

MOREHEAD STATE UNIVERSITY

**REPORT ON AUDIT OF INSTITUTION
OF HIGHER EDUCATION
IN ACCORDANCE WITH OMB CIRCULAR A-133
June 30, 2003 and 2002**

MOREHEAD STATE UNIVERSITY
REPORT ON AUDIT OF INSTITUTION
OF HIGHER EDUCATION
IN ACCORDANCE WITH OMB CIRCULAR A-133
June 30, 2003 and 2002

CONTENTS

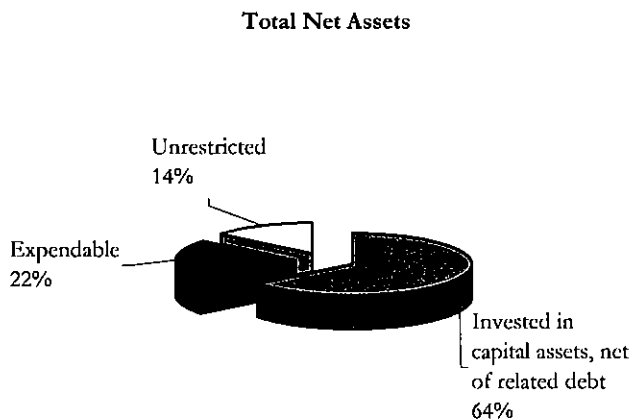
MANAGEMENT DISCUSSION AND ANALYSIS.....	1-13
REPORT OF INDEPENDENT AUDITORS	14-15
FINANCIAL STATEMENTS	
STATEMENTS OF NET ASSETS	16
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS	17-18
STATEMENTS OF CASH FLOWS.....	19-20
NOTES TO FINANCIAL STATEMENTS.....	21-37
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS	38-48
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS	49
REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	50-51
REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133	52-53
SCHEDULE OF FINDINGS AND QUESTIONED COSTS	
SCHEDULE OF FINDINGS AND QUESTIONED COSTS	54-55
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS	56-57
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS.....	58

MANAGEMENT'S DISCUSSION AND ANALYSIS

Morehead State University's (the University) Management Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial performance of the University for the year ended June 30, 2003. Management has prepared this discussion, along with the financial statements and related footnotes, to provide summary financial information. MD&A should be read in conjunction with the accompanying financial statements and footnotes.

Financial Highlights

- The financial statements indicate that the University's financial condition remained strong at June 30, 2003. Financial operations were conducted in accordance with the approved budget plan.
- Total assets were \$167 million versus \$166 million at June 30, 2002. Significant components of the assets include \$ 8.8 million in cash, \$34 million in investments and \$110 million in capital assets net of depreciation.
- Total liabilities were \$44 million versus \$50 million at June 30, 2002. The significant components of the liabilities were \$5.9 million in accounts payable and accrued liabilities, and \$31.1 million in bonds, notes, and capital lease obligations.



- Total net assets were \$122 million versus \$116 million at June 30, 2002. Significant components of net assets include \$79 million invested in capital assets, net of depreciation and related debt, \$26 million in expendable restricted net assets, and \$17 million in unrestricted net assets.

- Operating revenues this year were \$62 million versus \$57 million for year ending June 30, 2002 and operating expenses were \$103 million versus \$97 million at June 30, 2002 resulting in an operating loss of \$40 million for both years. Net nonoperating revenues for both years were \$42 million. These were comprised primarily of state appropriations. The combination of the net loss from operations, the net nonoperating revenues, and capital appropriations of \$5 million, resulted in an increase in net assets of \$6 million versus \$13 million at June 30, 2002.

Using the Annual Report

This annual report consists of a series of financial statements, prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*. These financial statements differ significantly in both the form and the accounting principles utilized from financial statements presented prior to the 2001-2002 fiscal year. The financial statements presented in prior years focused on accountability of funds, while these statements focus on the financial condition of the University, the results of operations, and cash flows of the University as a whole.

One of the most important questions asked about University finances is whether the University is better off as a result of the year’s activities. The information needed to answer this question is in the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows. These statements present financial information of the University in a format similar to that used by corporations, and present a long-term view of the University’s finances.

The Statement of Net Assets includes all assets and liabilities. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. The University’s net assets (the difference between assets and liabilities) are one indicator of the University’s financial health. Over time, increases or decreases in net assets can indicate improvement or erosion of the University’s financial health. Changes in net assets should be considered in conjunction with non-financial factors such as enrollment levels and conditions of facilities.

The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. GASB 35 requires State appropriations and gifts to be classified as nonoperating revenues. Accordingly, the University will generate a net operating loss prior to the addition of nonoperating revenues. The utilization of long-lived assets, referred to as Capital Assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. New accounting standards adopted in the prior year require Universities to record and report depreciation on all of their capital assets. The University, as a matter of policy, has accounted for and reported depreciation for the previous 13 years with the exception of library books. An adjustment of \$10.2 million was recorded last year to account for prior depreciation on Library books.

Another important factor to consider when evaluating financial viability is the University’s ability to meet financial obligations as they mature. The Statement of Cash Flows presents information related to cash inflows and outflows, summarized by operating, non-capital financing, capital financing and investing activities.

Reporting Entity

Morehead State University is a component unit of the Commonwealth of Kentucky.

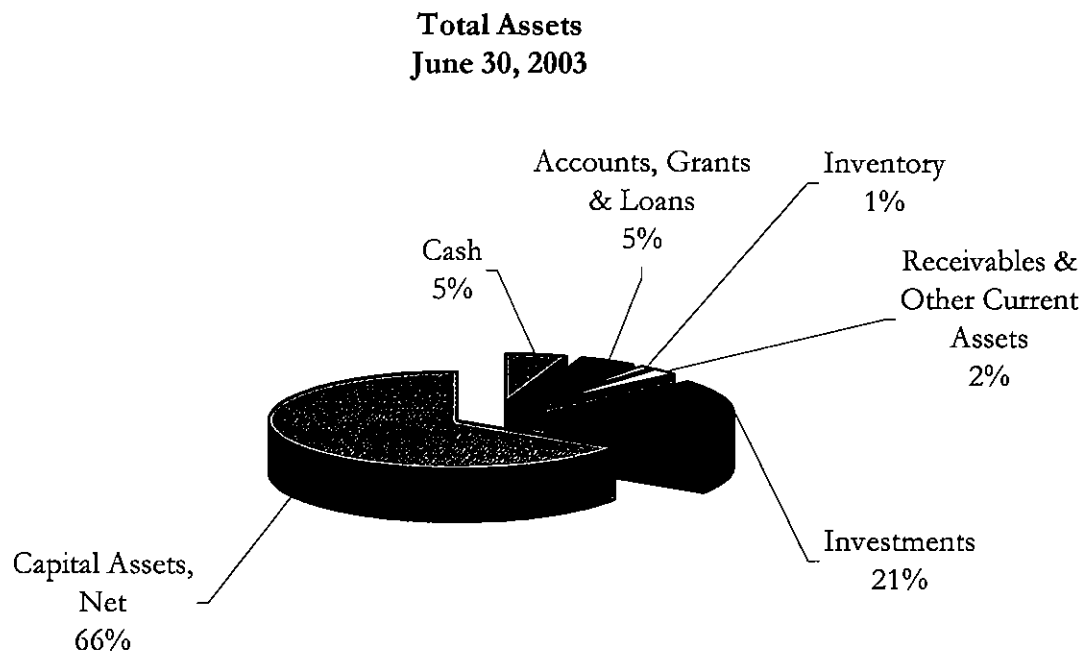
Condensed Financial Information

Statement of Net Assets (in thousands)

	<u>2003</u>	<u>2002</u>
<u>Assets</u>		
Current assets	\$ 19,344	\$ 28,477
Capital assets	109,841	104,236
Other noncurrent assets	<u>37,398</u>	<u>32,952</u>
Total current assets	166,583	165,665
<u>Liabilities</u>		
Current liabilities	11,434	12,115
Noncurrent liabilities	<u>32,988</u>	<u>37,831</u>
Total liabilities	44,422	49,946
<u>Net Assets</u>		
Invested in capital assets, net of related debt	78,714	68,128
Restricted, expendable	26,510	30,981
Unrestricted	<u>16,937</u>	<u>16,610</u>
Total net assets	<u>\$ 122,161</u>	<u>\$ 115,719</u>

Assets

As of June 30, 2003, the University's total assets amount to approximately \$166.5 million versus \$165.6 million at June 30, 2002. Investment in capital assets, net of depreciation, represented the University's largest asset, totaling \$109.8 million compared to \$104.2 million at June 30, 2002. Cash and investments, totaling \$43.1 million versus \$50.1 million at June 30, 2002, were the University's next largest asset.



Total assets increased by \$.9 million during the year ended June 30, 2003. The principal areas of change were:

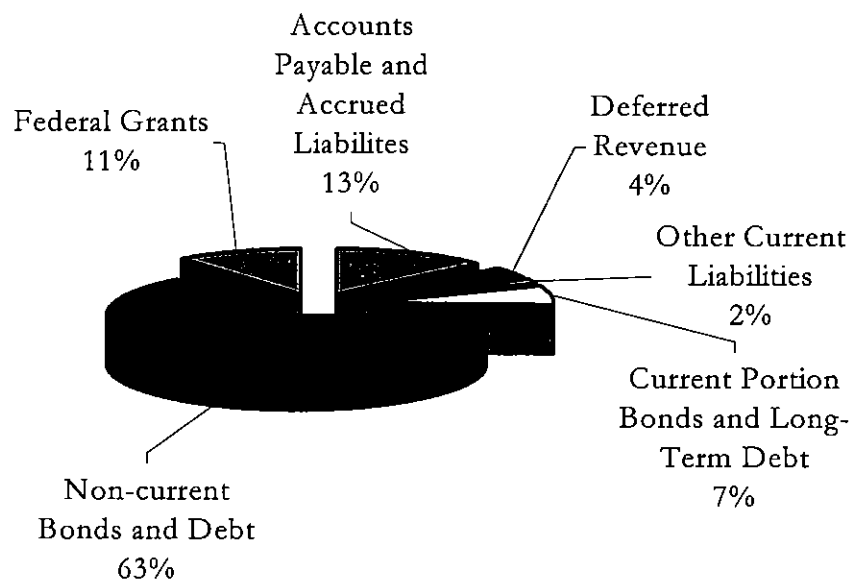
- cash and investments, excluding endowment investments, decreased approximately \$11.4 million,
- accounts, grants, and loans receivable increased approximately \$2.9 million,
- endowment investments increased approximately \$4.5 million,
- capital assets, net of accumulated depreciation, increased approximately \$5.6 million,
- inventory and other current assets decreased \$.7 million.

Liabilities

At June 30, 2003, the University's liabilities totaled approximately \$44.3 million versus \$49.9 the previous year. Bonds, notes payable, and capital lease obligations for capital assets represented \$31.1 million versus \$36.1 million at June 30, 2002.

Total liabilities decreased by \$5.5 million during the year ended June 30, 2003. This decrease was due to a \$5.0 million decrease in bonds payable, notes payable, and capital lease related to a bond refunding. In addition, liability for deferred revenue and other liabilities decreased \$.5 million.

