STATE OF ILLINOIS
GOVERNORS STATE UNIVERSITY

FINANCIAL AUDIT

FOR THE YEAR ENDED JUNE 30, 2005

Performed as Special Assistant Auditors for the Auditor General, State of Illinois

STATE OF ILLINOIS
GOVERNORS STATE UNIVERSITY
FINANCIAL AUDIT

For the Year Ended June 30, 2005

TABLE OF CONTENTS

	Page No.
Table of Contents	1
Financial Statement Report	
Summary	2
Independent Auditors' Report	3
Management's Discussion and Analysis	4
Basic Financial Statements	
Statement of Net Assets	11
Statement of Revenue, Expenses, and Changes in Net Assets	12
Statement of Cash Flows	13
Notes to the Financial Statements	14

Other Reports Issued Under Separate Cover:

Compliance Reports (including Single Audit) for Governors State University for the Year Ended June 30, 2005

Compliance Reports for Governors State University Foundation for the Two Years Ended June 30, 2005

Financial Audit Report for Governors State University Foundation for the Year Ended June 30, 2005

Compliance Reports for Governors State University Alumni Association for the Two Years Ended June 30, 2005

Financial Audit Report for Governors State University Alumni Association for the Year Ended June 30, 2005

STATE OF ILLINOIS
GOVERNORS STATE UNIVERSITY

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of Governors State University was performed by Nykiel, Carlin & Co., Ltd.

Based on their audit, the auditors expressed unqualified opinions on Governors State University's basic financial statements.

NYKIEL·CARLIN &CO. Certified Public Accountants/Business Consultants

INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying basic financial statements of Governors State University and its aggregate discretely presented component units, collectively a component unit of the State of Illinois, as of and for the year ended June 30, 2005, as listed in the Table of Contents. These financial statements are the responsibility of Governors State University's management. Our responsibility is to express opinions on these financial statements based on our audit. The prior year comparative information has been derived from the Governors State University's basic financial statements as of and for the year ended June 30, 2004, on which we expressed unqualified opinions on the basic financial statements in our report dated November 22, 2004.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Governors State University and its aggregate discretely presented component units as of June 30, 2005 and the respective changes in net assets and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The *Management's Discussion and Analysis* on pages 4 through 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with, *Government Auditing Standards* we have also issued a report dated December 7, 2005 on our consideration of the Governors State University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Nykiel, Carlin & Co., Ltd.

NYKIEL, CARLIN & CO., LTD.
Kankakee, Illinois

December 7, 2005

200 East Court St., Suite 608 Kankakee, Illinois 60901 • Telephone 815-933-1771 • Fax 815-933-1163

STATE OF ILLINOIS
GOVERNORS STATE UNIVERSITY

MANAGEMENT'S DISCUSSION AND ANALYSIS
For the Year Ending June 30, 2005

Purpose

This section of Governors State University's (GSU) annual financial report presents an analysis and overview of the financial activities of the University and its component units' financial activities for the fiscal year ended June 30, 2005. The GSU Foundation and the GSU Alumni Association are considered to be component units of the University. Separate financial statements for the Foundation or Alumni Association may be obtained by writing the: Vice-President of Development, Governors State University, 1 University Parkway, University Park, Illinois 60466.

The financial statement presentation focuses on the University as a whole. The financial statements are designed to emulate corporate presentation models whereby all University activities are consolidated into one total. The focus of the Statement of Net Assets is designed to be similar to bottom line results for the University; it combines and consolidates current financial resources with capital assets. The Statement of Revenues, Expenses, and Changes in Net Assets focuses on both the gross and net costs of University activities which are supported mainly by state appropriations and tuition revenues. The Statement of Cash Flows presents the receipt and use of cash resources by the University. This approach is intended to summarize and simplify the user's analysis of the cost of services provided.

Financial and Enrollment Highlights

Accreditations

In March 2003 the National Commission for the Accreditation of Teacher Accreditation voted full accreditation for the College of Education; in June 2003 the Illinois State Board of Education followed suit. In June 2003 the Council on Social Work Accreditation voted a full accreditation for the Master of Social Work program. During 2004, the National Council of Teachers of English (NCTE) awarded accreditation through 2009 and the National Association of Schools of Public Affairs and Administration (NASPAA) renewed accreditation through 2005. During FY 05, all programs had accreditation status.

Rescissions and Appropriations

State of Illinois revenue shortfalls that began during FY 01 are continuing to impact the University. As the following table shows, the FY 05 appropriation is only 95% of what it was in FY 00. The FY 05 appropriation includes approximately $100,000 received as a member initiative. However, appropriations have increased for FY 06 as certain initiatives and programs received additional funding for specific expansion.

