

Kettering University

Financial Report

June 30, 2006

Kettering University

Contents

Report Letter	1
Financial Statements	
Balance Sheet	2
Statement of Activities and Changes in Net Assets	3
Statement of Cash Flows	4
Notes to Financial Statements	5-13



Plante & Moran, PLLC

Suite 1A

111 E. Court St.

Flint, MI 48502

Tel: 810.767.5350

Fax: 810.767.8150

plantemoran.com

Independent Auditor's Report

To the Board of Trustees
Kettering University

We have audited the accompanying balance sheet of Kettering University as of June 30, 2006 and 2005 and the related statements of activities and changes in net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of Kettering 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, which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 Kettering University as of June 30, 2006 and 2005 and the changes in its net assets and 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 a report under separate cover dated August 11, 2006 on our consideration of Kettering University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements for the year ended June 30, 2006. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Plante & Moran, PLLC

August 11, 2006

A member of



A worldwide association of independent accounting firms

Kettering University

Balance Sheet

	June 30	
	2006	2005
Assets		
Cash and cash equivalents (Note 3)	\$ 8,474,929	\$ 7,122,944
Investments (Note 4)	61,241,813	56,820,502
Restricted cash (Note 10)	1,836,975	1,836,975
Investments held in trust	3,797,775	3,732,618
Accounts receivable - Net	1,919,809	3,582,791
Promises to give - Net (Note 5)	94,667	223,754
Contribution receivable - Under split-interest agreement (Note 6)	547,287	518,245
Land, buildings, and equipment - Net of accumulated depreciation (Note 7)	81,847,611	84,466,786
Prepaid expenses and other assets	1,653,778	1,650,496
Total assets	<u>\$ 161,414,644</u>	<u>\$ 159,955,111</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable	\$ 2,720,753	\$ 3,142,432
Bonds payable (Note 10)	26,462,359	26,943,612
Accrued expenses	913,261	956,748
Deferred income	1,987,903	2,383,384
Notes and land contracts payable (Note 11)	576,428	641,127
Annuity liability	356,046	310,671
Total liabilities	33,016,750	34,377,974
Net Assets		
Unrestricted:		
Undesignated, academic, and other programs	10,127,608	8,026,582
Plant	59,777,976	62,604,317
Designated - Quasi-endowment	20,851,807	17,765,250
Total unrestricted	90,757,391	88,396,149
Temporarily restricted (Note 12)	2,197,797	2,854,948
Permanently restricted	35,442,706	34,326,040
Total net assets	<u>128,397,894</u>	<u>125,577,137</u>
Total liabilities and net assets	<u>\$ 161,414,644</u>	<u>\$ 159,955,111</u>

Kettering University

Statement of Activities and Changes in Net Assets

	Year Ended June 30	
	2006	2005
Changes in Unrestricted Net Assets		
Revenue and gains:		
Tuition and fees	\$ 57,516,789	\$ 56,225,167
Scholarship allowance	(12,055,660)	(11,001,965)
Special programs allowance	(774,892)	(748,932)
Tuition and fees - Net of allowances	44,686,237	44,474,270
Contributions	962,859	2,734,126
Grants and contracts	1,562,333	3,585,913
Corporate professional development and research	1,957,086	1,426,581
Investment income	2,446,772	1,515,200
Net realized gain (loss) on investments and cash equivalents	205,752	(124,333)
Net unrealized gain on investments and cash equivalents	3,077,768	3,190,434
Auxiliary service	3,546,546	3,771,560
Resident advisor allowance	(164,035)	(185,821)
Room scholarship allowance	(8,220)	(8,540)
Other income	557,611	492,419
Net assets released from restrictions	1,318,296	2,456,705
Total revenue and gains	60,149,005	63,328,514
Expenses:		
Educational and general:		
Instruction	23,075,507	22,677,063
Research	3,571,480	5,476,493
Academic support	5,965,393	5,787,930
Student services	5,354,676	5,056,694
Institutional services	14,232,090	14,866,285
Scholarships	2,456,665	2,368,408
Total educational and general	54,655,811	56,232,873
Auxiliary services	3,131,952	2,955,235
Total expenses	57,787,763	59,188,108
Increase in Unrestricted Net Assets	2,361,242	4,140,406
Changes in Temporarily Restricted Net Assets		
Contributions	661,145	642,206
Net assets released from restrictions	(1,318,296)	(2,456,705)
Decrease in Temporarily Restricted Net Assets	(657,151)	(1,814,499)
Increase in Permanently Restricted Net Assets - Contributions	1,116,666	1,692,397
Increase in Net Assets	2,820,757	4,018,304
Net Assets - Beginning of year	125,577,137	121,558,833
Net Assets - End of year	\$ 128,397,894	\$ 125,577,137