Total Liabilities June 30, 2003

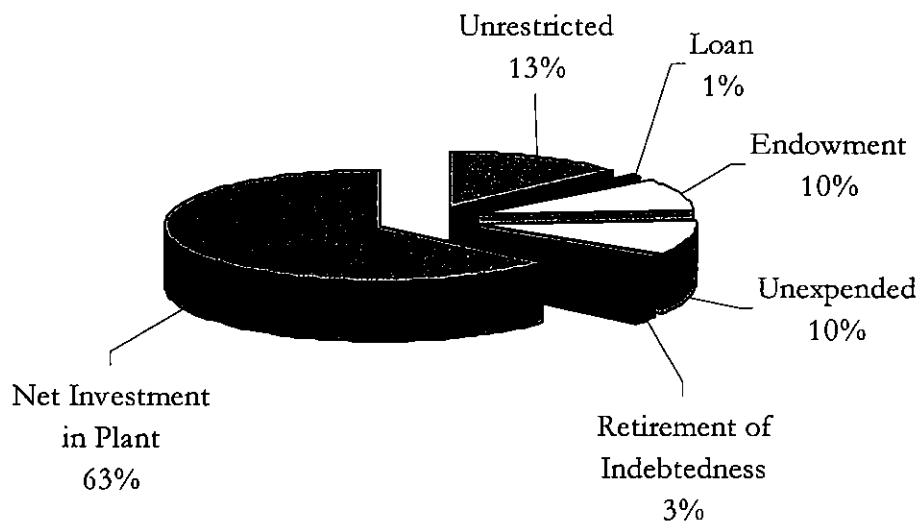


Net Assets

Net assets at June 30, 2003 totaled approximately \$122.1 million compared to \$115.7 million at June 30, 2002. Net assets invested in capital assets, net of related debt, totaled \$78.7 million versus \$68.1 million at June 30, 2002. Restricted net assets totaled \$26.5 million compared to \$31 million at June 30, 2002. Unrestricted net assets accounted for \$16.9 million versus \$16.6 million at June 30, 2002. Total net assets increased by \$6 million during the year ended June 30, 2003.

Net assets invested in capital, net of related debt, increased by \$10.6 million. Increases in net assets invested in capital assets were primarily due to \$7.5 million in capital appropriations for capital construction versus \$18.6 million last year, and \$6 million in payments of principal on debt (exclusive of bond refunding) compared to \$4.6 million during fiscal year 2002. Decrease in net assets invested in capital assets (net) were from current year depreciation of \$5.6 million compared to \$5.2 million last year, new debt issued of \$6.0 million versus \$10.9 last year, as well as disposals and sales of \$.5 million compared to \$.8 million during fiscal year 2002.

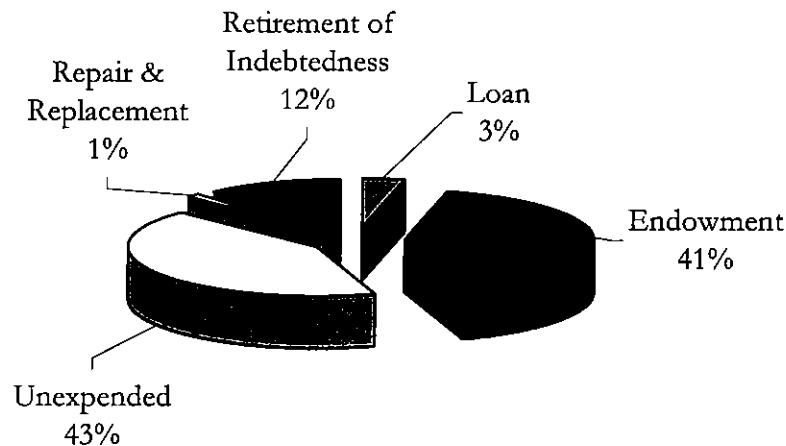
Net Assets June 30, 2003



Restricted Net Assets

Restricted net assets are subject to stipulations made by entities external to the University that govern the use of these funds. Restricted net assets decreased by \$4.4 million from the previous year to \$26.5 million. Major components of the decrease include a \$4.7 million decrease in bond sinking funds primarily from the refunding the University's Consolidated Education Building Revenue Series "I" Bonds in November 2002, \$2.6 million decrease in unexpended restricted net assets (primarily in the plant fund). In addition, the University experienced a \$2.9 million increase in endowment funds to \$11.8 million at June 30, 2003.

Restricted Net Assets June 30, 2003



Unrestricted net assets increased by \$.3 million from the previous year to \$16.9 million. Unrestricted net assets are not subject to externally imposed restrictions. However, substantially all of the unrestricted net asset balance has been allocated for the support of academic programs and other initiatives, the completion of capital projects, or working capital requirements. The allocation of unrestricted net assets as of June 30, 2003 is as follows:

Allocation of Unrestricted Net Assets (in thousands)

Working capital	\$ 7,040
Allocated project funds	905
Capital construction	2,434
Operating budgets	3,808
Accreditations	42
Internal reserves	<u>2,708</u>
Unrestricted net assets	<u>\$ 16,937</u>

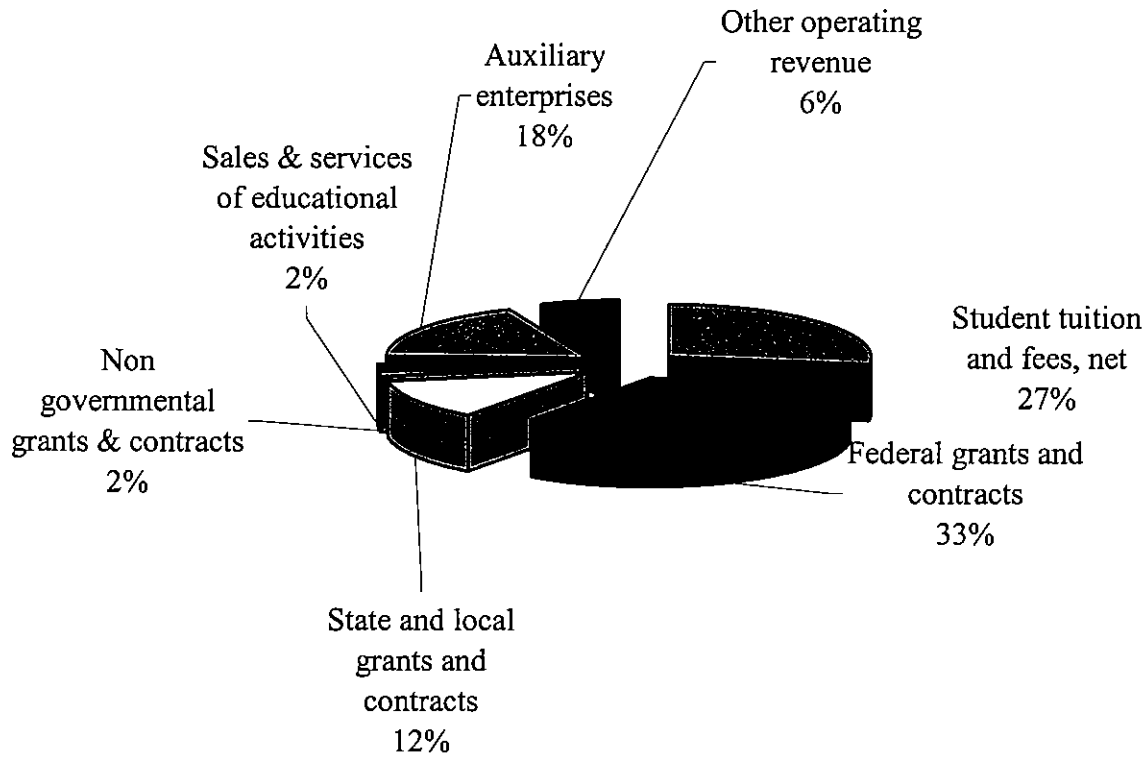
Statement of Revenues, Expenses and Changes in Net Assets (in thousands)

	<u>2003</u>	<u>2002</u>
<u>Operating Revenues</u>		
Student tuition and fees, net	\$ 16,901	\$ 15,839
Federal grants and contracts	20,351	19,445
State and local grants and contracts	7,592	5,868
Nongovernmental grants and contracts	891	552
Sales and services of educational activities	1,238	1,215
Auxiliary enterprises	11,287	11,660
Other operating revenue	<u>3,925</u>	<u>2,706</u>
Total operating revenue	62,185	57,285
<u>Operating Expenses</u>		
Educational and general	87,603	82,852
Auxiliary enterprises	9,027	8,758
Depreciation	5,695	5,283
Other operating expenses	<u>239</u>	<u>361</u>
Total operating expenses	<u>102,564</u>	<u>97,254</u>
Operating loss	(40,379)	(39,969)
<u>Nonoperating Revenues (Expenses)</u>		
State appropriations	43,116	43,034
Gifts	-	662
Investment income	651	657
Interest on capital assets - debt related	<u>(1,926)</u>	<u>(1,930)</u>
Net nonoperating revenues (expenses)	<u>41,841</u>	<u>42,423</u>
Income before other revenues, expenses, gains or losses	1,462	2,454
Capital appropriations	<u>4,980</u>	<u>10,867</u>
Increase in net assets	6,442	13,321
Net assets, beginning of year	<u>115,719</u>	<u>102,398</u>
Net assets, end of year	<u>\$ 122,161</u>	<u>\$ 115,719</u>

Revenues

Total operating revenues were approximately \$62.1 million for the year ended June 30, 2003 compared to \$57.3 million the previous year. The most significant sources of operating revenue for the University are grants and contracts and net student fees.

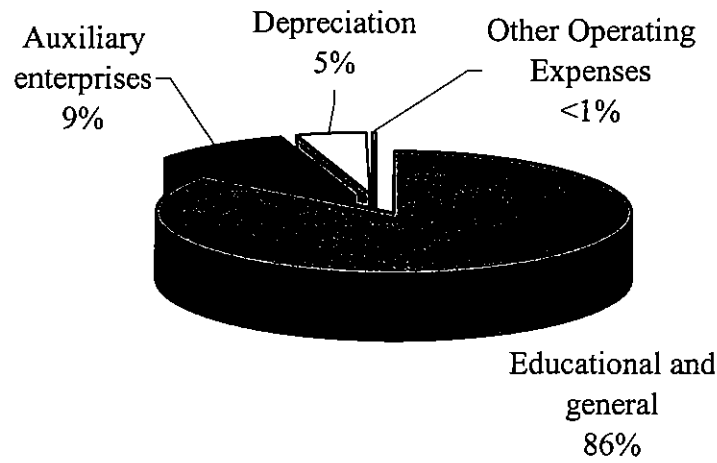
TOTAL OPERATING REVENUE June 30, 2003



Expenses

Operating expenses totaled approximately \$103 million compared to \$97 million at June 30, 2002. Of this amount, approximately \$87.6 million was used for educational and general expenses related to functions such as instruction, research, and public service.

TOTAL OPERATING EXPENSE June 30, 2003



Cash Flows

Another way to assess the financial health of an institution is to look at the Statement of Cash Flows. The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the University during the period. The Statement of Cash Flows also helps financial statement readers assess:

- the University's ability to generate future net cash flows
- the University's ability to meet obligations as they become due, and
- the University's need for external financing.

Statement of Cash Flows (in thousands)

	<u>2003</u>	<u>2002</u>
Cash Provided/Used By:		
Operating activities	\$ (38,135)	\$ (34,208)
Noncapital financing activities	43,215	43,747
Capital and related financing activities	(13,263)	(3,380)
Investing activities	<u>(2,867)</u>	<u>(3,156)</u>
Net (decrease) increase in cash	(11,050)	3,003
Cash, beginning of the year	<u>19,904</u>	<u>16,901</u>
Cash, end of the year	<u>\$ 8,854</u>	<u>\$ 19,904</u>

Major sources of funds included in operating activities are student tuition and fees (\$16.5 million versus \$15.2 million the previous year) and grants and contracts (\$27.1 million compared to \$26.7 million at June 30, 2002). The largest cash payments for operating activities were made to employees (\$61.6 million versus \$58.2 million the previous year) and suppliers (\$36.5 million compared to \$33.1 million June 30, 2002).

