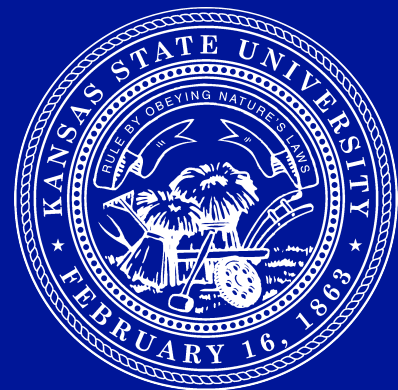


Kansas State University

Annual Financial Report

Fiscal Year Ended June 30, 2006



Kansas State University Manhattan, Kansas

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Kansas State University
Management's Discussion and Analysis
For the Year Ended June 30, 2006

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial performance of Kansas State University (University) based on currently known facts, decisions and conditions. Readers are encouraged to consider this information in conjunction with the statements and footnotes. The financial statements, footnotes, and this discussion are the responsibility of management.

USING THE FINANCIAL STATEMENTS

This report consists of the three financial statements. The Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) Statement 35, Basic Financial Statements---and Management's Discussion and Analysis---for Public Colleges and Universities, as amended by GASB Statements 37 and 38. These statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis to focus on the University as a whole.

STATEMENT OF NET ASSETS

The Statement of Net Assets presents the assets, liabilities, and net assets of the University at a point in time (at the end of the fiscal year). The Statement of Net Assets includes all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector institutions. Under the accrual basis of accounting all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

Within the Statement of Net Assets, assets and liabilities are further classified as current or non-current. The current classification distinguishes those assets that are highly liquid and available for immediate and unrestricted use by the University, and those liabilities likely to be settled in the next 12 months.

Net assets are divided into three categories:

1. **Invested in capital assets, net of debt**, indicates the university's equity in property, plant, and equipment owned by the University.
2. **Restricted net assets** are further divided into two subcategories, non-expendable and expendable. The corpus of non-expendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the University but must be spent for purposes as determined by donors and/or external entities who have placed time or purpose restrictions on the use of the assets.
3. **Unrestricted net assets** are available to the University for any lawful purpose of the institution.

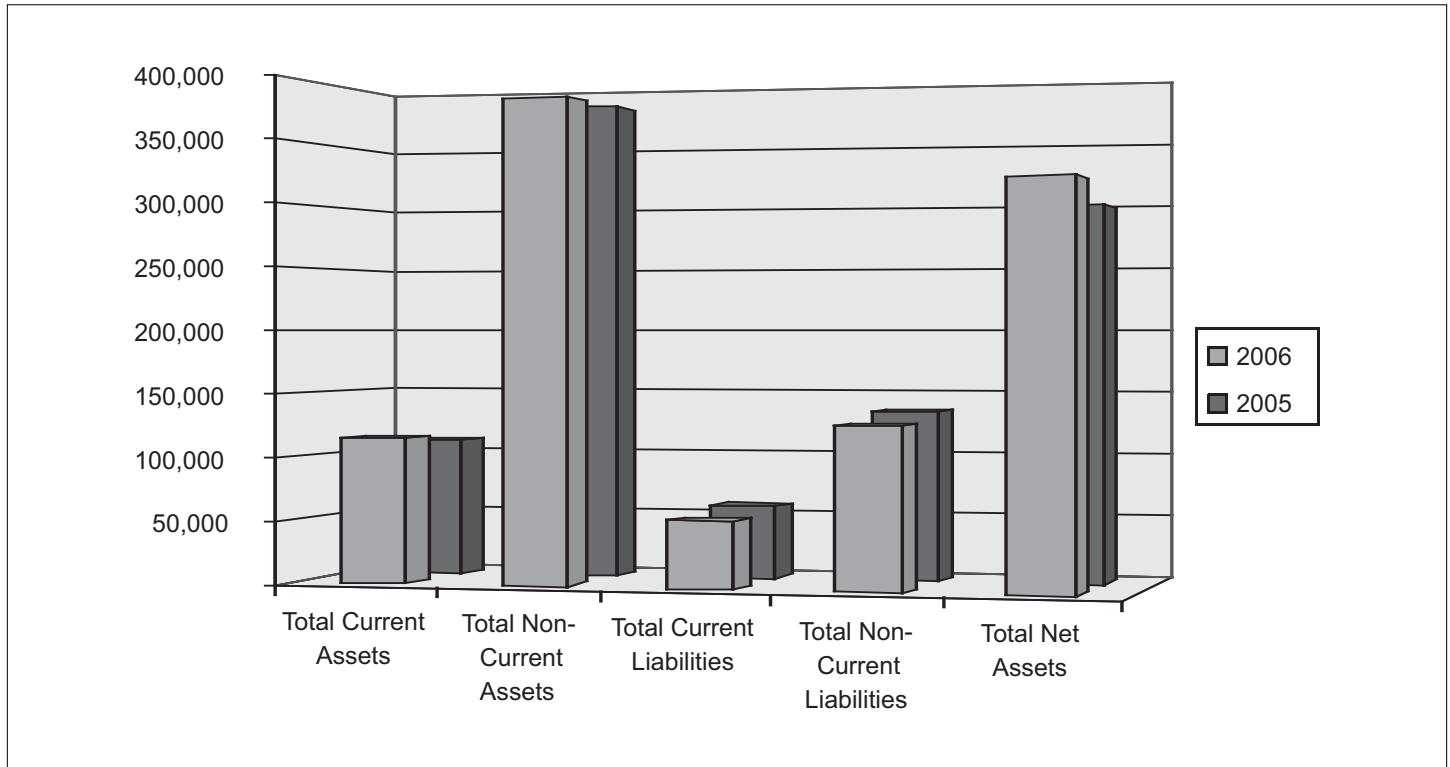
Total assets at June 30, 2006 were \$496.3 million, an increase of \$5 million (1%). Capital assets, net of depreciation, comprised 64.2%, or \$318.8 million of the total assets.

Total liabilities were \$179.8 million at June 30, 2006, a decrease of \$13.1 million (6.8%), compared to \$192.9 million at June 30, 2005. Long-term liabilities comprised 70.5%, or \$126.7 million of the total liabilities.

Total net assets at June 30, 2006 were \$316.5 million, an \$18.4 million increase over the prior year. The breakout of net assets is shown below:

Capital assets, net of related debt.....	\$188,665,306
Restricted net assets	63,651,402
Unrestricted net assets.....	64,185,428
Total net assets.....	\$316,502,136

The composition of current and non-current assets and liabilities and net assets is displayed below for both the 2005 and 2006 fiscal year ends (in thousands):



STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses and Changes in Net Assets presents the total revenues earned and expenses incurred by the University for operating, non-operating and other related activities during a period of time. Its purpose is to assess the University's operating results.

Revenues

Operating revenues at the University as of June 30, 2006 increased by 9.2% over the previous fiscal year. The following is a brief summary of the significant changes:

- Student fee revenues, after scholarship allowances, were \$119.5 million in 2006, compared to \$102.8 million in 2005. This increase is a result of a tuition increase approved by the Kansas Board of Regents for fiscal year 2006. The goal of the tuition increase, which was the result of collaboration between University Administration and University students, was to provide additional funds to the University to improve or enhance student education while State appropriations decreased significantly. The increase was used for specific expenses including faculty salary increases, instructional and technological upgrades, and additional scholarships.
- Grants and contracts (federal, state and local, and non-governmental) increased \$5.5 million over the previous fiscal year. This category of revenue includes funds received from the federal government for financial aid as well as other sponsored research revenue. In conjunction with this increase in grants and contracts revenue, the revenue from the University's facilities and administrative overhead reimbursement also increased from the prior year.

