AGENDA

JOINT MEETING
FINANCE/AUDIT AND CONSTRUCTION COMMITTEES

UNIVERSITY OF SOUTHERN INDIANA
BOARD OF TRUSTEES

November 4, 2004

(CONSTRUCTION)

1. **REPORT OF CHANGE ORDERS ISSUED BY THE VICE PRESIDENT FOR BUSINESS AFFAIRS**
(Attachment A)

(FINANCE/AUDIT)

2. **REVIEW OF RECOMMENDATION OF REQUEST FOR GENERAL REPAIR AND REHABILITATION FUNDS**

The following request will be reviewed and is recommended for approval by the Board of Trustees at its meeting on November 4, 2004.

The request authorizes President Hoops to request approval of the Indiana Commission for Higher Education, the State Budget Committee, and the Governor of the State of Indiana for appropriation of general repair and rehabilitation funds for the following project:

Emergency repairs and safety improvements to Murphy Auditorium in New Harmony	$112,000

3. **REPORT ON VEBA (VOLUNTARY EMPLOYEES' BENEFIT ASSOCIATION) TRUST ACCOUNTS**

An update and overview of the VEBA Trust Accounts will be presented.

4. **APPROVAL OF RECOMMENDATION TO TRANSFER ADDITIONAL FUNDS TO THE VEBA (VOLUNTARY EMPLOYEES' BENEFIT ASSOCIATION) TRUST ACCOUNTS**

The VEBA Trust Investment Policy requires the approval of the Board of Trustees for a transfer of additional funds to the VEBA Trust Accounts.

Approval of a recommendation to the Board of Trustees to transfer $250,000 to the VEBA Trust sub account at Fifth Third Bank is recommended

5. **APPROVAL OF BUDGET APPROPRIATIONS, ADJUSTMENTS, AND TRANSFERS**

Approval of the budget appropriations, adjustments, and transfers in Attachment B is recommended.

6. **REVIEW OF 2004 AUDITED FINANCIAL STATEMENTS**

A report will be presented on the 2004 audited financial statements (Attachment C)

Report to University of Southern Indiana Board of Trustees
November 4, 2004

Change Orders Issued by the Vice President for Business Affairs

On September 6, 2001, the Board of Trustees adopted a procedure related to changes in construction contracts which included the following: "Change orders up to $25,000 may be issued by the Vice President for Business Affairs and reported to the Board of Trustees at its next meeting." Consistent with that policy, the following change orders have been issued.

PROJECT: David L. Rice Library

	Description	Contractor	Amount
CO-GC01	Construct concrete walk along project site fence and University Boulevard to improve access to campus and pedestrian safety from residence halls and parking lots	Deig Brothers Construction Co., Inc.	$10,098

PROJECT: Science and Education Center

	Description	Contractor	Amount
CO 4 - Contract 18	Adjustment to the contract amount to settle dispute of amount deducted on Change Order No. 3 for drywall repairs and use of scaffold	Premier Electric Co., Inc.	$14,172

PROJECT: Henry W. and Betty Jane Ruston Hall

	Description	Contractor	Amount
CO-E08	Provide and install additional voice and data outlets in custodial and mechanical rooms	J.E. Shekell Refrigeration, Heating, and Air Conditioning Co., Inc.	$3,087

BUDGET APPROPRIATIONS, ADJUSTMENTS, AND TRANSFERS

1. Additional Appropriation of Income

From:	Unappropriated Current Operating Funds		
To:	1-10700	School of Business	
		Personal Services	7,500
From:	Unappropriated Auxiliary Funds		
To:	3-30200	University Center	
		Supplies and Expense	1,138
From:	Unappropriated Restricted Funds		
To:	4-45085	IU School of Medicine – Research – Professor Stith	
		Supplies and Expense	10,088
To:	4-45086	IU School of Medicine – Research – Professor Aldrich	
		Supplies and Expense	24,735
To:	4-45088	IU School of Medicine – Lab start-up costs	
		Supplies and Expense	10,532
To:	4-45090	IU School of Medicine – General Account	
		Personal Services	284,040
		Supplies and Expense	104,541
To:	4-45093	IU School of Medicine – Research – Professor Seetharamaiah	
		Supplies and Expense	21,483
To:	4-45100	IU School of Medicine – Research – Professor Seetharamaiah	
		Supplies and Expense	15,982
To:	4-45104	IU School of Medicine – Faculty Development	
		Supplies and Expense	2,600
To:	4-45105	IU School of Medicine – Research – Professor Anthony	
		Supplies and Expense	40,000
To:	4-45106	IU School of Medicine – Research – Professor Tunnicliff	
		Supplies and Expense	20,315
To:	4-45107	IU School of Medicine – Research – Professor Raess	
		Supplies and Expense	8,000
To:	4-46270	National Science Foundation – Research – Professor Deloney-Marino	
		Supplies and Expense	20,000
To:	4-46287	Indiana Arts Council New Harmony Gallery	
		Supplies and Expense	3,619
To:	4-46288	Indiana Arts Council Ropewalk Writers Series	
		Supplies and Expense	3,781