The largest cash receipt in the noncapital financing activities group is the operating appropriation from the Commonwealth of Kentucky of \$43.1 million versus \$43.0 million the previous year. Cash used by capital and related financing activities is primarily expended on the construction and acquisition of capital assets. Cash provided by investing activities reflects the market return on endowment investments.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation (but not of related debt), totaled approximately \$110 million at June 30, 2003, a net increase of \$5.6 million over the prior year-end. Significant changes to capital assets during fiscal 2002 - 2003 included:

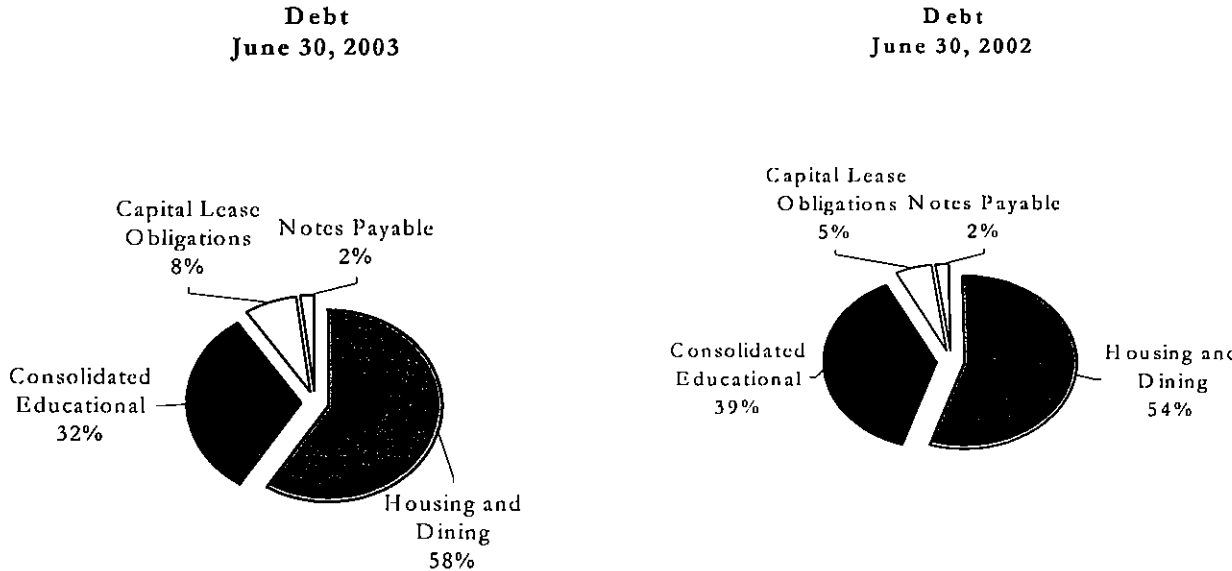
• Buildings and structures	\$9.8	million
• Land and Improvements	2.1	million
• Library additions, equipment and vehicles	1.7	million
• Net change in construction in progress	(2.9)	million
• Increase in accumulated depreciation, net	(5.1)	million

Significant new projects brought on-line included the dam repair, the acquisition of the Hogge building, the Life Safety Auxiliary Facility project, the renovation of family housing, and the acquisition of the Martindale property.

At June 30, 2003, the University has capital construction projects underway including the renovation of the Adron Doran Student Center, the Satellite Tracking Station, and the renovation of the Theater in the Combs building.

Debt

At year-end, the University had some \$31.1 million in outstanding debt verses \$36.1 the previous year with \$28.2 million in bonds payable compared to 33.5 million at June 30, 2002. In addition, the University had capital lease obligations of \$2.3 million compared to \$1.9 million the previous year-end. The University had \$.6 million in notes payable at June 30, 2003.



The University’s debt is summarized by type of debt instrument as follows (in thousands):

Housing and Dining System revenue bonds	\$ 18,355
Consolidated educational buildings revenue bonds	9,840
Capital lease obligations	2,362
Notes payable	<u>570</u>
	<u>\$ 31,127</u>

Debt outstanding decreased approximately \$5 million from the end of the prior year.

The University issued its Housing & Dining System Revenue Bonds, Series Q during the fiscal year. The bonds were dated April 16, 2003 and were issued in the principal amount of approximately \$4.8 million. The proceeds of the Series Q issue were used to refund portions of the University’s previously issued Housing & Dining System Revenue Bonds Series M.

FACTORS IMPACTING FUTURE PERIODS

The following are known facts and circumstances that could affect future financial results:

- Tuition rates for FY 2003-04 will increase approximately 15% for resident and nonresident undergraduate and graduate students. Based on actual results from the 2002-2003 fiscal year and budgeted enrollment for 2003-2004 fiscal year this should provide additional operating revenues of approximately \$2 million.
- State appropriations (less debt service) were decreased by approximately \$1 million or 2.47 % during the 2002-2003 fiscal year. The Commonwealth of Kentucky has advised the University that due to anticipated shortfalls in revenue at the state level budget cuts are imminent. In order to be proactive, the University's administration has asked all departments to submit action plans for budget cuts of 2.6% to 5.0% that can be implemented if such cuts are enacted. Due to the uncertain nature of the revenue shortfalls and budget cuts, the effect on future operations is not known at this time.
- At June 30, 2003, grants and contracts of approximately \$33 million had been awarded to the University, but not expended. These contracts will provide grant revenue to future periods.
- The University's Board of Regents has approved an operating budget for the fiscal year ending June 30, 2004 totaling \$96 million.
- The University's Board of Regents has approved an operating budget for the fiscal year ending June 30, 2004 totaling \$96 million.



Crowe Chizek and Company LLC
Member Horwath International

REPORT OF INDEPENDENT AUDITORS

Members of the Board of Regents and
Dr. Ronald G. Eaglin, President
Morehead State University
Morehead, Kentucky

We have audited the accompanying statements of net assets of Morehead State University as of June 30, 2003 and 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amount and disclosures in the financial statements. The scope of such tests and procedures equaled or exceeded the minimum audit scope compliance requirements of Kentucky Revised Statutes 164A.550 to 164A.630 (House Bill 622). An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Morehead State University as of June 30, 2003 and 2002, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 5, 2003 on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audits were performed for the purpose of forming an opinion on the basic financial statements of Morehead State University taken as a whole. The accompanying Schedule of Expenditures of Federal Awards and notes are presented for purposes of additional analysis as required by U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. In addition, the data contained on pages 38 through 41 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The Management's Discussion and Analysis (MD&A) on pages 1 through 13 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Crowe Chizek and Company LLC

Crowe Chizek and Company LLC

Louisville, Kentucky
September 5, 2003

MOREHEAD STATE UNIVERSITY
STATEMENTS OF NET ASSETS
June 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 8,854,349	\$ 19,904,545
Accounts, grants and loans receivable, net	8,317,343	5,225,717
Investments	-	479,450
Inventory	1,675,081	1,830,468
Other current assets	496,830	1,037,301
Total current assets	<u>19,343,603</u>	<u>28,477,481</u>
Noncurrent assets		
Accounts, grants and loans receivable, net	3,181,118	3,280,380
Investments	34,216,779	29,671,127
Capital assets, net	<u>109,840,928</u>	<u>104,235,933</u>
Total noncurrent assets	<u>147,238,825</u>	<u>137,187,440</u>
Total assets	<u>166,582,428</u>	<u>165,664,921</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	5,890,848	5,990,896
Deferred revenue	1,840,576	2,406,773
Other current liabilities	720,272	613,661
Bonds, notes and capital lease obligations, current portion	<u>2,981,985</u>	<u>3,103,651</u>
Total current liabilities	<u>11,433,681</u>	<u>12,114,981</u>
Noncurrent liabilities		
Bond, notes and capital lease obligations, noncurrent portion	28,144,775	33,004,681
Federal refundable grants	<u>4,843,063</u>	<u>4,826,374</u>
Total noncurrent liabilities	<u>32,987,838</u>	<u>37,831,055</u>
Total liabilities	<u>44,421,519</u>	<u>49,946,036</u>
NET ASSETS		
Invested in capital assets, net of related debt	78,714,168	68,127,601
Restricted		
Nonexpendable	-	-
Expendable	26,509,386	30,980,923
Unrestricted	<u>16,937,355</u>	<u>16,610,361</u>
Total net assets	<u>\$ 122,160,909</u>	<u>\$ 115,718,885</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
 Years ended June 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
REVENUES		
Operating revenues		
Student tuition and fees (net of scholarship allowances of \$12,998,476 and \$11,475,117)	\$ 16,900,936	\$ 15,838,505
Federal grants and contracts	20,351,171	19,445,248
State and local grants and contracts	7,591,565	5,868,272
Nongovernmental grants and contracts	891,476	551,634
Sales and services of educational activities	1,238,434	1,215,260
Auxiliary enterprises		
Residence halls (net of scholarship allowances of \$124,904 and \$115,315)	7,095,547	6,942,151
Bookstore	3,187,897	3,920,544
Other auxiliaries	1,003,058	797,597
Other operating revenues	<u>3,925,256</u>	<u>2,706,247</u>
Total operating revenues	<u>62,185,340</u>	<u>57,285,458</u>
EXPENSES		
Operating expenses		
Education and general		
Instruction	35,470,049	33,057,372
Research	1,239,926	443,931
Public service	9,273,462	9,350,617
Library	2,748,493	2,653,574
Academic support	6,047,201	6,170,341
Student services	7,064,599	7,605,556
Institutional support	10,078,772	9,492,194
Operation and maintenance of plant	6,318,881	5,633,831
Depreciation	5,011,505	4,609,142
Student aid	9,361,498	8,444,691
Auxiliary enterprises		
Residence Halls	4,547,477	4,293,991
Bookstore	3,407,945	3,580,014
Other auxiliaries	1,071,459	883,776
Depreciation	683,387	673,984
Other operating expenses	<u>239,580</u>	<u>361,562</u>
Total operating expenses	<u>102,564,234</u>	<u>97,254,576</u>
Operating loss	(40,378,894)	(39,969,118)

(Continued)

MOREHEAD STATE UNIVERSITY
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
 Years ended June 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
NONOPERATING REVENUES (EXPENSES)		
State appropriations	\$ 43,115,440	\$ 43,034,427
Gifts	-	661,473
Investment income (net of investment expense of \$77,081 and \$125,056)	651,325	656,663
Interest on capital asset - related debt	<u>(1,926,021)</u>	<u>(1,929,722)</u>
Net nonoperating revenues	<u>41,840,744</u>	<u>42,422,841</u>
 Income before other revenues, expenses, gains or losses	 1,461,850	 2,453,723
 Capital appropriations	 <u>4,980,174</u>	 <u>10,867,209</u>
 Increase in net assets	 6,442,024	 13,320,932
 Net assets, beginning of year	 115,718,885	 117,546,244
Cumulative effect of changes in accounting principle, adoption of GASB Statement No. 35	<u>-</u>	<u>(15,148,291)</u>
 Net assets, beginning of year, as restated	 <u>115,718,885</u>	 <u>102,397,953</u>
 Net assets, end of year	 <u>\$ 122,160,909</u>	 <u>\$ 115,718,885</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
Years ended June 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities		
Tuition and fees	\$ 16,517,887	\$ 15,216,558
Grants and contracts	27,174,521	26,751,717
Payments to suppliers	(36,517,013)	(33,195,466)
Payments to employees	(61,691,667)	(58,231,727)
Loans issued to students	(423,780)	(505,752)
Collection of loans issued to students	435,055	475,624
Auxiliary enterprises:		
Residence halls	7,095,879	6,588,691
Bookstore	3,107,901	3,973,633
Other auxiliaries	1,003,042	797,597
Sales and services of educational activities	1,238,434	1,215,260
Other receipts	<u>3,925,257</u>	<u>2,706,248</u>
Net cash from operating activities	(38,134,484)	(34,207,617)
Cash flows from noncapital financing activities		
State appropriations	43,115,440	43,034,427
Gifts and grants for other than capital purposes:		
Private gifts for endowment purposes	-	661,473
Student organization agency receipts	2,394,156	1,915,217
Student organization agency disbursements	<u>(2,294,954)</u>	<u>(1,864,435)</u>
Net cash from noncapital financing activities	43,214,642	43,746,682
Cash flows from capital financing activities		
Proceeds from capital debt and leases	6,030,458	10,923,875
Capital appropriations	4,980,174	10,867,209
Purchase of capital assets	(11,335,938)	(18,567,060)
Principal paid on capital debt and leases	(11,012,030)	(4,673,887)
Interest paid on capital debt and leases	<u>(1,926,021)</u>	<u>(1,929,722)</u>
Net cash flows from capital financing activities	(13,263,357)	(3,379,585)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	1,379,528	659,718
Interest received on investments	651,325	815,672
Purchase of investments	<u>(4,897,850)</u>	<u>(4,630,995)</u>
Net cash flows from investing activities	<u>(2,866,997)</u>	<u>(3,155,605)</u>
Net (decrease) increase in cash and cash equivalents	(11,050,196)	3,003,875
Cash and cash equivalents at beginning of year	<u>19,904,545</u>	<u>16,900,670</u>
Cash and cash equivalents at end of year	<u>\$ 8,854,349</u>	<u>\$ 19,904,545</u>

