

AGENDA
FINANCE/AUDIT COMMITTEE
UNIVERSITY OF SOUTHERN INDIANA
BOARD OF TRUSTEES

November 1, 2012

1. REVIEW OF AUDITED FINANCIAL STATEMENTS

A report will be presented on the audited financial statements for the fiscal year ending June 30, 2012.
(Attachment A)

2. UPDATE ON VOLUNTARY EMPLOYEE BENEFIT ASSOCIATION TRUST

A report on the status of the VEBA (Voluntary Employees' Benefit Association) Trust will be presented.

3. UPDATE ON SERIES K BOND ISSUE

A report will be presented on the completion of the Series K Bond issuance. Series K will be used to finance construction of the Teaching Theatre project and refund various prior bond issues.

University of Southern Indiana Fiscal Year Ended June 30, 2012

Management's Discussion and Analysis

Management's discussion and analysis reviews the financial performance of the University during the fiscal year ended June 30, 2012, 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)	2012	2011	2010
Current Assets	\$58,770	\$61,564	\$68,254
Non-current Assets:			
Capital assets, net of depreciation	176,744	184,097	180,872
Other non-current	50,523	42,780	40,196
Total Assets	\$286,037	\$288,441	\$289,322
Current Liabilities	\$23,786	\$25,899	\$22,157
Non-current Liabilities	131,860	136,744	146,867
Total Liabilities	\$155,646	\$162,643	\$169,024
Net Assets:			
Invested in capital assets, net of debt	\$42,996	\$40,675	\$51,311
Restricted - expendable	334	25	44
Unrestricted	87,061	85,097	68,943
Total Net Assets	\$130,391	\$125,797	\$120,298

Assets

Current assets at June 30, 2012, consist predominantly of cash and cash equivalents, short-term investments, receivables and net of allowances for bad debt. Also included are prepaid expenses, inventory, deposit with bond trustee, and accrued interest. Non-current assets include capital assets net of depreciation, long-term investments, and deferred outflow of resources related to the series 2006 and Series 2008A hedgeable financial derivatives. Both current and non-current assets include lesser-valued resources that are grouped together and listed under the term “Other”.

Total assets decreased \$2.4 million (.8 percent) in 2012 compared to an \$881,000 (.3 percent) decrease in 2011 and a \$1.9 million (.7 percent) increase in 2010. The current year decrease is explained by the following fiscal year events:

- Cash and investments increased \$3.4 million in 2012 compared to a \$22.6 million increase in 2011, and a \$10.2 million decrease in 2010 reflecting the positive contribution from operations in 2012.
- Student receivables comprise 54 percent of the total accounts receivable amount and increased only \$50,345 in 2012 compared to a \$968,057 increase in 2011 and a \$215,809 increase in 2010. Fiscal year 2012 student receivables are only one percent higher than those of fiscal year 2011, partially reflecting a combination of a modest enrollment increase of 1.1 percent and a fall and spring student fee increase of 4.5 percent netted against a summer 2012 tuition discount of approximately 20 percent.
- Non-student receivables increase \$1.1 million in 2012 with a \$1 million of the increase in direct student loan reimbursements from the Department of Education and various grant reimbursements due to the University and accrued as receivables for fiscal year end.
- Gross capital assets decreased by \$7.4 million in fiscal year 2012. Net capital assets increased \$4.1 million as described in Note 16 of the *Notes to Financial Statements* but were offset by depreciation of \$12 million generating the decrease in net capital assets.

Liabilities

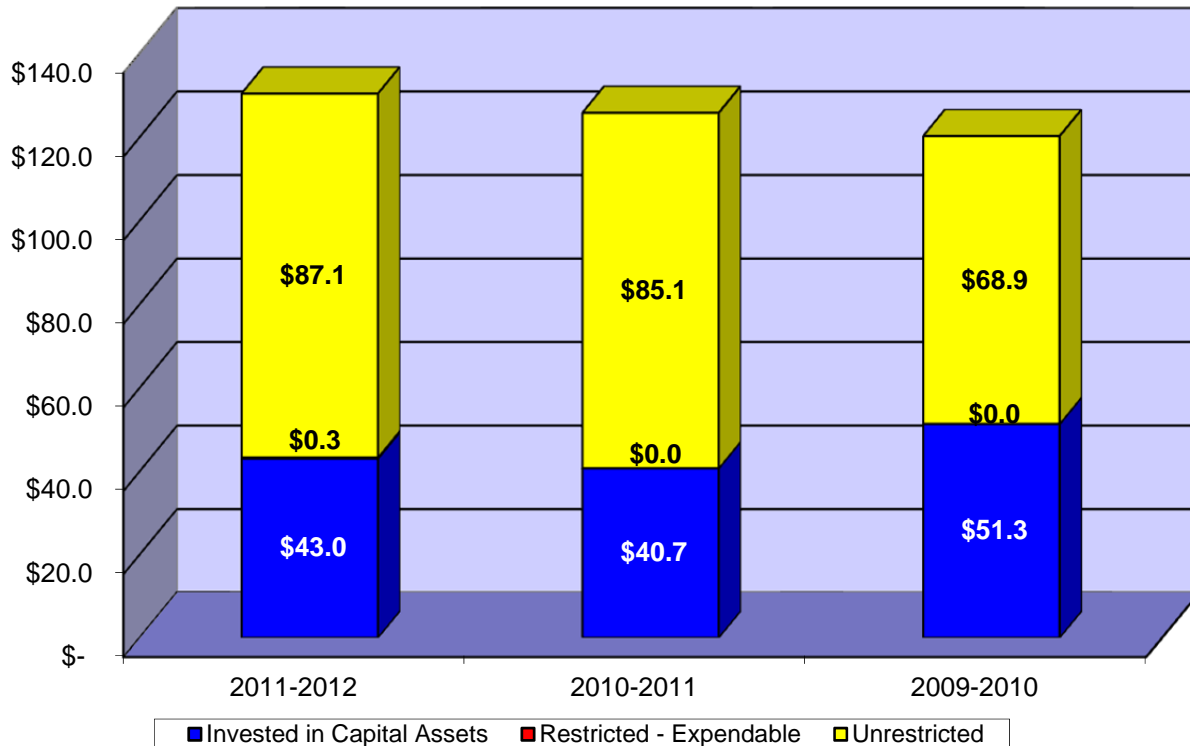
Current liabilities at June 30, 2012, are primarily composed of accrued payroll and related benefits and deductions and the current portion of bonds payable. Also included are accounts payable, debt interest payable, deferred revenue, and other miscellaneous liabilities. Non-current liabilities are predominately bonds payable. Also included are derivative instruments-interest rate swap for Series 2006 and Series 2008A hedgeable financial derivatives, compensated absences, termination and postemployment benefits, an unamortized bond premium, and miscellaneous other long-term liabilities. Total liabilities decreased \$7 million (4.3 percent) in 2012 compared to a decrease of \$6.4 million (3.8 percent) in 2011 and a decrease of \$7.6 million (4.3 percent) in 2010. Activities that influenced this change include the following:

- Accrued payroll, related benefits, and deductions increased \$67,827 in 2012 compared to an \$897,460 increase in 2011 and an increase of \$39,291 in 2010.
 - Recognition of voluntary termination benefits decreased \$39,737 for 2012.
 - Benefit withholdings increased \$87,742 for the 2012 fiscal year.
 - Fiscal year-end withholding liabilities increased \$78,818 and wages payable decreased \$264,515.
 - The liability for post retirement benefits increased by \$2.2 million in 2012 and has been reclassified from a current to a non-current liability.
 - Compensated absences increased \$217,208 and other minor changes in miscellaneous deductions explain the remaining 2012 changes.
- The 2012 net change to notes and bonds payable equals a \$9.4 million decrease.
 - Paying down the existing debt decreased bonds payable by \$9 million.
 - See Note 6 in *Notes to Financial Statements* for more information on notes and bonds payable.

