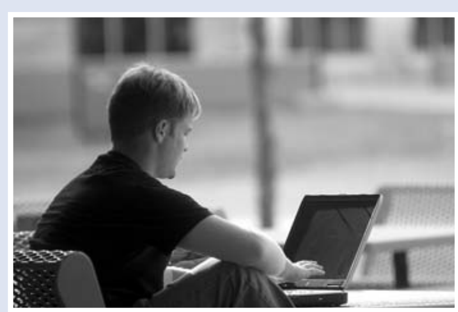
Statement of Cash Flows—continued

Fiscal Year Ended June 30	2006	2005
Cash Flows from Investing Activities		Reclass*
Proceeds from sales and maturities of investments	$ 23,849,862	$ 13,597,494
Interest on investments	2,023,577	2,069,491
Purchase of investments	(39,329,268)	(23,451,795)
Change in deposit with trustee	263,242	917,496
Net cash used by investing activities	**$(13,192,587)**	**$ (6,867,314)**
Net increase in cash	($ 4,531,594)	$ 678,192
Cash – beginning of year	21,897,420	21,219,228
Cash – end of year	**$ 17,365,826**	**$ 21,897,420**

Reconciliation of net operating revenues (expenses) to net cash provided (used) by operating activities:		
Operating income (loss)	$(35,502,812)	$(31,835,938)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	8,328,213	8,209,153
Provision for uncollectible accounts	11,896	66,125
Changes in assets and liabilities:		
Receivables	(1,427,880)	(383,395)
Inventories	(33,918)	70,999
Other assets	107,622	237,277
Accounts payable	28,452	579,833
Deferred revenue	443,981	(266,417)
Deposits held for others	9,474	447,653
Compensated absences	556,457	136,539
Loans to students	17,943	25,528
Net cash used by operating activities:	**$(27,460,572)**	**$(22,712,643)**

Noncash Transactions		
Unrealized (gain) loss on short-term investments	$ (56,359)	$ 107,760
Unrealized (gain) loss on long-term investments	690,759	(62,922)
Net Noncash transactions	**$ 634,400**	**$ 44,838**

*See Note 18 in the Notes to Financial Statements



Notes to Financial Statements

NOTE 1 – Summary of Significant Accounting Policies

The University of Southern Indiana was established in 1985 as described in the Indiana Code (IC 20-12-64-1 through IC 20-12-64-14). The University is managed by a nine-member board of trustees whose members are appointed by the governor. The board must include at least one alumnus, one resident of Vanderburgh County, and one full-time student in good standing. Each member must be a citizen of the United States and a resident of Indiana. Trustees serve staggered four-year terms with the exception of the student trustee, who serves a term of two years.

The University is a special-purpose governmental entity which has elected to report as a business-type activity using proprietary fund accounting, following standards set forth by the Governmental Accounting Standards Board (GASB). The financial reporting emphasizes the entity as a whole rather than the individual fund groups—unrestricted, designated, auxiliary, restricted, loans, agency, and plant funds—that comprise the whole.

The University also is considered a component unit of the State of Indiana. As such, the University is financially integrated with the State and depends on annual appropriations from the State to maintain quality service to students and to deliver quality programs to the tri-state area. The University also must receive authorization from the State before undertaking major capital projects. As a component unit, public higher education institutions, as a group, will be discreetly presented on the Comprehensive Annual Financial Report issued annually by the State of Indiana.

The University includes the University of Southern Indiana Foundation, Inc. as a component unit as defined by GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. The Foundation is a private nonprofit organization that reports under the standards of the Financial Accounting Standards Board (FASB). 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 report for these differences.

Accounting Methods and Policies

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting.

- Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.
- Restricted revenues and receivables resulting from non-exchange transactions are recognized when all applicable eligibility requirements are met. Resources received before eligibility requirements are met are recorded as deferred revenues.
- Revenue from major sources is susceptible to accrual if the amount is measurable.
- Internal service activity, referred to as chargeback income/expense, has been eliminated from the statement of activities to prevent the double-counting of expenses and the recognition of self-generated revenue.

Capital Assets Accounting Policies

The University established a capitalization threshold of $5,000 and a useful life greater than two years. The University records depreciation for all capital assets with the exception of land, historical sites, art, and museum objects. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset. The estimated useful life of each capital asset group is as follows:

- Building components (shell, roof, utilities, and internal) — 8-50 years
- Equipment — 5-15 years
- Land improvements — 15 years
- Infrastructure — 25 years
- Library materials — 10 years

Plant assets are removed from the records at the time of disposal. See Note 15 in the *Notes to Financial Statements* for current-year activity and accumulated depreciation on the various classes of assets.

Operating Revenues and Expenses

Operating revenues of the University consist of student fee income, operating grants and contracts, collections of loans to students, sales and services of educational activities, and auxiliary enterprise revenues. Operating expenses include payments to suppliers for goods and services, employee wages and benefits, and payments for scholarships.

Other Disclosures

The Statement of Cash Flows is presented using the direct method, and it identifies the sources and uses of both cash and cash equivalents during the fiscal year. Cash equivalents are investment instruments, typically certificates of deposits and repurchase agreements, which have an original maturity date of 90 days or less.

Investments are recognized in the accounting records at cost on the date of purchase. For financial statement presentation, they are reported at the market value in effect on June 30 of the current fiscal year. Unrealized gain or loss is included with interest income on the Statement of Revenues, Expenses, and Changes in Net Assets.