(Continued)

MOREHEAD STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
Years ended June 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Reconciliation of net operating income (loss) to net cash from operating activities		
Operating loss	\$ (40,378,894)	\$ (39,969,118)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation	5,694,892	5,283,126
Loss on disposal of capital assets	36,051	-
Changes in assets and liabilities:		
Receivables, net	(2,992,364)	(1,922,843)
Inventory	155,387	163,515
Accounts payable and accrued liabilities	(100,048)	700,444
Deferred revenue	(566,197)	1,521,812
Federal grants refundable	<u>16,689</u>	<u>15,447</u>
Net cash from operating activities	<u>\$ (38,134,484)</u>	<u>\$ (34,207,617)</u>

See accompanying notes.

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

**NOTE 1 - ORGANIZATION AND SUMMARY OF
SIGNIFICANT ACCOUNTING POLICIES**

Reporting Entity: Morehead State University (the University) is a component unit of the Commonwealth of Kentucky and is included in the general-purpose financial statements of the Commonwealth.

Basis of Presentation: The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The University reports as a Business Type Activity (BTA). BTAs are those activities that are financed in whole or in part by fees charged to external parties for goods and services.

Effective July 1, 2001, the University adopted GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*, as amended by GASB Statement No. 37. The University also adopted GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, on July 1, 2001. GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted:**
 - Nonexpendable*- Net assets subject to externally imposed stipulations that they be maintained permanently by the University. Such assets include the University's permanent endowment funds.
 - Expendable*- Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.
- **Unrestricted:** Net assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

**NOTE 1 - ORGANIZATION AND SUMMARY OF
SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The financial statement presentation required by GASB Statement No. 35 is intended to provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows. It replaces the fund group perspective previously required.

Fund balances as of July 1, 2001 have been restated to reflect the applications of the provisions of GASB Statement No. 35, as follows:

Combined fund balances, as previously reported	\$ 117,546,244
GASB Statement No. 35 adjustments:	
Accumulated depreciation on library books, beginning of year	(10,281,294)
Loan fund balances required to be reported as other liabilities by GASB No. 35	(4,810,927)
Grants and contracts restricted fund balances required to be reported as deferred revenue by GASB No. 35	<u>(56,070)</u>
Total GASB Statement No. 35 adjustments	<u>(15,148,291)</u>
Combined fund balances, restated as net assets	<u>\$ 102,397,953</u>

Allowance for Doubtful Accounts: The allowance for doubtful accounts is established through a provision for doubtful accounts charged to expense. The allowance represents an amount which, in management's judgment, will be adequate to absorb probable losses on existing accounts that may become uncollectible.

Inventories: Inventories representing approximately 60% and 69% of total inventories at June 30, 2003 and 2002, respectively, are stated at the lower of cost (first-in, first-out basis) or market. The remainder of the inventories is stated at the lower of moving-average-cost or market.

Investments: The University values investments at fair value based on quoted market prices.

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

**NOTE 1 - ORGANIZATION AND SUMMARY OF
SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Capital Assets: Capital assets are stated at cost for purchased assets and at fair value at date of donation in the case of gifts. Expenditures, which increase values or extend useful lives of the respective assets are capitalized, whereas expenditures for maintenance and repairs are charged to expense as incurred. Depreciation of assets is computed using the straight-line method over the assets estimated useful lives. The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research and public service. Estimated lives used for depreciation purposes are as follows:

<u>Classification</u>	<u>Estimated Life</u>
Land improvements	20 years
Buildings	50 years
Vehicles	5-9 years
Equipment	5-15 years
Library books	10 years

Accrued Vacation Pay: Accrued vacation pay is included in accounts payable and accrued liabilities in the statement of net assets and represents earned vacation available to employees at current compensation rates.

Deferred Revenue: Deferred revenues include amounts received for tuition and fees prior to the end of the fiscal year but related to the subsequent reporting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

Restricted Asset Spending Policy: The University's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination on whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

Operating Activities: The University defines operating activities, as reported on the statement of revenues, expenses and changes in net assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for services and goods received. Nearly all of the University's expenses are from exchange transactions. Certain significant revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as nonoperating revenues, in accordance with GASB Statement No. 35.

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

**NOTE 1 - ORGANIZATION AND SUMMARY OF
SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenditures during the reporting period. Actual results could differ from the estimated amounts.

Reclassification: Certain reclassifications have been made to the 2003 financial statements to conform to the classifications used in 2002.

NOTE 2 - CASH, CASH EQUIVALENTS AND INVESTMENTS

The statement of net assets classification "cash and cash equivalents" includes all readily available sources of cash such as petty cash, demand deposits, certificates of deposit and temporary investments in marketable securities with original maturities less than three months.

At June 30, 2003 and 2002, the University had petty cash funds totaling \$131,319 and \$115,969, respectively, and deposits as reflected by bank balances as follows:

	<u>2003</u>	<u>2002</u>
Insured, commercial banks	\$ 210,139	\$ 316,447
Uninsured, commercial banks; collateral held by pledging institution's agent in the University's name	7,163,088	17,248,186
Maintained by Commonwealth of Kentucky	<u>1,646,740</u>	<u>3,135,740</u>
	<u>\$ 9,019,967</u>	<u>\$ 20,700,373</u>

The difference in the cash carrying amount per the statement of net assets and the above bank balances represented items in transit.

A portion of the University's investments are held in the state depository and invested by the Commonwealth's Office of Financial Management. Investments at cost with the Commonwealth as of June 30, 2003 and 2002 were \$18,971,228 and \$20,988,039, respectively. The University's investments are classified as to credit risk by the three categories described below:

Category 1: Insured or registered, with securities held by the University or its agent in the University's name.

(Continued)

MOREHEAD STATE UNIVERSITY
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2003 and 2002

NOTE 2 - CASH, CASH EQUIVALENTS AND INVESTMENTS (Continued)

Category 2: Uninsured and unregistered, with securities held by the counter party's trust department or agent in the University's name.

Category 3: Uninsured and unregistered, with securities held by the counter party, or by its trust department or agent, but not in the University's name.

All of the University's investments are Category 1 as of June 30 and are as follows:

<u>2003</u>	<u>Cost</u>	(Carrying Value) Market Value	Unrealized Gain (Loss)
Investments held in trust	\$ 14,205,385	\$ 14,823,197	\$ 617,812
Investments in state investment pool	<u>18,971,228</u>	<u>19,393,582</u>	<u>422,354</u>
	<u>\$ 33,176,613</u>	<u>\$ 34,216,779</u>	<u>\$ 1,040,166</u>
 <u>2002</u>			
U. S. Government obligations	\$ 150,873	\$ 150,873	\$ -
Investments held in trust	9,549,810	8,804,240	(745,570)
Investments in state investment pool	<u>20,988,039</u>	<u>21,195,464</u>	<u>207,425</u>
	<u>\$ 30,688,722</u>	<u>\$ 30,150,577</u>	<u>\$ (538,145)</u>

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 3 - ACCOUNTS, GRANTS AND LOANS RECEIVABLE

Accounts, grants and loans receivable consist of the following as of June 30:

	<u>2003</u>	<u>2002</u>
Student tuition and fees	\$ 420,574	\$ 731,466
Student loans	3,546,428	3,596,556
Grants and contracts	3,200,786	3,204,108
Auxiliary enterprises	696,851	610,886
Other	<u>4,069,509</u>	<u>834,488</u>
	11,934,148	8,977,504
Less: allowance for doubtful accounts	<u>(435,687)</u>	<u>(471,407)</u>
	11,498,461	8,506,097
Current portion	<u>8,317,343</u>	<u>5,225,717</u>
Noncurrent portion	<u>\$ 3,181,118</u>	<u>\$ 3,280,380</u>

NOTE 4 - CAPITAL ASSETS, NET

Capital assets as of June 30, 2003, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land and improvements	\$ 9,136,544	\$ 2,122,170	\$ -	\$ 11,258,714
Buildings	142,742,608	9,838,999	-	152,581,607
Library books	14,275,103	988,956	-	15,264,059
Vehicles	1,754,637	265,354	113,826	1,906,165
Equipment and livestock	30,688,122	1,028,704	431,024	31,285,802
Art collection	66,075	-	-	66,075
Construction in progress	<u>6,240,254</u>	<u>7,507,467</u>	<u>10,415,711</u>	<u>3,332,010</u>
	204,903,343	21,751,650	10,960,561	215,694,432
<u>Accumulated Depreciation</u>				
Land improvements	3,415,046	277,951	-	3,692,997
Buildings	61,872,599	2,807,346	-	64,679,945
Library books	10,922,820	699,829	-	11,622,649
Vehicles	1,364,162	143,126	108,854	1,398,434
Equipment and livestock	<u>23,092,783</u>	<u>1,766,640</u>	<u>399,944</u>	<u>24,459,479</u>
	<u>100,667,410</u>	<u>5,694,892</u>	<u>508,798</u>	<u>105,853,504</u>
Capital assets, net	<u>\$104,235,933</u>	<u>\$ 16,056,758</u>	<u>\$ 10,451,763</u>	<u>\$109,840,928</u>

(Continued)

MOREHEAD STATE UNIVERSITY
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2003 and 2002

NOTE 4 - CAPITAL ASSETS, NET (Continued)

Capital assets as of June 30, 2002, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land and improvements	\$ 8,507,603	\$ 628,941	\$ -	\$ 9,136,544
Buildings	120,307,187	22,435,421	-	142,742,608
Library books	13,351,412	923,691	-	14,275,103
Vehicles	1,586,687	242,647	74,697	1,754,637
Equipment and livestock	29,566,563	1,878,890	757,331	30,688,122
Art collection	66,075	-	-	66,075
Construction in progress	<u>13,782,784</u>	<u>17,248,442</u>	<u>24,790,972</u>	<u>6,240,254</u>
	187,168,311	43,358,032	25,623,000	204,903,343
 <u>Accumulated Depreciation</u>				
Land improvements	3,194,923	220,123	-	3,415,046
Buildings	59,358,830	2,513,769	-	61,872,599
Library books	10,281,294	641,526	-	10,922,820
Vehicles	1,317,897	111,782	65,517	1,364,162
Equipment and livestock	<u>21,987,317</u>	<u>1,795,926</u>	<u>690,460</u>	<u>23,092,783</u>
	<u>96,140,261</u>	<u>5,283,126</u>	<u>755,977</u>	<u>100,667,410</u>
 Capital assets, net	 <u>\$ 91,028,050</u>	 <u>\$ 38,074,906</u>	 <u>\$ 24,867,023</u>	 <u>\$104,235,933</u>