Net assets at June 30, 2012, are \$4.6 million greater than on June 30, 2011. Capital assets, net of related debt, increased \$2.3 million; restricted expendable assets increased \$308,897; and unrestricted assets increased \$2 million. Unrestricted assets equal \$87.1 million and comprise 67 percent of total net assets. Of the total unrestricted amount, \$62.6 million has been internally designated as follows:

- \$17.2 million reserve for equipment and facilities maintenance and replacement
- \$15.8 million reserve for University benefits
- \$12 million reserve for auxiliary systems
- \$4.5 million reserve for working capital and outstanding encumbrances
- \$6 million reserve for academic operations and initiatives
- \$2.8 million reserve for insurance and equipment
- \$3.4 million reserve for medical premiums

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 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 and non-exchange governmental and corporate grants are required to be classified as non-operating revenues. This creates large operating deficits for public universities which rely heavily on state funding and governmental grants 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 Revenue, Expenses, and Changes in Net Assets			
Year ended June 30 (in thousands)	2012	2011	2010
Total operating revenues	\$73,235	\$69,622	\$66,704
Total operating expenses	(140,344)	(135,537)	(127,562)
Operating losses	(67,109)	(65,915)	(60,858)
Net non-operating revenues/(expenses)	71,322	69,049	70,333
Income/(expenses) before other revenues, expenses, gains, or losses	4,213	3,133	9,475
Capital gifts, grants, and appropriations	381	2,366	45
Increase (decrease) in net assets	\$4,594	\$5,499	\$9,520

Revenues

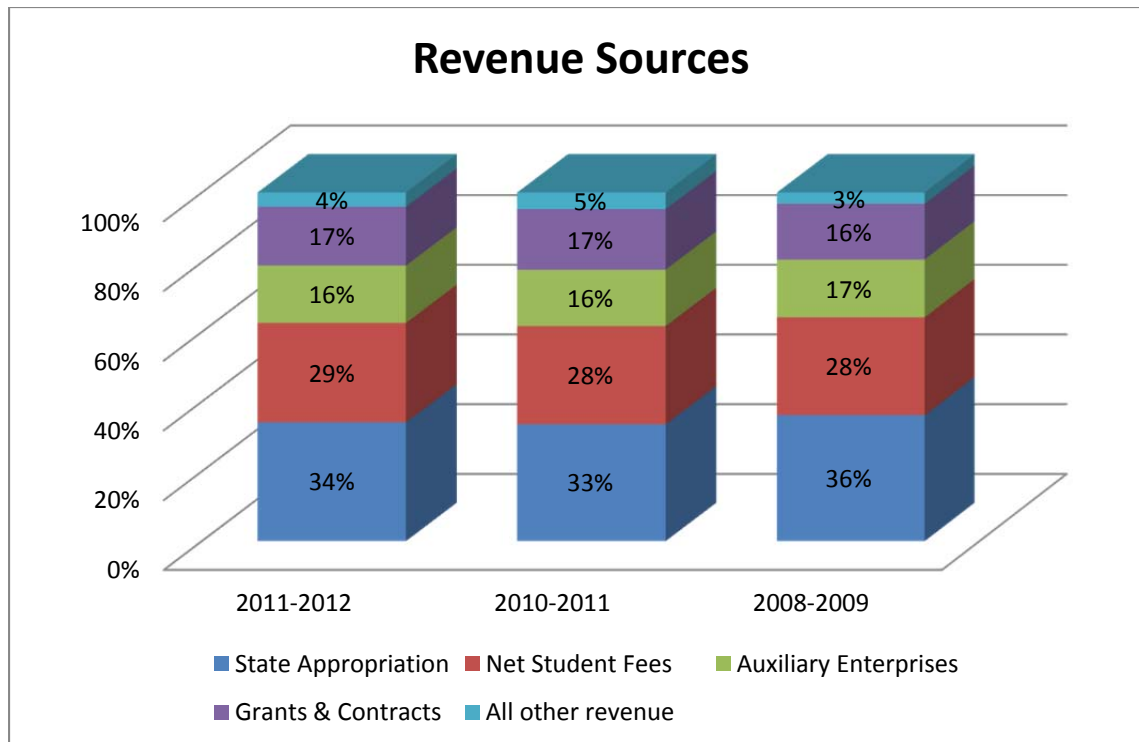
Operating revenues increased \$3.6 million (5.2 percent) in 2012 compared to \$2.9 million (4.4 percent) in 2011 and \$1.9 million (2.9 percent) in 2010. The increases are explained by the following significant fiscal year activities:

- Net student fee revenue increased from \$41.8 million in 2011 to \$43.3 million in 2012. This change was due principally to a fall and spring student fee increase of 4.5 percent netted against a summer 2012 tuition discount of approximately 20% and an enrollment increase of 1.1 percent.
- Auxiliary income increased from \$24 million in 2011 to \$25 million in 2012. The increase stemmed from a 7.6 percent increase in housing, a 13.9 percent increase in parking income, and a 10.8 percent increase in dining revenues in 2012.

Non-operating revenues experienced an increase of 2.6 percent for the fiscal year ended June 30, 2012, compared to a 1.5 percent decrease in 2011.

- State appropriations increased 1.8 percent from \$50.7 million in 2011 to \$51.6 million in 2012. The increase in operating funding resulted from the University's performance related to the State of Indiana funding model that now uses performance metrics to determine funding levels.
- Federal grants and contracts decreased \$1 million (6.5 percent) compared to an increase of \$2.2 million (16.4 percent) in 2011. Federal student financial assistance accounted for \$977,000 of the decrease due to the elimination of the Academic Competitiveness and SMART grant programs.
- Gift income increased \$1 million in 2012 primarily as a result of increased scholarship giving from the University of Southern Indiana Foundation after the recovery of its endowment funds.
- Investment income decreased by \$413,062 in 2012 as a result of declining interest rates.

Total revenues (operating, non-operating, and other) increased \$3.7 million in fiscal year 2012. The graph below shows the composition of the University's revenue for fiscal years 2010-2012:



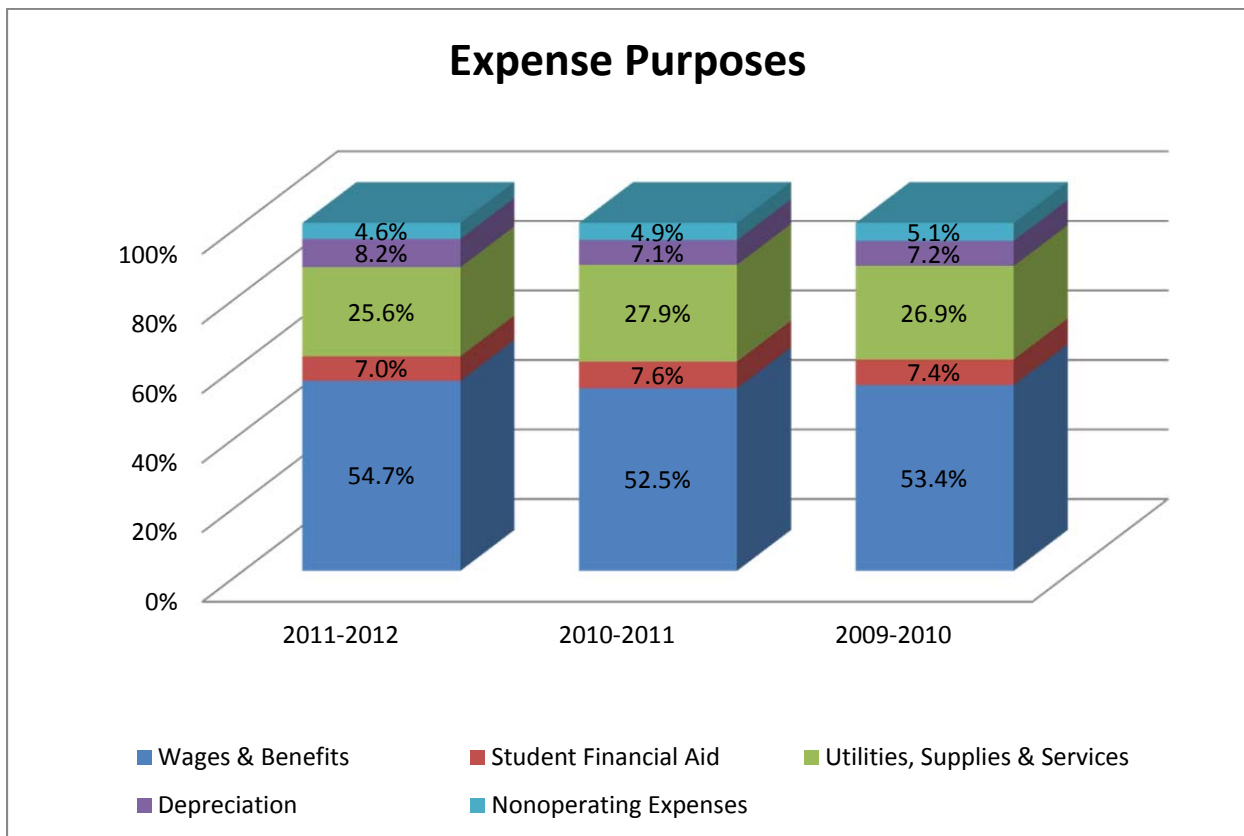
Expenses

Operating expenses increased \$4.8 million (3.6 percent) this fiscal year compared to an \$8 million (6.25 percent) increase in 2011. The growth in operating expenses was driven by increases in salaries and benefits. Changes in expense categories were as follows:

- Compensation (salaries, wages, and benefits) comprised 57.3 percent of total operating expenses and increased 7.5 percent over 2011. Salaries and wages increased \$1.7 million and benefit expenses increased \$3.9 million. Instructional salary expenses increased by \$206,000 (1 percent) while administrative salaries increased by just under \$408,000 (2.7 percent) and support staff salaries increased \$438,000 (4.4 percent). Medical insurance costs increased by \$664,000.
- Student financial aid decreased by \$586,177 for a 5.4 percent decrease. Federal Pell grants decreased by \$735,000, other federal aid decreased by \$977,000 due to the elimination of the Academic Competitiveness and SMART grant programs, non-employee remitted fees increased by \$538,000, and state financial aid increased \$667,000.
- Supplies and other services expense decreased by \$2.3 million (6.6 percent) in 2012 compared to \$3.6 million (11.8 percent) increase in 2011. Decreases were predominantly in the area of capital outlay including a decrease in capital and non-capital equipment expense of \$3.3 million with other expense classifications remaining flat or slightly below 2011 levels. Increases in honorariums and professional services of \$1.2 million and software licenses of \$369,000 netted against the reduction in equipment expenses produced the \$2.3 million reduction in this expense category.
- Depreciation increased \$1.9 million or 18.7 percent, in fiscal year 2012 compared to an increase of \$380,000, or 4 percent, in fiscal year 2011.

Non-operating expenses consist of interest on capital asset-related debt and other costs associated with issuing bonds and refinancing debt. These expenditures decreased \$257,000 this year compared to an increase of \$111,000 in 2011. The change in fiscal year 2012 resulted from less interest on capital debt expense.

Total expenses (operating and non-operating) increased \$4.5 million in fiscal year 2012 compared to an \$8.1 million increase in 2011 and a \$7.6 million increase in 2010. The composition of total expenses for all three years is depicted by major categories in the graph below:



Change in Net Assets

The difference between annual revenues and expenses causes an increase or decrease to net assets. For fiscal year ending June 30, 2012, net assets increased \$4.6 million compared to a \$5.5 million increase for fiscal year ending June 30, 2011. Total revenues increased more than total expenses during fiscal year 2012.

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 fiscal years 2010-2012:

STATEMENT OF CASH FLOWS Year ended June 30 (in thousands)	2012	2011	2010
Net cash (used) provided by			
Operating activities	(\$53,906)	(\$53,865)	(\$51,013)
Noncapital financing activities	77,260	75,583	75,019
Capital financing activities	(20,723)	(27,163)	(53,292)
Investing activities	(9,132)	33,345	19,356
Net increase (decrease) in cash	\$6,501	\$27,900	(\$ 9,930)

Operating activities

- Cash used by operating activities increased \$41,406 in 2012 compared to a \$2.9 million increase from 2010 to 2011.
- 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 \$1.7 million in 2012 compared to a \$563,879 increase from 2010 to 2011.
- State appropriations provided the largest cash inflow in all fiscal years.

Capital financing activities

- Cash used by capital financing activities decreased \$6.1 million in 2012 compared to a \$26.1 million decrease in 2011.
- Proceeds from refunding Series 2001A bonds generated the largest cash inflow in 2012; capital gifts and grants generated the largest cash inflow in 2010 and 2011.
- Principal and interest paid on capital debt generated the largest cash outflow in 2012 while purchases of capital assets generated the largest cash outflow in 2010 and 2011.

Investing activities

- Cash used by investing activities increased \$42.2 million during 2012 compared to a \$14 million increase in 2011. The 2012 increase resulted partially from a change in the amount on deposit with the bond trustee for the Series J Bonds.

- Proceeds from sales and maturities of investments decreased \$4.5 million in 2012 compared to a \$6.9 million decrease in 2011.
- Cash used for purchases of investments increased \$10.3 million in 2012 following an \$11.5 million decrease from 2010 to 2011.

Summary of Statement of Cash Flows

For the year ended June 30, 2012, 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 than in the previous fiscal year. As a result of these activities, the University decreased its cash position by \$6.5 million, ending the fiscal year with a cash balance of \$31.2 million.

Factors Impacting Future Periods

The 2009 Indiana General Assembly approved \$15 million in bonding authority for the construction of a \$16.5 million, 350-seat Teaching Theatre on the USI campus to replace the current theatre, costume shop, and scene shop located four miles from campus. The project received final approvals from the Commission for Higher Education and the State Budget Committee in 2011 and construction began in August 2012. The University intends to avail itself of only \$13 million of the \$15 million legislative authorization, and fund the balance of the \$16.5 million project from \$2 million in private gifts, currently being solicited, and \$1.5 million of University resources, much of which has already been expended to fund the design. In the event that private gifts are not forthcoming, the University has access to endowment income from the University of Southern Indiana Foundation that will cover any shortfall.

In the fall of 2012, the University will issue \$13 million in fee replacement bonds for the teaching theatre and in addition will refund \$43.9 million in Series H and I fee replacement bonds. With interest rates at historic lows, refunding savings to the State of Indiana are expected to exceed \$5.8 million over the life of the bonds and generate over 11 percent in net present value savings.

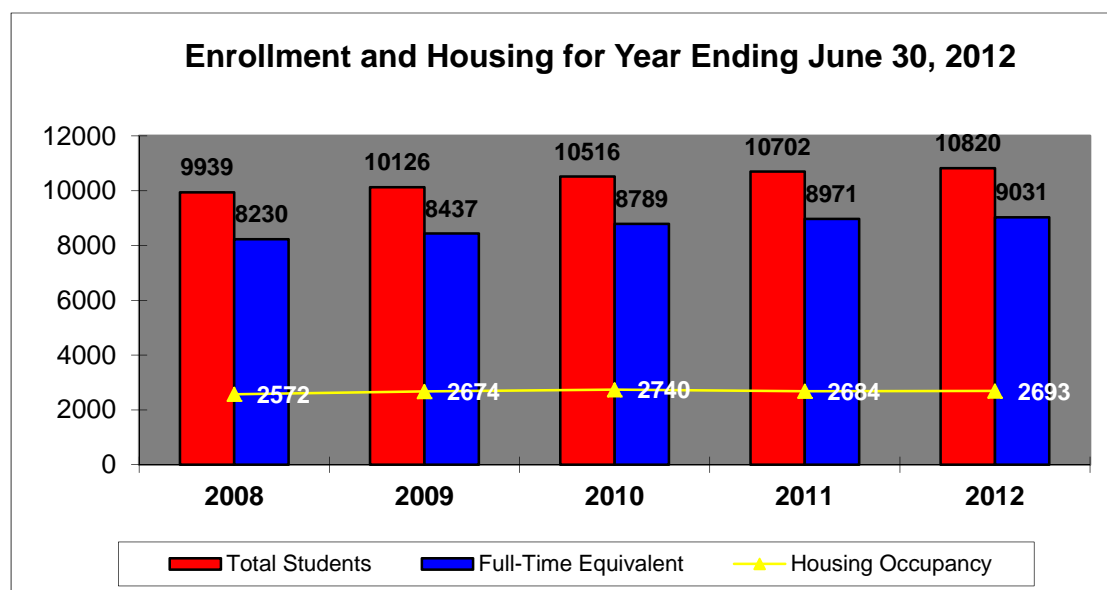
The University is dependent upon appropriations provided by the State of Indiana, and monitors the financial position of the State very closely. Indiana closed its most recent fiscal year with a \$2 billion surplus. Indiana law requires the State's Commission on Higher Education to issue non-binding tuition increase recommendations to the state universities. While the Commission's recommendations are non-binding, in practice they have considerable weight in the Trustees' decision-making process on raising tuition revenue. The State of Indiana has implemented performance metrics as a component of state appropriation funding to Indiana public universities. For the 2012-13 fiscal year, state operating appropriations were reduced by 5 percent across Indiana public higher education institutions and institutions were then measured by defined performance metrics to determine the dollars that would be restored to individual institution budgets. The University of Southern Indiana performance results exceeded the original reduction of 5 percent with the University receiving 5.4 percent in the performance-based funding. For the 2013-14 fiscal year, institution budgets will be reduced by 6 percent and institutions will again be measured to determine the amount of performance funding that will be returned to operating budgets. Current indications are that USI performs well on all of the