Kettering University

Statement of Cash Flows

	Year Ended June 30	
	2006	2005
Cash Flows from Operating Activities		
Increase in net assets	\$ 2,820,757	\$ 4,018,304
Adjustments to reconcile increase in net assets to net cash from operating activities:		
Restricted investment trust activity	73,626	(41,505)
Depreciation and amortization expense	4,692,145	4,665,493
Loss on disposal of assets	46,430	337,900
Contributions permanently restricted and for purchases of fixed assets	(1,485,588)	(2,662,423)
(Gain) loss on sale of investments	(205,752)	124,333
Unrealized gain on investments	(3,077,768)	(3,190,434)
Changes in operating assets and liabilities:		
Accounts receivable	1,662,982	(1,458,110)
Promises to give	129,087	1,708,738
Contribution receivable	(29,042)	(850)
Prepaid expenses and other assets	(43,780)	(43,106)
Accounts payable	(421,679)	929,203
Accrued expenses	(43,487)	92,240
Deferred income	(395,481)	482,647
Annuity liability	45,375	310,671
Net cash provided by operating activities	3,767,825	5,273,101
Cash Flows from Investing Activities		
Purchases of fixed assets	(2,078,902)	(3,483,683)
Proceeds from sales of fixed assets	-	150
Proceeds from sales and maturities of investments - Net	1,624,988	1,972,295
Purchase of investments	(2,827,936)	(2,231,041)
Net cash used in investing activities	(3,281,850)	(3,742,279)
Cash Flows from Financing Activities		
Proceeds from contributions permanently restricted and for purchases of fixed assets	1,485,588	2,662,423
Restricted investment trust activity	(73,626)	41,505
Payments on bonds payable and bond premium	(481,253)	(466,253)
Payment on notes and land contract payable	(64,699)	(62,944)
Net cash provided by financing activities	866,010	2,174,731
Net Increase in Cash and Cash Equivalents	1,351,985	3,705,553
Cash and Cash Equivalents - Beginning of year	7,122,944	3,417,391
Cash and Cash Equivalents - End of year	\$8,474,929	\$7,122,944
Supplemental Cash Flow Information - Cash paid for interest	\$1,369,237	\$1,388,141

Note 1 - Organization

Kettering University (the "University"), formerly GMI Engineering and Management Institute, is a private educational institution located in Flint, Michigan. The University provides education and training in the areas of engineering and industrial administration. The curriculum includes a cooperative system under which students alternate between periods of study on campus and related work experience at their corporate partner.

Note 2 - Basis of Presentation and Summary of Significant Accounting Policies

The University's financial statements have been prepared on an accrual basis of accounting. The University classifies its net financial resources into three net assets categories according to donor-imposed restrictions as follows:

- **Unrestricted Net Assets** - Unrestricted net assets are free of donor-imposed restrictions. Unrestricted net assets reflect revenue, expenses, gains, and losses that are not charged in temporarily or permanently restricted assets related to education and general, sponsored research and departmental, unexpended plant and debt service, invested in plant, long-term investment, and student loan activities.
- **Temporarily Restricted Net Assets** - Temporarily restricted net assets include gifts for which donor-imposed restrictions have not been met (primarily future capital projects) and trust activity and pledges receivable for which the ultimate purpose of the proceeds are not permanently restricted.
- **Permanently Restricted Net Assets** - Permanently restricted net assets include gifts, trusts, and pledges that require, by donor restriction, that the corpus be invested in perpetuity and only the income be made available for program operations in accordance with donor restrictions.

