

KANSAS STATE UNIVERSITY FOUNDATION

Manhattan, Kansas

**FINANCIAL STATEMENTS
WITH
REPORT OF CERTIFIED PUBLIC ACCOUNTANTS**

Years Ended June 30, 2006 and 2005

VARNEY & ASSOCIATES, CPAs, LLC
Manhattan, Kansas

KANSAS STATE UNIVERSITY FOUNDATION

Manhattan, Kansas

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June 30, 2006 and 2005

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September 26, 2006

To the Board of Trustees of
Kansas State University Foundation
Manhattan, Kansas

Independent Auditors' Report

We have audited the accompanying consolidated statements of financial position of Kansas State University Foundation (a nonprofit organization) as of June 30, 2006 and 2005 and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kansas State University Foundation 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.

Certified Public Accountants

KANSAS STATE UNIVERSITY FOUNDATION
 Manhattan, Kansas
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
 June 30,

	2006	2005
ASSETS		
Cash and cash equivalents	\$ 32,494,121	\$ 25,720,691
Short-term investments and certificates of deposit	3,586,032	3,564,054
Equity Investments	133,481,062	137,804,969
Book value - \$107,438,473 at June 30, 2006		
Book value - \$113,068,514 at June 30, 2005		
Corporate and other fixed income	51,920,421	53,098,155
Book value - \$51,999,183 at June 30, 2006		
Book value - \$51,784,273 at June 30, 2005		
U.S. Government and government agency obligations	1,352,295	1,586,697
Book value - \$1,334,193 at June 30, 2006		
Book value - \$1,381,628 at June 30, 2005		
Real estate investments	27,930,245	16,235,583
Book value - \$26,218,166 at June 30, 2006		
Book value - \$15,340,486 at June 30, 2005		
Alternative strategies	103,567,410	68,978,183
Book value - \$97,773,642 at June 30, 2006		
Book value - \$64,552,799 at June 30, 2005		
Other securities and investments	340,995	390,851
Book value - \$283,721 at June 30, 2006		
Book value - \$357,998 at June 30, 2005		
Pledges receivable, net	13,422,606	8,799,847
Receivables from estates	6,750,111	2,954,366
Loans receivable	710,861	1,639,167
Real estate and other depreciable property	19,903,983	20,195,627
Accumulated depreciation	(3,853,002)	(3,553,794)
Net real estate and other depreciable property - Golf Course	1,745,980	1,913,451
Cash surrender value of life insurance policies	2,756,425	2,575,063
Other assets and accrued income	722,515	524,821
	\$ 396,832,060	\$ 342,427,731
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable, deposits and other liabilities	\$ 720,895	\$ 1,022,856
Accrued liabilities	1,211,876	1,411,683
Assets held for others	6,172,878	4,741,853
Current obligations, unitrust and annuity liabilities	2,492,663	2,350,527
Total Current Liabilities	\$ 10,598,312	\$ 9,526,919
Other Liabilities		
Unitrust and annuity liabilities, less current obligation	\$ 19,927,549	\$ 18,201,668
Note Payable - Nanoscale	1,825,868	1,895,754
Note Payable - Printing Services	684,334	727,337
Mortgage Payable - Golf Course	1,663,110	1,950,000
Line of Credit - Golf Course	1,191,008	1,881,927
Bonds payable - Educational and Agricultural Research Facility Rev Bonds	590,000	635,000
Total Other Liabilities	\$ 25,881,869	\$ 25,291,686
TOTAL LIABILITIES	\$ 36,480,181	\$ 34,818,605
Net Assets		
Unrestricted net assets (designated)	\$ 31,590,034	\$ 27,485,615
Temporarily restricted net assets	83,156,464	68,901,535
Permanently restricted net assets	245,605,381	211,221,976
TOTAL NET ASSETS	\$ 360,351,879	\$ 307,609,126
TOTAL LIABILITIES AND NET ASSETS	\$ 396,832,060	\$ 342,427,731

Financial Statements

KANSAS STATE UNIVERSITY FOUNDATION
 Manhattan, Kansas
CONSOLIDATED STATEMENT OF ACTIVITIES
 For The Year Ended June 30, 2006