applicable performance metrics being advanced by the State, which should lead to a modest appropriation increase in the coming fiscal year. The University continues to seek equity adjustments to its appropriation that begin to rectify the fact that the University operates with a lower appropriation per student than almost all other four-year universities in Indiana.

Healthcare costs are expected to increase significantly for the 2013 calendar year. The University is currently modifying the designs of its three health plans, and modeling employer/employee contribution changes to minimize the impact of this increase. These costs will cause the University to cease contributions to its VEBA Trust, and begin drawing from the Trust to supplement the University health care budget.

USI maintains its reputation as a great value in higher education. The University's market position, value, quality, and pricing have helped it continue to grow enrollment and broaden the catchment area for prospective students while increasing student quality during a period of challenging economic times. The entering fall 2012 class, although slightly smaller in number than its preceding class, is the strongest academic class in the history of the University in terms of entering grade point average and test scores. This is a result of calculated upward revisions to admissions requirements designed to decrease the need for expensive remediation and increase the graduation rate. The slight decline in enrollment that resulted from these changes was anticipated and accounted for in the operating budget.

The University of Southern Indiana is maturing. Its rate of growth is leveling, as it continues to develop into a residential campus and gains prominence not only locally and regionally but also nationally and internationally. Total enrollment for academic years ending 2008 through 2012 reflects an increase of 8.9 percent; full-time equivalents for the same period increased 9.7 percent. Full-time students represent 83.5 percent of the total student population. Housing occupancy has been consistently well in excess of 90 percent the past five-year period, and was 92 percent on the first day of classes in the current year. The following graph illustrates enrollment and housing occupancy for the five-year period 2008 to 2012.



UNIVERSITY OF SOUTHERN INDIANA
 Statement of Net Assets
 June 30, 2012 and 2011

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 31,190,213	\$ 37,690,741
Short-term investments	15,656,177	12,643,370
Accounts receivable	9,317,060	8,201,817
Inventories	1,195,013	1,459,180
Deposit with bond trustee	54,642	52,379
Other current assets	1,357,146	1,216,091
Total current assets	<u>\$ 58,770,251</u>	<u>\$ 61,263,578</u>
Noncurrent Assets		
Long-term investments	\$ 46,972,627	\$ 40,099,897
Deferred outflow of resources	2,899,717	1,857,807
Deposit with bond trustee	300,000	300,000
Capital assets, net	176,744,006	184,097,001
Other noncurrent assets	350,639	822,137
Total noncurrent assets	<u>\$ 227,266,989</u>	<u>\$ 227,176,842</u>
Total Assets	\$ 286,037,240	\$ 288,440,420
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 1,615,771	\$ 1,574,040
Accrued payroll, benefits, and deductions	6,715,057	6,650,237
Notes and bonds payable	10,709,160	9,393,392
Debt interest payable	1,991,121	2,182,085
Deferred revenue	1,936,808	2,045,431
Other current liabilities	818,339	967,633
Total current liabilities	<u>\$ 23,786,256</u>	<u>\$ 22,812,818</u>
Noncurrent Liabilities		
Notes and bonds payable	\$ 120,301,498	\$ 131,010,659
Unamortized bond premium	1,082,867	1,181,309
Derivative instruments-interest rate swap	2,899,717	1,857,807
Other postemployment benefits	5,285,749	3,085,915
Compensated absences and termination benefits	2,253,827	2,651,020
Other noncurrent liabilities	36,357	43,624
Total noncurrent liabilities	<u>\$ 131,860,015</u>	<u>\$ 139,830,334</u>
Total Liabilities	\$ 155,646,271	\$ 162,643,152
NET ASSETS		
Invested in capital assets, net of related debt	\$ 42,995,532	\$ 40,675,094
Restricted		
Expendable		
Debt Service	300,000	300,000
Scholarship, research, and other	34,233	25,336
Repairs and rehabilitation		
Unrestricted	87,061,204	84,796,837
Total Net Assets	<u>\$ 130,390,969</u>	<u>\$ 125,797,267</u>

UNIVERSITY OF SOUTHERN INDIANA
Statement of Revenue, Expenses, and Change in Net Assets
Years ended June 30, 2012 and 2011

	2012	2011
REVENUES		
Operating Revenues		
Student fees	\$ 62,043,693	\$ 59,842,645
Scholarship discounts & allowances	(18,704,782)	(18,042,400)
Grants and contracts	2,180,821	1,669,781
Auxiliary enterprises	25,412,932	24,669,747
Room & board discounts & allowances	(453,303)	(713,912)
Other operating revenues	<u>2,755,407</u>	<u>2,196,252</u>
Total operating revenues	<u>\$ 73,234,768</u>	<u>\$ 69,622,113</u>
EXPENSES		
Operating Expenses		
Compensation:		
Salaries & Wages	\$ 55,386,900	\$ 53,719,281
Benefits	20,642,206	17,865,688
Other postemployment benefits	4,345,355	3,197,243
Student financial aid	10,343,969	10,930,146
Utilities	5,754,420	5,579,139
Supplies and other services	31,897,994	34,155,182
Depreciation	<u>11,973,251</u>	<u>10,090,913</u>
Total operating expenses	<u>\$ 140,344,095</u>	<u>\$ 135,537,592</u>
Operating loss	\$ (67,109,327)	\$ (65,915,479)
NON-OPERATING REVENUES (EXPENSES)		
State appropriations	\$ 51,578,673	\$ 49,657,868
Gifts	2,278,671	1,205,951
Federal grants and contracts	15,072,366	16,116,920
State and local grants and contracts	8,060,351	7,619,097
Nongovernmental grants and contracts	287,313	310,637
Investment income (net of investment expense of \$58,208 and \$51,521 for 2012 and 2011)	763,322	1,113,971
Interest on capital asset-related debt	(6,652,700)	(6,906,545)
Other non-operating expenses	<u>(66,139)</u>	<u>(69,172)</u>
Net non-operating revenues	<u>\$ 71,321,857</u>	<u>\$ 69,048,727</u>
Income before other revenues, expenses, gains, or losses	\$ 4,212,530	\$ 3,133,248
Capital appropriations		1,086,974
Capital grants and gifts	<u>381,172</u>	<u>1,278,854</u>
Total other revenues	<u>381,172</u>	<u>2,365,828</u>
Increases in net assets	<u>\$ 4,593,702</u>	<u>\$ 5,499,076</u>
NET ASSETS		
Net assets – beginning of year	\$ 125,797,267	\$ 120,298,191
Net assets – end of year	\$ 130,390,969	\$ 125,797,267