Financial and Enrollment Highlights (Continued)

	Net Revenue From Appropriations					
Fiscal Years:	2005	2004	2003	2002	2001	2000
Initial appropriation	$ 24,280,100	$ 24,180,100	$ 26,350,600	$ 28,045,900	$ 26,384,200	$ 24,854,500
Less:						
Payments to Health Reserve Fund	(656,200)	(656,200)	(656,200)	(656,200)	-	-
Rescission (actual)		(440,748)	(722,000)	(369,500)	-	-
Appropriations available	$ 23,623,900	$ 23,083,152	$ 24,972,400	$ 27,020,200	$ 26,384,200	$ 24,854,500
Appropriations available as a percentage of Year 2000	95.0%	92.9%	100.5%	108.7%	106.2%	100.0%

To offset the reduction in state support the University has engaged in a number of cost reduction actions. In FY 03, courses were eliminated, existing positions were eliminated for the second year, and vacant positions due to retirements or resignations were eliminated. In FY 04, reductions in non-personnel areas including equipment, commodities and contractual services were implemented. During FY 05, the University remained frugal and minimized expenses at all opportunities. The FY 06 budget will reflect additional expenditures in certain areas consistent with the appropriated purpose. In addition, additional contributions will be due to the retirement system based on a newly enacted law. Also, any increase in individual salaries above 6% per year will require additional employer funded payments to the retirement system.

Enrollment

Student credit hours produced during FY 05 increased by 1.3% from the levels of FY 04; from 101,720 to 103,045. Degrees awarded decreased by 3.7%, well within the usual variance from year to year. Credit hours for FY 06 are expected to increase, based on the full accreditations of the Master of Social Work, the Master of Physical Therapy programs and all other programs. In addition, expansion into other south and west markets should increase enrollment as well.

Sick and Vacation Payouts

Many of the University's faculty and staff were first hired shortly after the University was chartered in 1969 and are now approaching retirement. We anticipate that sick and vacation payouts to departing employees will exceed $1,300,000 per year for the next three to five years; this is as opposed to an average payout of less than $400,000 per year over the first twenty-five years of existence. The current portion for FY 05 is $1,000,000.

Statement of Net Assets

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. Net assets represent the University's equity and are a way to measure the financial health of the University.

	(in thousands) 2005	2004	Change
Current assets	$ 16,786	$ 12,136	38%
Non-current assets	56,602	57,669	-2%
Total assets	73,388	69,805	5%
Current Liabilities	7,340	7,156	3%
Non-current liabilities	12,175	10,759	13%
Total liabilities	19,515	17,915	9%
Net assets	$ 53,873	$ 51,890	4%

Cash and cash equivalents consist of cash in banks and in Illinois Funds. Illinois Funds is a money market fund operated by the State Treasurer and available to all Illinois State agencies. Cash changes are reflected in the Statement of Cash Flows.

Accounts receivable are primarily student accounts receivable and are displayed net of an allowance for uncollectible accounts of $3,139,000 and $3,000,000 for FY 05 and FY 04, respectively. Gross student receivables declined primarily due to a concerted effort to structure student payments. Therefore, available cash increased.

Grants receivable increased as the University received additional reimbursable federal and state grants.

Long-term receivables consist of student federal Perkins loan receivables. New loans are made annually from additional federal contributions and from collections on existing loans. Perkins loans are repayable over ten years after separation from the University.

Statement of Net Assets (continued)

Capital assets increased by approximately $866,000 due to a continued expansion of smart/genius classrooms. However, capital assets net of accumulated depreciation declined as depreciation outpaced new acquisitions. Asset acquisitions were less than in FY 04 due to the completion of the Faculty Office Complex (FOC) in FY 04.

Accounts payable declined as the state improved its payment cycle, the University remained conservative on spending, and early expenditure of funds was encouraged. The liability for accrued compensated absences consists of amounts due employees for unused sick and vacation time. At June 30, 2005, accrued vacation leave remained virtually unchanged. Accrued vacation leave reflects continued accumulations per person and costing at current dollars. Sick leave decreased by 5% which reflects various payouts as employees begin to separate from service. Sick leave is paid out at 50% of the value of compensable leave earned through December 31, 1998.

Liability for Compensated Absences

	2005	2004	Change
Vacation leave	$ 3,342,848	$ 3,346,983	0%
Sick leave	3,214,587	3,370,031	-5%
Total	$ 6,557,435	$ 6,717,014	-2%

Deferred revenue consists of Spring/Summer tuition and fees assessed prior to the end of the fiscal year but not fully earned until after the end of the fiscal year.

Refundable grants represent the U.S. Department of Education's equity in the Perkins Loan fund administered by the University. GSU receives new federal dollars each year to lend to students at an interest rate much lower than those charged for Direct Loans. For each new federal dollar put into the program, the University matches $0.25.

Notes payable includes medium-term financing for the new telephone system, computer network and miscellaneous equipment. The certificates of participation remaining for the Computing Building mature in 2022. More detailed information about the University's long-term debt is presented in the footnotes to the financial statements.

The increase in the University's net assets is the result of an approximately $3 million increase in unrestricted net assets. That increase was primarily the result of tuition and fee revenue, federal grant revenue, and educational department sales increases and the reduction of accrued compensated absences.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets represents the operating results of the University, as well as the non-operating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered non-operating revenues according to accounting principles generally accepted in the United States of America.