To:	4-46619	Indiana Campus Compact – Research – Professor Valadares	
		Supplies and Expense	1,825
To:	4-46620	Indiana Campus Compact – Research – Professor Gilbert	
		Supplies and Expense	1,871
To:	4-46709	Perkins Option Program 2004-2005	
		Personal Services	15,071
		Supplies and Expense	6,385

2. Transfer of Funds

From:	3-33400	Residence Life Activity Fund	
To:	2-20110	Student Activities	700

3. Transfer and Appropriation of Funds

From:	2-20050	Student Services Operations	
To:	2-20120	Multicultural Center	
		Supplies and Expense	1,150
From:	2-20120	Multicultural Center	
To:	2-20110	Student Activities	
		Supplies and Expense	100
From:	2-21200	Technology Fee	
To:	1-13300	Instructional Technology Services	
		Capital Outlay	100,000
From:	6-60060	New Harmony Project Reserve	
To:	6-60170	Schnee/Ribeyre/Elliott House	
		Supplies and Expense/Capital	150,000
From:	6-60100	Special Projects	
To:	6-60175	Master Plan	50,000

UNIVERSITY OF SOUTHERN INDIANA

FINANCIAL STATEMENTS

FOR FISCAL YEAR ENDING JUNE 30, 2004

Prepared by

Diana M. Biggs, CPA, CIA
Director of Internal Audit

University of Southern Indiana
Statement of Cash Flows - cont'd

Fiscal Year Ended June 30	2004	2003
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	$ 14,452,135	$ 8,548,312
Interest on investments	878,096	1,029,397
Purchase of investments	(18,583,654)	(16,048,760)
Net cash used by investing activities	**$ (3,253,423)**	**$ (6,471,051)**
Net increase in cash	$ 1,941,122	$ 2,879,275
Cash - beginning of year	19,278,106	16,398,831
Cash - end of year	**$ 21,219,228**	**$ 19,278,106**

Reconciliation of net operating revenues (expenses) to net cash provided (used) by operating activities:		
Operating income (loss)	$ (31,034,625)	$ (27,175,620)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	6,489,209	6,562,814
Provision for uncollectable accounts	(24,087)	42,169
Changes in assets and liabilities:		
Receivables	(656,496)	(278,332)
Inventories	(279,737)	(211,867)
Other assets	(397,400)	98,583
Accounts payable	340,811	470,569
Deferred revenue	152,074	(140,202)
Deposits held for others (Auxiliary housing, Eagle card)	(22,449)	(94,953)
Compensated absences	135,269	99,535
Loans to students and employees	67,141	28,029
Net cash used by operating activities:	**$ (25,230,290)**	**$ (20,599,275)**

Noncash Transactions		
Unrealized (gain)/loss on investments	$ 410,140	$ (219,729)
Long-term investments	(410,140)	219,729
Acounting loss on early retirement of debt	(342,776)	
Interest on capital asset-related debt	342,776	

University of Southern Indiana
Fiscal Year Ended June 30, 2004

Management's Discussion and Analysis

This portion of the University of Southern Indiana annual financial report presents a discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2004 with comparative data for the period ended June 30, 2003. This discussion has been prepared by management and should be read in conjunction with the financial statements, the summary of significant accounting policies, and the notes to the financial statements.