Contributions - Contributions received include unconditional promises that are recognized as revenue at the time of the donor's commitment. Unconditional promises are recognized at the estimated present value of the future cash flows, net of allowances. Promises made that are designated for future periods are classified as restricted support. However, if a restriction is fulfilled in the same time period in which the contribution is received, the University reports the support as unrestricted. Conditional promises are recorded when donor stipulations are substantially met.

Note 2 - Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Grants and Contracts (Government and Private) - Revenue from government and private grants and contracts is recognized as it is earned in accordance with the agreement. Any funding received before it is earned is recorded as a refundable advance. Expenses incurred before cash is received are recorded as receivables.

Endowment Payout - Endowment Income - The University's spending policy determines the amount of endowment income to be distributed for spending purposes during the year. Any excess/deficit is designated as quasi-endowment.

Fair Value of Financial Instruments - Statement of Financial Accounting Standards No. 107, *Disclosure About Fair Value of Financial Instruments*, requires disclosures about the fair value of financial instruments whether or not such instruments are recognized in the balance sheet. The carrying value of financial instruments approximates fair market value. Assets and liabilities are stated at their fair market value, which approximate current market values as of June 30, 2006 and 2005. Based on the borrowing rates currently available to the University, the carrying value of the bonds payable approximates fair value.

Cash and Cash Equivalents - Cash includes all checking and savings accounts of the University and excludes any amounts held for investment. Cash equivalents include all investments that mature or can be liquidated within a 90-day period. Cash and cash equivalents are recorded at fair market value.

Accounts Receivable - Accounts receivable consist primarily of student obligations and are reported net of an allowance for doubtful accounts based on management's estimate of collectibility. The estimate is calculated using a historical analysis of write-offs compared to June 30 balances. All amounts deemed to be uncollectible are charged against the allowance for doubtful accounts in the period that determination is made. The allowance for doubtful accounts was \$300,000 and \$317,000 at June 30, 2006 and 2005, respectively.

Promises to Give - Promises to give are reported net of an allowance for uncollectible accounts based on management's estimate of collectibility. The estimate is calculated using a historical analysis of write-offs compared to June 30 balances. All amounts deemed to be uncollectible are charged against the allowance for doubtful accounts in the period that determination is made.

Note 2 - Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Investments - Investments are stated at fair market value, as determined by quoted market prices. Realized and unrealized gains and losses on investments are included as net appreciation in the fair market value of investments (which are principally included as unrestricted revenue in the statement of activities and changes in net assets). Investments held in trust include monies designated by donors to be permanently held in trusts.

Land, Buildings, and Equipment - Land, buildings, and equipment additions are stated at cost, less accumulated depreciation. Donations of property and equipment are recorded at their estimated fair value. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Depreciation is computed on the straight-line method over the estimated useful lives of 30-50 years for buildings and 5-20 years for equipment. Upon the sale or disposal of depreciable assets, the related cost and accumulated depreciation are removed from the accounts with resulting gains or losses included in the statement of activities and changes in net assets for the period. Repair costs are charged to expense as incurred.

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 amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Advertising Expenses - The University expenses advertising costs as incurred. The University incurred approximately \$224,000 and \$178,000 of advertising costs during the years ended June 30, 2006 and 2005, respectively.

Fund-raising Expenses - Fund-raising costs consist of salaries, fringe benefits, and other costs incurred by the University Advancement Departments. Fund-raising costs are included in the statement of activities and changes in net assets as "institutional services," and such amounts total \$1,383,327 and \$2,263,304 for the years ended June 30, 2006 and 2005, respectively.

Income Taxes - The University is a Michigan nonprofit organization and is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.

Artwork - The University has artwork with an insured value of approximately \$100,000 that has not been capitalized, as any proceeds from the sales of items would be reinvested in the collection.

Kettering University

Notes to Financial Statements June 30, 2006 and 2005

Note 2 - Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Reclassification - Certain amounts have been reclassified in 2005 to conform with the presentation adopted in 2006.