	(in thousands) 2005	2004	Change
Operations:			
Revenues			
Net tuition and fees	$ 15,659	$ 13,998	12%
Grants and contracts	6,754	5,991	13%
Sales of educational departments	6,520	5,966	9%
Auxiliary enterprises	1,909	1,535	24%
Payments made on behalf of the University	8,350	22,351	-63%
Other operating revenues	1,235	960	29%
Total operating revenues	40,427	50,801	-20%
Expenses	63,313	73,514	-14%
Net operating loss	(22,886)	(22,713)	1%
Non-operating and Other Revenues and Expenses:			
State appropriations	24,280	23,710	2%
Investment income	154	43	258%
Transfers from the Capital Development Board	629	1,714	-63%
Other income and expense	(194)	(309)	-37%
Total non-operating and other revenue and expenses	24,869	25,158	-1%
Increase in net assets	1,983	2,445	-19%
Net assets - Beginning of year	51,890	49,445	5%
Net assets - End of year	$ 53,873	$ 51,890	4%

Tuition and fees increased primarily as a result of tuition increases during FY 05, including implementation of "Truth in Tuition" and increases in enrollment, which resulted in corresponding fees and tuition increases.

Sales by educational departments increased by 9%, directly related to increased delivery of training services under contract with the Illinois Department of Children and Family Services. Auxiliary revenue, consisting of parking, food service, bookstore, and theatre charges, increased approximately 24% in FY 05.

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

Payments made by the State on behalf of the University decreased from more than $22 million in FY 04 to just over $8 million in FY 05 as the State passed legislation affecting the funding of post-employment benefits in FY 04. In FY 05, revenue from state appropriations increased because there was no rescission. Investment income consists entirely of interest income and increased due to improved cash flow and a more positive market in general.

The Illinois Capital Development Board (CDB) makes annual campus capital improvements on-behalf of the University and the University recognizes those improvements as a capital contribution and additions to its capital assets. In FY 05, CDB expenditures for the University were approximately $629,000 as compared to FY 04 when the Faculty Office Complex was transferred increasing capital assets by over $1.7 million.

Operating Expenses (by functional classifications and in thousands)

	2005	2004	Change	Percent
Instruction	$ 26,220	$ 34,383	$ (8,163)	-24%
Research	1,116	1,123	(7)	-1%
Public service	8,954	9,402	(448)	-5%
Academic support	1,648	1,912	(264)	-14%
Student services	3,732	3,780	(48)	-1%
Institutional support	11,376	11,687	(311)	-3%
Operation and maintenance of facilities	6,011	6,966	(955)	-14%
Auxiliary activities	1,810	1,790	20	1%
Depreciation	2,446	2,471	(25)	-1%
	$ 63,313	$ 73,514	$ (10,201)	-14%

Instruction and academic support decreased primarily as a result of the decrease in the on behalf payments explained above. Operation and maintenance of facilities decreased primarily due to the payoff of long term financing late in FY 04. Total operating expenses decreased primarily due to the decrease in on behalf payments and the University's continued conservative spending.

Operating Expenses (by natural classifications and in thousands)

	2005	2004	Change	Percent
Salaries and benefits	$ 46,930	$ 58,447	$ (11,517)	-20%
Scholarships and awards	1,356	1,011	345	34%
Capital expenditures	2,020	1,743	277	16%
Services, supplies and other	10,561	9,842	719	7%
Depreciation	2,446	2,471	(25)	-1%
	$ 63,313	$ 73,514	$ (10,201)	-14%

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

Salary and benefit expenses, representing the largest operating expense, decreased as the State's catch up payment of retirement funding was not repeated in FY 05. Capital expenditures increased primarily because of a commitment to fund deferred maintenance projects that had been previously postponed.

Statement of Cash Flows

The Statement of Cash Flows below provides information about cash receipts and cash payments received and made during the year. This statement also helps users assess the University's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

	(in thousands) 2005	2004	Change	%
Cash provided by (Used in):				
Operating activities	$ (19,487)	$ (18,702)	$ (785)	4%
Non-capital financing activities	23,235	23,710	(475)	-2%
Capital and related financing activities	(1,117)	(2,943)	1,826	-62%
Investing activities	143	43	100	233%
Net increase in cash	2,774	2,108	666	32%
Cash – Beginning of year	6,046	3,938	2,108	
Cash – End of year	$ 8,820	$ 6,046	$ 2,774	

The primary cash receipts from operating activities consist of tuition and fee revenues. Cash outlays include payment of wages, benefits, services, supplies, and scholarships. Overall, net cash increased, reflecting cash management, focus on reducing student receivables, maximizing cash flow, increased revenues, and control of expenditures.

State appropriation is the only source of non-capital financing. The new accounting standards require that we reflect this source of revenue as non-operating even though the University's budget depends on this to continue the current level of operations.