Prepaid expenses and inventories of materials and supplies are considered expenditures when used. The inventory on hand at the end of the fiscal year is valued using a perpetual system, and cost is determined using the first-in, first-out method of inventory accounting.

Inventories of retail merchandise are considered expenditures when purchased. The value of the inventory on hand at the end of the fiscal year is based on a physical count. Cost is determined using the retail or weighted average method of accounting.

The University prepares its financial statements according to the standards set by the Governmental Accounting Standards Board (GASB). To the best of our knowledge, USI has not adopted any Financial Accounting Standard Board (FASB) statements issued after November 30, 1989.

NOTE 2 – Deposit and Investment Risk Disclosures

It is the policy of the University of Southern Indiana to manage the investment portfolio of the University in a manner described in Section 30-4-3-3 of the Indiana Code. Authorized investments include obligations of the U.S. Treasury and U.S. government agencies, certificates of deposit, repurchase agreements, money market mutual funds, savings, and negotiable order-of-withdrawal accounts. Investments with Indiana institutions are limited to those banks, savings banks, and savings and loan institutions that provide deposit insurance for university funds under Indiana statutes by the Public Deposit Insurance Fund, in addition to the amounts insured by agencies of the United States government (FDIC/SAIF). Investments with non-Indiana institutions must be insured by agencies of the U.S. government to the maximum statutory amount of $100,000.

Deposits – At June 30, 2006, the bank balances of the University's operating demand deposit accounts were $8,765,081, of which $429,636 was covered by federal depository insurance. The remaining balance was insured by the Public Deposit Insurance Fund, which covers all public funds held in approved Indiana depositories. None of these funds was exposed to custodial credit risk, which is the risk that, in the event of the failure of a depository financial institution, the University will not be able to recover deposits or collateral securities that are in the possession of an outside party.

Investments – The University's investments at June 30, 2006, are identified in the table below:

INVESTMENTS

			Investment Maturities (in Years)		
Investment Type	Market Value	Type %	Less than 1 year	1–5 years	6–10 years
Money market accounts	$ 3,849,485	6%	$ 3,849,688		
Repurchase agreements	7,969,556	12%	7,969,556		
Certificates of deposit	35,068,128	52%	29,975,733	5,092,371	
U S Treasury and agency securities	20,298,483	30%	3,148,402	14,499,917	2,650,164
Totals	**$67,185,855**	100%	**$44,943,379**	**$19,592,287**	**$2,650,164**
Maturity %		100%	67%	29%	4%

Investment custodial credit risk – This is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Of the $67.2 million invested, $18.3 million in U.S. government securities are held in the name of the nominee bank and insured by policies of the financial institution or guarantees of the U.S. government. The remaining $2.0 million in U.S. government securities and $8.0 million in repurchase agreements are registered in the University's name and backed by the implicit guarantee of the U.S. government. All cash in the money market accounts and the certificates of deposit are insured by FDIC/SAID, the Public Deposit Insurance Fund, or collateral as required by federal regulations.

Interest rate risk – This is the risk that changes in interest rates will adversely affect the fair value of an investment. The University's investment policy does not address exposure to fair value losses arising from changes in interest rates, but the investment objective is to obtain the highest revenue while maintaining safety and insuring adequate liquidity for institutional needs. To that end, management maintains a larger percentage (67%) of investments in cash equivalents and short-term investments to be in a position to take advantage of the best rates in a timely fashion as well as sustaining adequate cash flow for operating needs.

Credit risk – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Of the total U.S. government securities listed in the table above, $18.8 million are invested in government-sponsored enterprises that are neither guaranteed or insured by the full faith and credit of the U.S. Treasury, and therefore have more credit risk than any direct obligation of the U.S. Treasury.

Concentration of credit risk – This is the risk of loss attributed to the magnitude of the University's investment in a single issuer. The University's policy limits the investments in any one Indiana institution to 25 percent of the total portfolio as valued at the end of the preceding month. At June 30, 2006, the University was in compliance with that policy.

Foreign currency risk – This is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The University does not have any global investments and, therefore, is not exposed to foreign currency risk.

NOTE 3 – Accounts Receivable

Accounts receivable are recorded net of allowance for uncollectible student fees of $251,055 and auxiliary services fees of $139,256. Prior-year allowances were $244,077 for student fee receivables and $134,338 for auxiliary services receivables. The accounts receivable balance for FY 2006 includes $2,583,636 in net student receivables and $3,039,372 in external receivables.

NOTE 4 – Due from State of Indiana

The twelfth payment of the 2005 fiscal year general operating appropriations was set aside last fiscal year until such time if and when the state assigned sufficient funds to pay some or all of the payment due. Senate Bill 345, enacted during the 2006 legislative session, appropriated funds from the State general fund to the budget agency to pay a portion of the payment due during the 2006-07 fiscal year. The funds are to be used for general repair and rehabilitation rather than general operating. When received, USI will treat the payment as reducing its claim to the amount budgeted for general operating appropriations for fiscal year ending 2005. For financial statement presentation, $1,225,670 has been reclassified from noncurrent to a current receivable and included as a restricted net asset. The balance of $1,612,030 remains a noncurrent unrestricted receivable.

NOTE 5 – Debt Related to Capital Assets

Notes Payable – In January 1997, the University issued two promissory notes totaling $2,127,318 to provide financing for an energy management performance contract. The note has a fixed interest rate of 5.68 percent, and the balance outstanding at June 30, 2006, is $137,374.