UNIVERSITY OF SOUTHERN INDIANA
Statement of Cash Flows
Years Ended June 30, 2012 and 2011

	2012	2011
Cash Flows from Operating Activities		
Tuition and fees	\$ 42,679,127	\$ 41,686,275
Grants and contracts	1,988,308	1,372,753
Payments to suppliers	(31,725,086)	(34,048,702)
Payments for utilities	(5,754,420)	(5,579,139)
Payments to employees	(55,651,416)	(53,218,582)
Payments for benefits	(22,855,584)	(19,089,242)
Payments for scholarships	(10,343,969)	(10,930,146)
Loans issued to students	(479,097)	(413,507)
Collection of loans to students	476,925	440,539
Auxiliary enterprises receipts	24,995,408	23,688,050
Sales and services of educational depts.	354,718	171,094
Other receipts (payments)	2,408,834	2,055,761
Net cash used by operating activities	<u>\$ (53,906,252)</u>	<u>\$ (53,864,846)</u>
Cash Flows from Noncapital Financing Activities		
State appropriations	\$ 51,578,673	\$ 50,218,831
Gifts and grants for other than capital purposes	25,698,702	25,252,605
Other non-operating receipts (payments)	(16,306)	111,159
Net cash provided by noncapital financing activities	<u>\$ 77,261,069</u>	<u>\$ 75,582,595</u>
Cash Flows from Capital Financing Activities		
Proceeds from capital debt	\$ 11,550,000	\$ -
Capital appropriations	-	1,086,974
Capital grants and gifts	298,827	1,241,638
Bond financing costs	(66,141)	(69,171)
Purchase of capital assets	(4,620,255)	(13,315,571)
Principal paid on capital debt	(20,943,392)	(9,021,775)
Interest paid on capital debt and leases	(6,942,106)	(7,084,877)
Deposit with trustee	-	(300,000)
Net cash provided by capital financing activities	<u>\$ (20,723,067)</u>	<u>\$ (27,462,782)</u>
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	\$ 34,272,218	\$ 38,792,003
Interest on investments	893,340	1,455,965
Purchase of investments	(44,295,573)	(33,731,469)
Change in deposit with trustee	(2,263)	27,128,597
Net cash used by investing activities	<u>\$ (9,132,278)</u>	<u>\$ 33,645,096</u>
Net increase (decrease) in cash	\$ (6,500,528)	\$ 27,900,063
Cash – beginning of year	37,690,741	9,790,678
Cash – end of year	<u>\$ 31,190,213</u>	<u>\$ 37,690,741</u>

	2012	2011
Reconciliation of net operating revenues (expenses) to net cash provided (used) by operating activities:		
Operating loss	\$ (67,109,327)	\$ (65,915,479)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation expense	11,973,251	10,090,913
Provision for uncollectible accounts	31,023	38,231
Changes in assets and liabilities:		
Receivables	(1,146,266)	(1,542,214)
Inventories	264,167	416,890
Other assets	422,760	3,691
Accounts payable	(26,438)	782,211
Deferred revenue	(108,623)	1,242,120
Deposits held for others	(7,266)	(390,007)
Employee and retiree benefits	1,802,640	1,381,765
Loans to students	(2,173)	27,032
Net cash used by operating activities:	<u>\$ (53,906,252)</u>	<u>\$ (53,864,846)</u>
<hr/>		
Noncash Transactions		
Unrealized gain/(loss) on short-term investments	\$ (51,501)	\$ (21,527)
Unrealized gain/(loss) on long-term investments	90,537	198,381
Bonds payable – LT and ST Series 2001A	1,406,674	-
Bonds payable – LT and ST Series 2011A	(1,406,674)	-
Net noncash transactions	<u>\$ 39,036</u>	<u>\$ 176,854</u>

NOTE 1 – Summary of Significant Accounting Policies

The University of Southern Indiana was established in 1985 as described in the Indiana Code (IC 21-24-1 through IC 21-24-4-1). 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 the State of Indiana. Trustees serve four-year terms with varying expiration dates 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. The University must receive authorization from the State before undertaking major capital projects. As a component unit, public higher education institutions, as a group, will be discretely 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 capitalizes equipment with a cost of \$5,000 or more. Building components, land improvements, infrastructure, and computer software are capitalized if costs exceed \$50,000. All capitalized assets have a useful life greater than two years. Library materials are capitalized using the group method. Periodicals and subscriptions are expensed as incurred. Renovations to buildings and other improvements are capitalized if costs are greater than \$50,000 and the renovation meets one of the

following criteria:

- Increases the capacity (applies to buildings only)
- Increases the useful life
- Increases the operating efficiency

The University records depreciation for all capital assets with the exception of land and historical sites. 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
- Computer Software -- 3 years
- Equipment -- 3-10 years
- Infrastructure -- 25 years
- Land improvements -- 15 years
- Library materials -- 10 years

Capital assets are removed from the records at the time of disposal. See Note 16 in the *Notes to Financial Statements* for current-year activity and accumulated depreciation on the various classes of assets.

The University owns a collection of museum exhibit items located in Historic New Harmony. The collection consists of 2,800 objects that are primarily 19th century decorative arts, furniture, prints, medical equipment, and textiles. The collection consists of both donated and purchased items. Per the code of ethics for museums, Historic New Harmony does not place a monetary value on the collection. Museums are organized as public trusts that act as stewards for the public in collecting, protecting, preserving, and interpreting objects. A well-documented inventory is maintained, but the value is unknown and therefore not included in the capitalized asset value at June 30, 2012.

The University owns a permanent art collection whose primary function and aim is education in accordance with one element of the University's mission: to enhance 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 which have been appraised or purchased are valued at \$2,046,633. 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, 2012.

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.

Non-operating Revenues and Expenses

Non-operating revenues of the University consist of state appropriations, gifts, non-exchange grants, and investment income. Non-operating expenses include interest on capital asset related debt, bond issuance costs, and annual bond management fees.

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).

NOTE 2 – 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 and its faculty and students, 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, 2012, the USI Foundation distributed \$2,642,735 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 discretely presented in the University's financial statements.

On June 22, 2011, the Foundation acquired the net assets of University of Southern Indiana/New Harmony Foundation, which was formed to support and develop Historic New Harmony, an auxiliary enterprise of the University which operates in New Harmony, an historic town in southwestern Indiana located thirty miles from campus.

The USI Foundation maintains its 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 as permanently restricted, temporarily restricted, and unrestricted. Complete financial statements, including explanatory notes, for the USI Foundation can be obtained from the Office of the Vice President for Finance and Administration at 8600 University Blvd., Evansville, IN 47712.

NOTE 3 – 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 IC 30-4-3-3. 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 -- Federal Deposit Insurance Corporation/Savings Association Insurance Fund (FDIC/SAIF). Investments with non-Indiana institutions must be insured by agencies of the U.S. government to the maximum statutory amount of \$250,000.

Deposits – At June 30, 2012, the bank balances of the University’s operating demand deposit accounts were \$28,924,834, of which \$389,140 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 were 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, 2012, are identified in the table below:

Investment Type	Market Value	Type %	Investment Maturities (in Years)			
			Less than 1 year	1 – 5 years	6 – 10 years	More than 10 years
Money market accounts	\$3,186,491	3%	\$3,186,491			
Repurchase agreements	28,003,722	30%	28,003,722			
Certificates of deposit	20,804,943	22%	12,721,263	7,782,996	300,684	
U S Treasury & agency securities	41,823,860	45%	2,194,289	13,948,371	18,580,500	7,100,700
Totals	\$93,819,016	100%	\$46,105,765	\$21,731,367	\$18,881,184	\$7,100,700
Maturity %	100%		49%	23%	20%	8%

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 \$93.8 million invested, \$41.8 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. There are \$28 million in repurchase agreements 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/SAIF, 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 maintained 49 percent 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, \$39.3 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 of cash, certificate of deposits, and repurchase agreements as valued at the end of the preceding month. Operating funds which are invested in overnight repurchase agreements as part of the cash management program are excluded from the 25 percent limit. At June 30, 2012, the University was in compliance with that policy. The University has more than 5 percent of investments with one institution but mitigates this risk with FDIC and Indiana Public Depository insurance protection.