NOTE 5 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, are as follows:

	<u>2003</u>	<u>2002</u>
Payable to vendors and contractors	\$ 1,935,482	\$ 1,753,174
Accrued vacation	1,447,439	1,350,898
Accrued salaries and other liabilities	<u>2,507,927</u>	<u>2,886,824</u>
	 <u>\$ 5,890,848</u>	 <u>\$ 5,990,896</u>

(Continued)

MOREHEAD STATE UNIVERSITY
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2003 and 2002

NOTE 6 - DEFERRED REVENUE

Deferred revenue consists of the following as of June 30:

	<u>2003</u>	<u>2002</u>
Unearned summer school tuition and fees	\$ -	\$ 677,471
Unearned grants and contracts	<u>1,840,576</u>	<u>1,729,302</u>
	<u>\$ 1,840,576</u>	<u>\$ 2,406,773</u>

NOTE 7 - LONG-TERM LIABILITIES

Long-term liabilities at June 30, 2003, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Housing and Dining System Revenue Bonds	\$ 19,615,000	\$ 4,485,000	\$ 5,745,000	\$ 18,355,000	\$ 1,400,000	\$ 16,955,000
Consolidated Educational Building Revenue Bonds	13,925,000	-	4,085,000	9,840,000	1,000,000	8,840,000
Capital lease obligations	1,888,332	1,545,458	1,072,030	2,361,760	471,985	1,889,775
Notes payable	<u>680,000</u>	<u>-</u>	<u>110,000</u>	<u>570,000</u>	<u>110,000</u>	<u>460,000</u>
Total bonds, notes and capital lease obligations	36,108,332	6,030,458	11,012,030	31,126,760	2,981,985	28,144,775
Federal refundable grants	<u>4,826,374</u>	<u>16,689</u>	<u>-</u>	<u>4,843,063</u>	<u>-</u>	<u>4,843,063</u>
Total long-term liabilities	<u>\$ 40,934,706</u>	<u>\$ 6,047,147</u>	<u>\$ 11,012,030</u>	<u>\$ 35,969,823</u>	<u>\$ 2,981,985</u>	<u>\$ 32,987,838</u>

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 7 - LONG-TERM LIABILITIES (Continued)

Long-term liabilities at June 30, 2002, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Housing and Dining System Revenue Bonds	\$ 15,970,000	\$ 5,125,000	\$ 1,480,000	\$ 19,615,000	\$ 1,360,000	\$ 18,255,000
Consolidated Educational Building Revenue Bonds	11,310,000	4,875,000	2,260,000	13,925,000	945,000	12,980,000
Capital lease obligations	2,578,344	133,875	823,887	1,888,332	688,651	1,199,681
Notes payable	<u>-</u>	<u>790,000</u>	<u>110,000</u>	<u>680,000</u>	<u>110,000</u>	<u>570,000</u>
Total bonds, notes and capital lease obligations	29,858,344	10,923,875	4,673,887	36,108,332	3,103,651	33,004,681
Federal refundable grants	<u>4,810,927</u>	<u>15,447</u>	<u>-</u>	<u>4,826,374</u>	<u>-</u>	<u>4,826,374</u>
Total long-term liabilities	<u>\$ 34,669,271</u>	<u>\$ 10,939,322</u>	<u>\$ 4,673,887</u>	<u>\$ 40,934,706</u>	<u>\$ 3,103,651</u>	<u>\$ 37,831,055</u>

The following is a summary of bonds, capital lease obligations and notes payable at June 30:

	<u>2003</u>	<u>2002</u>
2.75 - 7.15% Housing and Dining System Revenue Bonds, Series H, I, N, O, P, and Q, repayable in annual installments with the final installment due May, 2021	\$ 18,355,000	\$ 19,615,000
5.50 - 6.875% Consolidated Educational Building Revenue Bonds, Series H, I, K, and L, repayable in annual installments with the final installment due May, 2014	9,840,000	13,925,000
5.20% Capital lease obligation with a finance corporation, repayable in semi-annual installments, paid off in fiscal year 2003	-	298,333
6.00% Capital lease obligation with MSU Foundation, repayable in monthly installments, paid off in fiscal year 2003	-	119,929

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 7 – LONG-TERM LIABILITIES (Continued)

	<u>2003</u>	<u>2002</u>
5.00% Capital lease obligation with MSU Foundation, repayable in monthly installments with the final installment due February, 2019	205,320	213,752
4.55% Capital lease obligation with a finance corporation, repayable in semi-annual installments with the final installment due October, 2003	65,627	192,534
4.3531% Capital lease obligation with a finance corporation, repayable in semi-annual installments, paid off in 2003	-	54,186
5.07% Capital lease obligation with a finance corporation, repayable in semi-annual installments with the final installment due January, 2005	434,313	635,695
5.04% Capital lease obligation with a finance corporation, repayable in semi-annual installments with the final installment due January, 2006	287,287	373,903
5.00% note payable to an individual, repayable in annual installments with the final installment due June, 2010	500,000	600,000
5.00% note payable to an individual, repayable in annual installments with the final installment due June, 2010	70,000	80,000
5.75% capital lease obligation with MSU Foundation, repayable in monthly installments with the final installment due June, 2012	907,425	-
5.00% capital lease obligation with MSU Foundation, repayable in monthly installments with the final installment due June, 2004	<u>461,788</u>	<u>-</u>
	<u>\$ 31,126,760</u>	<u>\$ 36,108,332</u>

(Continued)

MOREHEAD STATE UNIVERSITY
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2003 and 2002

NOTE 7 - LONG-TERM LIABILITIES (Continued)

In order to retire the revenue bonds, the University is required to make deposits to sinking funds in annual amounts sufficient to meet the principal and interest payments due within the next twelve months. As of June 30, 2003 and 2002, the reserve requirements have been fully funded.

The revenue bonds are collateralized by various buildings. The revenues derived from student registration fees and residence hall rental fees are pledged as collateral on the revenue bond issues.

The following equipment held under capital lease obligations at June 30:

	<u>2003</u>	<u>2002</u>
Equipment	\$ 4,047,618	\$ 3,762,432
Less: accumulated depreciation	<u>2,943,278</u>	<u>2,556,849</u>
	<u>\$ 1,104,340</u>	<u>\$ 1,205,583</u>

The following is a schedule by years of future minimum payments required for the capital lease obligations as of June 30, 2003:

	<u>Capital Leases</u>
Year Ending June 30,	
2004	\$ 603,319
2005	536,199
2006	305,112
2007	200,725
2008	200,725
Thereafter	<u>1,433,812</u>
Total minimum lease payments	3,279,892
Less: amounts representing interest	<u>918,132</u>
Present value of minimum lease payments	<u>\$ 2,361,760</u>

(Continued)

MOREHEAD STATE UNIVERSITY
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2003 and 2002

NOTE 7 - LONG-TERM LIABILITIES (Continued)

The principal and interest repayment requirements relating to the outstanding bonds and notes payable at June 30, 2003, are as follows:

Year ending June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 2,510,000	\$ 1,325,754	\$ 3,835,754
2005	2,630,000	1,200,224	3,830,224
2006	2,650,000	1,087,976	3,737,976
2007	2,585,000	973,304	3,558,304
2008	2,310,000	853,644	3,163,644
2009-2021	<u>16,080,000</u>	<u>3,857,653</u>	<u>19,937,653</u>
	<u>\$ 28,765,000</u>	<u>\$ 9,298,555</u>	<u>\$ 38,063,555</u>

NOTE 8 - PENSION PLAN

Kentucky Teachers Retirement System: All faculty and exempt employees required to hold a degree and occupying full-time positions, defined as seven-tenths (7/10) of normal full-time service on a daily or weekly basis, are required by state law to participate in the Kentucky Teachers Retirement System (KTRS). KTRS, a cost sharing, multiple-employer, public employee retirement system, provides retirement benefits based on an employee's final average salary and number of years service. Benefits are subject to certain reductions if the employee retires before reaching age sixty, unless the employee has twenty-seven or more years of participation in the plan. The plan also provides for disability retirement, death and survivor benefits, and medical insurance.

The Kentucky Teachers Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Teachers Retirement System, 479 Versailles Road, Frankfort, Kentucky 40601-3868 or by calling (502) 573-5120.

Funding for the plan is provided from eligible employees who contribute 6.16% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 13.84% of current eligible employees' salaries to the KTRS through appropriations to the University. Contribution requirements of the plan members and the University are established by Kentucky Revised Statute and the KTRS Board of Trustees. The University's contributions to KTRS for the years ending June 30, 2003, 2002 and 2001 were \$3,471,705, \$3,381,575 and \$3,043,873, respectively, equal to the required contributions for each year.

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 8 - PENSION PLAN (Continued)

Kentucky Employee Retirement System: Substantially all other full-time University employees are required by law to participate in the Kentucky Employees Retirement System (KERS), a cost sharing multiple-employer, public employee retirement system. KERS provides retirement benefits based on an employee's final average salary and number of years of service. Benefits are subject to certain reductions if the employee retires before reaching age sixty-five, or less than twenty-seven years of service. The plan also provides for disability retirement, death and survivor benefits and medical insurance.

The Kentucky Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Employees Retirement System, 1260 Louisville Road, Perimeter Park West, Frankfort, Kentucky 40601 or by calling (502) 564-4646.

Funding for the plan is provided from eligible employees who contribute 5.00% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 5.89% of current eligible employees' salaries to the KERS through appropriations to the University. University contribution rates are determined by the Kentucky Revised Statute and the Board of Trustees of the Kentucky Retirement Systems each biennium. The University's contributions to KERS for the years ending June 30, 2003, 2002 and 2001 were \$573,276, \$540,971 and \$580,052, respectively, equal to the required contributions for each year.

Optional Retirement Plans: Optional retirement plans (ORP's) are available to employees hired on or after January 1, 1997, who would otherwise be participants in the Kentucky Teachers' Retirement System. The ORP is established as a 403(b) defined contribution plan under the Internal Revenue Code guidelines. The providers of the University's ORP's are the Teachers Insurance and Annuity Association-College Retirement Equities Fund, Variable Annuity Life Insurance Company and Aetna Life Insurance and Annuity Company. Under these plans the employee's contribution is 6.16% of their gross salary and the University's contribution is 10.76% to the retirement company and 4.08% to Kentucky Teachers Retirement System. The University's contributions under these plans for the years ending June 30, 2003, 2002 and 2001 were \$328,230, \$220,759 and \$134,616, respectively, equal to the required contributions for each year.

NOTE 9 - LEASES

The University has operating lease agreements for use of equipment and various parcels of real estate cancelable annually with the option to renew. The University recognizes the expenditures related to those obligations as lease payments are made. Total rent expenses under operating type leases were approximately \$497,000 in 2003 and 2002.

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 10 - CONTINGENCIES AND COMMITMENTS

The University is defendant in several lawsuits; however, University management is of the opinion, based on advice of legal counsel, that the ultimate resolution of these litigation matters will not have a material effect on the future operations or financial position of the University.

The University has made certain commitments related to the completion of various construction in progress totaling approximately \$11,200,000. Such construction is principally financed by appropriations from the Commonwealth of Kentucky and proceeds from bonds.

NOTE 11 - SELF-INSURANCE PROGRAM

The University maintains a self-insurance program for employees' health and dental insurance. The University funds the plan at the single rate for all permanent full-time employees with the employees paying the difference between the single plan and the family plan, if applicable. Expenses incurred to cover claims paid by the University under the plan for fiscal year ending June 30, 2003 and 2002 totaled \$4,746,014 and \$4,490,435, respectively.