Bonds Payable – Outstanding bonds payable at June 30, 2006, total $121,563,547 and are identified in the following schedule of bonds and notes payable.

SCHEDULE OF BONDS AND NOTES PAYABLE

	Issue Date	Interest Rate	Current Year Rate	Maturity Date	Original Issue Amount	June 30, 2006 Principal Outstanding	Interest Outstanding	Total Outstanding
Student Fee Bonds								
Series D, Health Professions Center	1993	2.25% to 5.8%	5.35%	2015	$24,678,101	$3,163,548	$5,186,452	**$8,350,000**
Series F, Liberal Arts Center	1998	3.55% to 4.7%	4.50%	2013	15,280,000	7,920,000	1,647,235	**9,567,235**
Series G, Recreation & Fitness Center	1999	0% to 10%*	3.06%	2019	4,700,000	4,100,000	1,357,440	**5,457,440**
Series H, Science & Education Center	2001	3.5% to 5.0%	3.75%	2021	25,260,000	22,600,000	10,377,096	**32,977,096**
Series I, Library Construction	2004	2.0% to 5.375%	3.00%	2023	49,590,000	47,060,000	21,873,413	**68,933,413**
Auxiliary System Bonds								
Series 2001A, Student Housing Facilities	2001	4.0% to 5.0%	5.00%	2018	23,775,000	18,745,000	6,728,375	**24,473,375**
Series 2001B, Student Housing Facilities	2001	0% to 10%*	3.01%	2021	10,800,000	10,200,000	5,200,700	**15,400,700**
Series 2003, Student Housing Facilities	2003	2.5% to 4.5%	3.00%	2024	8,005,000	7,725,000	3,412,365	**11,137,365**
Notes Payable								
Energy Conservation Loan	1997	5.68%	5.68%	2007	2,127,318	137,374	3,873	**141,247**
Total					$164,215,419	$121,650,922	$55,786,949	$177,437,871

*These are variable interest bonds with daily, weekly, or term rates. The rates listed above are the average rates paid during the fiscal year. Not included in the table above is $50,000 drawn on a new bond issued June 22, 2006. See Note 6 for a full description of this bond.

The University of Southern Indiana Student Fee Bonds Series D of 1993, Series F of 1998, Series G of 1999, Series H of 2001, and Series I of 2004 are secured by a pledge of and first lien on student fees.

The University of Southern Indiana Auxiliary System Revenue Bonds, Series 2001A; the Auxiliary System Variable Rate Demand Revenue Bonds, Series 2001B; and Auxiliary System Revenue Bonds, Series 2003, are secured by a pledge of and parity first lien on the net income from the Auxiliary System (student housing, parking facilities, and dining services), any insurance proceeds, amounts held in the debt service funds or project funds, and investment income thereon.

Student fee bond Series G and Auxiliary System Revenue Bond Series 2001B are variable rate bonds currently bearing interest at daily, weekly, and term rates ranging between zero and 10 percent. The rates in effect at June 30, and the rates used to calculate the future debt service requirements, were 4.04 percent for Series G and 3.97 percent for Series 2001B. All the other bonds are term or serial with fixed annual rates as identified in the preceding table. Annual debt service requirements through maturity for bonds and notes payable are presented in the following chart:

ANNUAL DEBT SERVICE REQUIREMENTS

Fiscal Year	Bonds	Notes	Total Principal	Total Interest	Total Debt Service
2006-07	$5,519,060	$137,374	$5,656,434	$5,992,589	$11,649,023
2007-08	7,017,056		7,017,056	5,769,973	12,787,029
2008-09	7,273,768		7,273,768	5,504,798	12,778,566
2009-10	7,626,540		7,626,540	5,210,056	12,846,596
2010-11	7,130,364		7,130,364	4,887,709	12,018,073
2011-16	36,826,760		36,826,760	19,404,364	56,231,124
2016-21	34,925,000		34,925,000	8,015,461	42,940,461
2021-26	15,185,000		15,185,000	1,002,000	16,187,000
Total	**$ 121,513,548**	**$ 137,374**	**$ 121,650,922**	**$ 55,786,949**	**$ 177,437,871**

Not included in the table above is the principal and interest on a new bond issued June 22, 2006. See Note 6 for a full description of this bond.

NOTE 6 – 2006 Bond Issue

On June 22, 2006, the University issued a Junior Lien Student Fee Bond, Series 2006, in the amount of $7,250,000 to construct and equip an addition to the University's Recreation and Fitness Center. This issue carries a formula-driven variable interest rate based upon LIBOR that changes quarterly through December 31, 2007. During the variable rate period, the University is able to execute draws on the approved amount and incur interest expense only on the monies acquired. As of June 30, 2006, the University had drawn down $50,000 of the approved bond amount. Effective January 1, 2008, the interest rate will be fixed at 4.67 percent with a 20-year amortization based upon a swap agreement entered into with Old National Bank of Evansville

NOTE 7 – Compensated Absence Liability

Vacation leave and similar compensated absences (such as sick leave) based on past service are accrued as a liability as earned. The liability is measured at the salary rate in effect at the balance sheet date, and additional amounts are accrued for all required salary-related payments due a terminating or retiring employee. The salary-related payments subject to this accrual include the University's share of Social Security and Medicare taxes, as well as the University's contributions to a defined benefit pension plan.