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 4 – Accounts Receivable

Accounts receivable are recorded net of allowance for uncollectible student fees of \$607,829 and auxiliary services fees of \$308,183. Prior-year allowances were \$589,765 for student fee receivables and \$295,224 for auxiliary services receivables. The accounts receivable balance for the 2011-12 fiscal year includes \$4,993,976 in net student receivables and \$4,323,084 in external receivables.

NOTE 5 – Derivative Instruments

The fair value balances and notional amounts of the derivative instruments outstanding at June 30, 2012, classified by type and the fair value changes of those derivative instruments are as follows:

Derivative Instrument	Type	Change in Fair Value		Fair Value at June 30, 2012	
		Amount	Classification	Amount	Current Notional
Series 2006	Cash flow hedge: Pay-fixed interest rate swap	\$(444,962)	Derivative Instrument Interest Rate Swap	\$(1,409,640)	\$6,209,115
Series 2008A	Cash flow hedge: Pay-fixed interest rate swap	\$(596,948)	Derivative Instrument Interest Rate Swap	\$(1,490,077)	\$9,050,000

As of June 30, 2012, the University determined that both pay-fixed interest rate swaps met the criteria for effectiveness. The pay-fixed, receive-variable interest rate swaps are designed to synthetically fix the cash flows on the variable rate bonds. The fair value of the interest rate swaps was estimated based on the present value of their estimated future cash flows.

The following table displays the objectives and terms of the University's hedging derivative instruments outstanding at June 30, 2012, along with the credit rating of the associated counterparty:

Type	Objective	Current Notional	Effective Date	Maturity Date	Terms	Counterparty Credit Rating
Pay-fixed interest rate swap	Hedge of changes in cash flows on the Series 2006 Bonds	\$6,209,115	1/01/2008	1/01/2028	65% of 3 mo. USD-LIBOR-BBA	A2
Pay-fixed interest rate swap	Hedge of changes in cash flows on the Series 2008 Bonds	\$9,050,000	7/01/2008	10/01/2021	65% of 3 mo. USD-LIBOR-BBA w/- 1 day look back, 79.0 bps	A2

Credit Risk — The fair value of the hedging derivative instruments is in a liability position as of June 30, 2012, with Series 2006 having a balance of \$1,409,640 and Series 2008A having a balance of \$1,490,077. Since both of the derivative instruments and the debts being hedged are with the same counterparty, there is no credit risk exposure. The fair value of the derivative instruments would simply be netted against the payoff of the debts.

Interest Rate Risk — Interest rate risk is the risk that changes in interest rates will adversely impact the fair market value of the derivative instruments. On a pay-fixed, receive-variable interest rate swap, the University will be negatively impacted by the lower rate environment, which will decrease the fair market values of its derivative instrument. The derivative instrument for Series 2006 fixes the hedged debt at 4.67 percent and Series 2008A is fixed at 3.97 percent.

Basis Risk — Basis risk is the risk that the University may lose cash flows because of the differences in the indexes upon which the derivative instrument and the item it hedges are based. The University is not exposed to basis risk since both derivative instruments and the associated debts being hedged are based on the three-month LIBOR index.

Termination Risk — The University or its counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. The University is also exposed to termination risk if the student fee or auxiliary bonds are prepaid or partially prepaid. This risk is only to the extent the notional amount of the swap transactions exceeds the remaining amount after the prepayment.

Rollover Risk — Rollover risk is the risk that the maturity of the derivative instrument is shorter than the maturity of the associated debt. Since both the derivative instruments and the debt being hedged have identical maturity dates, there is no rollover risk to the University.

NOTE 6 – Debt Related to Capital Assets

Bonds Payable – Outstanding bonds payable at June 30, 2012, total \$131,010,659 and are identified in the following schedule.

SCHEDULE OF BONDS AND NOTES PAYABLE	<i>Issue Date</i>	<i>Interest Rate</i>	<i>Current Year Rate</i>	<i>Maturity Date</i>	<i>Original Issue Amount</i>	June 30, 2012		
						<i>Principal Outstanding</i>	<i>Interest Outstanding</i>	<i>Total Outstanding</i>
Student Fee Bonds								
Series D, Health Professions Center	1993	2.25% to 5.8%	5.75%	2015	\$24,678,101	\$1,036,544	\$2,303,456	\$3,340,000
Series F, Liberal Arts Center	1998	3.55% to 4.7%	4.70%	2013	15,280,000	1,600,000	62,425	1,662,425
Series G, Recreation & Fitness Center	1999	0% to 10%*	.25%	2019	4,700,000	2,600,000	33,210	2,633,210
Series H, Science & Education Center	2001	3.5% to 5.0%	4.50%	2021	25,260,000	16,165,000	4,441,301	20,606,301
Series I, Library Construction	2004	2.0% to 5.375%	5.00%	2023	49,590,000	31,710,000	9,751,400	41,461,400
Series 2006, Recreation & Fitness Center	2006	4.67%	4.67%	2028	7,250,000	6,209,115	2,590,907	8,800,022
Series J, Business and Engineering Center	2009	2.5 to 5.0%	5.00%	2028	50,185,000	45,245,000	22,893,768	68,138,768
Auxiliary System Bonds								
Series 2003, Student Housing Facilities	2003	3.0% to 4.5%	3.50%	2024	8,005,000	5,845,000	1,776,453	7,621,453
Series 2008A, Student Housing Facilities	2008	3.97%	3.97%	2021	9,800,000	9,050,000	2,808,775	11,858,775
Series 2011A, Student Housing Facilities	2011	1.63%	1.63%	2016	11,550,000	11,550,000	470,663	12,020,663
Total					\$218,523,101	\$131,010,659	\$47,132,359	\$178,143,017
*This bond is a variable interest bond with weekly rates. The rate listed above is the average rate paid during the fiscal year.								

The University of Southern Indiana Student Fee Bonds Series D of 1993, Series F of 1998, Series G of 1999, Series H of 2001, Series I of 2004, and Series J of 2009 are secured by a pledge of and first lien on student fees. Student Fee Bonds Series 2006 are secured by a pledge of and junior lien on student fees.

The University of Southern Indiana Auxiliary System Revenue Bonds, Series 2003; Auxiliary System Revenue Bonds, Series 2008A; and Auxiliary System Revenue Bonds, Series 2011A 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 is a variable rate bond currently bearing interest at weekly rates ranging between zero and 10 percent. The rate in effect at June 30, and the rate used to calculate the future debt service requirements, was .20 percent. 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
2012-13	10,709,160		10,709,160	6,250,822	16,959,982
2013-14	10,093,825		10,093,825	5,847,144	15,940,969
2014-15	10,092,567		10,092,567	5,451,630	15,544,197
2015-16	10,517,766		10,517,766	5,055,737	15,573,503
2016-17	9,460,798		9,460,798	4,066,879	13,527,677
2017-22	46,721,227		46,721,227	14,731,538	61,452,765
2022-27	25,434,740		25,434,740	5,277,394	30,712,134
2027-29	7,980,576		7,980,576	451,214	8,431,790
Total	\$ 131,010,659	\$0	\$ 131,010,659	\$ 47,132,358	\$ 178,143,017

NOTE 7 – 2012 Refunding Bond Issue

On December 14, 2011 the University of Southern Indiana issued \$11,550,000 in Series 2011A revenue auxiliary system bonds with an interest rate of 1.63 percent to refund \$11,550,000 of outstanding fixed rate Series 2001A auxiliary system revenue bonds with a fixed interest rate of 5 percent. The 1.63 percent interest rate is a fixed rate with a five-year amortization based upon a direct bond purchase agreement with JPMorgan Chase Bank. The proceeds of \$11,550,000 redeemed series 2001A in full. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the Statement of Net Assets. The refunding resulted in an accounting loss of \$168,708. The University of Southern Indiana in effect reduced its aggregate debt service payment by \$1,406,674 over the next 5 years and realized an economic gain (difference between the present values of the old and new debt service payments) of \$1,172,752.