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2006 Total</u>	<u>2005 Total</u>
REVENUES, GAINS AND OTHER SUPPORT					
Contributions	\$ 431,724	\$ 42,563,012	\$ 21,465,873	\$ 64,460,609	\$ 42,384,211
Investment income	2,108,145	9,505,210	700,206	12,313,561	6,524,692
Net realized and unrealized gains on asset transactions	11,276,386	1,896,140	14,696,647	27,869,173	26,647,607
Other support					
Operational service charges, management fees and other	3,387,251	-	-	3,387,251	3,164,252
Receipts for grants, research, supplies, travel and other					
University departmental activities and funding allotments, etc.	35,941	4,708,481	400	4,744,822	5,089,902
Actuarial gain/(loss) on unitrusts and annuities obligations	705,708	(1,894,251)	(449,135)	(1,637,678)	(753,205)
Net assets released from restrictions	(2,692,286)	4,722,872	(2,030,586)	-	-
Satisfaction of program restrictions	47,375,512	(47,375,512)	-	-	-
Total Revenue, Gains and Other Support	<u>\$ 62,628,381</u>	<u>\$ 14,125,952</u>	<u>\$ 34,383,405</u>	<u>\$ 111,137,738</u>	<u>\$ 83,057,459</u>
EXPENSES AND SUPPORT					
Direct University support					
Scholarships and other student awards	\$ 8,731,925	\$ -	\$ -	\$ 8,731,925	\$ 6,627,739
Academic	7,390,198	-	-	7,390,198	7,230,057
Administrative - Faculty and student support	22,092,443	-	-	22,092,443	19,198,714
Capital improvements	8,946,080	-	-	8,946,080	5,002,847
Subtotal	<u>\$ 47,160,646</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 47,160,646</u>	<u>\$ 38,059,357</u>
Investment - Portfolio management	2,345,811	-	-	2,345,811	2,031,814
Investment - Loan interest expense and write-off	389,919	-	-	389,919	506,935
KSUF Administration	3,065,805	-	-	3,065,805	3,134,027
KSUF Fundraising	5,561,781	-	-	5,561,781	4,502,143
Total Expenses and Support	<u>\$ 58,523,962</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 58,523,962</u>	<u>\$ 48,234,276</u>
CHANGE IN NET ASSETS	\$ 4,104,419	\$ 14,125,952	\$ 34,383,405	\$ 52,613,776	\$ 34,823,183
NET ASSETS AT BEGINNING OF YEAR	27,485,615	68,901,535	211,221,976	307,609,126	282,023,396
ADJUSTMENT TO NET ASSETS (KSUGCMRF Quasi Reorganization)	-	128,977	-	128,977	(9,237,453)
NET ASSETS AT END OF YEAR	<u>\$ 31,590,034</u>	<u>\$ 83,156,464</u>	<u>\$ 245,605,381</u>	<u>\$ 360,351,879</u>	<u>\$ 307,609,126</u>

The accompanying notes are an integral part of these financial statements.

Financial Statements

KANSAS STATE UNIVERSITY FOUNDATION
 Manhattan, Kansas
CONSOLIDATED STATEMENT OF ACTIVITIES
 For The Year Ended June 30, 2005

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2005 Total</u>	<u>2004 Total</u>
REVENUES, GAINS AND OTHER SUPPORT					
Contributions	\$ 1,426,114	\$ 30,094,553	\$ 10,863,544	\$ 42,384,211	\$ 42,831,044
Investment income	(1,355,257)	6,953,885	926,064	6,524,692	5,620,049
Net realized and unrealized gains on asset transactions	11,533,033	1,688,271	13,426,303	26,647,607	29,386,208
Other support					
Operational service charges, management fees and other	3,164,252	-	-	3,164,252	2,688,590
Receipts for grants, research, supplies, travel and other					
University departmental activities and funding allotments, etc.	37,924	4,843,978	208,000	5,089,902	2,506,118
Actuarial gain/(loss) on unitrusts and annuities obligations	-	(3,085,403)	2,332,198	(753,205)	1,421,568
Net assets released from restrictions	(247,689)	(1,196,599)	1,444,288	-	-
Satisfaction of program restrictions	38,193,920	(38,193,920)	-	-	-
Total Revenue, Gains and Other Support	<u>\$ 52,752,297</u>	<u>\$ 1,104,765</u>	<u>\$ 29,200,397</u>	<u>\$ 83,057,459</u>	<u>\$ 84,453,577</u>
EXPENSES AND SUPPORT					
Direct University support					
Scholarships and other student awards	\$ 6,627,739	\$ -	\$ -	\$ 6,627,739	\$ 6,928,496
Academic	7,230,057	-	-	7,230,057	6,049,465
Administrative - Faculty and student support	19,198,714	-	-	19,198,714	18,133,312
Capital improvements	5,002,847	-	-	5,002,847	7,210,108
Subtotal	<u>\$ 38,059,357</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 38,059,357</u>	<u>\$ 38,321,381</u>
Investment - Portfolio management	2,031,814	-	-	2,031,814	1,798,961
Investment - Loan interest expense and write-off	506,935	-	-	506,935	899,277
KSUF Administration	3,134,027	-	-	3,134,027	2,573,686
KSUF Fundraising	4,502,143	-	-	4,502,143	3,819,922
Total Expenses and Support	<u>\$ 48,234,276</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 48,234,276</u>	<u>\$ 47,413,227</u>
CHANGE IN NET ASSETS	<u>\$ 4,518,021</u>	<u>\$ 1,104,765</u>	<u>\$ 29,200,397</u>	<u>\$ 34,823,183</u>	<u>\$ 37,040,350</u>
NET ASSETS AT BEGINNING OF YEAR	\$ 22,967,594	\$ 77,034,223	\$ 182,021,579	\$ 282,023,396	244,983,046
ADJUSTMENT TO NET ASSETS (KSUGCMRF Quasi Reorganization)	-	(9,237,453)	-	(9,237,453)	-
NET ASSETS AT END OF YEAR	<u>\$ 27,485,615</u>	<u>\$ 68,901,535</u>	<u>\$ 211,221,976</u>	<u>\$ 307,609,126</u>	<u>\$ 282,023,396</u>

The accompanying notes are an integral part of these financial statements.