The total cumulative compensated absence liability reflected in the Statement of Net Assets is $1,847,109 and $1,795,942 for June 30, 2006 and 2005 respectively. The current year change represents $23,673 increase in accrued vacation, $18,904 increase in sick leave liability; $3,257 increase in Social Security and Medicare taxes; and $5,334 increase in PERF contributions. During the fiscal year, $149,386 was paid out to terminating employees. Payout for terminating employees in fiscal year 2006-07 is expected to increase approximately 40 percent because of the number who will have reached the requisite retirement age and years of service. For that reason $209,117 of the total compensated absence liability has been classified as a current liability and the remaining $1,637,992 is classified as a non-current liability.

NOTE 8 – Termination Benefits Liability

The Governmental Accounting Standards Board (GASB) issued a new statement, Statement No. 47: *Accounting for Termination Benefits*, effective for fiscal year 2006. This statement requires the University to recognize a liability and an expense for voluntary termination benefits, such as early-retirement incentives, when the offer is accepted and the amount can be estimated. Members of USI's regular full-time faculty and administrative staff who have been employed in an eligible position prior to January 1, 1999, who have 15 or more consecutive years of service, and who are age 60 or older may receive early-retirement benefits upon request. These benefits include a lump-sum severance pay calculated as a percent of final-year salary based on length of service, not to exceed 25 percent, and continued contribution to retirement annuity contracts through the end of the fiscal year in which the retiree reaches age 66. Salaries are assumed to increase at a rate of 3.1 percent annually for purposes of calculating this liability.

USI has ten retirees currently receiving early-retirement benefits and twelve more who have arranged to begin receiving benefits within the next two years. The liability for these benefits total $896,273 at June 30, 2006. Of that amount, $225,269 is expected to be paid out during the following fiscal year, and the remaining $670,984 has been classified as noncurrent. This liability will change annually as more employees elect this benefit and as benefits for current retirees end.

NOTE 9 – Retirement Plans

Substantially all regular employees of the University are covered by either the *Teachers Insurance and Annuity Association-College Retirement Equities Fund Retirement Plan* (TIAA-CREF) or the *State of Indiana Public Employees Retirement Fund* (PERF). A small number of employees are covered under the *Indiana State Teachers Retirement Fund* (STRF). The TIAA-CREF plan is an IRC 403(b) defined contribution plan; PERF and STRF are defined benefit plans under IRC 401(a) and are state plans described in IC 5-10.2-2 and 5-10.3. The University contributed $4,231,911 to these programs in fiscal year 2005-06, which represents approximately 10 percent of the total University payroll and 12 percent of the benefit-eligible employees' payroll for the same period.

Faculty and Administrative Staff – Eligible employees may participate in the TIAA-CREF Retirement Plan upon the completion of one year of employment. Participation may begin sooner if the employee was a participant in TIAA-CREF, or another university-sponsored retirement plan, for at least one year prior to eligible employment at USI. The University contributes 11 percent of each participating employee's base appointment salary up to $10,800 and 15 percent of the base appointment salary above $10,800. The University contributed $3,619,103 to this plan for 477 participating employees for fiscal year ending June 30, 2006, and $3,544,534 for 475 participating employees for fiscal year ending June 30, 2005. The annual payroll for this group totaled $27,481,962 and $26,380,719 for fiscal years ending June 30, 2006 and 2005 respectively.

TIAA-CREF issues an annual financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by writing Teachers Insurance and Annuity Association-College Retirement Equities Fund, 730 3rd Avenue, New York, NY 10017-3206, or via its web site at *www.tiaa-cref.org*.

The University also contributes to STRF for three faculty and administrative employees who were grandfathered into the plan. STRF is a cost-sharing, multiple-employer public retirement program that provides retirement benefits to plan members and beneficiaries. The STRF retirement benefit consists of the pension provided by employer contributions, plus an annuity provided by the members' contributions, and the interest credited to the member's account. The University has elected to contribute both the employer and employee share of required contributions, currently 7 percent and 3 percent of employees' wages for employer and employee respectively. This has totaled $24,568 and $23,628 for fiscal years ending June 30, 2006 and 2005 respectively.

STRF issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by writing the State Teacher's Retirement Fund, 150 West Market Street, Suite 300, Indianapolis, IN 46204, or by calling 317/232-3860.

Clerical and Support Staff – Employees in eligible positions and who work at least half-time participate in PERF, a retirement program administered by an agency of the State of Indiana. PERF is an agent multiple-employer public employee retirement system, which provides retirement benefits to plan members and beneficiaries. Benefit provisions are established and/or amended by the State of Indiana. There are two parts to this plan: an annuity savings plan to which the University contributes 3 percent of the employee's salary, and a defined benefit agent multi-employer plan to which the University contributed 4.5 percent of the employee's salary this fiscal year. Employees are eligible to participate in this plan immediately upon employment and are fully vested in the defined benefit part of the plan after ten years of employment. The University contributed $588,240 for 337 employees participating in PERF during the 2005-06 fiscal year and $517,196 for 330 employees participating during 2004-05.

As of July 1, 1997, the latest year for which actuarial data are available, the total pension benefit obligation of the defined benefit plan was $5,695,466,720 for the State of Indiana and its municipalities. The University of Southern Indiana is one participant in this plan. Actuarial information related to the University's portion of the plan is disclosed in the following tables for three past fiscal years.