- Sales and services of educational activities increased \$1.4 million from the previous fiscal year. These revenues are generated by activities that are related incidentally or exist primarily to afford hands on experience related to providing instruction, research, and public service.
- Auxiliary enterprises increased \$1 million from the previous fiscal year. Auxiliary enterprises include Housing, Parking, University health services, and a variety of other smaller services.

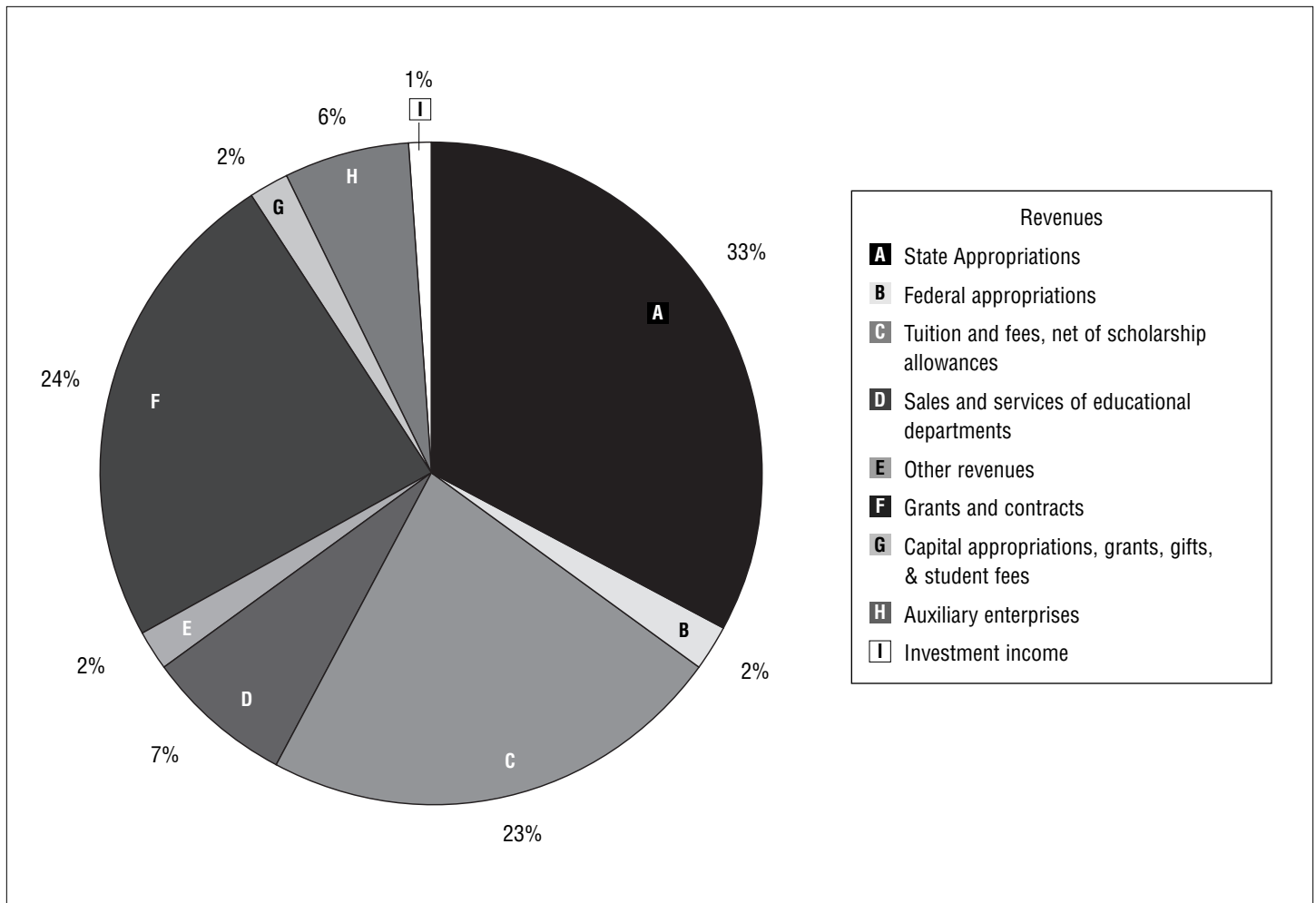
Total non-operating revenues were up 5.8% from the prior year from \$167.3 million to \$177 million. The following is a brief summary of the significant changes:

- State appropriations, the largest single source of revenue at the University, increased from \$163.5 million to \$171.7 million.
- Investment income increased from \$1.6 million to \$3 million.

Other revenues included the following:

- Capital appropriations and grants and gifts increased from \$5.1 million to \$7.6 million.

In summary, total revenues increased by \$39.7 million, from \$471.7 million to \$511.4 million, an overall increase of 8.4%. The compositions of these revenues are displayed in the following graph:



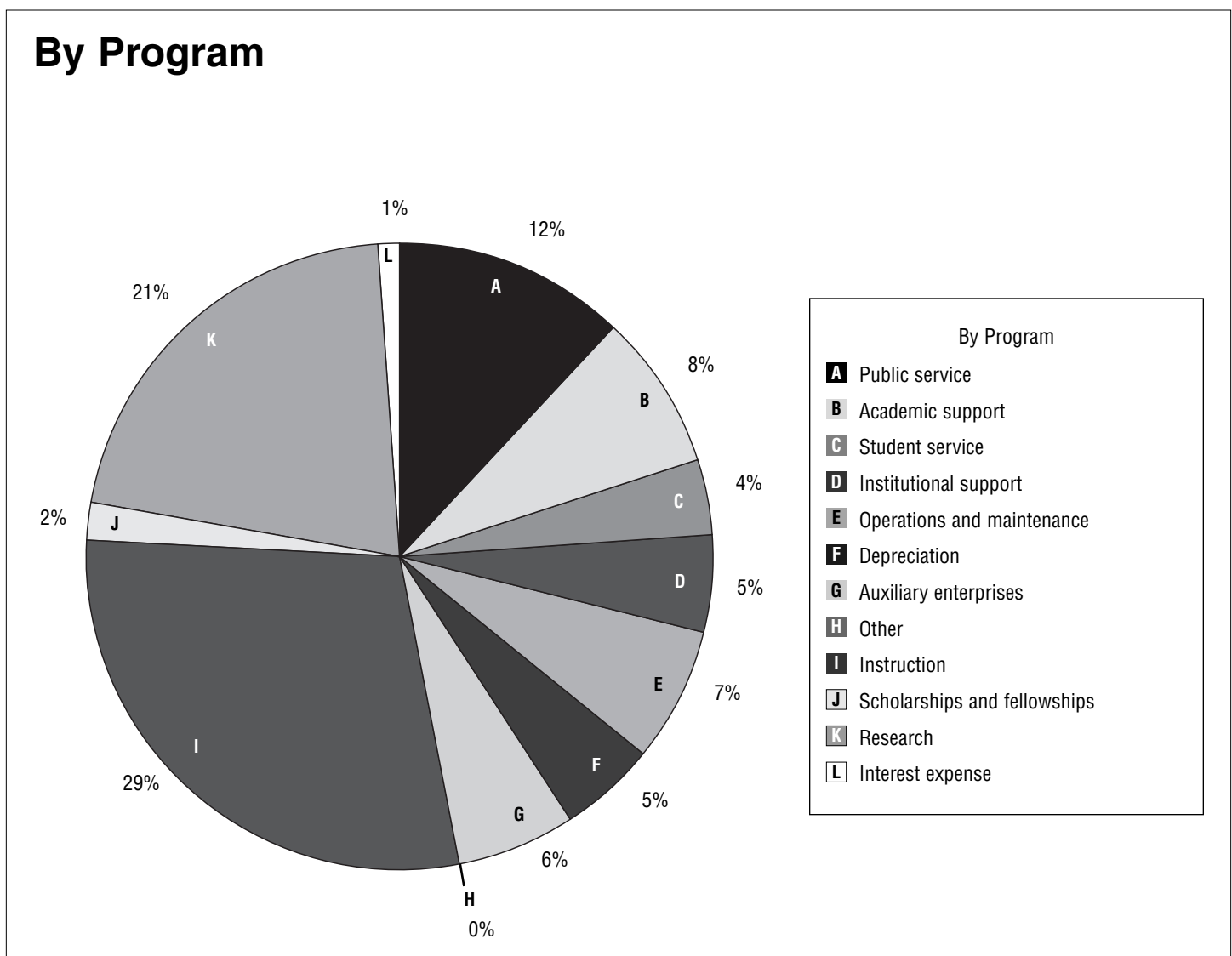
Expenses

Operating expenses were \$487.3 million for the 2006 fiscal year. This was an increase over the prior year of \$22.5 million, or 4.9%. The following is a brief summary of the significant changes:

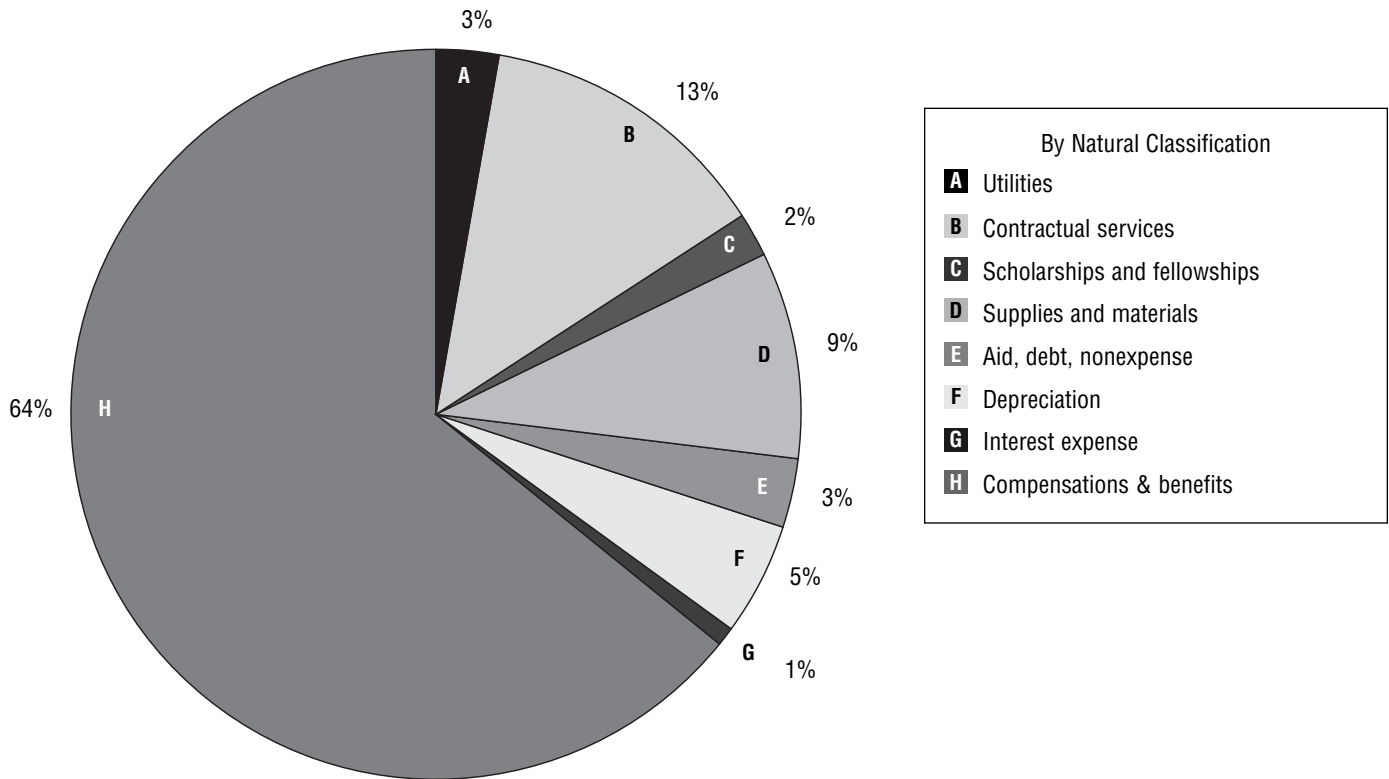
- Expenses related to the University's mission of instruction, research and public service increased \$8.4 million in 2006. This increase is directly related to the University's tuition increase earmarked for faculty salaries and the increase in grant and contract revenue.
- Scholarships and fellowships expenses increased by \$2.3 million. The majority of this change is a result of the University's effort to increase financial aid by designating a portion of tuition increases for need-based scholarships.

Non-operating expenses are represented primarily by interest expense, which increased by \$2.4 million from the prior year as a result of the additional debt issued in 2005 fiscal year.

The composition of total expenses, including operating and non-operating are displayed below:



By Natural Classification



Extraordinary Items

The University did not have any special and extraordinary items in 2006.

Net Assets

Net assets increased by \$18.4 million compared to the previous fiscal year, which generally indicates that the financial condition has improved over the year. There were many offsetting variances, but the increase is primarily due to an increase in accounts receivable and a decrease in accounts payable.

STATEMENT OF CASH FLOWS

The Statement of Cash Flows presents cash receipts and payments of the University during a period of time. Its purpose is to assess the University's ability to generate future net cash flows and meet its obligations as they come due.

SUMMARY OF THE STATEMENT OF CASH FLOWS (in thousands of dollars):

	June 30, 2006	June 30, 2005
Net cash provided (used) by:		
Operating activities	\$ (152,073)	\$ (145,760)
Non-capital financing activities	171,493	162,964
Capital and related financing/appropriations	(57,700)	25,637
Investing activities	28,328	(60,460)
Net increase in cash	(9,952)	(17,619)
Beginning cash and cash equivalent balances	103,665	121,284
Ending cash and cash equivalent balances	\$ 93,713	\$ 103,665

Cash provided by operating activities includes tuition and fee and grant and contract revenues. Cash used for operating activities includes payments to employees and suppliers. Cash provided by non-capital financing/appropriations includes state appropriations and the receipt and disbursement of the federal direct student loan program. Cash provided for capital and related financing activities represents proceeds from debt, the principal and interest payments towards debt, capital appropriations and grants, and the purchase and construction of capital assets. Cash provided by investing activities includes purchases and sales of investments as well as investment income earnings and losses realized.

The University's overall liquidity decreased by \$10 million during fiscal year 2006. This decline is the net result of an increase in state appropriations and redemption of investments during the year, offset by the expenditure of existing bond proceeds.

CAPITAL ASSETS

The University made significant investments in capital during the 2005-2006 fiscal year. Detailed information regarding capital asset additions, retirements & depreciation is available in Note 3 to the financial statements.

The following is a brief summary of the construction projects that were completed during the current fiscal year:

- Renovations to the Galachia Institute for Gerontology and Family Studies was completed Fall 2005 providing new clinical and support space, which will enhance and expand the teaching, research and clinical training activities for undergraduate and graduate students. The project had an estimated cost of \$1.6 million and was funded through private gifts.
- The Energy Conservation Facilities Project was completed at a total cost of approximately \$19.3 million. Over 100 energy saving measures were identified, including new windows, plumbing and lighting retrofits, and boiler replacements, to name a few. The University is responsible for repaying the State with the utility and maintenance savings estimated to be \$1.7 million annually.
- Construction and renovation projects affecting a variety of buildings and parking lots were completed during the year at an estimated cost of \$2.1 million.