The discussion and analysis is designed to focus on current activities, resulting changes, and current 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 summary of significant accounting policies, 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 noncurrent (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)	**2004**	**2003**	**2002**
Current Assets	$78,565	$37,791	$46,879
Noncurrent Assets:			
Capital assets, net of depreciation	124,470	121,509	112,334
Other noncurrent	14,099	11,617	7,770
Total Assets	$217,134	$170,917	$166,983
Current Liabilities	$13,387	$12,662	$11,270
Noncurrent Liabilities	131,202	91,299	96,217
Total Liabilities	$144,589	$103,961	$107,487
Net Assets:			
Invested in capital assets, net of debt	$25,517	$25,504	$12,926
Restricted - expendable	6,064	4,588	17,475
Unrestricted	40,964	36,864	29,095
Total Net Assets	$72,545	$66,956	$59,496

Assets

Current assets at June 30, 2004, consist predominantly of cash on deposit with bond trustees, cash and cash equivalents, and short-term investments. Also included are accounts receivables and inventories. Noncurrent assets include capital assets net of depreciation and long-term investments. Both current and noncurrent assets include lesser-valued resources that are grouped together and listed under the term O*ther*.

Total assets increased $46.2 million (27.2%) in 2004 compared to a $3.9 million (2.4%) increase in 2003. This increase is explained by the following fiscal year events:

- The proceeds from two bond issues were deposited into project and debt service funds with bond trustees. At fiscal year end, $36 million remained on deposit with the trustee. Only $349.5 thousand was on deposit with trustees at the end of the previous fiscal year.
- Cash and cash equivalents, short-term investments, and long-term investments increased $5.7 million dollars, or 13.9%. The prior fiscal year increase was $10.6 million, or 35.3%.
- Accounts receivable increased $800 thousand, or 13.7%. Both 2004 and 2003 include a receivable from the State of Indiana for the twelfth-month appropriation payment of $2.8 million and $2.7 million respectively.
- Other noncurrent assets include a capital projects receivable from the USI Foundation in the amount of $490 thousand for scientific equipment in the Pott School of Engineering.

Liabilities

Current liabilities at June 30, 2004, are primarily composed of accrued payroll and related deductions and the current portion of bonds payable. Also included are accounts payable, debt interest payable, and miscellaneous other liabilities. Noncurrent liabilities are predominately bonds payable. Also included are compensated absences, an unamortized bond premium, and miscellaneous other long-term liabilities. Total liabilities increased $40.6 million (39.1%) in 2004 compared to a decrease of $3.5 million in 2003. Activities during the year that influenced this change include the following:

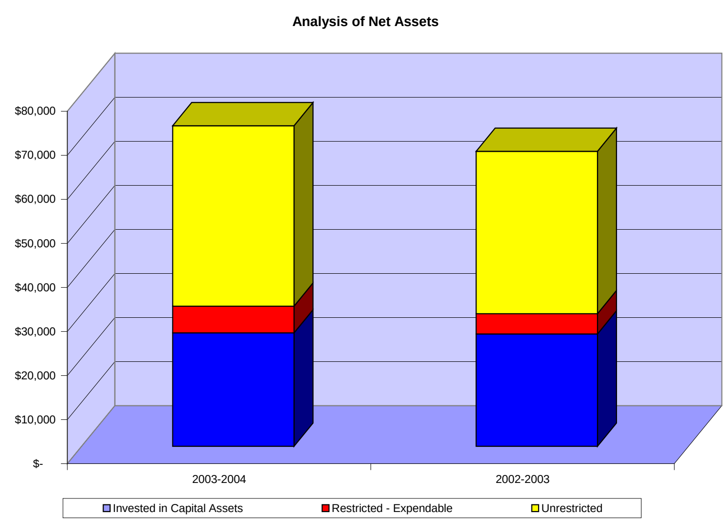
- The total liability for compensated absences increased $135.3 thousand compared to $99.5 thousand increase in the prior fiscal year. Percentage increases for the fiscal years ending 2004 and 2003 are 8.9% and 7.0% respectively.
- Accrued payroll and related deductions increased from $4.3 million to $4.8 million. This is an 11.8% increase compared to a 5.2% increase in the previous fiscal year.
- Two new bond issues, Auxiliary System 2003 and Series I of 2004, caused long-term bonds payable to increase $38 million, or 42.9%.
- Related to the bond issues, debt interest payable increased $104 thousand in 2004 compared to a $13.5 thousand decrease the year before.
- An unamortized bond premium on the Series I issue added $1.97 million to total liabilities. The premium will be amortized over the life of the bond.