Financial Statements

KANSAS STATE UNIVERSITY FOUNDATION
 Manhattan, Kansas
CONSOLIDATED STATEMENTS OF CASH FLOWS
 For The Years Ended June 30,

	<u>2006</u>	<u>2005</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 52,613,776	\$ 34,823,183
Adjustments to reconcile change in net assets to net cash used by operating activities		
Contributions for endowment	\$ (6,021,229)	\$ (9,042,645)
Contributions for term endowment	(1,848,730)	(1,146,377)
Non-cash contributions	(23,279,270)	(11,312,337)
Non-cash expenditures	6,711,988	6,835,386
Net realized and unrealized loss on asset transactions	(27,869,173)	(26,648,424)
Depreciation	332,717	362,573
Depreciation Golf Course	195,561	-
Unitrust and annuity liability distributions	2,739,164	2,379,635
(Increase) decrease in Golf Course Assets	-	15,136,384
(Increase) decrease in pledges receivable	(4,622,759)	(2,100,278)
(Increase) decrease in receivables from estates	(3,795,745)	(1,614,516)
(Increase) decrease in loans	928,306	50,429
(Increase) decrease in cash surrender value of life insurance policies	(181,362)	(449,049)
(Increase) decrease in other assets and accrued income	(197,694)	601,011
Increase (decrease) in accounts payable	(301,961)	125,255
Increase (decrease) in accrued liabilities	(199,807)	203,349
Increase (decrease) in assets held for others	1,431,025	2,052,886
Increase (decrease) in unitrust and annuity liabilities	1,868,017	1,184,401
Total Adjustments	<u>\$ (54,110,952)</u>	<u>\$ (23,382,317)</u>
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	<u>\$ (1,497,176)</u>	<u>\$ 11,440,866</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of investments	\$ 316,606,859	\$ 194,477,054
Proceeds from sale of real estate	4,065,884	888,218
Purchase of investments	(314,664,325)	(212,571,969)
Purchase of real estate	(1,659,706)	(973,011)
KSUGCMRF Quasi Reorganization	128,977	(9,237,453)
Expenditures for depreciable property	(174,091)	(184,218)
Expenditures for depreciable property - Golf Course	(28,089)	-
Net Cash Provided by (Used in) Investing Activities	<u>\$ 4,275,509</u>	<u>\$ (27,601,379)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions for endowment	\$ 6,021,229	\$ 9,042,645
Contributions for term endowment	1,848,730	1,146,377
Increase (decrease) in bonds, mortgage, notes payable and line of credit	(1,135,698)	(5,933,443)
Life income payments, including unitrust and annuity payments	(2,739,164)	(2,379,635)
Net Cash Provided by Financing Activities	<u>\$ 3,995,097</u>	<u>\$ 1,875,944</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>\$ 6,773,430</u>	<u>\$ (14,284,569)</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>25,720,691</u>	<u>40,005,260</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u><u>\$ 32,494,121</u></u>	<u><u>\$ 25,720,691</u></u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Non-cash investing and financing activities		
Gifts in kind, securities and properties	<u>\$ 23,279,270</u>	<u>\$ 11,312,337</u>
Interest expense	<u>\$ 389,919</u>	<u>\$ 368,474</u>

Financial Statements

KANSAS STATE UNIVERSITY FOUNDATION
Manhattan, Kansas
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006 and 2005

Note 1: Significant Accounting Policies

Organization

The purpose of the Foundation is to encourage, receive, and hold in trust any real or personal property given for the use of Kansas State University, its faculty and students; and to invest, disburse, manage and control all such gifts to provide those services to the University which are not or cannot be provided through state appropriations or student fees.

Income Taxes

The Foundation is a non-profit Section 501(c)(3) tax exempt organization. It is not subject to income taxes except on unrelated business income. No unrelated business income tax has been paid in the current year.

Method of Accounting

The financial statements are presented on the accrual basis of accounting.

Subsidiary

The Kansas State University Foundation financial statements include a supporting organization, the Kansas State University Golf Course Management and Research Foundation, formed in 1997. The financial statements have been consolidated in accordance with accounting principles generally accepted in the United States of America. All significant inter-organizational accounts and transactions are eliminated in the consolidated financial statements.