STATE OF ILLINOIS
GOVERNORS STATE UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2005
With Comparative Totals as of June 30, 2004

	June 30, 2005		June 30, 2004	
	University	**Component Units**	University	Component Units
ASSETS				
Current Assets				
Cash and cash equivalents (Notes 2 & 3)	$ 8,820,364	$ 431,962	$ 6,045,789	$ 557,037
Trust escrow (Notes 2 & 12)	2,119,169	-	-	-
Certificates of deposit (Notes 2 & 3)	-	818,349	-	-
Accounts receivable, net of allowance for uncollectible accounts of $3,139,000	3,296,140	-	3,798,266	-
Grants receivable	1,964,237	-	1,785,309	-
Inventories (Note 2)	28,996	-	44,264	-
Student loans - current	557,000	-	462,000	-
Total Current Assets	16,785,906	1,250,311	12,135,628	557,037
Non-current Assets				
Endowment investments (Notes 2 & 3)	-	-	-	662,183
Student loans, net of allowance for uncollectible loans of $1,043,000	2,642,104	-	2,686,717	-
Capital assets (Note 6)	95,106,322	1,167,851	94,239,513	1,117,851
Less accumulated depreciation (Note 6)	(41,146,189)	-	(39,256,567)	-
	56,602,237	1,167,851	57,669,663	1,780,034
Total Assets	73,388,143	2,418,162	69,805,291	2,337,071
LIABILITIES				
Current Liabilities				
Accounts payable	3,987,424	148,014	4,249,989	104,680
Accrued compensated absences (Notes 2 & 8)	1,000,000	-	1,000,000	-
Deferred revenue	1,835,900	-	1,820,000	-
Notes payable (Note 7)	436,936	-	10,888	-
Certificates of participation (Note 7)	80,000	-	75,000	-
	7,340,260	148,014	7,155,877	104,680
Non-current Liabilities				
Accrued compensated absences (Notes 2 & 8)	5,557,435	-	5,717,014	-
Refundable grants	3,060,361	-	3,032,911	-
Notes payable (Note 7)	1,632,455	-	4,474	-
Certificates of participation (Note 7)	1,925,000	-	2,005,000	-
	12,175,251	-	10,759,399	-
Total Liabilities	19,515,511	148,014	17,915,276	104,680
NET ASSETS (Note 2)				
Invested in capital assets, net of related debt	52,004,910	1,167,851	52,887,584	1,117,851
Restricted				
Nonexpendable	-	744,912	-	758,669
Expendable		330,243		
Loans	605,298	-	596,148	-
Other	222,249	-	405,735	285,403
Unrestricted	1,040,175	27,142	(1,999,452)	70,468
Total Net Assets	$ 53,872,632	$ 2,270,148	$ 51,890,015	$ 2,232,391

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

STATE OF ILLINOIS
GOVERNORS STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2005
With Comparative Totals for the Year Ended June 30, 2004

	June 30, 2005		June 30, 2004	
	University	Component Units	University	Component Units
OPERATIONS				
Revenue				
Student tuition and fees net of scholarship allowances of $2,104,108 (Note 2)	$ 15,658,923	$ -	$ 13,997,573	$ -
Federal grants and contracts	5,489,654	-	4,484,966	-
State grants and contracts	809,198	-	886,282	-
Other grants and contracts	455,359	40,000	619,839	2
Sales and services of educational departments	6,520,128	-	5,966,323	-
Auxiliary enterprises	1,908,766	-	1,535,253	-
Payments made on behalf of the University	8,350,099	-	22,351,412	-
Other operating revenues	1,234,707	77,729	958,854	30,934
Total operating revenues	40,426,834	117,729	50,800,502	30,936
Expense				
Instruction	26,219,975	-	34,382,971	-
Research	1,116,425	-	1,122,751	-
Public service	8,954,648	-	9,402,083	-
Academic support	1,648,342	-	1,911,897	-
Student services	3,731,811	-	3,779,458	-
Institutional support	11,375,776	-	11,687,457	-
Operation and maintenance of plant	6,010,867	-	6,965,754	-
Auxiliary enterprises	1,809,814	-	1,790,411	-
Depreciation	2,445,624	-	2,470,930	-
University support	-	247,674	-	237,549
Other expense	-	66,973	-	107,541
Total operating expenses	63,313,282	314,647	73,513,712	345,090
Operating income (loss)	(22,886,448)	(196,918)	(22,713,210)	(314,154)
NON-OPERATING REVENUES (EXPENSES)				
State appropriation	24,280,100	-	23,709,622	-
Gifts	-	177,344	-	200,223
Investment income	154,083	31,088	43,326	64,498
Interest on capital assets-related debt	(122,225)	-	(288,637)	-
Other non-operating expense	(71,871)	-	(19,666)	-
Net non-operating revenues	24,240,087	208,432	23,444,645	264,721
Income (loss) before other revenues, expenses, gains and losses	1,353,639	11,514	731,435	(49,433)
Transfers from the Capital Development Board	628,978	-	1,713,587	-
Additions to permanent endowments	-	26,243	-	34,662
Increase (decrease) in net assets	1,982,617	37,757	2,445,022	(14,771)
NET ASSETS				
Net assets - beginning of year	51,890,015	2,232,391	49,444,993	2,247,162
Net assets - end of year	$ 53,872,632	$ 2,270,148	$ 51,890,015	$ 2,232,391

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

STATE OF ILLINOIS
GOVERNORS STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2005
With Comparative Totals for the Year Ended June 30, 2004