Net Assets

Net assets at June 30, 2004, were $5.6 million greater than on June 30, 2003. Expendable restricted assets changed most notably for capital projects funds. Capital project funds increased $1.6 million as bond proceeds were received and on hand as the construction of the new library building began.

Unrestricted assets increased $4.1 million in fiscal year 2004. This increase is 47.2% less than the prior year increase of $7.8 million. Smaller returns on investment income -- plus unrealized losses on investments this year compared to unrealized gains last year -- are largely responsible for the modest increase in 2004 over 2003. Reserves were maintained or increased at year end. Of the nearly $41 million in unrestricted net assets, $22.8 million have been internally designated as follows:

- $2.0 million reserve for replacement of administrative software system
- $2.5 million reserve for working capital
- $3.3 million reserve for outstanding encumbrances
- $6.7 million reserve for equipment and facilities maintenance and replacement
- $5.1 million reserve for auxiliary system operations
- $5.6 million reserve for University Center renovation and expansion



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, nonoperating revenues, and capital funding have had on the net assets of the University.

Activities are reported as either operating or nonoperating. 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 bad debts and discounts and allowances for scholarships, room, and board. The 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 nonoperating revenues. This creates large operating deficits for public universities which rely heavily on state funding to meet their missions and goals. A more important measure of fiscal year net income is the amount shown on the statement as "Income/(expenses) before other revenues, expenses, gains or losses".

Year ended June 30 (in thousands)	**2004**	**2003**	**2002**
Total operating revenues	$59,919	$53,965	$47,054
Total operating expenses	(90,954)	(81,141)	(76,954)
Operating losses	(31,035)	(27,176)	(29,901)
Net nonoperating revenues/(expenses)	35,533	34,179	33,407
Income/(expenses) before other revenues, expenses, gains or losses	4,499	7,003	3,506
Capital gifts, grants and appropriations	1,091	456	175
Special item – change in accounting policy	0	0	(3,595)
Increase (decrease) in net assets	$5,590	$7,459	$86

*Percentage increase in net assets excluding special items.

Revenues

Operating revenues increased $5.9 million (11.0%) this fiscal year compared to $6.9 million (14.7%) increase in the previous fiscal year. All major components of operating revenue increased but some at a smaller percentage than the prior year.

- Net student fee revenue increased from $24.1 million in 2003 to $28.2 million in 2004. This 17.1% increase was due to increases in enrollment growth of 2.3% and student fee rates of 8.4%. The previous year's increase of 16.2% reflected a 3.3% enrollment growth and 9.9% student fee rate increase.
- Grants and contracts from federal, state, and nongovernmental agencies increased 8.3%, or $0.9 million. The University received 55% from federal agencies, 41% from state agencies, and 4% from nongovernmental entities. Of the total grant revenue, 86.5% provided financial aid to the University's students.

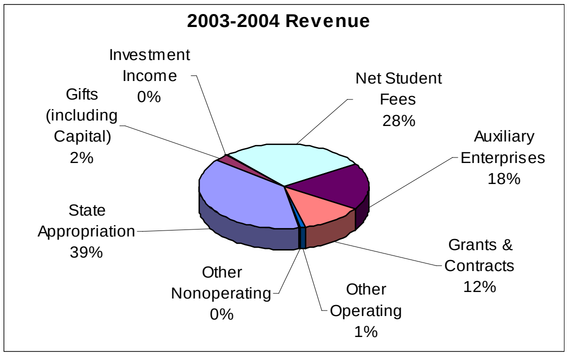
- Sales and services of educational departments decreased 24.6% in fiscal year 2004 compared to an increase of 26.6% in 2003. This income represents revenue that is a byproduct of the University's primary mission of educating students. It includes income from health professional practice units, video and information technology practice units, student publications, student theatre and choir, printing services, and other academic-related activities. Advances in technology have encouraged many users to turn to the Internet for research and publication. As a result, income from printing services and library services dropped significantly, which accounted for much of the current year decrease in educational related sales.
- Auxiliary enterprises revenue, after bad debt and room and board allowances, increased $1.1 million, or 6.1%, in 2004. The prior fiscal year increased $2.4 million, or 16.1%. Causes for this year's tempered revenue increase can be attributed to a less aggressive enrollment growth and a smaller increase in the number of residents in student housing facilities. O'Bannon Hall, a student residence facility, opened in the fall of 2002 causing revenue from that source to increase substantially in the prior fiscal year.
- Other operating income includes contracted services, facilities rentals, and miscellaneous sales and services. This revenue decreased $70.1 thousand, or 7.6%, in fiscal year 2004 compared to an increase of 30.2% in fiscal year 2003. In 2003, the University received a $100 thousand contract to connect off-site student housing facilities to the campus telephone and network system so these students could enjoy the same services as those students living on campus.