Additionally, the University was involved in several construction projects that were in physical construction or planning and design phases at year-end:

- An addition to the Marianna Kistler Beach Museum of Art is a \$5 million project started in Fall 2005. The project will provide galleries to exhibit the permanent collection and additional storage space and will be funded through private gifts.
- The Jardine Terrace Apartments renovation continued through FY2006. This Department of Housing and Dining Services project has an estimated cost of \$102 million and will be funded through a 30-year series of bond agreements with future repayment of the bonds coming from Housing Operation revenues.
- The Grain Science Center Biological and Industrial Value-Added Program Complex project, which commenced in FY 2004, will continue with construction of the Grain Science Feed Mill. It has an estimated cost of \$5.5 million. The Grain Science Flour Mill was completed Fall 2006 at a cost of approximately \$6.8 million and was funded through private gifts. A teaching/research/ administration building will complete the complex and will be funded through private gifts.
- Construction continued on the Biosecurity Research Institute. This has an expected completion of Fall 2006. This \$53.4 million project will enable investigation of infectious diseases and provide for safe handling of biotechnology products. The majority of the funding is being provided through the issuance of revenue bonds, with future repayment of the bonds coming from state appropriations and various university revenue funds
- Renovations to Haymaker Hall, which is a part of the Department of Housing and Dining Services, began in Fall 2005. The project is estimated at \$3.7 million, to be funded by Housing Operation revenues. The renovations will convert the old style student rooms to suites of rooms.
- A multi-year renovation and addition to the Vanier Football Complex was started in Fall 2005. The project is estimated at \$5.5 million and funded through private gifts.
- Several projects are in the planning stages, including a \$6.4 million Student Life Center at the Salina Campus and a \$17 million Parking Garage at the Manhattan Campus.

DEBT ADMINISTRATION

At June 30, 2006, the University had \$127.5 million in debt outstanding. The University paid \$8,780,602 in principal and interest payments related to all outstanding revenue bonds.

Moody's Investors Service currently rates the University "Aa3". More detailed information about the University's long-term liabilities is available in Notes 7, 8, and 9 to the financial statements.

ECONOMIC OUTLOOK

The State of Kansas revenues exceeded estimates in FY 2006 and revenues for FY 2007 are coming in higher than projected. The Kansas economy is expected to continue the trend of positive growth through FY 2007. Future increases in State funding are likely to be moderate. Thirty-four percent of the total resources for the University, during a fiscal year, are provided by the State. Appropriations for fiscal year 2007 are currently set at \$179.1 million, which is an increase of 2% from fiscal year 2006.

The University is not aware of any additional currently known facts, decisions, or conditions that are expected to have significant effect on the financial position or results of operations during this fiscal year beyond those unknown variations having a global effect on virtually all types of business operations.

Overall, the financial position of the University continues to be strong. Enrollment for the academic 2006-2007 year is expected to be relatively consistent with academic 2005-2006 year.

Kansas State University
Statement of Net Assets
For the Year Ended June 30, 2006

	University Funds		Component Units	
	2006	2005	2006	2005
ASSETS				
Cash and cash equivalents	\$ 83,487,230	\$ 83,481,051	\$ 22,465,019	\$ 20,462,980
Accounts receivable, net	22,468,695	18,842,225	5,626,233	3,789,736
Pledges receivable	-	-	28,695	528,662
Investments	1,963,733	-	2,687,968	1,881,895
Loans to students, net	2,997,632	3,308,391	-	-
Inventories	3,222,933	3,098,627	437,288	347,587
Prepaid expenses	899,227	173,410	1,626,617	168,542
Total Current Assets	<u>115,039,450</u>	<u>108,903,704</u>	<u>32,871,820</u>	<u>27,179,402</u>
Noncurrent Assets				
Restricted cash and cash equivalents	10,225,690	20,184,246	17,002,831	13,205,494
Pledges receivable	-	-	42,866	86,239
Investments	38,526,509	65,690,956	2,038,625	2,038,625
Loans to students, net	13,640,414	13,394,391	-	-
Other assets	-	742,701	1,441,757	1,084,729
Capital assets, net	318,844,114	282,116,899	5,791,150	5,148,361
Total Noncurrent Assets	<u>381,236,727</u>	<u>382,129,193</u>	<u>26,317,229</u>	<u>21,563,448</u>
TOTAL ASSETS	<u>496,276,177</u>	<u>491,032,897</u>	<u>59,189,049</u>	<u>48,742,850</u>
LIABILITIES				
Current Liabilities				
Accounts payable and accrued liabilities	15,761,435	24,339,131	8,147,149	7,549,530
Deferred revenue	16,423,468	16,884,087	16,248,601	12,605,165
Revenue bonds payable	4,985,000	2,620,000	1,276,700	853,861
Accrued compensated absences	12,383,960	11,027,703	849,172	885,322
Other liabilities	1,430,948	1,170,974	1,705,115	1,866,163
Capital lease payable	1,279,453	1,194,204	419	5,014
Deposits held in custody for others	830,329	890,959	387,639	509,932
Total Current Liabilities	<u>53,094,593</u>	<u>58,127,058</u>	<u>28,614,795</u>	<u>24,274,987</u>
Noncurrent Liabilities				
Other liabilities	4,172,464	4,566,541	-	-
Revenue bonds payable	118,130,000	123,115,000	13,974,189	15,252,029
Other loan payable	2,350,000	2,875,000	1,000,000	50,000
Accrued compensated absences	1,344,631	2,406,385	-	-
Capital lease payable	682,353	1,830,314	-	-
Total Noncurrent Liabilities	<u>126,679,448</u>	<u>134,793,240</u>	<u>14,974,189</u>	<u>15,302,029</u>
TOTAL LIABILITIES	<u>179,774,041</u>	<u>192,920,298</u>	<u>43,588,984</u>	<u>39,577,016</u>
NET ASSETS				
Invested in capital assets, net of related debt	188,665,306	147,906,763	(9,460,158)*	(10,962,543)*
Restricted for:				
Nonexpendable	2,614,105	2,483,960	12,599,818	7,868,160
Expendable				
Scholarships, research, instruction, public service, & other	(6,307,934)	(6,832,114)	4,359,679	5,308,340
Loans	19,507,470	19,693,415	-	-
Capital projects	36,699,753	70,185,382	43,334	28,995
Debt service	11,138,008	12,900,532	3,433,756	3,461,598
Unrestricted	64,185,428	51,774,661	4,623,636	3,461,284
TOTAL NET ASSETS	<u>\$ 316,502,136</u>	<u>\$ 298,112,599</u>	<u>\$ 15,600,065</u>	<u>\$ 9,165,834</u>

*See accompanying Note 14.