PERF–SCHEDULE OF FUNDING PROGRESS (dollars in thousands)

Fiscal Year Ending June 30	Actuarial Value of Plan Assets (A)	Actuarial Accrued Liability (B)	Unfunded (Overfunded) Accrued Liability (C)	Funded Ratio (A/B)	Actual Covered Payroll (D)	Unfunded (Overfunded) Liability as % of Payroll (C/D)
2003	$5,881	$5,262	($619)	111.8%	$7,305	(8.5%)
2004	4,571	4,300	(271)	106.3%	7,606	(3.6%)
2005	5,046	5,148	102	98.0%	7,843	1.3%

PERF–DEVELOPMENT OF NET PENSION OBLIGATION	2003	2004	2005
Annual Required contribution (ARC) *	$349,754	$251,893	$273,415
Interest on Net Pension Obligation @ 7.25%	(24,266)	(25,016)	(35,940)
Adjustments to ARC **	27,653	28,507	(40,956
Annual Pension Cost (APC)	353,141	255,384	196,519
Contributions made by USI ***	363,478	406,062	285,029
Decrease in Net Pension Obligation	(10,337)	(150,678)	(88,510)
Net Pension Obligation, Beginning of Year	(334,708)	(345,045)	(495,723)
Net Pension Obligation, End of Year	($345,045)	($495,723)	($584,233)

* Determined to be equal to the same percent of salary as the entire state of Indiana
** Net Pension Obligation at beginning of year divided by amortization factor of 12.1037
*** Percentage of APC contributed: 2003 at 102.9%; 2004 at 159.0%; and 2005 at 145.0%

The required contribution was determined as part of the actuarial valuation using the projected unit cost method. The actuarial assumptions included: (a) 7.25 percent investment rate of return (net of administrative services), (b) projected salary increases of five percent per year, and (c) two percent per year cost-of-living adjustments. Current-year information concerning funding and obligation was not available at the time of this report.

PERF issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. That report may be obtained by writing the Public Employees' Retirement Fund, Harrison Building, Suite 800, 143 West Market Street, Indianapolis, Indiana 46204, or by calling 317/232-4162.

NOTE 10 – Risk Management

The University is exposed to various risks of loss: torts; errors or omissions; theft, damage, or destruction of assets; job-related illness or injuries to employees; and natural disasters. The University manages these risks of loss through combinations of risk retention and commercial insurance. Property insurance for buildings and contents and other special form coverage is subject to a self-insured retention of $25,000 per occurrence. Earthquake and flood have a minimum deductible of $100,000 each loss. Educators' legal liability has a $50,000 deductible for each wrongful acts claim. General liability, commercial crime, workers' compensation, commercial auto, and medical malpractice, as well as life and disability insurance, are insured by commercial insurance subject to various deductibles. No liability exists at the balance sheet date for unpaid claims.

The University has three health care plans for full-time benefit-eligible employees and three plans for retirees. Two of the plans for employees and two for retirees are funded under a cost-plus arrangement whereby the University is billed for actual claims paid by the insurer on behalf of the covered participants plus an administrative fee. The majority of employees and retirees, 82% and 89% respectively, participate in the self-funded plan. For fiscal year ended on June 30, 2006, the University's contribution to these health care plans totaled $5,256,707 for 748 employees and 111 retirees. For the same period, employees and retirees made contributions totaling $1,329,069.

The University assumes the risk for claims exceeding the maximum expected cost but has mitigated the additional risk by purchasing specific and aggregate stop loss coverage at 125% of the expected claims liability. The University also has established a reserve to cover any unpaid liability beyond 125%. The liability for medical claims incurred but not reported at June 30, 2006, is based on an average monthly claim multiplied by the plan provider's average turnaround time from when claims are incurred to when claims are submitted to USI for payment. Changes in the balance of claims liabilities during the 2006 fiscal year are as follows:

Beginning liability, June 30, 2005	$ 960,730
Claims incurred	3,394,324
Claims paid	3,697,976
Ending liability, June 20, 2006	$ 657,078

NOTE 11 – Post-retirement Health Care Benefits

The University provides post-retirement medical, dental, and life insurance benefits, as authorized by the Board of Trustees, to all employees who retire from the University after attaining age 60 with at least ten years of service and to those retiring under the Rule of 85.

The University contributes 75 percent of the group plan premium for medical/dental coverage for the retirees (and dependents) who were active employees as of June 30, 1993. For retirees who were hired on or after July 1, 1993, the University will contribute to the group-plan premium on the following schedule:

Years of Service	University	Employee
10-14	25%	75%
15-19	50%	50%
20+	75%	25%

The University offers two group term life insurance plans: original and revised. Whichever plan the retiree participated in during active employment is the plan that continues during the period of retirement. Under the original plan, the coverage is reduced to 50 percent of the highest volume attained during employment, with a maximum of $20,000. Under the revised plan, the coverage is reduced to $5,000. The University pays the entire premium for both plans. Accidental Death and Dismemberment coverage terminates on the retirement date under both plans.

In the future, a VEBA Trust (see Note 12) will help defray the costs of providing post-retirement benefits. In fiscal year 2005-06, the University paid $473,442 to provide these benefits to 118 retirees and 59 spouses and dependents. This expense for fiscal year 2004-05 was $431,802 for 112 retirees and 53 spouses and dependents.