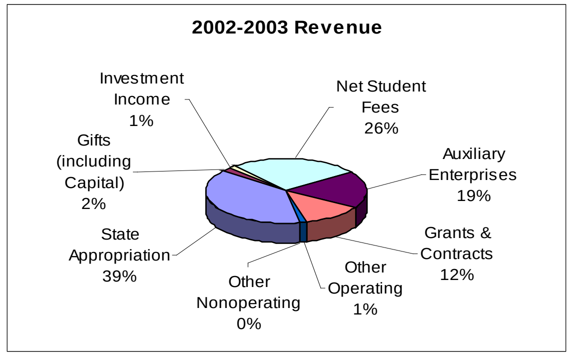
Nonoperating revenues experienced a net increase of 7.5% for the fiscal year ended June 30, 2004 compared to a .4% decrease in the prior fiscal year:

- State appropriations for general operating support increased 9.6%, from $35.6 million in 2003 to $39.0 million in 2004.
- Gift revenues increased at about the same rate as the year before: 8.3% and 8.7% for 2004 and 2003 respectively. Of the $1.5 million gifts received in 2004, 99.8% came from the USI Foundation for scholarships, educational grants, academic enhancements, athletics, and other university support.
- Investment income decreased 62.5%, from $1.2 million to $0.5 million, this fiscal year. Investment income decreased 21.9% in the prior fiscal year due to lower interest rates. Older investments, bearing higher interest rates, matured and were replaced by instruments earning a much lower return. Both lower rates and unrealized loss on investments were the primary cause of the decrease in 2004.
- Other nonoperating revenues include proceeds from dissolution of a small capital trust, an insurance claim received for water leak damage in a classroom building, payment from Sodexho for capital improvements, and the sale of call rights on the University Center bond.

Other revenues include capital appropriations and capital gifts and grants. The state cancelled capital appropriations for 2003, but reinstated them again in 2004, awarding the University $100,103. Capital gifts of $990,700 were received from the USI Foundation for purchase of classroom equipment and major renovation projects.

Total revenues (operating, nonoperating, and other) increased $9.4 million in fiscal year 2004 compared to a $7.1 million increase in 2003. The graph below shows the composition of the University's revenue for the fiscal years ending June 30, 2004 and 2003:





Expenses

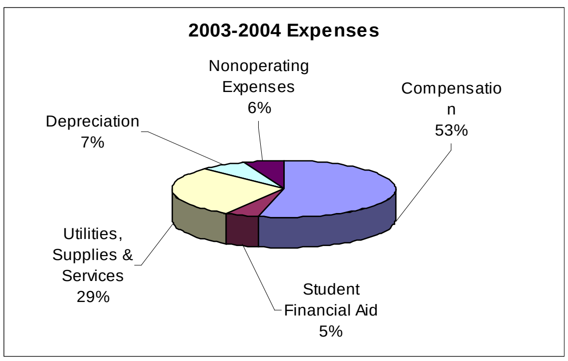
Operating expenses for fiscal year 2004 were $90.9 million, an increase of $9.8 million, or 12.1%, over the previous fiscal year. Except as noted otherwise, the increase in operating expenses is a result of enrollment growth, staffing increases, and an increase in campus plant facilities. Changes in expense categories were as follows:

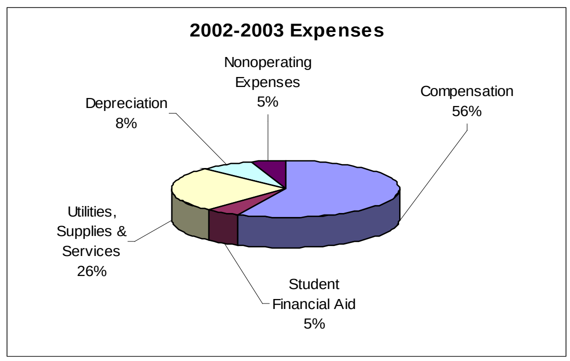
- Compensation (salaries, wages and benefits) increased 6.5%, from $48.4 million to $51.6 million. This is down slightly from the 7.0% increase in the prior fiscal year. Staffing increases caused by enrollment growth, promotions, and annual raises in salary contributed to this change in both years.
- Student financial aid increased from $4.2 million to $4.9 million, or 15.7%. The prior year increase was slightly less than $0.3 million, or 6.9%.
- Utilities increased 12.7% over the previous fiscal year, which reflects the rising cost of natural gas and other commodities and an increasing number of campus facilities. The University had been able to negotiate lower rates for bulk purchases of natural gas before the prices increased in 2002, which was reflected in an 8.9% decrease in costs last fiscal year.
- Supplies and other services increased $5.8 million, or 29.5%, compared to last year's increase of $1.4 million, or 7.6%. Training costs, software, and software maintenance fees for the SCT Banner project account for $1.3 million. Purchases of furniture, lab equipment, computers, computer software, and other supplies to equip and service the Pott School of Science and Engineering and the Bower-Suhrheinrich School of Education and Human Services classroom building, which opened in fall 2003, make up another $1.3 million. Purchases of computers and telecommunication equipment and other equipment and furnishings for classrooms, offices, and student facilities increased $0.9 million; purchases of bookstore merchandise for resale increased $0.3 million; and leasehold improvements, deferred maintenance, and regular repairs and rehabilitation increased $0.4 million.
- Depreciation expense decreased slightly -- $74 thousand compared to $0.4 million decrease in the previous year. Depreciation is expected to increase over the next few years because of additions to fixed assets of new equipment and buildings.

Nonoperating expenses consist of interest on capital asset-related debt and other costs associated with issuing bonds and refinancing debt. These expenditures increased $1.5 million, or 36.5%, because the University issued two new revenue bonds and advance refunded two older bond series during the fiscal year. (See notes 3 and 4 in *Notes to Financial Statements* for more information on each of these bond issues.) As a result interest expense increased $0.6 million, bond issuance costs increased $0.5 million, and $0.4 million loss on early retirement of debt was incurred.

In 2002 the capitalization threshold increased from $1,000 to $5,000, causing a special item which reduced net assets $3.6 million that year. There are no special items to be reported for the 2003 or the 2004 fiscal year.

Total expenses (operating and nonoperating) increased $11.1 million in fiscal year 2004 compared to a $3.2 million increase in 2003. The composition of total expenses for both years is depicted by major category in the graph below:





Change in Net Assets

The differences between revenues and expenses result in an increase or decrease in net assets. For fiscal year ending June 30, 2004, net assets increased $5.8 million compared to a $7.5 million increase for fiscal year ending June 30, 2003. Total expenses increased at a greater rate than total revenues during fiscal year 2004, which caused this 22.2% decrease over the previous fiscal year.

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 2004, 2003, and 2002:

STATEMENT OF CASH FLOWS **Year ended June 30** (in thousands)	**2004**	**2003**	**2002**
Net cash (used) provided by			
operating activities	($25,230)	($20,599)	($22,645)
noncapital financing activities	40,582	36,960	34,186
capital financing activities	(10,157)	(7,010)	(12,942)
investing activities	(3,253)	(6,471)	3,055
Net increase in cash	$1,941	$2,879	$1,655

Operating activities

- Cash used by operating activities increased $4.6 million over the prior fiscal year compared to a $2.0 million decrease from 2002 to 2003.
- 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 $3.6 million over the prior fiscal year compared to a $2.8 million increase from 2002 to 2003.
- State appropriations provided the largest cash inflow in all fiscal years.

Capital financing activities

- Cash flow used for capital financing activities increased $3.1 million in 2004 and decreased $5.9 million in 2003.
- Deposits with bond trustees generated the largest cash outflow for fiscal years 2004 and 2002 and the largest inflow for fiscal year 2003.
- Proceeds from capital debt provided $60.6 million in cash inflow in 2004.
- Principal paid on capital debt in 2004 used $20.7 million, $14.8 million of which was used to refund two bond issues. Principal paid on capital debt in 2003 used $3.8 million.