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 amounts reported in the financial statements and accompanying notes. Estimates are reviewed periodically and any changes in such estimates may affect amounts reported in future periods.

Asset Valuation

Assets acquired by purchase are recorded at cost; assets acquired by gift are recorded at fair market value as of the date of gift.

Investments

Investments are reported at market value. Investments with the Common Fund and with other investment managers and in mutual funds are classified according to the types of securities held by the funds: equities, including common and preferred stocks; fixed income instruments, including corporate and other bonds; U.S. Government and government agency obligations; and other securities, including venture capital, real estate, emerging market and private equity funds.

Income on pooled investments is distributed to all participating funds in accordance with the policies of the Foundation's Executive Committee.

Receivables

Pledges receivable are reported at net realizable value. The balance is discounted using a six percent rate to recognize the present value of the future pledges receivable. An allowance for uncollectible pledges is estimated and netted against pledges receivable.

KANSAS STATE UNIVERSITY FOUNDATION
Manhattan, Kansas
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
June 30, 2006 and 2005

Note 1: Significant Accounting Policies (Continued)

Receivables (Continued)

Receivables from estates are recorded at the time the Foundation is notified of the death of a donor and the amount can be reasonably measured.

Concentrations of Credit Risk

Management recognizes and accepts the risk for any financial institution deposits that exceed FDIC insurance limits.

Loans Receivable

Loans, including student loans, real estate mortgages and other loans, are recorded at amounts advanced to borrowers less principal repayments received. Uncollectible loans are written-off using the direct write-off method.

Fixed Assets

Depreciation is provided on a straight line basis over the estimated useful lives of capitalized assets. Normal repairs and maintenance are expensed.

The Foundation's capitalization policy is to capitalize any fixed asset over \$1,000.

Accrued Liabilities

Accrued liabilities include allowances for compensated absences and other accruals.

Contributions Establishing Charitable Trusts

The Foundation accepts donor contributions to establish trust agreements in exchange for a named beneficiary to receive a fixed dollar annual return or a specific percentage of the fair value of the trust assets for the beneficiary's lifetime or a specific time period. A portion of the donation is considered to be a charitable contribution and the remaining portion represents a liability equal to the present value of future payments. The liability is revalued annually based on actuarially computed present values.

Pension Plan

The Foundation has a defined contribution pension plan for eligible employees.

Restricted Assets

Temporarily restricted net assets are those whose use by the Foundation has been limited by donors to a specific time period or purpose. Upon expiration of the donors' restrictions, temporarily restricted net assets are classified as unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reported as restricted contributions and subsequently released for restrictions in the accompanying financial statements.

Permanently restricted net assets are restricted by donors to be maintained by the Foundation in perpetuity.

KANSAS STATE UNIVERSITY FOUNDATION
 Manhattan, Kansas
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2006 and 2005

Note 1: Significant Accounting Policies (Continued)

Contributions of Services

Contributions of services are recognized in the financial statements if the services received create or enhance non-financial assets or require specialized skills, are provided by individuals possessing those skills, and typically need to be purchased if not provided by donation.

Cash and Cash Equivalents

The Foundation considers all money market accounts with brokers and all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents for purposes of the statement of cash flows.

Note 2: The Common Fund

The Common Fund held bond, equity, venture capital, real estate and short term investments of the Foundation totaling an estimated \$159,116,290 and \$130,010,909 at June 30, 2006 and 2005, respectively, at market value, which is approximately 40% and 39% of total assets. The Foundation's investments with the Common Fund are carried in twenty-eight different types of funds to provide diversification. The following schedule reflects the Foundation holdings in each of the Common Fund fund types:

Fund Description	Book Value	Market Value	Book Value	Market Value
	June 30, 2006	June 30, 2006	June 30, 2005	June 30, 2005
Emerging Markets	\$ 10,395,376	\$ 17,618,512	\$ 9,204,811	\$ 13,195,730
International Equity - LH	12,545,655	18,758,843	11,156,911	15,345,751
Multi-Strategy Bond	5,037,253	5,178,408	4,189,955	4,460,985
Absolute Return Fund	5,474,977	7,181,123	5,818,494	6,843,075
Capital International Partners	332,344	332,344	-	-
Capital Ventures VI	256,378	256,378	142,926	142,926
Capital Venture Partners VII	100,481	100,481	-	-
Short-Term Investments	24,909,397	24,909,397	14,104,541	14,104,541
Endow. Realty Investors II	825,506	825,506	1,888,706	1,888,706
Realty Investors, LLC	7,726,038	7,726,038	6,835,755	6,835,755
Global Distressed Partners III	158,487	158,487	-	-
Global Hedged Partners, LLC	5,518,662	5,518,663	4,598,762	4,598,762
Endow. Energy Partners III	502,500	502,500	432,062	432,062
Endow. Private Equity Partners II	622,866	622,866	902,810	902,810
Endow. Private Equity Partners IV	2,589,831	2,589,831	2,151,652	2,151,652
Endow. Private Equity Partners V	1,404,977	1,404,977	596,903	596,903
Endow. Private Equity Partners VI	177,941	177,941	62,871	62,870
Endow. Inter. Private Equity Partn. III	751,551	751,551	709,780	709,780
Endow. Venture Partners I	65,840	65,840	-	-
Endow. Venture Partners III	545,867	545,867	530,629	530,629
Endow. Venture Partners IV	477,622	477,622	492,925	492,925
Endow. Venture Partners V	1,043,607	1,043,607	887,740	887,740
Distressed Debt Partners, LP	-	-	309,584	309,584
Distressed Debt Partners, II	1,050,463	1,050,463	616,066	616,066
International Partners IV, LP	884,698	884,698	505,181	505,181
High Quality Bond Fund	29,828,928	28,367,410	30,386,379	30,589,562
Multi-Strategy Commodities Fund	7,958,545	8,494,990	1,999,504	2,031,592
Equity Opportunity Fund	11,720,868	15,054,074	12,931,120	16,141,048
CIF All Cap Equity Fund	7,126,082	8,517,873	5,031,671	5,634,274
Total	\$ 140,032,740	\$ 159,116,290	\$ 116,487,738	\$ 130,010,909

KANSAS STATE UNIVERSITY FOUNDATION
 Manhattan, Kansas
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2006 and 2005

Note 2: The Common Fund (Continued)

The Common Fund is an independent professional investment manager and advisor for the Foundation. It is a nonprofit corporation organized to provide investment management services exclusively for educational institutions. The Common Fund is governed by a Board of Trustees elected by its member colleges, universities, and independent schools.

The Foundation had outstanding commitments on June 30, 2006 and 2005 with the following funds:

	Original Commitment	Commitments Remaining as of	
		June 30, 2006	June 30, 2005
Common Fund Endowment Energy Partners III	\$ 1,000,000	\$ 92,000	\$ 92,000
Common Fund Endowment Private Equity Partners II	2,500,000	136,531	136,531
Common Fund Private Equity Partners IV	2,000,000	-	-
Additional commitment - Common Private Equity Pttrs I	1,500,000	311,500	1,371,500
Common Fund International Private Equity Partners III	1,000,000	79,586	252,086
Common Fund Endowment Venture Partners III	1,930,000	19,300	19,300
Common Fund Endowment Venture Partners IV	1,500,000	101,250	116,250
Common Fund Venture Partners V	1,760,000	362,212	547,012
Common Fund Int'l Partners IV, LP	2,000,000	970,000	1,430,000
Common Fund Capital Private Equity Partners V	3,000,000	1,597,500	2,377,500
Common Fund Capital Venture Partners VI	700,000	426,970	542,470
Common Fund Distressed Debt II	1,000,000	312,740	493,190
Common Fund Int'l Private Equity Partners V	4,000,000	3,648,000	-
Common Fund Private Equity Partners VI	3,500,000	3,298,575	-
Common Fund Realty Investors	10,975,000	5,000,000	-
Common Fund Venture Partners VII	2,500,000	2,392,500	-

Note 3: Asset Holdings and Rate of Return

The Foundation has a general policy of investing assets to maximize rates of return, consistent with sound and safe business principles. The Foundation also holds certain assets for the benefit of Kansas State University which do not provide a market rate of return on funds invested. Some examples of these investments and other direct benefits provided to the University include:

University Real Estate Fund (Formerly Perimeter Policy) - Certain real estate holdings adjacent to the University Campus were purchased and are held for current and potential university use.

Smith Scholarship House - The Foundation has provided the building rent-free in order to maintain the House in operation for the benefit of the students.

Ramada Inn and University Amoco - The hotel and service station located adjacent to the University were built on land acquired by the Foundation to meet the needs of public lodging and service facilities close to the University campus.

Faculty and Accommodation Loans - The Foundation provides faculty loans at favorable interest rates to University faculty and staff to enable them to conduct business travel pending reimbursement from the University. Non-interest bearing accommodation loans are made to faculty and staff when salaries are not received on time from the University.

KANSAS STATE UNIVERSITY FOUNDATION
 Manhattan, Kansas
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2006 and 2005

Note 4: Pooled Investment Policies

The Foundation's Executive Committee determines the percentage distribution of total return to the participating funds in the Pooled Endowment Fund. For the fiscal years ended June 30, 2006 and 2005, the total return of the Pooled Endowment Fund from all assets was +13.47% and +13.74%, respectively. The distributions approved by the Foundation's Executive Committee are:

1. 4.0% of the market value will be distributed to the income account of the participating funds for spending and .25% of the market value will be distributed to the campus units as discretionary funds.
2. 1.5% of the market value for fiscal year 2006 (1.6% for 2005) will be distributed to the Foundation for allocation as determined each year by the Executive Committee.
3. The balance of the total return is reinvested in the principal account of the participating funds.