	June 30, 2005		June 30, 2004	
	University	**Component Units**	University	Component Units
CASH FLOWS FROM OPERATING ACTIVITIES				
Student tuition and fees	$ 16,598,800	$ -	$ 14,136,751	$ -
Grants and contracts	6,602,733	40,000	5,795,943	2
Payments to suppliers	(13,544,706)	(198,111)	(10,231,336)	(164,575)
Payments for scholarships	(3,323,261)	(73,202)	(2,751,352)	(100,995)
Payments to employees and fringe benefits	(35,448,928)	-	(34,183,144)	-
Auxiliary enterprises	1,908,766	-	1,535,253	-
Sales and services of educational departments	6,520,128	-	5,966,323	-
Student loans issued	(995,775)	-	(733,706)	-
Student loans collected	945,388	-	804,671	-
Other operating revenue	1,249,975	77,729	958,813	30,934
Net cash used by operating activities	(19,486,880)	(153,584)	(18,701,784)	(234,634)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
State appropriations	23,235,441	-	23,709,622	-
Contributions	-	127,344	-	200,223
Contributions for permanent endowments	-	26,243	-	34,662
Net cash provided by noncapital financing activities	23,235,441	153,587	23,709,622	234,885
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES				
Purchase of capital assets	(678,624)	-	(770,582)	-
Principal payments on capital debt	(315,826)	-	(1,883,705)	-
Interest payments on capital debt	(122,225)	-	(288,637)	-
Net cash used by capital financing activities	(1,116,675)	-	(2,942,924)	-
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from sales and maturities of investment securities	-	870,465	-	272,713
Interest and dividend income	142,689	24,836	43,326	18,724
Purchase of investment securities	-	(1,029,858)	-	(303,755)
Investment fees refunded	-	21,963	-	-
Investment fees	-	(12,484)	-	(12,705)
Net cash provided (used) by investing activities	142,689	(125,078)	43,326	(25,023)
Net increase (decrease) in cash and cash equivalents	2,774,575	(125,075)	2,108,240	(24,772)
Cash and cash equivalents - beginning of year	6,045,789	557,037	3,937,549	581,809
Cash and cash equivalents - end of year	$ 8,820,364	$ 431,962	$ 6,045,789	$ 557,037
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES:				
Operating loss	$ (22,886,448)	$ (196,918)	$ (22,713,210)	$ (314,154)
Adjustments to reconcile operating loss to net cash used by operating activities:				
Depreciation expense	2,445,624	-	2,470,930	-
Changes in net assets -				
Accounts and grants receivable	1,367,857	-	(276,754)	3,274
Inventories	15,268	-	(41)	-
Accounts payable	(262,565)	43,334	1,827,188	76,246
Refundable grants	27,450	-	32,788	-
Accrued compensated absences	(159,579)	-	(301,650)	-
Deferred revenue	15,900	-	188,000	-
Student loans	(50,387)	-	70,965	-
Net cash used by operating activities	$ (19,486,880)	$ (153,584)	$ (18,701,784)	$ (234,634)

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

1. FINANCIAL REPORTING ENTITY AND COMPONENT UNIT DISCLOSURE

Governors State University (GSU) was chartered in 1969 to provide affordable and accessible undergraduate and graduate education to its culturally and economically diverse life-long learners in the Chicago metropolitan area. It is governed by the Board of Trustees of Governors State University created in January 1996 as a result of legislation to reorganize governance of state higher education institutions and provides liberal arts, science, and professional preparation at the upper-division and master's levels.

The financial reporting entity as defined by Governmental Accounting Standards Board (GASB) Statement No. 14 *The Financial Reporting Entity,* and GASB Statement No. 39 *Determining Whether Certain Organizations are Component Units*, consists of the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion could cause the financial statements to be misleading or incomplete. Accordingly, the financial statements include the accounts of Governors State University as the primary government and the Governors State University Foundation and the Governors State University Alumni Association as component units of the University. All significant transactions between the University, the Foundation, and the Alumni Association have been eliminated. The two component units are combined for presentation.

The University (and its component units) are a component unit of the State of Illinois for financial reporting purposes and its fiscal balances and activity are included in the State's comprehensive annual financial report.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The financial statements of the University are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by GASB using the economic resources measurement focus and the accrual basis of accounting. When both restricted and unrestricted resources are available for use, it is the University's policy to use restricted resources first, then unrestricted resources as needed.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the University follows all applicable GASB pronouncements. In addition, the University applies all Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) opinions and accounting research bulletins of the Committee of Accounting Procedures issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The University has elected not to apply FASB pronouncements issued after November 30, 1989.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents
In accordance with GASB Statement No. 9, cash equivalents are defined as short-term, highly liquid investments that are both:

1)Readily convertible to known amounts of cash
2)So near to their maturity that they present insignificant risk of changes in value because of changes in interest

Although generally investments with original maturities of less than three months may be defined as cash equivalents, the Foundation and Alumni Association displays certificates of deposits as a discrete item and classifies it as investments.

Trust Escrow
The University borrowed $2,294,857 for the purchase and installation of a voice over internet protocol system. The funds are being held in an escrow account at LaSalle Bank National Association pending payment to the vendors.

Investments
Investments are carried at their fair value as determined by quoted market price and consist of U. S. government securities, common stocks, certificates of deposit and mutual funds.

Inventories
Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out inventory valuation method.

Accrued Compensated Absences
Accrued compensated absences include earned but unused vacation and sick leave days valued at the current rate of pay.

Allowance for Uncollectible Accounts
The allowance for doubtful accounts is based on management's best estimate of uncollectible accounts considering type, age, collection history, and other appropriate factors.