Investing activities

- Cash provided from investing activities decreased by $3.2 million during 2004 and $9.5 million in 2003.
- Proceeds from sales and maturities of investments increased $6.0 million in 2004 compared to a $4.4 decrease in 2003.
- Proceeds from interest on investments decreased $0.2 million in 2004 compared to a $0.5 million decrease in fiscal year 2003.
- Purchases of investments, a cash outflow, increased $2.5 million in 2004 and $4.5 million in 2003.

Summary of Statement of Cash Flows

For the year ended June 30, 2004, more cash was used for operating activities, more cash was provided by noncapital financing activities, more cash was used by capital financing activities, and less cash was used by investing activities. As a result of these activities, the University increased its cash position by $1.9 million, ending the fiscal year with a cash balance of $21.2 million.

Factors Impacting Future Periods

Ruston Hall, a new student residence hall, is scheduled to open in fall 2004. Bonds for $8 million were sold in July 2003 and construction is nearly complete. This 220-bed facility will generate additional room rental revenue and meal plan income. As of June 30, the construction-in-progress costs were $6.2 million with an expected cost-to-complete of an additional $1.7 million including furnishings and equipment.

The University's plan to construct a parking garage has moved to the 2007-2009 biennium. The University continues to evaluate its parking situation and the need for additional space. Funds are being set aside to address this issue.

Construction for the new David L. Rice Library is underway. This is a $30.7 million project that consists of a new library facility including furniture, fixtures and equipment; retrofitting the existing library for offices, classrooms, meeting rooms, and the bookstore; construction of a distribution services facility; and redirection of the campus access road. Completion of the new library is expected by summer 2006, but construction on the related projects will continue for at least another year.

The University issued Series I revenue bonds to finance the construction of the library project discussed above. As part of that bond issue, the University responded to requests from the state budget agency to reduce future demands for fee-replacement state-appropriated funds by advance refunding Series D debt. This action resulted in $333,890 cash savings to the state over the next twelve years.

The Indiana General Assembly granted USI $9.75 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 organizations. The UC will expand into the current library building once the new library is constructed providing additional conference and meeting spaces. The State Budget Committee and the Indiana Commission for Higher Education must approve this project and the financing plan before USI can proceed further.

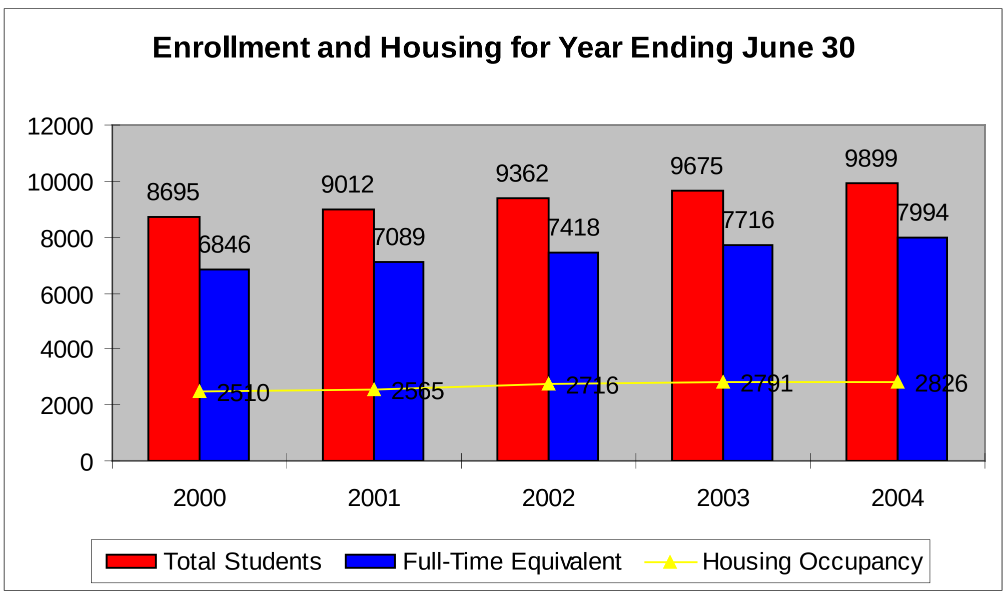
Moody's Investors Service assigned an A2 rating to the University's debt obligations in November 2001. In July 2003, Moody's reviewed and rated the auxiliary system bonds as A3. Moody's staff visited the USI campus in May 2004 and reaffirmed these ratings.