During fiscal year 2003, the distribution policy was modified in order to comply with state statutes (UMIFA) regarding endowments with a market value less than historic book value. As a result, effective January 1, 2003, for those participating accounts with a market value less than their historic book value, current income (interest, dividends, rents) is distributed based upon the following prioritization:

1. The Foundation allocation is distributed to the extent there is sufficient current income to do so.
2. To the extent current income remains available, a distribution is made for funding the purpose of the participating account, up to that amount that would have been distributed had the account's market value been greater than the historic book value.
3. To the extent current income remains available, a distribution to the campus unit's discretionary fund will be made, up to that amount that would have been distributed had the account's market value been greater than the historic book value.
4. Remaining current income, if any, and the remainder of the approved distribution will be returned to the account as an addition to principal.

At June 30, 2006, the KSU Foundation had 36 endowment funds with a market value less than historic book value. At June 30, 2005, the KSU Foundation had 155 endowment funds with a market value less than historic book value.

Note 5: Pledges Receivable

Pledges receivable of \$14,832,044 for 2006 and \$9,656,938 for 2005 have been discounted to their present values on the financial statements reported as \$13,422,606 for 2006 and \$8,799,847 for 2005. The Foundation estimates payments of the pledges will be received as follows:

	June 30,	
	2006	2005
Gross pledges receivable	\$ 15,704,880	\$ 9,959,979
Allowance for uncollectible pledges	(872,836)	(303,041)
Subtotal	\$ 14,832,044	\$ 9,656,938
Present value discount	(1,409,438)	(857,091)
Net Pledges Receivable	\$ 13,422,606	\$ 8,799,847

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 June 30, 2006 and 2005

Note 5: Pledges Receivable (Continued)

	June 30,	
	2006	2005
FYE June 30, 2006	\$ -	\$ 3,131,555
FYE June 30, 2007	5,700,747	2,531,728
FYE June 30, 2008	1,903,296	911,521
FYE June 30, 2009	2,046,143	534,348
Thereafter	3,772,420	1,690,695
Total	\$ 13,422,606	\$ 8,799,847

Note 6: Conditional Promises

Conditional promises are not reported on the financial statements due to the unknown occurrence of a specified future and uncertain event. Donors have notified the Foundation of conditional promises approximating \$129,067,364 for 2006 and \$108,246,338 for 2005 in the form of bequests. Donors have also informed the Foundation of conditional promises in the form of life insurance policies approximating \$31,672,738 for 2006 and \$31,802,060 for 2005. The cash surrender value of these policies, which is a known occurrence and certain event, is reported on the financial statements totaling \$2,756,425 for 2006 and \$2,575,063 for 2005.

Note 7: Loans Receivable

Loans are composed of student, real estate mortgages/contract sales, and other loans for fiscal years ended June 30, 2006 and 2005.

	June 30,	
	2006	2005
Faculty/departmental and other loans *	\$ 57,774	\$ 935,017
Real estate mortgages/contract sales loans **	393,608	466,670
Student loans ***	259,479	237,480
Total	\$ 710,861	\$ 1,639,167

* Faculty loans are at 14% if not paid timely, departmental loans are between 8% and 8.75%.

** Interest rates ranged from 7.25% to 10% and maturities ranged from 2006 to 2016.

*** Student loan rates range between 5% to 6% with various maturities.

Note 8: Unrestricted Net Assets (Designated)

Unrestricted net assets of the Foundation have been designated. The Executive Committee of the Foundation designated the income from the investments of the Underwriting funds to be used for operation of the Foundation. The Trust Management Committee designated a reserve account for the Charitable Gift Annuity Pool to assure future obligations of annuity payments. The remaining balance has been designated by the Executive Committee for other purposes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2006 and 2005

Note 8: Unrestricted Net Assets (Designated) (Continued)

The unrestricted net assets are composed of the following:

	<u>2006</u>	<u>2005</u>
Underwriting funds and Expendable & Gift Annuity Pool Reserve	\$ 18,714,088	\$ 17,504,474
Net investment in property and equipment, Foundation Center	1,666,214	1,653,644
Real estate utilized by College of Agriculture	129,862	129,862
KSU Underwriting Fund and other funds held for Kansas State	2,962,942	2,771,331
University Real Estate Fund (formerly Perimeter Policy)*	8,116,928	5,426,304
Total	<u>\$ 31,590,034</u>	<u>\$ 27,485,615</u>

Some prior year categories have been restated to more accurately reflect the composition of the Unrestricted Net Assets.

**Previously, the University Real Estate Fund was an investment of the Pooled Endowment Fund.*

Note 9: Pension Plan

The Kansas State University Foundation Board of Trustees has established the Kansas State University Foundation Defined Contribution Retirement Plan. The Plan provides for employer and employee contributions at 8.5% and 5.5%, respectively. Employees are fully vested when plan contributions are made. Employer contributions paid by the Foundation were \$300,469 and \$269,075 for the years ended June 30, 2006 and 2005.