NOTE 12 - RISK MANAGEMENT

The University is exposed to various risks of loss from torts; theft of, damage to, destruction of assets; business interruption; employee injuries and illnesses; natural disasters; and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from theft of, damage to, destruction of assets; business interruption; employee injuries and illnesses; natural disasters; and employee health and accident benefits. Settled claims have not exceeded this commercial coverage in any of the three preceding years. As a sovereign entity of the Commonwealth of Kentucky, the Kentucky Board of Claims handles tort claims on behalf of the University.

The Commonwealth of Kentucky operates a public entity risk pool operating as a common risk management and insurance program for its members. The University pays an annual premium to the pool for its workers' compensation insurance coverage. The pool's governing agreement specifies that the pool will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of specified stop loss amounts.

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 13 - KENTUCKY FOLK ART CENTER, INC.

The Kentucky Folk Art Center, Inc. (the KFAC) provides educational opportunities, benefits and programs to the public to enhance the awareness of and foster an appreciation and understanding of contemporary folk art. Under an operating agreement, the University provides office space and certain administrative services to the KFAC at no charge. As a result of the 1998 General Assembly's legislative decision to appropriate \$200,000 annually to KFAC as an affiliate of the University, the KFAC became an affiliated corporation in accordance with the provisions of KRS 164A.610. The financial statements of this affiliated corporation are reported upon separately.

NOTE 14 - MOREHEAD STATE UNIVERSITY FOUNDATION, INC.

These financial statements do not include the assets, liabilities, fund balances and current revenues and expenditures relating to Morehead State University Foundation, Inc. (the Foundation). Under an operating agreement, the University is reimbursed for office space and certain administrative services provided to the Foundation. The financial statements of the Foundation are issued separately. The Foundation is a non-profit, non-affiliated Kentucky corporation formed for educational and charitable purposes in accordance with the provisions of ICRS 273.

GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units - an amendment of GASB Statement No. 14*, is effective for the fiscal year ended June 30, 2004. This Statement will require reporting, as a component unit, an organization that raises and holds economic resources for the direct benefit of a governmental unit. Pertinent information regarding the Foundation will be reviewed to determine if it will be reported as a component unit of the University for the fiscal year ended June 30, 2004.

NOTE 15 - SEGMENT INFORMATION

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds are outstanding. A segment has a specifically identifiable revenue stream pledged in support of revenue bonds and has related expenses, gains and losses, assets, and liabilities, that are required by an external party to be accounted for separately. The University has one segment that meets the reporting requirements of GASB Statement No. 35, which is the University Housing and Dining System.

The Housing and Dining System is an organizational unit of the University that manages the University's student dormitory housing units. The gross revenues from the dormitory housing units are pledged for retirement of the Housing and Dining System Revenue Bonds.

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 15 - SEGMENT INFORMATION (Continued)

Condensed Statement of Net Assets at June 30:

	2003	2002
	<u>Housing</u>	<u>Housing</u>
	<u>and Dining</u>	<u>and Dining</u>
Assets		
Current assets	\$ 5,418,662	\$ 6,353,129
Noncurrent assets	-	150,873
Capital assets, net	<u>22,193,177</u>	<u>21,401,486</u>
Total assets	<u>27,611,839</u>	<u>27,905,488</u>
Liabilities		
Current liabilities	1,400,000	1,360,000
Noncurrent liabilities	<u>16,955,000</u>	<u>18,255,000</u>
Total liabilities	<u>18,355,000</u>	<u>19,615,000</u>
Net assets		
Invested in capital, net of related debt	3,838,177	1,786,486
Restricted, expendable	<u>5,418,662</u>	<u>6,504,002</u>
Total net assets	<u>\$ 9,256,839</u>	<u>\$ 8,290,488</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30:

	2003	2002
	<u>Housing</u>	<u>Housing</u>
	<u>and Dining</u>	<u>and Dining</u>
Operating revenues	\$ 7,138,024	\$ 6,916,394
Operating expenses	(4,547,477)	(4,293,991)
Depreciation expense	<u>(731,727)</u>	<u>(655,366)</u>
Operating income	1,858,820	1,967,037
Nonoperating revenue	84,427	141,072
Nonoperating expenses	<u>(976,896)</u>	<u>(1,006,154)</u>
Excess of revenues over expenses	966,351	1,101,955
Net assets, beginning of year	<u>8,290,488</u>	<u>7,188,533</u>
Net assets, end of year	<u>\$ 9,256,839</u>	<u>\$ 8,290,488</u>

(Continued)

MOREHEAD STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002

NOTE 15 - SEGMENT INFORMATION (Continued)

Condensed Statement of Cash Flows for the years ended June 30:

	2003 Housing and Dining	2002 Housing and Dining
Net cash flows from operating activities	\$ 2,590,547	\$ 2,622,403
Net cash flows from investing activities	(810,564)	(1,912,151)
Net cash flows from capital and related financing activities	<u>(3,760,314)</u>	<u>(166,435)</u>
Net (decrease) increase in cash and cash equivalents	(1,980,331)	543,817
Cash and cash equivalents, beginning of year	<u>2,682,288</u>	<u>2,138,471</u>
Cash and cash equivalents, end of year	<u>\$ 701,957</u>	<u>\$ 2,682,288</u>

SUPPLEMENTAL INFORMATION

MOREHEAD STATE UNIVERSITY
SCHEDULE OF BONDS, NOTES AND OTHER LONG-TERM PAYABLES
June 30, 2003

Housing and Dining System Revenue Bonds:	Issue Date	Amount of Issuance	Net Interest Cost	Outstanding June 30, 2002	Bonds Retired 2002-03	New Issues	Outstanding June 30, 2003	Interest Paid 2002-03	Debt Service Requirements	
									Principal	Interest
Series G	11-01-66	1,340,000	3.5000	75,000	75,000	-	-	1,313	-	-
Series H	11-01-66	1,840,000	3.7500	250,000	80,000	-	170,000	7,875	85,000	4,781
Series I	11-01-66	3,920,000	3.0000	690,000	165,000	-	525,000	18,225	170,000	13,200
Series M	10-01-91	6,675,000	6.00-6.30	4,680,000	4,680,000	-	-	-	-	-
Series N	06-01-00	4,790,000	5.00-5.75	4,650,000	150,000	-	4,500,000	281,615	155,000	241,404
Series O	06-01-00	4,625,000	5.00-5.25	4,345,000	415,000	-	3,930,000	249,029	440,000	190,155
Series P	07-01-01	5,125,000	2.75-4.90	4,925,000	180,000	-	4,745,000	211,530	185,000	201,650
Series Q	04-16-03	4,485,000	3.00-3.50	-	-	4,485,000	4,485,000	207,310	365,000	145,894
Total housing and dining system		32,800,000		19,615,000	5,745,000	4,485,000	18,355,000	976,897	1,400,000	797,084
Consolidated Educational Building Revenue Bonds:										
Series H	12-01-86	3,160,000	6.60-6.875	295,000	295,000	-	-	19,913	-	-
Series I	06-01-92	5,700,000	5.90-6.00	3,695,000	3,410,000	-	285,000	126,265	285,000	16,815
Series K	02-01-95	7,055,000	5.50-5.75	5,100,000	310,000	-	4,790,000	290,755	325,000	273,705
Series L	12-01-01	4,875,000	5.50-5.75	4,835,000	70,000	-	4,765,000	185,925	390,000	184,000
Total educational buildings		20,790,000		13,925,000	4,085,000	-	9,840,000	622,858	1,000,000	474,520
Lease Purchase Agreements:										
G. E. Capital Public Finance	12-01-98	1,123,416	4.3531	54,186	54,186	-	-	1,187	-	-
G. E. Capital Public Finance	10-27-98	594,325	4.5500	192,534	126,907	-	65,627	7,333	65,627	1,493
G. E. Capital Public Finance	09-08-99	753,600	5.2000	298,333	298,333	-	-	15,646	-	-
G. E. Capital Public Finance	01-26-01	828,494	5.0700	635,695	201,382	-	434,313	29,709	91,035	13,349
Public Finance MSU Foundation, Inc.	01-26-01	457,000	5.0400	373,903	86,616	-	287,287	17,767	211,721	19,370
MSU Foundation, Inc.	03-01-99	240,000	5.0000	213,752	8,432	-	205,320	10,496	8,863	10,065
MSU Foundation, Inc.	07-01-01	135,000	6.0000	119,929	119,929	-	-	-	-	-
MSU Foundation, Inc.		89,000		-	89,000	89,000	-	-	-	-
MSU Foundation, Inc.	10-21-02	466,458		-	4,670	466,458	461,788	25,671	8,563	43,451
MSU Foundation, Inc.	07-15-02	990,000	5.2500	-	82,575	990,000	907,425	47,209	86,176	43,608
Total lease purchase agreements		5,677,293		1,888,332	1,072,030	1,545,458	2,361,760	155,018	471,985	131,336

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF BONDS, NOTES AND OTHER LONG-TERM PAYABLES
 June 30, 2003

Notes Payable:	Issue Date	Amount of Issue	Net Interest Cost	Outstanding June 30, 2002	Bonds Retired 2002-03	New Issues	Outstanding June 30, 2003	Interest Paid 2002-03	Debt Service Requirements	
									Principal	Interest
Fred White	07-01-01	700,000	5,000	600,000	100,000	-	500,000	57,000	100,000	47,500
Freddie White	07-01-01	90,000	5,000	80,000	10,000	-	70,000	7,600	10,000	6,650
Total notes payable		790,000		680,000	110,000		570,000	64,600	110,000	54,150
Total		\$ 60,057,292		\$ 36,108,332	\$ 11,012,030	\$ 6,030,458	\$ 31,126,760	\$ 1,819,373	\$ 2,981,985	\$ 1,457,090

(Continued)

MOREHEAD STATE UNIVERSITY
SCHEDULES OF HOUSING SYSTEM
REVENUES AND EXPENDITURES
Year ended June 30, 2003

REVENUES	
Housing fees	\$ 7,138,024
Interest income	<u>82,427</u>
	<u>7,220,451</u>
OPERATING EXPENDITURES	
Residence hall grants	124,094
Maintenance and IT allocations	2,246,764
Residence hall services	920,063
Student housing	820,511
Telephone	296,472
Married student housing	<u>139,573</u>
	<u>4,547,477</u>
REVENUE IN EXCESS OF OPERATING EXPENDITURES	2,672,974
DEBT SERVICE EXPENDITURES	
Principal	1,360,000
Interest	<u>933,046</u>
	<u>2,293,046</u>
REVENUES IN EXCESS OF EXPENDITURES	<u>\$ 379,928</u>

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF BOND RESERVES
 June 30, 2003

	Sinking Fund	Housing and Dining System Debt Service Reserve Fund	Repair Fund	Consolidated Educational Building Bonds	Totals
Balances, beginning of year	\$ 15,218	\$ 4,182,926	\$ 306,343	\$ 3,880,003	\$ 8,384,490
Receipts and other additions:					
Transfers, net	4,780,290	-	75,888	250,859	5,107,037
Bond proceeds	-	-	-	-	-
Income from investments	<u>2,288</u>	<u>32,344</u>	<u>3,555</u>	<u>31,536</u>	<u>69,723</u>
Total available funds	<u>4,782,578</u>	<u>32,344</u>	<u>79,443</u>	<u>282,395</u>	<u>5,176,760</u>
Disbursements and other deductions:					
Transfers, net	-	189,737	-	1,198,783	1,388,520
Redemption of bonds	4,147,800	-	-	-	4,147,800
Payment of interest	622,858	-	-	-	622,858
Administrative fees	<u>1,210</u>	<u>-</u>	<u>-</u>	<u>2,059</u>	<u>3,269</u>
Total disbursements and other deductions	<u>4,771,868</u>	<u>189,737</u>	<u>-</u>	<u>1,200,842</u>	<u>6,162,447</u>
Balances, end of year	<u>\$ 25,928</u>	<u>\$ 4,025,533</u>	<u>\$ 385,786</u>	<u>\$ 2,961,556</u>	<u>\$ 7,398,803</u>