The State of Indiana continues to experience financial difficulties, and the amount of State funding has been affected by these difficulties. Repair and rehabilitation funds have been severely restricted and are currently funded at only 25% of the funding formula. Enrollment-change funding decreased 6% per FTE and was funded at only 50% in fiscal year 2004. Funding for enrollment change will increase to 90% in fiscal year 2005, but funding for personal services, supplies and expenses, and student aid will receive an inflationary increase of only 0.5%. Finally, for the third consecutive year, one monthly appropriation payment has been deferred to the following fiscal year.

The University has incurred costs for training, equipment and software in advance of implementing a new campus-wide administrative software system over the next two-and-a-half years. This project is budgeted to cost approximately $3 million for the system, including additional hardware and implementation costs that are not yet fully defined. This new system will increase efficiencies and functionality within the University.

Full-time equivalent (FTE) enrollment exceeded 8,000 for the first time in the fall of 2004. Full time students now represent 75% of the total student population. Both graduate credit hours and graduate FTE increased 10.5% over the fall of 2003. Total credit hours increased 1.5%, which will generate an increase in student fee revenue for the coming fiscal year.

The University's total enrollment for academic years ending 2000 through 2004 has increased 13.9%; full-time equivalents for the same period have increased 16.8%. The University is maturing and growing as a residential campus and all signs point to that trend continuing. The following graph illustrates the enrollment growth and housing occupancy for the five-year period, 2000 to 2004.



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 is also 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 must also 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 in 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 nonexchange 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 and probable.
- 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 13, Table III, in the *Notes to Financial Statements* for current year activity and accumulated depreciation on the various classes of assets.

The University owns and maintains museum exhibits and items of historical value at its New Harmony, Indiana, site. The exhibits are open to the public and relate the history of that community from its beginnings in 1816 through the decorative arts period ending in the mid-1800s. The museum collection has a book value of $1.1 million, which is included in the value of capital assets reflected in the Statement of Net Assets.

The University owns a permanent art collection of undetermined total value. The primary function and aim of the collection is education in accordance with the University's mission to support the cultural awareness of its students, faculty, staff, and the citizens of southwestern Indiana. The collection consists of both donated and purchased items. Many of the donated pieces were received without appraised values. Collection pieces whose values have been determined by appraisal or purchase price total $270,300. Appraised values for the remaining collection will be obtained over future periods. The currently-known value is not included in the capitalized asset value at June 30, 2004.

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.

Prepaids 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.

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.

COMPONENT UNIT
University of Southern Indiana Foundation
Statement of Activities
For Year Ended June 30, 2004

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues and Other Support				
Contributions	$ 2,018,016	$ 2,460,037	$ 2,047,416	$ 6,525,469
Change in value of split-interest agreements	-	(188,826)	510	(188,316)
Rental income	972,348	-	-	972,348
Miscellaneous income	76,244	86,003	-	162,247
Net assets released from restrictions	3,416,391	(3,416,391)	-	0
Total revenues and other support	6,482,999	(1,059,177)	2,047,926	7,471,748
Expenses				
Programs - University of Southern Indiana				
Scholarships and awards	747,701	-	-	747,701
Educational grants and academic enhancements	300,812	-	-	300,812
Athletics	223,917	-	-	223,917
Other University support	1,270,151	-	-	1,270,151
Capital projects	58,665	-	-	58,665
Community outreach	62,039	-	-	62,039
Total program services	2,663,285	0	0	2,663,285
Management and general	256,933	-	-	256,933
Fund raising	169,929	-	-	169,929
Uncollectible pledge loss	-	11,641	-	11,641
Total expenses	3,090,147	11,641	0	3,101,788
Other Changes				
Investment income, net	774,754	3,612,713	-	4,387,467
Loss on sale of property	(13,000)	-	-	(13,000)
Total other changes	761,754	3,612,713	0	4,374,467
Change in Net Assets	4,154,606	2,541,895	2,047,926	8,744,427
Net Assets, Beginning of Year	2,504,971	10,993,490	15,257,387	28,755,848
Net Assets, End of Year	$ 6,659,577	$ 13,535,385	$ 17,305,313	$ 37,500,275