Kansas State University
Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2006

	University Funds		Component Units	
	2006	2005	2006	2005
Operating Revenues:				
Tuition and fees, net of scholarship allowances of \$11,782,648	\$ 119,458,305	\$ 102,484,423	\$ 2,370,476	\$ 2,334,171
Federal appropriations	8,047,319	7,804,518	-	-
Federal grants and contracts	91,229,795	87,843,708	-	-
State and local grants and contracts	5,287,648	8,923,402	-	-
Nongovernmental grants and contracts	26,372,800	20,587,285	9,556,786	9,035,206
Sales and services of educational activities	33,991,435	32,631,798	20,865,116	20,355,842
Auxiliary enterprises				
Housing revenues (revenues are pledged as security for bonds)	24,314,927	23,707,201	-	-
Parking revenues (revenues are pledged as security for bonds)	2,053,938	2,178,307	-	-
Student health revenues	5,243,490	5,156,923	-	-
Other auxiliary revenues	725,058	275,683	-	-
Interest earned on loans to students	282,006	269,560	-	-
Other operating revenues	9,583,178	7,310,845	6,313,193	6,636,879
Contributions	-	-	6,897,987	6,232,878
Total Operating Revenues	<u>326,589,899</u>	<u>299,173,473</u>	<u>46,003,558</u>	<u>44,594,976</u>
Operating Expenses:				
Instruction	142,910,562	139,756,012	-	-
Research	104,674,318	101,137,129	-	-
Public Service	56,705,814	54,975,449	871,798	839,179
Academic Support	39,780,938	37,197,767	-	-
Student Service	18,955,789	19,349,071	31,107,742	2,588,242
Institutional Support	24,815,001	21,319,162	2,463,440	29,118,349
Operations & Maintenance of Plant	35,711,754	32,131,862	-	-
Depreciation	22,207,511	20,933,590	1,110,741	976,534
Scholarships & Fellowships	12,021,619	9,761,738	4,726,155	5,004,342
Auxiliary Enterprises	29,008,931	26,867,176	-	-
Other Expenses	525,310	1,297,761	2,924,864	2,215,753
Total Operating Expenses	<u>487,317,547</u>	<u>464,726,717</u>	<u>43,204,740</u>	<u>40,742,399</u>
Operating Income (Loss)	<u>(160,727,648)</u>	<u>(165,553,244)</u>	<u>2,798,818</u>	<u>3,852,577</u>
Nonoperating Revenues (Expenses)				
State appropriations	171,676,343	163,467,840	1,522,182	1,527,093
Investment income	2,974,972	1,579,686	1,994,250	1,329,467
Interest expense	(5,693,820)	(3,319,541)	(1,348,548)	(1,206,231)
Gain/Loss on disposal of assets	156,935	(469,154)	-	-
Student fees for capital projects	2,186,376	2,227,227	-	-
Net Nonoperating Revenues	<u>171,300,806</u>	<u>163,486,058</u>	<u>2,167,884</u>	<u>1,650,329</u>
Income (Loss) Before Other Revenues, Expenses, Gains and Losses	<u>10,573,158</u>	<u>(2,067,186)</u>	<u>4,966,702</u>	<u>5,502,906</u>
Capital appropriations	4,374,000	2,556,070	-	-
Capital grants and gifts	3,172,780	2,538,711	-	-
Additions to permanent endowment	132,521	115,673	4,731,658	701,948
Other additions/deductions, net	137,078	(1,206,806)	(3,264,129)	(1,714,908)
Increase (Decrease) in Net Assets	<u>18,389,537</u>	<u>1,936,462</u>	<u>6,434,231</u>	<u>4,489,946</u>
Net Assets				
Net Assets—Beginning of Year, as previously reported	298,112,599	299,176,137	9,165,834	4,675,888
Prior Period Restatement	-	-	-	-
Net Assets, Beginning of Year, as restated	<u>298,112,599</u>	<u>299,176,137</u>	<u>9,165,834</u>	<u>4,675,888</u>
Net Assets—End of Year	<u>\$ 316,502,136</u>	<u>\$ 298,112,599</u>	<u>\$ 15,600,065</u>	<u>\$ 9,165,834</u>

Kansas State University
Statement of Cash Flows
For the Year Ended June 30, 2006

	University Funds	
	2006	2005
Cash Flows from Operating Activities		
Tuition and fees	\$ 129,009,291	\$ 116,421,797
Endowment income	87,702	104,042
Sales and services of educational activities	33,680,916	31,055,892
Auxiliary enterprise charges		
Housing	24,174,357	23,519,473
Parking	2,018,362	2,077,105
Student Health	5,231,927	5,155,974
Other	799,973	251,406
Grants and contracts	121,411,955	115,092,929
Federal appropriations	8,047,319	7,804,518
Payments to suppliers	(171,185,743)	(161,274,595)
Compensation & benefits	(331,173,239)	(309,394,860)
Loans issued to students and employees	(5,265,932)	(4,163,647)
Collections on loans issued to students and employees	5,132,495	4,681,849
Other receipts (payments)	25,957,843	22,907,860
	(152,072,774)	(145,760,257)
Net Cash Flows from Operating Activities		
Cash Flows from Noncapital Financing Activities		
State appropriations	171,676,343	163,467,840
Direct lending receipts	95,153,511	91,844,920
Direct lending payments	(94,995,342)	(92,038,985)
Funds held for others	(60,630)	9,677
Other	(281,220)	(318,605)
	171,492,662	162,964,847
Net Cash Flows from Noncapital Financing Activities		
Cash Flows from Capital and Related Financing Activities		
Proceeds from capital debt	-	66,035,000
Capital appropriations	4,374,000	2,556,070
Capital grants and gifts	110,996	1,177,570
Student fees for capital projects	2,186,376	2,227,227
Purchases of capital assets	(56,439,546)	(37,647,597)
Principal paid on capital debt and leases	(3,145,000)	(4,425,510)
Interest paid on capital debt and leases	(5,635,602)	(3,272,752)
Other	848,936	(1,012,742)
	(57,699,840)	25,637,266
Net Cash Flows from Capital and Related Financing Activities		
Cash Flows from Investing Activities		
Investment income	3,126,861	1,200,736
Purchase/Redemption of investments	25,200,714	(61,661,075)
	28,327,575	(60,460,339)
Net Cash Flows from Investing Activities		
Net change in cash and cash equivalents	(9,952,377)	(17,618,483)
Cash and cash equivalents—beginning of year	103,665,297	121,283,780
Prior Period Restatement	-	-
Cash and cash equivalents—beginning of year	103,665,297	121,283,780
Cash and cash equivalents—end of year	\$ 93,712,920	\$ 103,665,297

Kansas State University
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2006

	University Funds	
	2006	2005
Reconciliation		
Operating income (loss)—SRECNA	\$ (160,727,648)	\$ (165,553,244)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	22,207,511	20,933,590
Changes in assets and liabilities:		
Accounts receivable, net	(3,645,838)	(1,469,311)
Loans to students, net	(133,437)	518,202
Inventories	(124,306)	(95,273)
Prepaid expenses	(725,817)	24,087
Accounts payable and accrued liabilities	(8,757,123)	1,226,282
Deferred revenue	(460,619)	(2,137,677)
Accrued compensated absences	294,503	793,087
	\$ (152,072,774)	\$ (145,760,257)
Net cash used in operating activities—Cash Flow		

Kansas State University
Notes to Financial Statements
For the Year Ended June 30, 2006

Note 1—Organization and Summary of Significant Accounting Policies

Organization. Kansas State University (University) is a comprehensive, research, federal land grant institution governed by the Kansas Board of Regents and is an agency of the State of Kansas. Accordingly, for financial reporting purposes, the University is included in the financial report of the State of Kansas.

The University is currently classified as a Doctoral/Research University – Extensive under the Carnegie Classification system and is accredited by the North Central Association of Colleges and Schools. Undergraduate, graduate and post-graduate degrees are available from nine colleges: Agriculture, Architecture, Planning & Design, Arts & Sciences, Business Administration, Education, Engineering, Human Ecology, Veterinary Medicine, and Technology & Aviation.