NOTE 8 – Operating Leases

For the fiscal year ended June 30, 2012, the University spent \$376,560 on operating leases which are included in supplies and other services in the Statement of Revenue, Expenses, and Changes in Net Assets of which \$105,573 was spent on leasing off campus classroom and office space, \$256,774 was spent on equipment, and \$14,213 was spent on vehicle leases.

NOTE 9 – 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 \$2,199,096 and \$2,384,956 for June 30, 2012 and 2011, respectively. The current year change represents \$244,760 decrease in accrued vacation; \$65,956 increase in sick leave liability; \$13,659 decrease in Social Security and Medicare taxes; and \$6,623 increase in Public Employees' Retirement Fund (PERF) contributions. During the fiscal year, \$259,500 was paid out to terminating employees. Payout for terminating employees in fiscal year 2012-13 is expected to increase approximately 64 percent because of the number who will have reached the requisite retirement age and years of service. For that reason, \$426,801 of the total compensated absence liability is classified as a current liability and the remaining \$1,772,295 is classified as a noncurrent liability.

NOTE 10 – Termination Benefits Liability

GASB Statement No. 47, *Accounting for Termination Benefits*, 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 retirement service 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 1.8 percent annually for purposes of calculating this liability.

USI has 25 retirees currently receiving early-retirement benefits, five of whose benefits stop after this fiscal year, and nine more who have arranged to begin receiving benefits within the next three years. The liability for these benefits totals \$788,584 at June 30, 2012. Of that amount, \$307,073 is expected to be paid out during the following fiscal year, and the remaining \$481,511 has been classified as noncurrent. This liability will change annually as more employees elect this benefit and as benefits for current retirees end.

NOTE 11 – 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 *Public Employees' Retirement Fund (PERF)*. The TIAA-CREF plan is an IRC 403(b) defined contribution plan; PERF is a defined benefit plan under IRC 401(a) and a state plan described in IC 5-10.2 and 5-10.3. The University contributed \$6,036,128 to these programs in fiscal year 2011-12, which represents approximately 11 percent of the total University payroll and 13 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 \$4,932,330 to this plan for 601 participating employees for fiscal year ending June 30, 2012, and \$4,813,874 for 596 participating employees for fiscal year ending June 30, 2011. The annual payroll for this group totaled \$35,954,661 and \$35,340,910 for fiscal years ending June 30, 2012 and 2011 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.

Support Staff Employees in eligible positions and who work at least half-time participate in PERF, a retirement program administered by the Indiana Public Retirement System, 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 8.6 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 \$1,094,090 for 416 employees participating in PERF during the 2011-12 fiscal year and \$898,047 for 415 employees participating during 2010-11.

The contribution requirements for plan members of PERF are set by the PERF Board of Trustees. Actuarial information related to the University's participation in the plan is disclosed in the tables below 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-Entry Age (B)	Underfunded/ (Overfunded) Accrued Liability (C)	Funded Ratio (A/B)	Actual Covered Payroll (D)	Underfunded/ (Overfunded) Liability as % of Payroll (C/D)
2009	7,347	8,461	1,114	86.8%	8,800	12.7%
2010	6,179	9,174	2,995	67.4%	8,912	33.6%
2011	5,307	9,399	4,092	56.5%	8,980	45.6%

PERF – Development of Net Pension Obligation

	2009	2010	2011
Annual Required Contribution (ARC) *	\$493,983	\$590,297	\$877,375
Interest on Net Pension Obligation @ 7%	(38,466)	(41,645)	(38,109)
Adjustments to ARC **	<u>43,834</u>	<u>47,457</u>	<u>43,873</u>
Annual Pension Cost (APC)	499,351	596,110	883,139
Contributions made by USI ***	<u>543,200</u>	<u>566,123</u>	<u>608,260</u>
Change in Net Pension Obligation	(43,849)	29,987	274,879
Net Pension Obligation, Beginning of Year	(530,559)	(574,408)	(544,421)
Net Pension Obligation, End of Year	(\$574,408)	(\$544,421)	(\$269,542)

* Pro rata portion of total ARC for State.

** Net Pension Obligation at beginning of year divided by amortization factor of 12.1037 for 2009 and 2010 and 12.409 for 2011.

*** Percentage of APC contributed: 2009 at 109%; 2010 at 95%; 2011 at 69%.

The required contribution was determined as part of the actuarial valuation as of June 30, 2011, using the Entry Age Normal Cost Method. The actuarial assumptions included: (a) 7 percent investment rate of

return (b) projected salary increases of 3.25 percent to 4.5 percent; and (c) annual cost-of-living adjustments of one percent.

The Indiana Public Retirement System (INPRS) issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for PERF participants. That report may be obtained by writing the INPRS, 1 North Capitol Avenue, Suite 001, Indianapolis, IN 46204 or by calling 317/232-3882.

NOTE 12 – 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 or \$2,500 per occurrence if the property is owned by the USI Foundation or SIHE Holdings, LLC. 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 four health care plans for full-time benefit-eligible employees and two plans for retirees. Two of the plans for employees and 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. Retirees and the majority of employees, 75 percent, participate in the fully-funded cost-plus plan. For fiscal year ended on June 30, 2012, the University’s contribution to these health care plans totaled \$9,846,138 for 962 employees and \$1,250,116 for 264 retirees. For the same period, employees and retirees made contributions totaling \$2,129,835 and \$253,788 respectively.

The University assumes the risk for medical claims exceeding the maximum expected cost but has mitigated the additional risk by purchasing specific and aggregate stop loss coverage at 125 percent of the expected claims liability. The University also has established a reserve to cover any unpaid liability beyond 125 percent. The liability for medical claims incurred but not reported at June 30, 2012, 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 2011 fiscal year are as follows:

Beginning liability, June 30, 2011	\$2,806,148
Claims incurred	8,904,672
Claims paid	(8,995,255)
Ending liability, June 30, 2012	\$2,715,565

NOTE 13 – VEBA Trust

The University established a Voluntary Employees' Benefit Association (VEBA) Trust for the purpose of providing medical, dental, and life insurance benefits to employees who retire after attaining age 60 with at least ten years of service and to those retiring under the Rule of 85. The trust is funded from three sources: University contributions and reserves designated by the Board of Trustees 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, 2012, is as follows:

VEBA TRUST	MARKET
Fund balance at July 1, 2011	\$13,164,949
Transfer from University reserves	650,000
Employee/employer contributions	172,363
Retiree/employer contributions	26,815
Reinvested net earnings	286,141
Net gain/(loss) on sales of trust investments	78,281
Less: Management fees and taxes	(35,430)
Net change in market value	(223,716)
Fund balance at June 30, 2012	\$14,119,403

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 14 – Other Postemployment Benefits (OPEB)

Plan Description. The USI Voluntary Employees’ Benefit Association (VEBA) Trust is a single-employer defined benefit healthcare plan administered by the Old National Trust Company. The VEBA Trust was established for the purpose of providing medical and dental benefits to eligible retirees and their spouses. The USI Board of Trustees has the authority to establish or amend the benefit provisions of the plan. Old National Trust Co. does not provide a stand-alone financial report of the USI VEBA Trust, but the plan assets and financial activity are included as part of its publicly-available audited financial report. That report may be obtained by writing to Old National Bancorp, One Main Street, Evansville, IN 47708, or by calling (800) 731-2265.

Funding Policy. The contribution requirements are established and may be amended by the USI Board of Trustees. The required contribution is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the governing board. For the fiscal year ended June 30, 2012, USI contributed \$2,145,520 to the plan, including \$1,640,018 for current premiums (approximately 84 percent of total premiums), and \$650,000 to prefund benefits. Plan members receiving benefits contributed \$311,158, or approximately 16 percent of the total premiums, through their required contributions for medical insurance coverage.