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2003

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>CFDA #</u>	<u>Grant Period</u>	<u>Grant Amount</u>	<u>Expenditures</u>
RESEARCH AND DEVELOPMENT:				
United States Department of Health and Human Services:				
Passed through Institute on Health - NIH - Amphetamine				
	93.279	7/1/02-6/30/05	\$ 115,625	\$ 26,136
UNITED STATES DEPARTMENT OF EDUCATION:				
Direct Programs - Fullbright 2002				
	84.000	6/1/02-8/31/02	15,000	4,139
Passed through Boyd County Schools - Cool Camp '02				
	84.000	10/1/01-6/30/03	38,903	<u>4,794</u> 8,933
UNITED STATES DEPARTMENT OF AGRICULTURE:				
Direct programs - Breeding Bird 02-04				
	10.000	5/1/02-4/30/04	20,324	12,433
Passed through National Forest Service - Forest Damage '02				
	10.664	1/1/02-7/1/03	24,900	<u>15,170</u> 27,603
DEPARTMENT OF COMMERCE: Tri-State Study 02-03				
	11.303	7/1/02-6/30/03	20,000	19,986
DEPARTMENT OF HOUSING/ URBAN DEPARTMENT				
Direct Programs - COPC 02-05				
	14.511	10/1/02-9/30/05	399,999	79,245
Passed through KY Housing Corporation - KY Homeless 00-03				
	14.239	10/23/00-7/31/03	69,566	2
Geological Map 02-03				
	15.810	3/15/02-5/14/03	9,000	<u>8,332</u> 87,579
NATIONAL AERONAUTICS AND SPACE ADMIN: Passed through University of Alabama - NOVA Conference '02				
	43.001	3/1/02-3/31/03	439	439

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2003

Federal Grantor/Pass Through Grantor/Program Title	CFDA #	Grant Period	Grant Amount	Expenditures
NATIONAL SCIENCE FOUNDATION:				
Direct programs -				
Shape Changes 02-04	47.076	4/1/02-3/31/04	22,500	3,221
Passed through University of KY Research Foundation -				
Planetary Neb. 02-04	47.076	4/1/02-3/31/04	21,829	7,111
Cortex Context 02-04	47.076	4/1/02-3/31/04	24,950	19,105
AMSP 02-03	47.076	10/1/02-9/30/03	140,500	82,103
Root Farm 02-04	47076	4/1/02-3/31/03	20,369	13,519
Memory Project 02-04	47.076	4/1/02-3/31/04	24,998	16,709
				<u>141,768</u>
Total Research and Development				<u>312,444</u>
UNITED STATES DEPARTMENT OF HEALTH AND HUMAN SERVICES:				
Passed through National Collegiate Athletics Association -				
NYSP Summer Food '02	93.570	6/19/02-7/26/02	22,415	18,919
NYSP 2002	93.570	1/1/02-8/31/02	63,500	47,319
				<u>66,238</u>
Passed through KY Dept. Mental Health Services -				
KIP Project 01-02	93.230	7/1/01-6/30/02	87,875	9
Passed through KY Cabinet Families And Children -				
STEPS 01-02	93.558	7/1/01-6/30/02	51,621	3,756
STEPS 02-03	93.588	7/1/02-6/30/03	51,621	25,535
				<u>29,291</u>
Passed through KY Cabinet Families and Children to Eastern KY Univ. -				
MSU Training Center 01-02	93.658	7/1/01-6/30/02	90,126	34
MSU Training Center 02-03	93.658	7/1/02-6/30/03	90,126	76,159
Public Child Welfare 01-02	93.648	7/1/01-6/30/02	76,208	(11)
Public Child Welfare 02-03	93.648	7/1/02-6/30/03	8,810	6,432
				<u>82,614</u>

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2003

Federal Grantor/Pass Through Grantor/Program Title	CFDA #	Grant Period	Grant Amount	Expenditures
Passed through University of Kentucky				
Research Foundation -				
Nurse Practitioner '01	93.247	1/1/01-6/30/04	28,088	15,488
Passed through KY Association of Senior				
Service Corps Program -				
KY Seniors Project 01-02	93.048	7/1/01-6/30/02	20,075	1
KY Medicare 02-03	93.048	7/1/02-6/30/03	26,300	<u>25,632</u>
				25,633
Total U.S. Department of Health And Human Services				<u>219,273</u>
UNITED STATES DEPARTMENT OF EDUCATION:				
Direct Programs -				
PT-3 Grant 00-04	84.342	6/1/00-5/31/04	1,325,497	331,874
CEOC - NE 99-03	84.066	9/1/99-8/31/03	687,929	406,963
CEOC - SE 02-03	84.066	9/1/02-8/31/03	190,000	144,638
Gear-up IRAPP 00-03	84.334	9/15/00-9/14/03	2,338,947	1,738,570
High Risk Drink 99-02	84.184	10/1/99-12/31/03	249,069	4,945
High Risk Drink 02-04	84.184	10/1/02-6/30/04	75,000	29,853
International 01-03	84.016	10/1/99-12/31/03	134,256	50,904
Student Support Services 97-01	84.042	9/1/97-8/31/02	895,164	881
Student Support Services 01-03	84.042	9/1/97-6/30/03	558,806	271,618
Talent Search 98-02	84.044	9/1/98-8/31/02	991,909	71,219
Talent Search 02-03	84.044	9/1/02-8/31/03	410,941	315,650
Talent Search II 98-02	84.044	9/1/98-8/31/02	582,476	43,849
Talent Search II 02-03	84.044	9/1/02-8/31/03	288,500	173,441
Title III Plan 02-03	84.031	10/1/02-9/20/03	34,948	8,663
Upward Bound 00-04	84.047	6/1/00-5/31/04	1,060,542	574,682
Upward Bound II 99-03	84.047	9/1/99-8/31/03	480,600	309,257
Upward Bound Math/Science 99-03	84.047	9/1/99-8/31/03	417,000	230,802
Federal Work Study	84.033	7/1/02-6/30/03	972,877	808,108
Pell Grant Program	84.063	7/1/02-6/30/03	10,763,372	10,763,372
SEOG	84.007	7/1/02-6/30/03	338,017	467,197
Perkins Loan Program	84.038	7/1/02-6/30/03	750,000	4,238,129
Federal Direct Loans	84.268	7/1/02-6/30/03	17,112,894	<u>17,112,894</u>
				38,097,509
Passed through National Writing				
Project Corp. -				
National Writing Project 01-02	84.298	7/1/01-6/30/02	25,000	204
National Writing Project 02-03	84.298	7/1/02-6/30/03	28,000	<u>27,978</u>
				28,182

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2003

Federal Grantor/Pass Through Grantor/Program Title	CFDA #	Grant Period	Grant Amount	Expenditures
Passed through Kentucky Postcouncil on Secondary Education-				
KY GearUp 02-03	84.334	9/15/02-9/14/03	415,516	191,712
KY GearUp 01-02	84.334	9/15/01-9/14/02	177,361	88,031
Content Area Rd. 02-03	84.000	1/1/02-6/30/03	39,903	17,416
Life Universe 02-03	84.000	1/1/02-6/30/03	57,864	23,879
				321,038
Passed through KY Cabinet for Health Services -				
Regional Tech 01-02	84.181	7/1/00-6/30/02	118,179	361
Passed through KY Dept. of Education -				
First Steps 02-03	84.181	7/1/02-6/30/03	118,176	114,017
Scholastic Adt 02-03	84.369	9/1/02-6/30/03	58,750	14,527
				128,544
Passed through KY Workforce Development Cabinet -				
MSU Adult Learn 01-02	84.002	7/1/01-6/30/02	130,412	4
MSU Adult Learn 02-03	84.002	7/1/02-6/30/03	169,419	164,371
W Liberty AL Ctr. 01-02	84.002	7/1/01-6/30/02	195,945	931
W Liberty AL Ctr. 02-03	84.002	7/1/02-6/30/03	242,080	234,053
Family Literacy/WL 01-02	84.002	7/1/01-6/30/02	20,080	424
Auto CAD '02	84.002	6/1/02-8/30/02	331	330
TEEP - Family 01-02	84.048	7/1/01-6/30/02	3,000	(15)
TEEP - Tech 01-02	84.048	7/1/01-6/30/02	7,000	538
TEEP - Agriculture 01-02	84.048	7/1/01-6/30/02	8,000	(11)
TEEP - Bus/Mkt 01-02	84.048	7/1/01-6/30/02	4,500	15
TEEP - Prof Dev 01-02	84.048	7/1/01-6/30/02	15,000	4,731
TEEP - Family 02-03	84.048	7/1/02-6/30/03	3,000	2,943
TEEP - Bus./Mkt 02-03	84.048	7/1/02-6/30/03	6,289	6,269
TEEP - Agriculture 02-03	84.048	7/1/02-6/30/03	3,715	3,748
TEEP - Tech 02-03	84.048	7/1/02-6/30/03	7,196	5,865
TEEP - Prof. Dev. 02-03	84.048	7/1/02-6/30/03	15,000	13,468
Seminar '02	84.048	4/1/02-6/30/03	35,000	3,354
Title Ic - Ind. Ed. 01-02	84.048	7/1/01-6/30/02	36,000	2,088
Title Ic - BIS 01-02	84.048	7/1/01-6/30/02	30,700	300
Title Ic - Vet 01-02	84.048	7/1/01-6/30/02	38,415	10,580
Title Ic - RS 01-02	84.048	7/1/01-6/30/02	26,500	2,241
Title Ic - ADN 02-03	84.048	7/1/02-6/30/03	42,444	29,439
Title Ic - RS 02-03	84.048	7/1/02-6/30/03	26,600	26,588
Title Ic - IET 02-03	84.048	7/1/02-6/30/03	36,000	35,759
Title Ic - IS 02-03	84.048	7/1/02-6/30/03	37,000	37,707
Title Ic - VET 02-03	84.048	7/1/02-6/30/03	56,771	56,615
				642,335

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2003

Federal Grantor/Pass Through Grantor/Program Title	CFDA #	Grant Period	Grant Amount	Expenditures
Passed through KY Workforce Cabinet to Perkins Comp. Rehab Center -				
CDP Rehabilitation Center 00-02	84.126	7/1/00-6/30/02	943,061	390
CDP Rehabilitation Center 02-03	84.126	7/1/02-6/30/04	1,305,744	<u>509,549</u>
				509,939
Passed through Higher Education Center for Alcohol & Drug Prevention -				
Reg. Network Act 95-98	84.146	7/1/95-6/30/03	10,130	6,124
Passed through Murray State University - Education Center 02-03				
	84.215	7/1/02-11/30/03	41,000	<u>9,081</u>
Total U.S. Department of Education				<u>39,743,113</u>
UNITED STATES DEPARTMENT OF LABOR:				
Passed through to KY Workforce Cabinet To TENCO Private Council -				
Today's Youth 01-02	17.250	7/1/01-6/30/02	211,835	525
Today's Youth 02-03	17.255	7/1/02-6/30/03	133,638	<u>115,015</u>
				115,540
OTHER FEDERAL AGENCIES				
APPALACHIAN REGIONAL COMMISSION:				
App. Higher Ed. 00-01	23.001	8/1/00-7/31/03	50,000	37,824
Appalachian Teach 02-03	23.001	8/1/02-1/30/03	3,000	<u>1,800</u>
				39,624
CENTER FOR DISEASE CONTROL AND PREVENTION:				
CDC Mobility 02-03	93.135	5/1/02-4/30/03	15,917	15,787
CORPORATION FOR NATIONAL SERVICE:				
Direct Programs -				
RSVP 01-02	94.002	7/1/01-6/30/02	57,352	(47)
RSVP 02-03	94.002	7/1/02-6/30/03	95,212	<u>89,045</u>
				88,998