Other major operating units of the University are the Agricultural Experiment Station and a statewide Cooperative Extension Service. The main campus covers 668 acres in the cities of Manhattan and Salina, Kansas. Additional University sites include 18,000 acres of the Agricultural Experiment Station (AES) located in research centers at Hays, Garden City, Colby, and Parsons and 8,600 acres in the Konza Prairie Research Natural Area, jointly operated by the AES and the Division of Biology.

Financial Reporting Entity. As required by the accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB), these financial statements present the financial position and financial activities of the University and its component units: the Kansas State University Research Foundation (KSURF), The IDEA Center, Inc, The K-State Union Corporation, the Intercollegiate Athletic Council of Kansas State University, Inc., and the Kansas State University Student Financial Assistance Foundation, Inc. Component unit financial activities and balances have been discretely presented

The Kansas State University Foundation accounts are not included in the University's financial statements.

Basis of Accounting. For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant intra-agency transactions have been eliminated.

The University has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The University has elected to not apply FASB pronouncements issued after the applicable date.

Cash Equivalents. For the purposes of the Statement of Cash Flows, the University considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Investments. The University accounts for its investments at fair value in accordance with GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investments Pools. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses, and Changes in Net Assets.

Accounts Receivable. Accounts receivable consists of tuition and fee charges to students and auxiliary enterprise services provided to students, faculty, and staff. Accounts receivable also include amounts due from the Federal, state and local governments or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's grants and contracts. Accounts receivable are recorded net of estimated uncollectible amounts.

Inventories. Inventories are stated at cost.

Kansas State University

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2006

Noncurrent Cash and Investments. Cash and investments that are externally restricted to make debt service payments, maintain sinking or reserve funds, or to purchase or construct capital or other noncurrent assets, are classified as noncurrent in the Statement of Net Assets.

Capital Assets. Capital assets are recorded at cost at the date of acquisition, or fair market value at the date of donation in the case of gifts. For equipment, the University's capitalization policy includes all items with a unit cost of \$5,000 or more, and an estimated useful life of greater than one year. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the structure are capitalized if the related project cost is \$100,000 or greater. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred.

Depreciation is computed using the straight-line method and half-year convention over the estimated useful lives of the assets, generally 40 years for buildings, 25 years for infrastructure and land improvements, 8 years for equipment, 5 years for vehicles, and 5 to 40 years for componentized buildings and building improvements.

Deferred Revenue. Deferred revenues consist primarily of summer school tuition not earned during the current year and amounts received from grant and contract sponsors that have not yet been earned.

Compensated Absences. Employee vacation and sick pay is accrued at year-end for financial statement purposes. The liability and expense incurred are recorded as accrued compensated absences in the Statement of Net Assets, and as a component of compensation and benefit expense in Note 13 Operating Expenses by Natural Classification.

Noncurrent Liabilities. Noncurrent liabilities include principal amounts of revenue bonds and loans payable, capital lease obligations with contractual maturities greater than one year, and other liabilities that are to be paid from funds that are classified as noncurrent assets.

Net Assets. The University's net assets are classified as follows:

Invested in capital assets, net of related debt: This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted net assets—nonexpendable: Restricted nonexpendable net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

Restricted net assets—expendable: Restricted expendable net assets include resources in which the University is legally or contractually obligated to spend resources in accordance with restrictions imposed by external third parties.

Unrestricted net assets: Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments. These resources are used for transactions relating to the educational and general operations of the University, and may be used at the discretion of the governing board to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for students, faculty and staff.

Tax Status. As a state institution of higher education, the income of the University is generally exempt from federal and state income taxes under Section 115(a) of the Internal Revenue Code; however, income generated from activities unrelated to the University's exempt purpose is subject to income taxes under Internal Revenue Code Section 511(a)(2)(B).

Kansas State University

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2006

Classification of Revenues. The University has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues: Operating revenues include activities that have the characteristics of exchange transactions, such as 1) student tuition and fees, net of scholarship discounts and allowances, 2) sales and services of auxiliary enterprises or educational activities, 3) most Federal, state and local grants and contracts, and 4) interest on institutional student loans.

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting and GASB Statement No. 35, Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities, such as state appropriations and investment income.

Scholarship Discounts and Allowances. Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the Statement of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University, and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants, and other Federal, state or nongovernmental programs, are recorded as either operating or nonoperating revenues in the University's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

Summer Session. Revenues and expenses for the summer session are reported within the fiscal year in which the summer session is predominately conducted. Accordingly, only revenues and expenses for the 2005 summer session are reported in the Statement of Revenues, Expenses, and Changes in Net Assets. For the 2006 summer session, revenues received prior to June 30, 2006 are reported as deferred revenues in the Statement of Net Assets while expenses paid prior to June 30, 2006 are reported as prepaid expenses. Kansas Board of Regents officials determined this methodology and believe the departure from generally accepted accounting principles will not have a material effect on the University's financial position.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles require management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

Note 2—Cash, Cash Equivalents, and Investments

Cash and Cash Equivalents. The carrying amount of the University's deposits with the State Treasurer and other financial institutions at June 30, 2006 were \$93,712,920. The University's deposits with the State Treasurer are pooled with the funds of other State Agencies and then, in accordance with statutory limitations, placed in short-term investments with the exception of the bond funds. All bond proceeds are invested in conjunction with specifications stated in the bond resolutions.

Investments. Kansas State University had the following investments, listed at fair value, as of June 30:

	2006	2005
U. S. Government Securities	\$ —	\$ —
Certificates of Deposits	2,613,733	2,483,757
Guaranteed Investment Contracts	37,876,509	63,207,199
Total Investments	\$ 40,490,242	\$ 65,690,956

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2006

Note 3—Capital Assets

Capital asset activity for the University for the year ended June 30, 2006 is summarized as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Capital Assets (not depreciated)				
Land and Improvements	7,399,668	-	-	7,399,668
Art Collections	1,919,000	34,150	-	1,953,150
Construction in Progress	26,580,421	40,344,368	9,146,157	57,778,632
Capital Assets (being depreciated)				
Buildings & Improvements	393,238,690	14,342,566	9,000	407,572,256
Land Improvements	17,017,709	527,819	-	17,545,528
Infrastructure	6,568,283	1,416,408	-	7,984,691
Equipment and Furnishings	132,113,393	10,445,396	1,915,079	140,643,710
Vehicles	21,441,697	1,033,467	1,213,978	21,261,186
Total Capital Assets	606,278,861	68,144,174	12,284,214	662,138,821
Accumulated Depreciation				
Buildings & Improvements	202,800,532	9,981,956	6,750	212,775,738
Land Improvements	6,426,488	675,475	-	7,101,963
Infrastructure	4,141,581	195,360	-	4,336,941
Equipment and Furnishings	90,901,722	10,536,816	1,774,362	99,664,176
Vehicles	19,797,996	817,904	1,200,011	19,415,889
Total Depreciation	324,068,319	22,207,511	2,981,123	343,294,707
Capital Assets, net	282,210,542	45,936,663	9,303,091	318,844,114

The University elected not to capitalize its library book collections. These collections adhere to the University's policy to (a) maintain them for public exhibition, education, or research; (b) protect, keep encumbered, care for, and preserve them; and (c) require proceeds from their sale to be used to acquire other collection items. Generally accepted accounting principles permit collections maintained in this manner to be charged to operations at the time of purchase rather than be capitalized.