Note 3 - Cash and Cash Equivalents

Cash and cash equivalents at market value as of June 30 are comprised of the following:

	<u>2006</u>	<u>2005</u>
Cash equivalents, including money market funds and commercial paper	\$ 6,004,506	\$ 4,735,110
Common funds - Short-term investments	<u>2,470,423</u>	<u>2,387,834</u>
Total	<u>\$ 8,474,929</u>	<u>\$ 7,122,944</u>

Note 4 - Investments

Investments at market value as of June 30 are comprised of the following:

	<u>2006</u>	<u>2005</u>
U.S. government and other obligations	\$ 4,865	\$ 4,865
Common stock	536,738	155,515
Mutual funds:		
Fixed income	19,157,716	19,086,621
Equity	<u>41,542,494</u>	<u>37,573,501</u>
Total	<u>\$ 61,241,813</u>	<u>\$ 56,820,502</u>

Kettering University

Notes to Financial Statements June 30, 2006 and 2005

Note 5 - Promises to Give

Unconditional promises of gifts are included in the financial statements as (1) promises to give and (2) revenue of the appropriate net asset category. Promises to give due after one year are recorded after discounting to the present value of the future cash flows. The University estimated the present value of future cash flows using its incremental borrowing rate, the bond buyers revenue index at the date of the gift. Rates range from 3.730 percent to 4.485 percent. The composition of unconditional promises to give at June 30 is as follows:

	<u>2006</u>	<u>2005</u>
Unconditional promises due are expected to be realized in the following periods:		
In one year or less	\$ 87,500	\$ 195,000
Between one year and five years	65,000	90,000
More than five years	<u>10,000</u>	<u>20,000</u>
Total unconditional promises	162,500	305,000
Less unamortized discount	12,051	21,084
Less allowance for doubtful accounts	<u>55,782</u>	<u>60,162</u>
Total	<u>67,833</u>	<u>81,246</u>
Net unconditional promises	<u>\$ 94,667</u>	<u>\$ 223,754</u>
Promises to give at June 30 have the following categories - Noncurrent:		
Endowment	\$ 47,854	\$ 47,854
Plant	102,595	236,062
Less allowance for doubtful accounts	<u>(55,782)</u>	<u>(60,162)</u>
Total	<u>\$ 94,667</u>	<u>\$ 223,754</u>

Kettering University

Notes to Financial Statements June 30, 2006 and 2005

Note 6 - Contribution Receivable Under Split-interest Agreement

The University is the beneficiary of an irrevocable charitable remainder unitrust. The assets of the trust are maintained in an investment account in the name of the trustee, the donor. The trust must make annual distributions to the donor equal to 8 percent of trust assets until the death of the donor and the donor's wife. The University has recorded an estimated liability for these distributions. This amount may be distributed out of the earnings of the trust. The University estimated the present value of future cash flows using a discount rate of 3 percent. The composition of the contribution receivable at June 30 is as follows:

	2006	2005
Fair value of charitable remainder unitrust	\$ 878,235	\$ 856,580
Less unamortized discount	<u>330,948</u>	<u>338,335</u>
Present value of charitable remainder unitrust	<u>\$ 547,287</u>	<u>\$ 518,245</u>

Note 7 - Land, Buildings, and Equipment

Land, buildings, and equipment at June 30 consist of the following:

	2006	2005
Land	\$ 10,592,528	\$ 10,510,028
Buildings	110,848,228	109,681,963
Equipment	32,626,699	32,637,341
Construction in progress	<u>179,209</u>	<u>28,031</u>
Total property	154,246,664	152,857,363
Less accumulated depreciation	<u>72,399,053</u>	<u>68,390,577</u>
Net property	<u>\$ 81,847,611</u>	<u>\$ 84,466,786</u>

Note 8 - Bond Financing Costs

The University has recorded costs associated with bond financing in prepaid expenses and other assets. Bond financing costs are amortized over the straight-line method over the 30-year term of the bond. As of June 30, 2006 and 2005, accumulated amortization was \$202,489 and \$161,991, respectively.

Kettering University

Notes to Financial Statements June 30, 2006 and 2005

Note 9 - Retirement Plan

The University participates in the Teachers Insurance Annuity Association and College Retirement Equities Fund, which is a defined contribution retirement plan covering eligible employees. The University makes a contribution of 9 percent of employee salaries to all eligible employees and an additional match up to 3 percent of employee salary deferrals. Employees hired on or after January 1, 2006 are subject to the following schedule: The University makes a 100 percent match on the first 3 percent of employee contribution and an additional 6 percent contribution with a minimum employee participation of 3 percent. The University contributed \$2,786,952 and \$2,652,214 for fiscal 2006 and 2005, respectively.