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

Net Assets
GASB Statement No. 35 requires the University's net resources to be classified into net asset categories and reported in its Statement of Net Assets. The University's net assets are classified as follows:

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net Assets (continued)

Invested in capital assets, net of related debt: This represents the University's total investment in capital assets, net of accumulated depreciation and outstanding debt obligations.

Restricted net assets - nonexpendable: Nonexpendable restricted 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 intact 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 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 and auxiliary enterprises. 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.

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, (3) most Federal, state and local grants and contracts, and (4) in accordance with GASB 24, *Accounting for Financial Reporting for Certain Grants and Other Financial Assistance*, payments made on-behalf of the University by the State of Illinois for healthcare and retirement costs.

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, such as state appropriations and investment income.

Scholarship Discounts and Allowances

Student tuition and fee revenues 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 charges and the amounts paid directly by students and/or third parties. 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Self Insurance

The University participates in the State University Risk Management Association (SURMA), a self-insurance pool. Through its participation in SURMA, the University has contracted with several commercial carriers to provide general liability insurance. The University's general liability coverage has a $350,000 deductible per occurrence, which is covered by SURMA. Participant contributions to SURMA are based upon actuarial valuations.

3. DEPOSITS AND INVESTMENTS

GASB Statement No. 40 *Deposit and Investment Risk Disclosures* was implemented in fiscal year 2005. In summary GASB Statement No. 40, requires general disclosures by investment type with disclosures of the specific risks those investments are exposed to.

Deposits consist of the following at June 30, 2005:

University:	Carrying Amount	Bank Balance
Cash in bank	$ 2,143,781	$ 2,857,300
Cash on hand	14,788	-
Illinois Funds	6,661,795	6,661,795
Total	$ 8,820,364	$ 9,519,095

Foundation:	Carrying Amount	Bank Balance
Cash in bank	$ 165,000	$ 165,000
Illinois Funds	93,560	93,560
Total	$ 258,560	$ 258,560

Alumni Association:	Carrying Amount	Bank Balance
Cash in bank	$ 766	$ 766
Illinois Funds	168,549	168,549
Total	$ 169,315	$ 169,315

Custodial Credit Risk – Deposits: Custodial credit risk is the risk that in the event of a bank failure, deposits may not be returned. The Federal Deposit Insurance Corporation insured bank balances of $200,766 at June 30, 2005. The remaining bank balances as of June 30, 2005, was collateralized through the University's agreement with the local bank. The Foundation places deposits through the University and all deposits are required to be either insured or collateralized. The Illinois Funds are arranged and contracted by the Treasurer of the State of Illinois and collateralized as required by that contract. Depositories and brokers are chosen based on stability and longevity, and due to insurance and collateralization, bank balances were not subject to custodial risk.

3. DEPOSITS AND INVESTMENTS (Continued)

The carrying value of the investment portfolio of the Foundation at June 30, 2005 is as follows:

Investments:	Carrying Amount	Fair Value
Negotiable Certificates of Deposit	$ 750,506	$ 750,506
Money Market Funds	3,511	3,511
	$ 754,017	$ 754,017

Custodial Credit Risk – Investments: Custodial credit risk is the risk that in the event of custodian failure, investment principal may not be returned. At June 30, 2005, investments consisted of a money market mutual fund and negotiable certificates of deposit. The Federal Deposit Insurance Corporation fully insured the certificates of deposit and the money market account was fully insured by the Securities Investor Protection Corporation (SIPC).

Interest Rate Risk: Interest rate risk exists when there is a possibility that changes in interest rates could adversely affect an investment's value. The Foundation's investment policy addresses the overall diversification of the portfolio with consideration for liquidity. It does not limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: Credit risk exists when there is a possibility that the issuer or other counterparty to an investment may be unable to fulfill its obligations. The Foundation's investment policy permits fixed income investments in securities rated within the four highest grades assigned by Moody's Investor Service, Inc. or Standard & Poor's Corporation or, if unrated, deemed by the investment manager to be of comparable quality.

As of June 30, 2005 the Foundation had no exposure to interest rate risk and credit risk. At June 30, 2005, all funds were carried in depository instruments rather than U.S. government securities and common stocks.

The carrying value of the investment portfolio of the Alumni Association at June 30, 2005 is as follows:

Investments:	Carrying Amount	Fair Value
Negotiable Certificates of Deposit	$ 67,843	$ 67,843
Money Market Funds	576	576
	$ 68,419	$ 68,419

3. DEPOSITS AND INVESTMENTS (Continued)

Custodial Credit Risk – Investments: Custodial credit risk is the risk that in the event of custodian failure, investment principal may not be returned. At June 30, 2005, investments consisted of a money market mutual fund and negotiable certificates of deposit. The Federal Deposit Insurance Corporation fully insured the certificates of deposit and the money market account was fully insured by the Securities Investor Protection Corporation (SIPC).

Interest Rate Risk: Interest rate risk exists when there is a possibility that changes in interest rates could adversely affect an investment's value. Due to the liquid nature of the investments, the Alumni Association does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: Credit risk exists when there is a possibility that the issuer or other counterparty to an investment may be unable to fulfill its obligations. The Alumni Association currently holds no investments with substantial credit risk.