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2006

Note 4—Accounts Receivable

Accounts receivable are shown net of allowances for doubtful accounts in the accompanying Statement of Net Assets. At June 30, 2006, accounts receivable consisted of the following:

	June 30, 2006
Student tuition and fees	\$ 5,356,553
Auxiliary enterprises and other operating activities	4,526,069
Federal, state, and private grants and contracts	13,455,858
Interest	566,263
	\$23,904,743
Less allowance for doubtful accounts	1,436,048
Net accounts receivable	\$22,468,695

Note 5—Loans Receivable

Student loans made through the Federal Perkins Loan Program and the Health Profession Student Loan Program comprise substantially all of the June 30, 2006 loan balances. The Programs provide for cancellation of a loan at rates of 10% to 30% per year up to a maximum of 100%, if the participant complies with certain provisions. The federal government reimburses the University for amounts cancelled under these provisions.

As the University determines that loans are uncollectible and not eligible for reimbursement by the federal government, the loans are written off and assigned to the U.S. Department of Education. The University has provided an allowance for uncollectible loans, which, in management's opinion, is sufficient to absorb loans that will ultimately be written off. At June 30, 2006, the allowance for uncollectible loans was approximately \$1,340,243.

Note 6—Deferred Revenue

Deferred revenues consist primarily of summer session tuition and fees and advance collections on grants and contracts. The breakdown of deferred revenues is as follows:

Tuition and fees	\$ 3,019,103
Grants and contracts	13,404,365
	\$16,423,468

Note 7—Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2006 consists of the following:

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds payable	\$125,735,000	\$ -	\$ 2,620,000	\$123,115,000	\$4,985,000
Loans payable	2,875,000	-	525,000	2,350,000	-
Lease obligations	3,024,518	209,333	1,272,045	1,961,806	1,279,453
Deposits held in custody for others	890,959	4,509,635	4,570,265	830,329	830,329
Other liabilities	5,737,515	1,397,052	1,531,155	5,603,412	1,430,948
Total Long-Term Liabilities	\$138,262,992	\$ 6,116,020	\$10,518,465	\$133,860,547	\$8,525,730

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2006

Note 8—Revenue Bonds Outstanding

Revenue bonds payable consisted of the following at June 30, 2006:

	Principal Outstanding <u>6/30/06</u>
<p>Kansas Development Finance Authority Revenue Bonds-Series 2005D (The Kansas Board of Regents – Kansas State University Research and Development Facilities Projects) issued on May 1, 2005 in the original amount of \$20,980,000. Due in annual installments beginning 4/1/07 with final maturity on 10/1/21. Interest ranging from 3.90% to 5.15% payable semi-annually.</p>	\$20,980,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 2005A (The Kansas Board of Regents – Kansas State University Housing System, Manhattan Campus) issued on February 1, 2005 in the original amount of \$44,535,000. Due in annual installments beginning 10/1/06 with final maturity on 4/1/35. Interest ranging from 3.00% to 5.00% payable semi-annually.</p>	\$44,535,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 2003J-1 (The Kansas Board of Regents – Kansas State University Energy Conservation Projects) issued on August 1, 2003 in the original amount of \$21,020,000. Due in annual installments beginning 8/1/05 with final maturity on 10/1/32. Interest ranging from 4.25% to 5.00% payable semi-annually.</p>	\$19,495,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 2003C (The Kansas Board of Regents – Kansas State University Research and Development Facilities Projects) issued on February 1, 2003 in the original amount of \$22,485,000. Due in annual installments beginning 10/1/22 with final maturity on 10/1/32. Interest ranging from 4.75% to 5.00% payable semi-annually.</p>	\$22,485,000
<p>Kansas Development Finance Authority Refunding Revenue Bonds- Series 2001G-1 (The Kansas Board of Regents – Kansas State University Salina Housing Project) issued on June 15, 2001 in the original amount of \$845,000. Due in annual installments with final maturity on 4/1/14. Interest ranging from 4.25% to 5.00% payable semi-annually.</p>	\$ 590,000
<p>Kansas Development Finance Authority Refunding Revenue Bonds- Series 2001G-2 (The Kansas Board of Regents – Kansas State University Recreation Project) issued on June 15, 2001 in the original amount of \$6,385,000. Due in annual installments with final maturity on 4/1/13. Interest ranging from 4.25% to 5.00% payable semi-annually.</p>	\$ 4,370,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 2000D (The Kansas Board of Regents – Kansas State University Ackert Hall Addition Project) issued on July 15, 2000 in the original amount of \$1,735,000. Due in annual installments with final maturity on 5/1/15. Interest ranging from 4.60% to 5.60% payable semi-annually.</p>	\$ 1,235,000

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2006

Revenue bonds payable consisted of the following at June 30, 2006:

	<u>Principal Outstanding 6/30/06</u>
<p>Kansas Development Finance Authority Revenue Bonds-Series 1998B (The Kansas Board of Regents – Kansas State University Student Union Renovation and Expansion Project) issued on April 1, 1998 in the original amount of \$9,320,000. Due in annual installments with final maturity on 4/1/18. Interest ranging from 3.90% to 5.00% payable semi-annually.</p>	\$ 6,865,000
<p>Kansas Development Finance Authority Revenue Bonds-Series 1995K (The Kansas Board of Regents – Kansas State University Farrell Library Expansion Project) issued on November 1, 1995 in the original amount of \$3,835,000. Due in annual installments with final maturity on 10/1/15. Interest ranging from 3.75% to 5.40% payable semi-annually.</p>	\$ 2,560,000

Series 2001G-2 Recreation Project, Series 1995K Farrell Library Expansion Project, and Series 1998B Student Union Renovation and Expansion Project are collateralized by a pledge of student fees. Series 2001G-1 Salina Housing Project and Series 2005A Housing System Manhattan Campus are collateralized by a pledge of housing revenues. Series 2000D Ackert Hall Addition Project is collateralized by a pledge of sponsored research overhead revenues. Series 2003C and Series 2005D Research and Development Facilities Projects are collateralized by a pledge of State appropriations and various university revenue funds. Series 2003J-1 Energy Conservation Projects are collateralized by the annual utility and maintenance savings realized by the implementation of the energy improvement projects.

Future debt service requirements for all bonds outstanding at June 30, 2006 are as follows:

Year Ending June 30:	Principal	Interest	Total
2007	\$ 4,985,000	\$ 5,611,233	\$10,596,233
2008	4,185,000	5,399,076	9,584,076
2009	4,370,000	5,232,975	9,602,975
2010	4,555,000	5,064,278	9,619,278
2011	4,765,000	4,883,336	9,648,336
2012-2016	22,400,000	21,413,781	43,813,781
2017-2021	21,825,000	16,195,894	38,020,894
2022-2026	20,095,000	10,919,379	31,014,379
2027-2031	20,910,000	6,295,939	27,205,939
2032-2035	15,025,000	1,402,024	16,427,024
Total	\$123,115,000	\$ 82,417,915	\$ 205,532,915

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2006

Note 9—Loan and Lease Obligations

In July 2003, Kansas State University and the Pooled Money Investment Board entered into a construction loan agreement for the Biological and Industrial Value Added Program for a maximum amount of \$4,000,000. The loan requires annual interest payments due August 1 of each year in which a principal balance remains outstanding, at a rate of 1.548% per annum. The entire principal balance is due August 1, 2007. As of June 30, 2006, \$3,875,000 had been borrowed and \$1,525,000 in principal payments had been made, leaving an outstanding balance of \$2,350,000.

The University is obligated for the purchase of certain equipment funded through the State of Kansas Equipment Lease Purchase Program in the amount of \$1,961,806 as of June 30, 2006. Payments to liquidate these obligations are scheduled as follows:

Year Ending June 30:	Total
2007	\$1,279,453
2008	448,941
2009	215,656
2010	6,457
2011	6,457
2012	<u>4,842</u>
	<u>\$1,961,806</u>

Note 10—Retirement Plans

The University participates in one cost-sharing multiple-employer defined benefit pension plan, one defined contribution pension plan, and one federal pension plan.