Note 10 - Bonds Payable

On August 15, 2001, the University issued Michigan Higher Education Facilities Authority Limited Obligation Revenue Refunding Bonds, Series 2001, in the amount of \$27,685,000. The proceeds were used to retire bonds in the amount of \$6,652,709 and notes in the amount of \$3,200,000, and the balance was used for capital improvements. The bonds sold at a premium of \$326,000 and included debt issuance and bond insurance costs of \$1,359,415.

The bonds require principal payments of \$445,000 beginning in fiscal year 2004 and increasing to \$1,780,000 in 2032. The stated interest rates begin at 4.0 percent per annum, increasing to 5.5 percent. The University is required to meet certain financial covenants, including debt service and fund balance requirements, the most restricted of which is the fund balance requirement.

Future principal amounts due for bonds and the bond premium are summarized below:

Years Ending	Amount
<u>June 30</u>	<u>Amount</u>
2007	\$ 506,253
2008	521,253
2009	551,253
2010	586,253
2011	611,253
Thereafter	<u>23,686,094</u>
Total	<u>\$ 26,462,359</u>

The University recognized interest expense of \$1,336,398 and \$1,355,298 related to the bonds for the years ended June 30, 2006 and 2005, respectively.

Restricted cash of \$1,836,975 at June 30, 2006 and 2005 is the amount required to be held for future bond payments.

Kettering University

Notes to Financial Statements June 30, 2006 and 2005

Note 11 - Notes and Land Contracts Payable

The University's long-term debt (other than bonds) includes the following:

	<u>2006</u>	<u>2005</u>
Land contract payable, payable in monthly installments of \$3,000 to \$3,500, including interest at 9.25 percent to 9.75 percent. A balloon payment of \$293,363 is due in July 2012	\$ 342,282	\$ 348,444
Interest-free notes payable to Sodexho, payable in annual installments of \$58,537 over seven years	<u>234,146</u>	<u>292,683</u>
Total	<u>\$ 576,428</u>	<u>\$ 641,127</u>

Maturities of long-term debt are as follows:

Years Ending <u>June 30</u>	<u>Amount</u>
2007	\$ 65,310
2008	65,982
2009	66,721
2010	68,472
2011	12,321
Thereafter	<u>297,622</u>
Total	<u>\$ 576,428</u>

The University recognized interest expense of \$32,838 and \$32,843 for the years ended June 30, 2006 and 2005, respectively, related to this debt.

The University has an available line of credit with maximum borrowings of \$1,500,000. This line of credit bears interest at a variable rate equal to the bank's prime rate (8.25 percent at June 30, 2006). There were no borrowings outstanding at June 30, 2006 and 2005. The line expires December 31, 2006.

Kettering University

Notes to Financial Statements June 30, 2006 and 2005

Note 12 - Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30 are available for the following purposes or periods:

	<u>2006</u>	<u>2005</u>
Purpose restrictions:		
Plant	\$ 1,373,864	\$ 2,029,154
Other	415,902	483,250
Time restrictions	<u>408,031</u>	<u>342,544</u>
Total	<u>\$ 2,197,797</u>	<u>\$ 2,854,948</u>

Note 13 - Conditional Asset Retirement Obligations

The University has an obligation related to the removal of asbestos within its buildings upon reconstruction, demolition, or abandonment. The University has not recorded a liability related to the potential costs associated with the asbestos abatement, as the fair value of the liability cannot currently be reasonably estimated because the range of time over which it may settle the obligation is unknown and cannot be estimated. There are currently no plans to undertake a major renovation that would require the removal of the asbestos or demolition of the buildings. The University will recognize a liability in the period in which sufficient information is available to reasonably estimate the fair value of the liability.

Note 14 - Contingencies

In the normal course of business, there are various unresolved legal actions. As of June 30, 2006, the outcome of these legal actions was not determinable. Management believes the resolution of these lawsuits will not have a material effect on the financial statements. A provision for a loss was included in the financial statements to cover the related insurance deductibles.