4. STATE UNIVERSITIES RETIREMENT SYSTEM

Plan Description

The University contributes to the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined benefit pension plan with a special funding situation whereby the State of Illinois makes substantially all actuarially determined required contributions on behalf of the participating employers. SURS was established July 21, 1941, to provide retirement annuities and other benefits for staff members and employees of the State universities, certain affiliated organizations and certain other State educational and scientific agencies and for survivors, dependents and other beneficiaries of such employees. SURS is considered a component unit of the State of Illinois financial reporting entity and is included in the State's financial reports as a pension trust fund. SURS is governed by Section 5/15, Chapter 40, of the *Illinois Compiled Statutes*. SURS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to SURS, 1901 Fox Drive, Champaign, IL 61820 or by calling 1-800-275-7877.

Funding Policy

Plan members are required to contribute 8% of their annual covered salary and substantially all employer contributions are made by the State of Illinois on behalf of the individual employers at an actuarially determined rate. The current rate is 11.12% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The employer contributions to SURS for the years ending June 30, 2005, 2004, and 2003 were $2,787,378, $17,129,658, and $2,793,545, respectively, equal to the required contributions for each year.

5. POSTEMPLOYMENT BENEFITS

In addition to providing pension benefits, the State provides certain health, dental and life insurance benefits to annuitants that are former State employees. This includes annuitants of the University. Substantially all State employees including the University's employees may become eligible for postemployment benefits if they eventually become annuitants. Health and dental benefits include basic benefits under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits for those under age 60 are equal to the annual salary at the time of retirement; life insurance benefits for those ages 60 and older are limited to $5,000 per annuitant.

Currently, the State does not segregate payments made to annuitants from those made to current employees for health, dental, and life insurance benefits. The cost of health, dental and life insurance benefits is recognized on a pay-as-you-go basis. These costs are funded by the State and are not an obligation of the University.

6. 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. Renovations to buildings and land improvements that significantly increase the value or extend the useful life of the structure are also capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets; 60 years for buildings and three to seven years for equipment.

Capital asset activity for the University and Foundation for the year ended June 30, 2005 is summarized as follows:

6. CAPITAL ASSETS (continued)

	Balance June 30, 2004	Additions	Retirements	Transfers	Balance June 30, 2005
Capital assets not being depreciated					
Land	$ 1,389,086	$ -	$ -	$ -	$ 1,389,086
Construction-in-progress	-	187,079	-	-	187,079
Artwork/Sculptures-University	268,323	-	-	-	268,323
Artwork/Sculptures-GSU Foundation	1,117,851	50,000	-	-	1,167,851
Total capital assets not being depreciated	$ 2,775,260	$ 237,079	$ -	$ -	$ 3,012,339
Other capital assets					
Site improvements	$ 1,011,175	$ -	$ -	$ -	$ 1,011,175
Buildings	72,506,763	628,978	-	-	73,135,741
Equipment	8,391,028	358,984	(468,005)	-	8,282,007
Library collection	10,673,138	319,641	(159,868)	-	10,832,911
Total other capital assets	92,582,104	1,307,603	(627,873)	-	93,261,834
Less accumulated depreciation for					
Site improvements	(634,006)	(16,010)	-	-	(650,016)
Buildings	(23,455,433)	(1,157,292)	-	-	(24,612,725)
Equipment	(6,417,393)	(705,286)	396,134	-	(6,726,545)
Library collection	(8,749,735)	(567,036)	159,868	-	(9,156,903)
Total accumulated depreciation	(39,256,567)	(2,445,624)	556,002	-	(41,146,189)
Other capital assets, net	$ 53,325,537	$ (1,138,021)	$ (71,871)	$ -	$ 52,115,645
Capital asset summary:					
Capital assets not being depreciated	$ 2,775,260	$ 237,079	$ -	$ -	$ 3,012,339
Other capital assets	92,582,104	1,307,603	(627,873)	-	93,261,834
Less accumulated depreciation	(39,256,567)	(2,445,624)	556,002	-	(41,146,189)
Total capital assets, net	$ 56,100,797	$ (900,942)	$ (71,871)	$ -	$ 55,127,984

7. LONG-TERM OBLIGATIONS

Changes in Long-Term Obligations

Changes in long-term obligations for the year ended June 30, 2005 were as follows:

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005	Amounts Due Within One Year
Notes Payable	$ 15,362	$ 2,294,857	$ 240,828	$ 2,069,391	$ 436,936
Certificates of Participation	2,080,000	-	75,000	2,005,000	80,000
	$ 2,095,362	$ 2,294,857	$ 315,828	$ 4,074,391	$ 516,936

7. LONG-TERM OBLIGATIONS (Continued)

Notes Payable

Notes payable interest rates ranged from 0.00% for a vehicle to 3.341% for the voice over internet protocol system. All notes are secured by equipment. Maturity dates range from December, 2005 through March, 2010. Future maturities of notes payable are as follows:

Year Ending June 30	Principal	Interest	Total
2006	$ 436,936	$ 63,779	$ 500,715
2007	447,133	49,109	496,242
2008	462,301	33,941	496,242
2009	477,983	18,259	496,242
2010	245,038	3,083	248,121
	$ 2,069,391	$ 168,171	$ 2,237,562