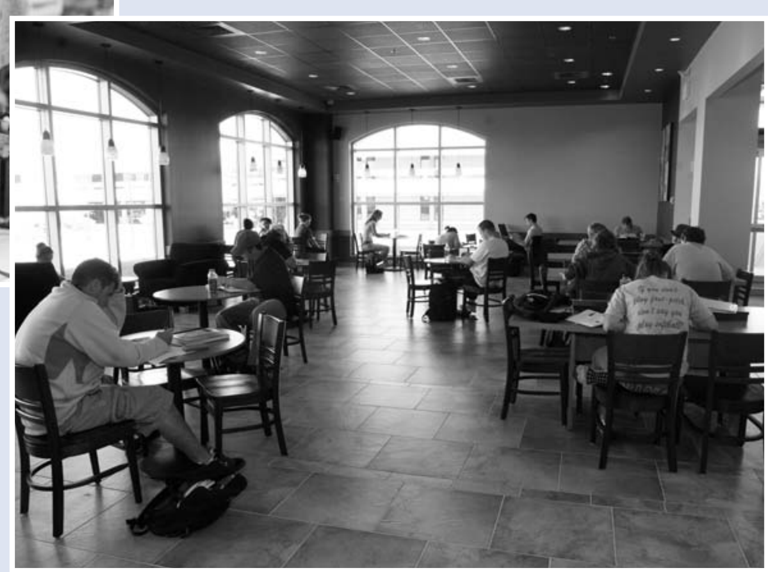
NOTE 12 – VEBA Trust

The University established a Voluntary Employees' Benefit Association (VEBA) trust for the purpose of providing retiree medical benefits for retired employees (excluding key employees as defined by §416 of the Internal Revenue Code) of USI and their dependents. The trust is funded from three sources: University contributions and reserves designated by the Board for this purpose, employee payroll deductions for post-retirement benefits, and retiree contributions for medical insurance premiums. Funds will accumulate in the trust for several years before any disbursements are made. The University does not anticipate that the trust will pay for all post-retirement benefits, but rather be used to reduce the increasing burden of such expenses on the current operating funds. A summary of the activity in the trust for the year ending June 30, 2006, is as follows:

VEBA TRUST

	MARKET
Fund balance at July 1, 2005	$4,658,079
Transfer from University reserves	500,000
Transfer of employee/employer contributions	148,079
Transfer of retiree/employer contributions	18,402
Reinvested net earnings	151,110
Net gain/(loss) on sales of trust investments	400,630
Less: Management fees and taxes	(26,448)
Net change in market value	(103,086)
Fund balance at June 30, 2006	**$5,746,766**

An actuarial valuation completed in 2005 projected the accumulated liability for future post-retirement health care for current retirees and active employees at approximately $31 million as of July 1, 2005. This liability is expected to increase each year through the foreseeable future. Funds that are placed into the trust cannot revert to the University under any circumstances; therefore, the financial statements of the University do not include the value of these assets.



NOTE 13 – Functional Expenditures

Operating expenses are reported by natural classification on the face of the Statement of Revenue, Expenses, and Changes in Net Assets. Some users of the financial statements have a need to know expenses by functional classification, either for trend analysis or for comparison to other higher education institutions. To satisfy these needs, the table below presents the University's 2005-06 operating expenses by functional classification.

FUNCTIONAL EXPENDITURES

FUNCTION	SALARIES and WAGES	BENEFITS	SCHOLAR-SHIPS	UTILITIES	SUPPLIES and OTHER SVCS	DEPRECIATION	2006 TOTAL	2005 TOTAL
Instruction	$22,026,280	$6,554,562			$1,494,043		$30,074,885	$28,929,118
Academic Support	4,340,549	1,428,551			3,491,651		9,260,751	9,280,790
Student Services	3,271,070	1,025,484			1,492,591		5,789,145	5,769,447
Institutional Support	6,020,683	2,618,918			3,702,073		12,341,675	10,643,332
Operation and Maintenance of Plant	2,466,652	890,608		3,280,027	5,179,643	5,976,469	17,793,400	13,968,432
Student Aid	202,027	308,869	5,331,182		3,570		5,845,648	5,569,078
Public Service	684,296	164,196			611,709		1,460,202	1,692,147
Research	85,592	19,301			212,847		317,740	167,402
Auxiliary Enterprises	3,500,223	966,169	321,985	746,990	12,683,375	2,351,744	20,570,485	19,780,627
TOTAL	**$42,597,372**	**$13,976,659**	**$5,653,167**	**$4,027,017**	**$28,871,502**	**$8,328,213**	**$103,453,930**	**$95,800,373**

NOTE 14 – Construction in Progress

Construction in progress at year end totals $23.6 million (see capital assets table below). Of that amount, $22.9 million represents expenditures on the new David L. Rice Library, which was completed and placed into operation during the summer of 2006. The estimated additional cost to complete is $225,000.

The University is reaching the end of a campus-wide, integrated administrative software system implementation. To date $1.7 million has been capitalized for equipment, training, and software for all components of the system except one. Still in progress at fiscal year end was the implementation of the student accounts receivable component, implementation of the document imaging and workflow software, and additional training and equipment. In addition to the $477,000 already reflected in construction in progress, another $275,000 is expected to be expended to complete the project.

The University has begun preliminary planning and design work on several projects that make up the remaining $213,000 in construction in progress. These projects include expansion of the campus Recreation and Fitness Center, expansion and renovation of a student housing recreation building; interior and exterior completion and furnishing of the lower level of a classroom building; construction of a new distribution center, a new classroom building, an art gallery, and a road that will loop around the campus; and landscape and hardscape development of the central campus quadrangle. These projects will continue for at least three years and are estimated to cost approximately $48.8 million to complete.

NOTE 15 – Capital Assets, net of Accumulated Depreciation

The table below displays the increase in total capital assets from $206.8 million at July 1, 2005, to $220.4 million on June 30, 2006.