Employees are eligible to participate on a voluntary basis on the Plan entry date following the completion of a 12 month period of service. An eligible employee is required to begin participation in the Plan no later than upon the completion of 2 years of service at the Foundation and the attainment of age 30.

Note 10: Real Estate and Other Depreciable Assets

Major asset categories at June 30 consist of:

	<u>2006</u>		<u>2005</u>	
	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>
Residential and commercial	\$ 15,877,355	\$ 3,853,002	\$ 14,091,265	\$ 3,553,794
Farms	4,026,628	-	6,104,362	-
Total	<u>\$ 19,903,983</u>	<u>\$ 3,853,002</u>	<u>\$ 20,195,627</u>	<u>\$ 3,553,794</u>

Straight-line depreciation is used for all categories over estimated useful lives of three to ten years for vehicles, computers and furnishings; fifteen years for certain building improvements and telephone equipment, and thirty to forty years for buildings.

Depreciation expense for fiscal years ended June 30, 2006 and 2005 was \$332,717 and \$362,573, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2006 and 2005

Note 11: Contributions

The Foundation historically publicizes contributions on the cash basis. The adoption of the accrual basis for financial statement purposes requires recognized receivables and liabilities to be reported during the year of occurrence. The following summarizes the effect of recording these accruals for the year ended June 30:

	<u>2006</u>	<u>2005</u>
Contributions - Cash Basis	\$ 57,700,900	\$ 41,795,932
Net changes		
Contributions, pledges to pay line of credit by six guarantors	-	1,881,927
Net increase (decrease) in pledges receivable	4,622,759	218,351
Net increase (decrease) in receivable from estates	3,795,745	1,614,516
Net (increase) decrease in unitrust and annuity liabilities and future obligations	<u>(1,658,795)</u>	<u>(3,126,515)</u>
Contributions - Accrual Basis	<u>\$ 64,460,609</u>	<u>\$ 42,384,211</u>

Note 12: Consolidation of Subsidiary

The Kansas State University Golf Course Management and Research Foundation (KSUGCMRF) is a supporting organization of the Foundation formed to build, own and operate a golf course. This not-for-profit corporation was formed in 1997 based on a request from the University to provide a golf course to further the University's mission. The corporation was granted tax-exempt status by the Internal Revenue Service with an accounting period ending December 31. A summary of financial information for KSUGCMRF at June 30 is as follows:

	<u>2006</u>	<u>2005</u>
Assets		
Cash	\$ 608,704	\$ 550,042
Real estate and other depreciable assets (net of depreciation)	1,745,980	1,913,451
Pledges receivable	1,450,401	1,877,321
Pledges receivable, line of credit guarantors	1,191,008	1,881,927
Other assets	<u>131,232</u>	<u>85,076</u>
	\$ 5,127,325	\$ 6,307,817
Liabilities		
Accrued liabilities	573,862	840,570
Mortgage payable	1,663,110	1,950,000
Line of Credit - Golf Course	<u>1,191,008</u>	<u>1,881,927</u>
Total Net Assets	<u>\$ 1,699,345</u>	<u>\$ 1,635,320</u>
Sources		
Contributions	\$ 1,497,857	\$ 655,494
Contributions, pledges to pay line of credit by six guarantors	-	1,881,927
Contributions, increase (decrease) in pledges	(1,117,838)	96,854
Operations net income (loss)	45,461	(512,155)
Other income	220,997	195,926
Uses	<u>(711,429)</u>	<u>(699,335)</u>
Change in Net Assets	\$ (64,952)	\$ 1,618,711
Net Assets - Beginning of Year	<u>1,635,320</u>	<u>9,254,062</u>
Adjustments to Net Assets (KSUGCMRF Quasi Reorganization)		
Revaluation of Real Estate and other depreciable assets	\$ 128,977	\$ (14,933,518)
Refinance and reduction of Bond Payable plus accrued interest	-	5,696,065
Net Adjustments to Net Assets (KSUGCMRF Quasi Reorganization)	<u>\$ 128,977</u>	<u>\$ (9,237,453)</u>
Net Assets - End of Year	<u>\$ 1,699,345</u>	<u>\$ 1,635,320</u>

Notes to Financial Statements

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 June 30, 2006 and 2005

Note 12: Consolidation of Subsidiary (Continued)

The KSUGCMRF defaulted on its debt in June 2005 ultimately resulting in a quasi reorganization. The KSUGCMRF was unable to make payments on the \$7.7 million Educational Facilities Revenue Bonds administered by US Bank and its \$1.8 million line of credit with Columbian Bank & Trust Company. US Bank received the golf course and eventually settled with the KSUGCMRF accepting a \$2 million payment. Columbian Bank released the KSUGCMRF of the \$1.8 million line of credit that was guaranteed by six guarantors. The guarantors are now settling their obligations via contributions to the KSUGCMRF which in turn pays the bank to eliminate the line of credit. In FY06 there were two entries made to retained earnings to properly reflect the current financial position of the Golf Course. An entry was made to remove \$197,497 worth of property tax accrual from the balance sheet as this amount was settled during the debt reorganization. In addition \$68,520 of depreciation expense was removed from the golf course operations income statement to reflect the revaluing of the assets during the quasi-reorganization. The net of these two entries is \$128,977.