Annual OPEB Cost and Net OPEB Obligation. The University's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

The following table shows the components of the USI VEBA Trust's annual OPEB cost for the last three fiscal years, the amount actually contributed to the plan, and changes in the net OPEB obligation to the plan:

	2010	2011	2012
Annual required contribution	\$3,243,885	\$3,243,885	\$4,379,913
Interest on net OPEB obligation	32,080	123,977	178,983
Adjustment to annual required contribution	(37,644)	(170,619)	(213,541)
Annual OPEB cost	3,238,321	3,197,243	4,345,355
Contributions made	(1,925,511)	(1,882,421)	(2,145,520)
Increase (decrease) in net OPEB obligation	1,312,810	1,314,822	2,199,835
Net OPEB obligation, beginning of year	458,283	1,771,093	3,085,915
Net OPEB obligation, end of year	\$1,771,093	\$3,085,915	5,285,750

The USI VEBA's annual OPEB cost, the percentage of the annual OPEB cost contributed to the plan, and the net OPEB obligation for the last three fiscal years are as follows:

Year Ending	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6-30-2010	\$3,238,321	59.5%	\$1,771,093
6-30-2011	\$3,197,242	58.9%	\$3,085,915
6-30-2012	\$4,345,355	49.4%	\$5,285,750

Funded Status and Funding Progress. As of June 30, 2012, the plan was 30.5 percent funded. The actuarial accrued liability (AAL) for benefits was \$46,266,049, and the actuarial value of assets was \$14,119,403, resulting in an unfunded actuarial accrued liability (UAAL) of \$32,146,646. The covered payroll (annual payroll of active employees covered by the plan) was \$47,528,932, and the ratio of the UAAL to covered payroll was 67.6 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Schedule of Funding Progress for the USI VEBA Trust Retiree Healthcare Benefit Plan						
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) – Projected Unit Credit Method (b)	Unfunded AAL (UAAL) (b – a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/2010	\$7,940,404	\$31,590,331	\$23,649,927	25.14%	\$45,316,205	52.19%
6/30/2011	\$13,164,949	\$31,590,331	\$18,425,382	41.67%	\$46,432,950	39.68%
6/30/2012	\$14,119,403	\$46,266,049	\$32,146,646	30.52%	\$47,528,932	67.64%

Actuarial Methods and Assumption. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the most recent actuarial study evaluation, which was July 1, 2011, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 5.8 percent investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on the asset classes held in the VEBA Trust, and an annual healthcare cost trend rate for each medical plan. In general, the trend rates start at 8 percent initially, reducing each year until reaching an ultimate rate of 5.7 percent in 2020. The actuarial value of assets for the purposes of determining the annual recommended contribution is the market value of the assets. The UAAL is being amortized as a level dollar amount on an open basis over a 30-year period.

NOTE 15 – Functional Expenditures

Operating expenses are reported by natural classification on the face of the Statement of Revenues, 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. This information is presented in the table below.

FUNCTION	SALARIES & WAGES	BENEFITS	SCHOLAR-SHIPS	UTILITIES	SUPPLIES & OTHER SVCS	DEPRECIATION	2012 TOTAL	2011 TOTAL
Instruction	\$28,251,874	\$11,754,027			\$2,636,799		\$42,642,700	\$38,405,077
Academic Support	4,828,889	2,226,490			4,025,953		11,081,332	10,868,864
Student Services	4,036,784	2,075,610			2,072,301		8,184,695	7,088,397
Institutional Support	8,930,182	3,371,033			3,115,767		15,416,982	15,707,243
Operation & Maintenance of Plant	3,233,299	2,190,429		4,690,998	4,078,087		14,192,813	16,314,865
Depreciation						11,973,251	11,973,251	10,090,913
Student Aid	161,297	882,367	10,343,969		7,080		11,394,713	11,897,706
Public Service	1,601,348	595,429			1,111,251		3,308,028	3,107,997
Research	162,010	32,518			285,490		480,018	240,062
Auxiliary Enterprises	4,181,218	1,859,658		1,063,421	14,565,266		21,669,563	21,816,468
TOTAL	\$55,386,901	\$24,987,561	\$10,343,969	\$5,754,419	\$31,897,994	\$11,973,251	\$140,344,095	\$135,537,592

NOTE 16 – Construction in Progress

Construction in progress at year-end totals \$3.7 million (see capital assets table below). Projects under construction include the Applied Engineering Center and the associated improvements to Bluff Lane, renovation of The Loft dining facility in the University Center, the first phase of the University bookstore renovation, and renovation of the Morton, Durbin, and Hanley buildings in student housing. The total expended to date on the projects is \$2.3 million, and the estimated additional cost to complete them is \$4.5 million.

Projects in design include advising centers for the College of Nursing and Health Professions and the Pott College of Science, Engineering, and Education and the third phase of the campus loop road project. Amounts expended to date on the projects total \$7,200, and the projects have a total estimated remaining cost of approximately \$1.2 million.

The balance of construction in progress relates to a Teaching Theatre on campus. To date, \$1.4 million has been spent for project planning. The design phase began in fall 2009 with an estimated project cost of \$17.3 million. The project was approved for construction by the State of Indiana legislature in spring 2011 with completion scheduled for summer 2014.

NOTE 17 – Capital Assets, Net of Accumulated Depreciation

The table below displays the increase in total capital assets from \$302.7 million at July 1, 2011, to \$306.8 million on June 30, 2012. Gross capital assets, less accumulated depreciation of \$130.1 million, equal net capital assets of \$176.7 million at June 30, 2012.

Capital Assets	Balance June 30, 2011	Additions	Deletions	Balance June 30, 2012	Accumulated Depreciation	Net Capital Assets
Land	\$4,608,923	\$14,000		\$4,622,923		\$4,622,923
Land Improvements	12,218,211	973,287		13,191,498	5,866,267	7,325,231
Infrastructure	6,281,213	558,008		6,839,221	1,788,261	5,050,960
Educational Buildings	156,761,161	114,175	1,330,444	155,544,892	60,185,692	95,359,200
Auxiliary Buildings	99,211,985	1,489,558		100,701,543	46,095,875	54,605,668
Equipment	17,451,581	1,270,054	259,772	18,461,863	13,383,547	5,078,316
Library Materials	3,564,288	134,692	10,778	3,688,202	2,731,614	956,588
Construction in Progress	2,620,485	4,802,392	3,677,757	3,745,120		3,745,120
Totals	\$302,717,847	\$9,356,166	\$5,278,751	\$306,795,262	\$130,051,256	\$176,744,006

NOTE 18 – Reclassify 2011 Financial Information

Other postemployment benefits are now discretely presented as a noncurrent liability based on a revised interpretation and clarification of GASB 45 requirements. The Statement of Net Assets and the Statement of Cash Flows have been amended so that the 2011 financial information is comparable and consistent with the 2012 financial statement presentation.

There was no change in total revenues, expenses, or net assets as a result of this reclassification.

NOTE 19 – Subsequent Events

The 2009 Indiana General Assembly approved \$15 million in bonding authority for the construction of a \$16.5 million, 350-seat Teaching Theatre on the USI campus to replace the current theatre, costume shop, and scene shop located four miles from campus. The project received final approvals from the Commission for Higher Education and the State Budget Committee in 2011 and construction will begin in August 2012. In October 2012, the University will issue \$13 million of the \$15 million legislatively authorized student fee replacement bonds and fund the balance of the \$16.5 million project from \$2 million in private gifts currently being solicited, and \$1.5 million of University resources, much of which has already been expended to fund the design. In the event that private gifts are not forthcoming, the University has access to endowment income from the University of Southern Indiana Foundation that will cover any shortfall.

In addition, the University will refund its Series H and Series I bonds taking advantage of historically low interest rates. The new Series K bond issue totaling \$59.3 million will be composed of a Series K-1 portion of \$13 million for the new Teaching Theatre bonding, a Series K-2 taxable portion of \$3.5 million, and a Series K-3 tax exempt portion of \$42.8 million. Series K-2 and Series K-3 will be direct bond purchases by Old National Bank and Bank of America respectively. Total all in costs for Series K will be 2.39% with the K-2 taxable portion at 1.25 percent, and the tax exempt K-3 portion at 1.95 percent. Savings over the life of the bonds will be \$5.7 million with net present value savings of 11.69 percent or \$5.1 million.