

Kettering University

Financial Report

June 30, 2007

Kettering University

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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, 2007 and 2006 and the related statements of activities and changes in net assets and cash flows for the years then ended. 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, 2007 and 2006 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 28, 2007 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, 2007. 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 28, 2007



Kettering University

Balance Sheet

	June 30	
	2007	2006
Assets		
Cash and cash equivalents (Note 3)	\$ 9,550,661	\$ 8,474,929
Investments (Note 4)	69,398,374	61,241,813
Restricted cash (Note 10)	1,836,975	1,836,975
Investments held in trust	4,174,759	3,797,775
Accounts receivable - Net	2,729,566	1,919,809
Promises to give - Net (Note 5)	27,149	94,667
Contribution receivable - Under split-interest agreement (Note 6)	599,078	547,287
Land, buildings, and equipment - Net of accumulated depreciation (Note 7)	79,603,956	81,847,611
Prepaid expenses and other assets	1,556,196	1,653,778
Total assets	<u>\$ 169,476,714</u>	<u>\$ 161,414,644</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable	\$ 2,852,762	\$ 2,720,753
Accrued expenses	902,902	913,261
Deferred income	1,664,133	1,987,903
Annuity liability	387,786	356,046
Notes and land contracts payable (Note 11)	610,028	576,428
Bonds payable (Note 10)	25,956,107	26,462,359
Asset retirement obligation (Note 13)	776,663	-
Total liabilities	33,150,381	33,016,750
Net Assets		
Unrestricted:		
Undesignated, academic, and other programs	10,405,116	10,127,608
Plant	57,193,240	59,777,976
Designated - Quasi-endowment	29,782,112	20,851,807
Total unrestricted	97,380,468	90,757,391
Temporarily restricted (Note 12)	2,754,937	2,197,797
Permanently restricted	36,190,928	35,442,706
Total net assets	<u>136,326,333</u>	<u>128,397,894</u>
Total liabilities and net assets	<u>\$ 169,476,714</u>	<u>\$ 161,414,644</u>

Kettering University

Statement of Activities and Changes in Net Assets

	Year Ended June 30	
	2007	2006
Changes in Unrestricted Net Assets		
Revenue and gains:		
Tuition and fees	\$ 56,139,467	\$ 57,516,789
Scholarship allowance	(12,223,037)	(12,055,660)
Special programs allowance	(811,465)	(774,892)
Tuition and fees - Net of allowances	43,104,965	44,686,237
Contributions	1,308,028	962,859
Grants and contracts	1,631,377	1,562,333
Corporate professional development and research	1,982,945	1,957,086
Investment income	4,121,845	2,446,772
Net realized gain on investments and cash equivalents	57,316	205,752
Net unrealized gain on investments and cash equivalents	7,596,610	3,077,768
Auxiliary service	3,073,779	3,546,546
Resident advisor allowance	(189,360)	(164,035)
Room scholarship allowance	(13,564)	(8,220)
Other income	532,469	557,611
Net assets released from restrictions	658,609	1,318,296
Total revenue and gains	63,865,019	60,149,005
Expenses:		
Educational and general:		
Instruction	23,083,089	23,075,507
Research	2,919,273	3,571,480
Academic support	5,627,706	5,965,393
Student services	6,764,075	5,354,676
Institutional services	13,342,995	14,232,090
Scholarships	2,570,880	2,456,665
Total educational and general	54,308,018	54,655,811
Auxiliary services	2,933,924	3,131,952
Total expenses	57,241,942	57,787,763
Increase in Unrestricted Net Assets	6,623,077	2,361,242
Changes in Temporarily Restricted Net Assets		
Contributions	1,215,749	661,145
Net assets released from restrictions	(658,609)	(1,318,296)
Increase (Decrease) in Temporarily Restricted Net Assets	557,140	(657,151)
Increase in Permanently Restricted Net Assets - Contributions	748,222	1,116,666
Increase in Net Assets	7,928,439	2,820,757
Net Assets - Beginning of year	128,397,894	125,577,137
Net Assets - End of year	\$ 136,326,333	\$ 128,397,894