Defined Benefit Plan

Classified employees participate in the Kansas Public Employees Retirement System (KPERS). Benefit provisions are established by state statute and provide retirement, disability, and death benefits to benefits eligible employees. KPERS issues a publicly available annual financial report that includes its financial statements and required supplementary information and is available upon request from KPERS.

For the year ended June 30, 2006, active KPERS members were required by statute to contribute 4% and the University to contribute 5.27% of the employees' covered payroll. The Kansas Legislature establishes and may amend active plan members' and the University's contribution rates. The University contributed \$2,417,717 during fiscal year 2006 and individual employees contributed \$1,821,833. In addition, payments to KPERS for death and disability coverage for all University employees totaled \$1,752,097.

Defined Contribution Plan

Eligible unclassified employees are required to participate in the Kansas Board of Regents (Regents) defined contribution retirement plan, which was authorized by K.S.A. 74-4925. The Regents have selected the following companies to provide investment options to participants: 1) Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF), 2) ING Financial Advisers, 3) Lincoln National Life Insurance Company, and 4) Security Benefit Life Insurance Company. Benefits under these plans depend solely on the contributed amounts and the returns earned on the investment of those contributions. All contributions are fully vested with the first contribution.

For the year ended June 30, 2006 active members were required by statute to contribute 5.5% and the University to contribute 8.5% of the employees' covered payroll. The Kansas Legislature establishes and may amend active plan members' and the University's contribution rates. The University contributed \$13,862,519 during fiscal year 2006 and individual employees contributed \$8,843,174.

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2006

Federal Retirement Plan

Some Extension Service employees at Kansas State University hold Federal appointments. Prior to December 31, 1986, Federal appointees were required to participate in the Federal Civil Service Retirement System (CSRS), a defined benefit plan. CSRS employees are subject to the Hospital Insurance portion of FICA, the CSRS employee deduction of 7.0%, and the employer contribution of 7.0%.

The Federal Employees Retirement System (FERS), also a defined benefit plan, was created beginning January 1, 1987. Employees hired after December 31, 1983 were automatically converted to FERS. Other Federal employees not covered by FERS had a one-time option to transfer to FERS up to December 31, 1987. New FERS employees contribute 0.8% with an employer contribution rate of 11.2%. FERS employees contribute at the full FICA rate. They also participate in a Thrift Savings Plan with an automatic employer contribution of 1%. Employees may also contribute to this plan at variable rates, in which case the employer contributes at a variable rate up to 4%. CSRS employees are also eligible for participation in the Thrift Savings Plan, but without employer contributions. Acceptance of new member participation was terminated effective July 1, 1986

For the year ended June 30, 2006, the University contributed \$883,457 and individual employees contributed \$738,221 to these plans.

Voluntary Tax-Sheltered Annuity Program

Employees may also elect to participate, up to the maximum dollar amount permitted by the Internal Revenue Code, in a voluntary tax-sheltered annuity program. This voluntary plan permits employees to designate a part of their earnings into tax-sheltered investments and thus defer federal and state income taxes on their contributions and the accumulated earnings under the plan. Participation and the level of employee contributions are voluntary. The employer is not required to make contributions to the plan

Note 11—Postemployment Benefits

In addition to pension benefits, the State provides post-employment health care benefits to eligible retired employees. The benefits are provided in accordance with the rules and regulations of the Kansas State Employees Health Care Commission. The Commission is responsible for the determination of the allocation of premium costs between the participants and the State. These allocations are subject to change each contract year. The University funds the benefits on a pay-as-you-go basis.

Note 12—Commitments and Contingencies

At June 30, 2006, the University had outstanding commitments on various construction projects and contracts for repairs and renovation of facilities of approximately \$45,500,000.

The University is a defendant in several lawsuits. However, University officials are of the opinion, based on advice of in-house legal counsel, that the ultimate outcome of all litigation will not have a material effect on the future operations or financial position of the University.

As a result of legislation, the University, as an agency of the State of Kansas, is subject to the state of Kansas' self-insurance program with regard to comprehensive general liability and personal injury insurance. The University is covered by the State's umbrella insurance policies for automobile liability and property insurance. Also, the University is self-insured relative to workers' compensation, medical, and unemployment insurance. These areas include stop-loss provisions that limit the University's exposure.

In the normal course of operations, the University receives grants, contracts, and other forms of reimbursement from various federal and state agencies. These activities are subject to audit and disallowance by agents of the funding authority, the purpose of which is to ensure compliance with conditions precedent to providing such funds. University officials believe that the liability, if any, for any reimbursement that may arise as the result of audits, would not have a material effect on the University's financial position.

Kansas State University
Notes to Financial Statements (Continued)
For the Year Ended June 30, 2006

Note 13—Operating Expenses by Natural Classification

Year Ended June 30, 2006

	Compensation and Benefits	Contractual Services	Supplies and Materials	Utilities	Scholarships and Fellowships	Aid, Debt and Nonexpense	Depreciation	Total
Instruction	\$ 118,412,282	\$ 14,872,153	\$ 7,203,094	\$ 552	\$	\$ 2,422,481	\$	\$ 142,910,562
Research	68,820,913	16,320,701	13,339,209	320,513		5,872,982		104,674,318
Public Service	42,406,124	7,560,634	4,342,840	18,596		2,377,620		56,705,814
Academic Support	24,988,144	6,580,723	7,777,770			434,301		39,780,938
Student Service	13,260,166	3,086,690	744,336	5,276		1,859,321		18,955,789
Institutional Support	15,909,094	6,992,535	598,229	(74)		1,315,217		24,815,001
Operations and Maintenance of Plant	15,381,035	6,191,907	2,396,312	11,679,768		62,732		35,711,754
Scholarships & Fellowships					12,021,619			12,021,619
Auxiliary Enterprises	16,729,471	3,665,015	6,409,693	1,833,835		370,917		29,008,931
Depreciation							22,207,511	22,207,511
Other		455,626	69,684					525,310
Total Operating Expenses	\$ 315,907,229	\$ 65,725,984	\$ 42,881,167	\$ 13,858,466	\$ 12,021,619	\$ 14,715,571	\$ 22,207,511	\$ 487,317,547

Note 14—Component Units

Buildings and improvements purchased by The Intercollegiate Athletic Council immediately become the property of Kansas State University. This results in a negative amount being reported for Invested in Capital Assets, Net of Related Debt on the Statement of Net Assets.

Note 15—Reporting Changes

In FY2006, the University implemented a new accounting system (Oracle Financials). With the implementation, a change was made in the manner in which information is gathered relating to certain revenues (tuition and sales and services of educational activities). For comparative purposes, FY2005 operating revenues have been re-stated using the methodology applied to gathering data for the FY2006 revenue categories. There is no effect on total revenue or net assets.

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Kansas State University
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Manhattan, Kansas 66506-0108

Notice of nondiscrimination

Kansas State University is committed to nondiscrimination on the basis of race, sex, national origin, disability, religion, age, sexual orientation, or other nonmerit reasons, in admissions, educational programs or activities and employment (including employment of disabled veterans and veterans of the Vietnam Era), as required by applicable laws and regulations. Responsibility for coordination of compliance efforts and receipt of inquiries concerning Title VI of the Civil Rights Act of 1964, Title IX of the Education Amendments of 1972, Section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, and the Americans With Disabilities Act of 1990, has been delegated to Clyde Howard, Director of Affirmative Action, Kansas State University, 214 Anderson Hall, Manhattan, KS 66506-0124, (Phone) 785-532-6220; (TTY) 785-532-4807.