CAPITAL ASSETS, NET OF ACCUMULATED DEPRECIATION

CAPITAL ASSETS	Balance June 30, 2005	Additions	Deletions	Balance June 30, 2006	Accumulated Depreciation	Net Capital Assets
Land	$ 4,055,134		$36,200	$4,018,934		$ 4,018,934
Land Improvements	4,967,250	747,685		5,714,935	3,043,553	2,671,382
Infrastructure	3,648,793			3,648,793	1,492,410	2,156,383
Educational Buildings	101,065,353			101,065,353	40,766,651	60,298,702
Auxiliary Buildings	59,437,172		133,661	59,303,511	23,388,193	35,915,318
Equipment	10,650,652	3,928,945	2,276,502	12,303,095	7,818,275	4,484,820
Library Materials	8,461,551	641,617	2,207	9,100,961	6,436,461	2,664,500
Museum Exhibits	1,052,220		6,185	1,046,035		1,046,035
Art Collection	—	582,620		582,620		582,620
Construction in Progress	13,432,248	11,690,691	1,515,137	23,607,802		23,607,802
Totals	**$206,770,373**	**$ 17,591,557**	**$ 3,969,891**	**$220,392,039**	**$ 82,945,543**	**$137,446,496**

The University's fine art collection, valued conservatively at nearly $600,000, was added to the capitalized assets this fiscal year. Gross capital assets, less accumulated depreciation of $82.9 million, equal net capital assets of $137.5 million at June 30, 2006.

NOTE 16 – Interrelated Organization

The University of Southern Indiana-New Harmony Foundation, Inc. was formed in 1986 to assist in supporting and developing Historic New Harmony, an auxiliary enterprise of USI which operates in New Harmony, an historic town in southwestern Indiana thirty miles from campus. During fiscal year 2005-06, the Foundation contributed $74,267 to Historic New Harmony Operations. At June 30, 2006, the stated value of USI-NH Foundation's net assets was $433,041. These assets are not included in the financial statements of the University.

NOTE 17 – Component Units

The University of Southern Indiana Foundation is a legally separate, tax-exempt entity formed in 1969 to provide support for the University of Southern Indiana, its faculty and students, and to promote educational, scientific, charitable and related activities and programs exclusively for the benefit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. During the year ended June 30, 2006, the USI Foundation distributed $2,064,886 in direct and indirect support to the University for both restricted and unrestricted purposes.

The majority of the resources that the Foundation holds and invests, and the income generated by those resources, are restricted to the activities of the University by the donors. Because these resources can only be used by or for the benefit of the University, the USI Foundation is considered a component unit of the University, and its audited financial statements are discreetly presented in the University's financial statements.

The USI Foundation maintains it accounts in accordance with the principles and practices of fund accounting. Resources are classified in accordance with activities or objectives specified by donors. The Statement of Activities displays revenues, expenses, and changes in net assets in the following classifications:

Permanently Restricted – Contributions are subject to donor-imposed stipulations. Net assets are to be maintained by the Foundation in perpetuity.

Temporarily Restricted – Contributions are subject to donor-imposed stipulations which are met by actions of the Foundation and/or the passage of time. Net assets are released from restrictions when expenses are incurred which satisfy the donor-restricted purposes or by the occurrence of other events specified by donors.

Unrestricted – Contributions and net assets are not subject to donor-imposed restrictions. Unrestricted assets support the operations of the Foundation, or they may be internally designated to support specific programs.

Complete financial statements, including explanatory notes, for the USI Foundation can be obtained from the Business Affairs office at 8600 University Boulevard, Evansville, Indiana 47712.

NOTE 18 – Reclassify 2005 Financial Information

So that the 2005 financial information is comparable and consistent with the 2006 financial statement presentation, some reclassifications and corrections were needed on the Statement of Net Assets (SNA), the Statement of Revenues, Expenses, and Change in Net Assets (SRECNA), and on the Statement of Cash Flows.

- On the SNA, a major portion of the amount on deposit with trustee was reclassified from current assets to non-current assets. A determination was made that the non-current classification was required because the funds were restricted by the bond issue to be used for construction and debt service of a capital project.
- Both student fees and auxiliary enterprise income on the SRECNA were incorrectly presented net of bad debts in 2005. The bad debts are now included in supplies and other services expenses, and gross revenue amounts are reported for both student fees and auxiliary enterprises.
- The repair and rehabilitation appropriation was presented as capital appropriations in 2005. This has been properly reclassified to non-operating state appropriations revenue.
- The above corrections and reclassifications necessitated changes to the Statement of Cash Flows as appropriate.

There was no change in total revenues, expenses, or net assets as a result of these reclassifications and corrections.