Statement of Cash Flows

	Year Ended June 30	
	2007	2006
Cash Flows from Operating Activities		
Increase in net assets	\$ 7,928,439	\$ 2,820,757
Adjustments to reconcile increase in net assets to net cash from operating activities:		
Restricted investment trust activity	197,698	73,626
Depreciation and amortization expense	5,120,724	4,692,145
Loss on disposal of assets	203,328	46,430
Contributions permanently restricted and for purchases of fixed assets	(829,917)	(1,485,588)
Gain on sale of investments	(57,316)	(205,752)
Unrealized gain on investments	(7,596,610)	(3,077,768)
Asset retirement obligation of long-lived assets	654,304	-
Changes in operating assets and liabilities:		
Accounts receivable	(809,757)	1,662,982
Promises to give	67,518	129,087
Contribution receivable	(51,791)	(29,042)
Prepaid expenses and other assets	97,582	(43,780)
Accounts payable	132,009	(421,679)
Accrued expenses	(10,359)	(43,487)
Deferred income	(323,770)	(395,481)
Annuity liability	31,740	45,375
Net cash provided by operating activities	4,753,822	3,767,825
Cash Flows from Investing Activities		
Purchases of fixed assets	(3,020,319)	(2,078,902)
Proceeds from sales and maturities of investments - Net	2,559,539	1,624,988
Purchase of investments	(3,376,876)	(2,827,936)
Net cash used in investing activities	(3,837,656)	(3,281,850)
Cash Flows from Financing Activities		
Proceeds from contributions permanently restricted and for purchases of fixed assets	829,917	1,485,588
Restricted investment trust activity	(197,698)	(73,626)
Payments on bonds payable and bond premium	(506,253)	(481,253)
Net proceeds from (payments on) notes and land contract payable	33,600	(64,699)
Net cash provided by financing activities	159,566	866,010
Net Increase in Cash and Cash Equivalents	1,075,732	1,351,985
Cash and Cash Equivalents - Beginning of year	8,474,929	7,122,944
Cash and Cash Equivalents - End of year	<u>\$ 9,550,661</u>	<u>\$ 8,474,929</u>
Supplemental Cash Flow Information - Cash paid for interest	<u>\$ 1,348,792</u>	<u>\$ 1,369,236</u>

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 is 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 values, which approximate current market values as of June 30, 2007 and 2006. 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 at June 30, 2007 and 2006.

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 year. 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 \$197,000 and \$224,000 of advertising costs during the years ended June 30, 2007 and 2006, respectively.

Fund-raising Expenses - Fund-raising costs consist of salaries, fringe benefits, and other costs incurred by the University's advancement departments. Fund-raising costs are included in the statement of activities and changes in net assets as "institutional services," and such amounts total \$1,651,964 and \$1,759,128 for the years ended June 30, 2007 and 2006, 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.

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

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.

Note 3 - Cash and Cash Equivalents

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

	<u>2007</u>	<u>2006</u>
Cash equivalents - Including money market funds and commercial paper	\$ 6,950,777	\$ 6,004,506
Common funds - Short-term investments	<u>2,599,884</u>	<u>2,470,423</u>
Total	<u>\$ 9,550,661</u>	<u>\$ 8,474,929</u>

Note 4 - Investments

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

	<u>2007</u>	<u>2006</u>
U.S. government and other obligations	\$ 815	\$ 4,865
Common stock	57,769	536,738
Mutual funds:		
Fixed income	20,525,099	19,157,716
Equity	<u>48,814,691</u>	<u>41,542,494</u>
Total	<u>\$ 69,398,374</u>	<u>\$ 61,241,813</u>

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 3.73 percent to 3.76 percent. The composition of unconditional promises to give at June 30 is as follows:

	<u>2007</u>	<u>2006</u>
Unconditional promises due are expected to be realized in the following periods:		
In one year or less	\$ 37,000	\$ 87,500
Between one year and five years	48,000	65,000
More than five years	<u>-</u>	<u>10,000</u>
Total unconditional promises	85,000	162,500
Less unamortized discount	7,076	12,051
Less allowance for doubtful accounts	<u>50,775</u>	<u>55,782</u>
Total	<u>57,851</u>	<u>67,833</u>
Net unconditional promises	<u>\$ 27,149</u>	<u>\$ 94,667</u>
Promises to give at June 30 have the following categories - Noncurrent:		
Endowment	\$ -	\$ 47,854
Plant	77,924	102,595
Less allowance for doubtful accounts	<u>(50,775)</u>	<u>(55,782)</u>
Total	<u>\$ 27,149</u>	<u>\$ 94,667</u>

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 3.00 percent. The composition of the contribution receivable at June 30 is as follows:

	<u>2007</u>	<u>2006</u>
Fair value of charitable remainder unitrust	\$ 933,344	\$ 878,235
Less unamortized discount	<u>334,266</u>	<u>330,948</u>
Present value of charitable remainder unitrust	<u>\$ 599,078</u>	<u>\$ 547,287</u>

Note 7 - Land, Buildings, and Equipment

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

	<u>2007</u>	<u>2006</u>
Land	\$ 10,593,028	\$ 10,592,528
Buildings	112,555,125	110,848,228
Equipment	32,951,441	32,626,699
Construction in progress	<u>165,682</u>	<u>179,209</u>
Total property	156,265,276	154,246,664
Less accumulated depreciation	<u>76,661,320</u>	<u>72,399,053</u>
Net property	<u>\$ 79,603,956</u>	<u>\$ 81,847,611</u>

Depreciation expense was \$4,446,662 and \$4,651,647 for the years ended June 30, 2007 and 2006, respectively.

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, 2007 and 2006, accumulated amortization was \$242,987 and \$202,489, respectively.

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 \$2,523,063 and \$2,786,952 for fiscal years 2007 and 2006, 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 increase 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.

Note 10 - Bonds Payable (Continued)

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

Years <u>Ending June</u>	<u>Amount</u>
2008	\$ 521,253
2009	551,253
2010	586,253
2011	611,253
2012	641,253
Thereafter	<u>23,044,842</u>
Total	<u>\$ 25,956,107</u>

The University recognized interest expense of \$1,316,565 and \$1,336,398 related to the bonds for the years ended June 30, 2007 and 2006, respectively.

Restricted cash of \$1,836,975 at June 30, 2007 and 2006 is required to be held for future bond payments.

Note 11 - Notes and Land Contracts Payable

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

	<u>2007</u>	<u>2006</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	\$ 335,509	\$ 342,282
Interest-free notes payable to Sodexho, payable in annual installments of \$58,537 due in June 2010	175,610	234,146
Interest-free notes payable to Follett, payable in annual installments of \$24,727 due in May 2011	<u>98,909</u>	<u>-</u>
Total	<u>\$ 610,028</u>	<u>\$ 576,428</u>

Note 11 - Notes and Land Contracts Payable (Continued)

Maturities of long-term debt are as follows:

Years Ending June 30	Amount
2008	\$ 90,709
2009	91,448
2010	93,199
2011	37,048
2012	<u>297,624</u>
Total	<u>\$ 610,028</u>

The University recognized interest expense of \$32,227 and \$32,838 for the years ended June 30, 2007 and 2006, 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, 2007. There were no borrowings outstanding at June 30, 2007 and 2006. The line expires December 31, 2007.

Note 12 - Temporarily Restricted Net Assets

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

	<u>2007</u>	<u>2006</u>
Purpose restrictions:		
Plant	\$ 1,275,781	\$ 1,373,864
Other	955,926	415,902
Time restrictions	<u>523,230</u>	<u>408,031</u>
Total	<u>\$ 2,754,937</u>	<u>\$ 2,197,797</u>

Note 13 - Conditional Asset Retirement Obligations

The University adopted Financial Accounting Standards Board Interpretation No. 47 (FIN 47), *Accounting for Conditional Asset Retirement Obligations*. FIN 47 requires that a liability be recognized for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. Upon recognition of a liability, the asset retirement cost is recorded as an increase in the carrying value of the related long-lived asset and then depreciated over the life of the asset. The University's asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. The University's obligations to remove asbestos were estimated using a per-square-foot estimate.

As a result of an evaluation of available asbestos remediation estimates, the University recorded a liability of \$725,853 for the asset retirement obligations at July 1, 2006. Accumulated depreciation was measured from 1982, the date the liability and capitalized asset would have been recognized if FIN 47 were in effect when the legal obligation to remediate asbestos occurred. Accordingly, the capitalized asset associated with the asset retirement obligation was \$143,099 and accumulated depreciation was \$71,550. The cumulative effect of \$654,304 was functionally allocated as a change in unrestricted net assets during the year ended June 30, 2007.

For the year ended June 30, 2007, depreciation expense associated with the capitalized asset was \$2,862 and accretion expense associated with the remediation liability was \$50,810.

Note 14 - Contingencies

In the normal course of business, there are various unresolved legal actions. As of June 30, 2007, 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.