The KSUGCMRF obtained a \$1,950,000 mortgage payable from Kansas State Bank to settle the debt with US Bank. The mortgage payable is secured with the pledges of the KSUGCMRF. The interest rate is 5.85% payable semi-annually with scheduled principal payments beginning December 2005 through the June 2011. The balance as of June 30, 2006 was \$1,663,110.

Maturities as of June 30, 2006 were as follows:

	Mortgage Payable to KS Bank
FYE June 30, 2007	\$ 297,007
FYE June 30, 2008	314,637
FYE June 30, 2009	333,312
FYE June 30, 2010	353,096
FYE June 30, 2011	365,058
Thereafter	-
Total	\$ 1,663,110

Interest expense paid for fiscal year end June 30, 2006 for the Kansas State Bank mortgage was \$103,654.

Interest expense paid for fiscal years ended June 30, 2006 and 2005 for the Educational Facilities Revenue Bonds and the line of credit was \$0 and \$254,226, respectively.

A quasi reorganization has been approved by the KSUGCMRF Board. The quasi reorganization effectively restates the assets and liabilities of the KSUGCMRF to a more realistic value.

Note 13: Note Payable - Nanoscale

Kansas State University Foundation constructed a research/office facility in the K-State Research Park in Fiscal Year 2002. The cost basis of the building is \$2,041,849. The project was financed with a note payable with an interest rate of 3.75% and due in July 2005. As of June 30, 2006, the note payable was \$1,825,868. The mortgage was refinanced July 2005 with an interest rate of 5.250% and due July 2008. The building is leased on a long-term basis to Nanoscale Materials, Inc., a spin-off research company associated with Kansas State University.

Interest for fiscal year ended June 30, 2006 and 2005 was \$96,837 and \$73,668, respectively.

Maturities as of June 30, 2006 were as follows:

	6/30/2006 Note Payable Nanoscale
FYE June 30, 2007	\$ 72,788
FYE June 30, 2008	83,190
FYE June 30, 2009	1,669,890
Thereafter	-
Total	\$ 1,825,868

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2006 and 2005

Note 14: Note Payable - Printing Services

Kansas State University Foundation purchased a warehouse/office building in the Manhattan Corporate Technology Park in Fiscal Year 2003. The cost basis of the building is \$865,000. The building was purchased through a bargain sale; the purchase was financed with a note payable with an interest rate of 4.50% and due in January 2008. As of June 30, 2006, the note payable was \$684,334. The building is leased to the Kansas State University until January of 2008.

Interest for fiscal year ended June 30, 2006 and 2005 was \$32,731 and \$33,814, respectively.

Maturities as of June 30, 2006 were as follows:

	Note Payable Printing Services
FYE June 30, 2007	\$ 45,860
FYE June 30, 2008	638,474
Thereafter	-
Total	\$ 684,334

Note 15: Bonds Payable - Educational and Agricultural Research Facility Revenue Bonds

Kansas State University Foundation acquired Educational and Agricultural Research Facility Revenue Bonds totaling \$820,000 for a College of Agriculture construction project in Finney County. Bonds payable for this project as of June 30, 2006 is \$590,000. Interest rates range from 5% to 6.25% with scheduled semi-annual payments beginning in December 2000 through the year 2015. The bonds are issued by Finney County, Kansas.

Interest expense for fiscal years ended June 30, 2006 and 2005 was \$38,380 and \$40,580, respectively.

Maturities as of June 30, 2006 were as follows:

	Note Payable Southwest Ag
FYE June 30, 2007	\$ 45,000
FYE June 30, 2008	45,000
FYE June 30, 2009	50,000
FYE June 30, 2010	55,000
FYE June 30, 2011	55,000
Thereafter	340,000
Total	\$ 590,000

Note 16: Prior Period Adjustment - Restatement of Golf Course Line of Credit

In fiscal year 2005, the Golf Course \$1.8 million dollar line of credit with Columbian Bank was assumed by the six guarantors and treated as a contribution and removed from the balance sheet. The guarantors are now settling their obligations via contributions to the KSUGCMRF which in turn pays the bank to eliminate the line of credit. As such, the line of credit is shown as a pledge receivable offset by the liability with the guarantors making payments to the KSUGCMRF to repay the line of credit. The fiscal year 2005 financial statements have been restated to reflect this change.