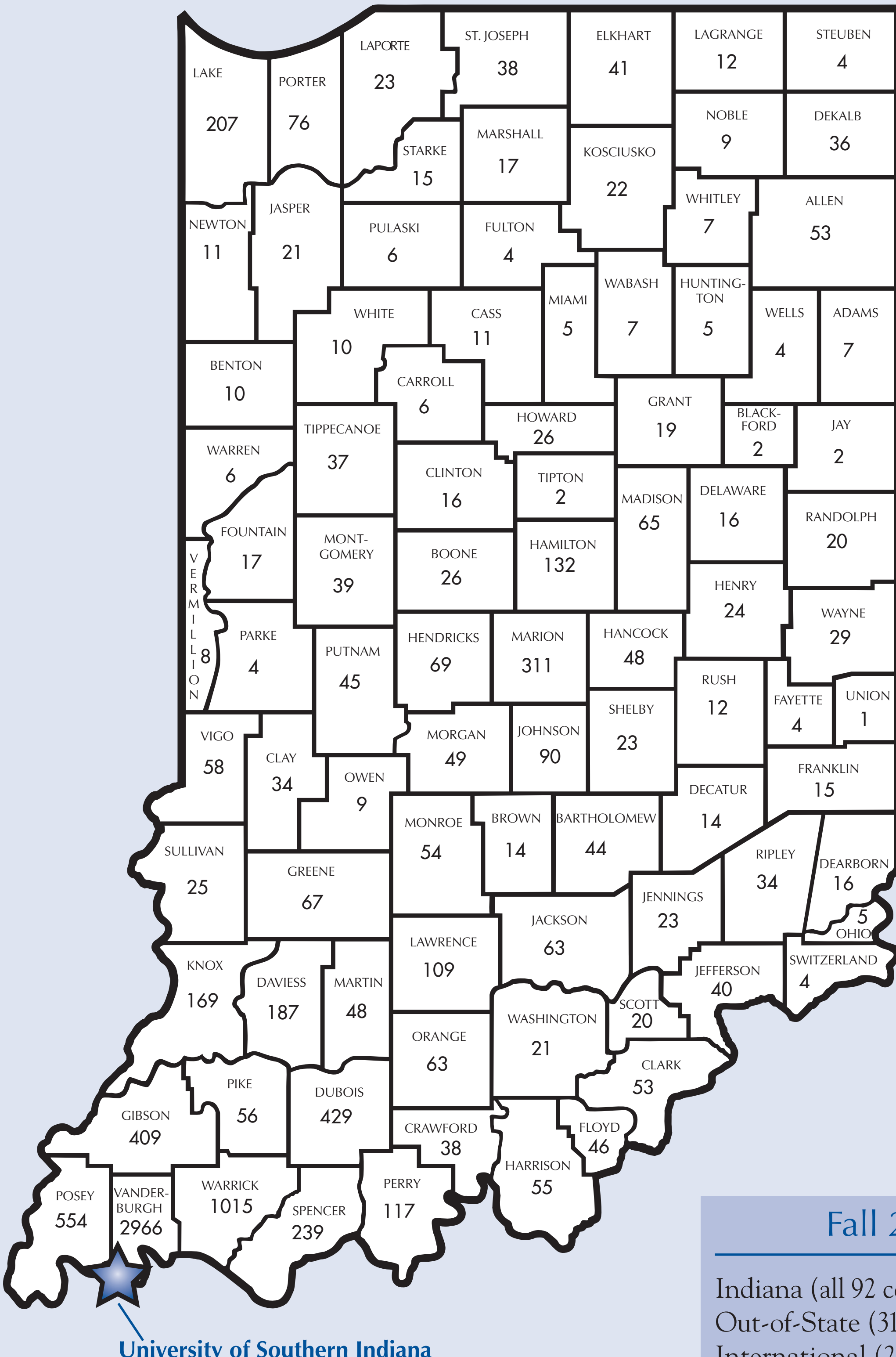
Supplementary Information

FIVE-YEAR COMPARATIVE DATA

	2005-06	2004-05	2003-04	2002-03	2001-02
Enrollment (Fall Semester)					
Total Students	10,004	10,050	9,899	9,675	9,362
Undergraduates	9,252	9,217	9,154	8,988	8,783
Women	6,106	6,120	6,028	5,898	5,660
African American	418	424	400	371	328
Other Minority	171	151	151	135	136
International	74	83	73	67	64
Age 25 plus	2,262	2,358	2,300	2,243	2,201
Indiana Residents	8,921	8,946	8,778	8,536	8,335
Full-time Equivalent	8,181	8,120	7,994	7,716	7,418
Degrees Granted (Academic Year)					
Master	227	229	164	154	152
Baccalaureate	1,114	1,151	1,096	1,010	1,049
Associate	163	159	150	165	155
Faculty (Fall Semester)					
Full-time	296	284	278	276	264
Percentage Tenured	39	41	41	44	45
Part-time (FTE)	145	150	150	142	137
FTE Students/FTE Faculty	18.6	18.7	18.7	18.5	18.5

This information is presented as additional data and is not subject to the audit opinion expressed by the Indiana State Board of Accounts.

Home Counties of USI Students (Fall 2005)



Fall 2005

Indiana (all 92 counties)	8,921
Out-of-State (31 states)	1,009
International (29 countries)	74
Total Enrollment	**10,004**

It is the policy of the University of Southern Indiana to be in full compliance with all federal and state non-discrimination and Equal Opportunity laws, orders, and regulations relating to race, sex, religion, disability, age, national origin, sexual orientation, or status as a disabled veteran or veteran of the Vietnam era. Questions or concerns should be directed to the Affirmative Action Officer, USI Human Resources Department, University of Southern Indiana, 8600 University Boulevard, Evansville, Indiana 47712.

The Disabled Student Services program is provided to help students overcome or compensate for obstacles related to a physical, emotional, or learning disability. Resources include a reader/taping service, test accommodations service, tutors, sign language interpreter service, notetaker supplies, literature, and personal assistance. Program staff work with all offices to insure that reasonable and approriate accommodations are provided to students with disabilities. A detailed brochure is available from the Counseling Center. Students requesting services must register with the Disabled Student Services program in the Counseling Center at least 60 days prior to date needed.

P06-5238

University of Southern Indiana
8600 University Boulevard
Evansville, Indiana 47712