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2003

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>CFDA #</u>	<u>Grant Period</u>	<u>Grant Amount</u>	<u>Expenditures</u>
Passed through KY Community Service Comm -				
MSU Corps 01-02	94.006	9/1/01-8/31/02	494,018	86,958
MSU Corps 02-03	94.006	9/1/02-8/31/03	605,809	499,072
Promise Corps 01-02	94.006	9/1/01-8/31/02	150,981	30,630
Promise Corps 02-03	94.006	9/1/02-8/31/03	247,489	<u>203,803</u>
				820,463
Passed through KY Cabinet for Families and Children -				
Promise Corp. PDAT	94.006	9/1/02-8/31/03	3,190	2,231
MSU Corp. PDAT	94.006	9/1/02-8/31/03	6,730	<u>2,859</u>
				5,090
Total Corp. for National Service				<u>914,551</u>
UNITED STATES DEPARTMENT OF AGRICULTURE:				
Passed through Rural Development Office -				
USDA 01-03	10.769	4/1/01-3/30/03	125,000	72,085
DEPARTMENT OF HOUSING/ URBAN DEVELOPMENT:				
Passed through KY Housing Corporation -				
Hazard YouthBldg. 02-04	14.243	10/1/01-9/30/04	30,000	28,869
NATIONAL AERONAUTICS AND SPACE ADMIN.:				
Passed through Western KY University -				
O/S Educators 01-02	43.001	6/1/01-11/30/02	7,000	4,505
Kentucky Earth 01-04	43.001	4/1/01-3/31/04	25,350	<u>10,541</u>
				15,046
NATIONAL SCIENCE FOUNDATION:				
Tech. Enhancement Core 99-02	47.076	8/1/99-7/31/02	89,177	2,020
Reson Instruct. 02-03	47.076	1/1/02-12/31/03	53,757	<u>47,621</u>
				49,641

(Continued)

MOREHEAD STATE UNIVERSITY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2003

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>CFDA #</u>	<u>Grant Period</u>	<u>Grant Amount</u>	<u>Expenditures</u>
DEPARTMENT OF ENERGY:				
Passed through KY Natural Resources Center -				
Energy Measure 00-02	81.052	7/1/02-6/30/03	5,337	5,337
SMALL BUSINESS ADMINISTRATION:				
Space Center IRAPP 01-03	59.000	9/1/01-8/31/03	907,887	282,334
Space Center S&T 01-03	59.000	9/1/01-8/31/03	1,058,113	32
SBDC Federal 01-02	59.037	10/1/01-9/30/02	138,825	34,510
SBDC Federal 02-03	59.037	10/1/02-9/30/03	138,825	<u>91,702</u>
Total Small Business Administration				<u>408,578</u>
TOTAL FEDERAL AWARDS				<u>\$ 41,939,888</u>

MOREHEAD STATE UNIVERSITY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2003

NOTE 1 - BASIS OF ACCOUNTING

This schedule includes the federal awards activity of Morehead State University and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Non-profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the financial statements.

NOTE 2 - LOANS

Loans made by the University to eligible students under the Federal Perkins Loan Program and federal student loans issued by the Federal Direct Loan Program during the year ended June 30, 2003 are summarized as follows:

Federal Perkins Loan Programs	
Loans disbursed	\$ 603,306
Federal Direct Loan Program	
Federal Subsidized Stafford Loans	\$ 8,859,126
Federal Unsubsidized Stafford Loans	7,369,511
Federal Plus Loans	884,257

At June 30, 2003, the University had loans outstanding in the amount of \$3,634,823 with an allowance for doubtful accounts of \$151,885 under the Perkins Loan program.



Crowe Chizek and Company LLC
Member Horwath International

REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE
AND INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Members of the Board of Regents and
Dr. Ronald G. Eaglin, President
Morehead State University
Morehead, Kentucky

We have audited the financial statements of Morehead State University as of and for the year ended June 30, 2003 and have issued our report thereon dated September 5, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more

of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. This report is intended solely for the information and use of the Board of Regents, audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Crowe Chizek and Company LLC

Crowe Chizek and Company LLC

Louisville, Kentucky
September 5, 2003



Crowe Chizek and Company LLC
Member Horwath International

REPORT OF INDEPENDENT AUDITORS
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE
WITH OMB CIRCULAR A-133

Members of the Board of Regents and
Dr. Ronald G. Eaglin, President
Morehead State University
Morehead, Kentucky

Compliance

We have audited the compliance of Morehead State University with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2003. The University's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the University's management. Our responsibility is to express an opinion on the University's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the University's compliance with those requirements.

In our opinion, Morehead State University complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 03-01 through 03-02.

Internal Control Over Compliance

The management of Morehead State University is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the University's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Morehead State University's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 03-01 through 03-02.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Regents, audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Crowe Chizek and Company, LLC

Crowe Chizek and Company LLC

Louisville, Kentucky
September 5, 2003

MOREHEAD STATE UNIVERSITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
June 30, 2003

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of Morehead State University.
2. No instances of noncompliance material to the financial statements of Morehead State University were disclosed during the audit.
3. There were reportable conditions relative to major federal award program identified as findings 03-01 through 03-02. These findings were not considered to be material weaknesses.
4. The auditors' report on compliance for the major federal award programs for Morehead State University expresses an unqualified opinion.
5. There were audit findings relative to the major federal award programs identified as findings 03-01 through 03-02.
6. Major programs identified:

Student Financial Aid Cluster:

Federal Pell Grants, CFDA 84.063

Federal Work Study, CFDA 84.033

Federal Supplemental Educational Opportunity Grants, CFDA 84.007

Federal Perkins Loans, CFDA 84.038

Federal Direct Loan Program, CFDA 84.268

Trio Cluster:

Upward Bound, CFDA 84.047

Talent Search, CFDA 84.044

Educational Opportunity Center, CFDA 84.066

Student Support Services, CFDA 84.042

Gear-Up IRAPP 00-03, CFDA 84.334

PT-3 Grant 00-04, CFDA 84.342

7. The threshold for distinguishing Types A and B programs was \$617,666.
8. Morehead State University was determined to be a low-risk auditee.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

None

(Continued)

MOREHEAD STATE UNIVERSITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS -
MAJOR FEDERAL AWARDS
June 30, 2003

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD AUDIT

See findings 03-01 through 03-02.

D. CORRECTIVE ACTION PLAN

See findings.

E. SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

See findings.

MOREHEAD STATE UNIVERSITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS -
MAJOR FEDERAL AWARDS
June 30, 2003

FINDING 03-01 – Federal Direct Loan Program (CFDA No. 84.268)

Criteria: The regulations concerning student financial aid and Return to Title IV calculations state that for students who withdraw from the University and received some type of Title IV funds, the institution must prepare a determination of any funds to be returned to various federal agencies. The regulations go on to state that a school must return the amount of Title IV funds for which it is responsible no later than 30 days after the date the University becomes aware of the student's separation.

Condition: During our testing of 25 students who received Title IV funds and withdrew during the 2002-2003 academic year, we noted that the funds determined to be returned to the lender by the University for one of these students were not returned within 30 days as stated in the federal regulations.

Questioned Costs: Upon review of the calculations performed, we noted that there were a couple of federal funds that were not returned within the 30-day limit. The aid determined to be returned consisted of: \$1,100.18 Unsubsidized Direct Stafford loan and \$347 Pell Grant awards.

Effect: The University is not in compliance with the federal guidelines concerning Return to Title IV procedures and therefore, may jeopardize future funding from the Department of Education.

Cause: The cause of this finding appears to be lack of communication between the Registrar's office and the Office of Accounting and Budgetary Control. It also appears that a withdrawal index was not entered into the system flagging this account to appear on the weekly withdrawal report generated by the Office of Accounting and Budgetary Control based on input from the Registrar's office. The Office of Accounting and Budgetary Control uses this report, which lists all students who have withdrawn from the University, to prepare the necessary Return to Title IV calculations.

Recommendation: We recommend that the University review its current procedures concerning Return to Title IV calculations to ensure that the University abides by all regulations regarding the time frame in which these funds are to be returned to the federal agencies.

Management's Response: We concur with this finding.

Corrective Action Plan: Due to confusion with the student's withdrawal date (husband was activated by military), the Registrar's office held the withdrawal form past the 30-day date of notification. Return of Title IV funds reports are prepared weekly by the Office of Accounting & Budgetary Control, based on data entered by the Registrar's office. Due to human error, the Registrar's office did not enter the withdrawal date in a timely manner; therefore, this student

MOREHEAD STATE UNIVERSITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS -
MAJOR FEDERAL AWARDS
June 30, 2003

did not show up on the weekly withdrawal list. Since this finding was due to extraordinary circumstances, we feel this is an isolated incident.

Controls in place to prevent future occurrences: The Registrar met with her staff and instructed them that after withdrawal notification has been received, they must enter the withdrawal notifications in a timely manner so that Accounting & Budgetary Control can process the reports and the university will be in compliance when processing Return of Title IV funds.

FINDING 03-02 -Federal Perkins Loan Program (CFDA No. 84.038)

Criteria: According to federal regulations, the University is required to make all necessary attempts to collect Perkins Loans that have defaulted during the academic year, which includes a minimum of two contacts with the borrower.

Condition: During our testing of 20 Perkins loans that went into default during the 2002-2003 year, we noted that the appropriate contact was not made to collect 15 of these accounts.

Effect: The University is not in compliance with the due diligence federal regulations, which could adversely affect future funding to the University from the Department of Education.

Cause: There appears to be several causes for this finding. These include the lack of management oversight, the inadequacy of noting in the system when and if any contacts were attempted and the failure to properly code accounts once they were returned from a collection agency preventing further action from being taken.

Recommendation: We recommend that the University review its current procedures for handling defaulted loan accounts and make the necessary changes to ensure the University is in compliance with the federal regulations.

Management's Response: We concur with this finding.

Corrective Action Plan: Due to turnover in the Perkins Loan Accountant's position and a vacancy of several months, collection procedures were not performed timely and contact adequately documented. Phone contact could have been made with these individuals but was not documented. Once the position was filled in April 2003, the new Perkins Loan Accountant went through a transition period of learning the Federal Perkins Loan regulations. All collection letters have now been sent to defaulted borrowers and phone call contact is in the process of being completed and documented which will bring the University into compliance with the Federal Perkins Loan regulations.

MOREHEAD STATE UNIVERSITY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
June 30, 2003

FINDING 02-04 - Audit Adjustments

During the audit we proposed several audit adjustments, particularly those related to debt.

Status: Corrective action has been taken.

FINDING 02-01 - Gear-Up Program (CFDA No. 84.334) and Talent Search Program (CFDA No. 84.044)

During the allowable cost testing of the Gear-Up 00-01 program and Talent Search program, we noted that three expenditures were classified incorrectly as supplies under Gear-Up and one expenditure incorrectly classified as supplies under Gear-Up and one expenditure incorrectly classified as office supplies under the Talent Search program.

Status: Corrective action has been taken.

FINDING 02-02 - Perkins Loan Program (CFDA No. 84.038)

During our testing of fifteen Perkins deferments, it came to our attention that one deferment form was missing for a student whose deferment period ended June 2003.

Status: Corrective action has been taken.

FINDING 02-03 - Federal Direct Loan Program (CFDA No. 84.268) and Pell Grant Program (CFDA No. 84.063)

While performing our Return to Title IV calculation test, we noted that some of the refund distribution sheets used to prepare the journal entry to reduce the particular fund revenue accounts did not sum accurately. Therefore, the entries were understated since not enough aid was adjusted and the University requested an overstated amount of funds.

Status: Corrective action has been taken.