Certificates of Participation

Certificates of participation totaling $2,280,000 (maturity date February 1, 2022) were sold under an installment purchase agreement dated August 1, 1998 through the Amalgamated Bank of Chicago acting as vendor and trustee. These non-state issued certificates of participation were sold by a private concern and will be repaid from future appropriations. Future debt service requirements are as follows:

Year Ending June 30	Principal	Interest	Total
2006	$ 80,000	$ 100,444	$ 180,444
2007	80,000	96,604	176,604
2008	85,000	92,763	177,763
2009	90,000	88,684	178,684
2010	95,000	84,274	179,274
2011 - 2015	540,000	347,244	887,244
2016 - 2020	700,000	196,563	896,563
2021 - 2022	335,000	26,136	361,136
	$ 2,005,000	$ 1,032,712	$ 3,037,712

8. ACCRUED COMPENSATED ABSENCES

Accrued compensated absences include earned but unused vacation and sick leave days valued at the current rate of pay.

Changes in
Accrued Compensated Absences
(in thousands)

Balance, beginning of year	$ 6,717
Additions / (Deductions), Net	(160)
Balance, end of year	6,557
Less: current portion	(1,000)
Long-term portion	$ 5,557

9. COMMITMENTS AND CONTINGENCIES

The outcome of any current litigation/arbitration related to lawsuits against the University and/or its management is unknown at this time. In the opinion of University management, the payment of any losses would be covered by insurance companies after payment of the first $350,000 by the State Universities Risk Management Association, a self-insurance pool.

10. COMPONENT UNITS

The University's financial statements include the activities of the University's component units, which represent discretely presented University related organizations. Below are the condensed financial statements by organization.

	Foundation	Alumni Association	Total
Condensed Statement of Net Assets			
ASSETS:			
Current assets	$ 1,012,577	$ 237,734	$ 1,250,311
Capital assets	1,167,851	-	1,167,851
TOTAL ASSETS	2,180,428	237,734	2,418,162
LIABILITIES:			
Current liabilities	61,520	86,494	148,014
TOTAL LIABILITIES	61,520	86,494	148,014
NET ASSETS:			
Invested in capital assets	1,167,851	-	1,167,851
Restricted:			
Nonexpendable	667,835	77,077	744,912
Expendable	322,437	7,806	330,243
Unrestricted	(39,215)	66,357	27,142
TOTAL NET ASSETS	$ 2,118,908	$ 151,240	$ 2,270,148

Condensed Statement of Revenues, Expenses, and Changes in Net Assets
(Budget allocations from GSU have been eliminated)

	Foundation	Alumni Association	Total
Operating revenues	$ 70,815	$ 46,914	$ 117,729
Operating expenses	(220,448)	(94,199)	(314,647)
Operating loss	(149,633)	(47,285)	(196,918)
Nonoperating revenue	192,302	16,130	208,432
Net change to endowments	25,993	250	26,243
Increase (decrease) to net assets	68,662	(30,905)	37,757
Net assets, beginning of year	2,050,246	182,145	2,232,391
Net assets, end of year	$ 2,118,908	$ 151,240	$ 2,270,148

10. COMPONENT UNITS (Continued)

	Foundation	Alumni Association	Total
Condensed Statement of Cash Flows			
Net cash used by operating activities	$ (143,389)	$ (10,195)	$ (153,584)
Net cash provided by noncapital financing activities	143,742	9,845	153,587
Net cash provided (used) by investing activities	(126,148)	1,070	(125,078)
Cash increase (decrease)	(125,795)	720	(125,075)
Cash, beginning of year	387,866	169,171	557,037
Cash, end of year	$ 262,071	$ 169,891	$ 431,962

Reconciliation of Net Operating Revenues/(Expenses) to Net Cash Used by Operating Activities

	Foundation	Alumni Association	Total
Operating loss	$ (149,633)	$ (47,285)	$ (196,918)
Adjustments to reconcile net loss to net cash used by operating activities:			
Accounts payable	6,244	37,090	43,334
Total	$ (143,389)	$ (10,195)	$ (153,584)

11. RESTRICTED ENDOWMENTS

All of the Foundation's endowment funds and a portion of endowed scholarship funds are invested in marketable securities. These securities are valued at market as of the statement of net assets date. Investment earnings include dividends, interest, and capital appreciation (both realized and unrealized) and are initially 100% assigned to the unallocated reserve in the restricted fund. Income is then allocated to various accounts based on the endowment agreement and the approved spending plan. Currently, all funds are held in insured certificates of deposit or other depository accounts.

12. NON-CASH TRANSACTIONS

The Capital Development Board (CDB) performs various capital improvements on behalf on the University. CDB turns over these improvements to the University throughout the year. During the year ended June 30, 2005, the University recognized capital contributions from CDB of $628,978.

Certain tuition and fee waivers are considered compensation and are not eliminated on the Statement of Revenue, Expenses, and Changes in Net Assets. These waivers do not involve cash. During FY 05, $622,808 of such waivers were awarded.

The University is installing a voice over internet protocol (VOIP) telephone system which was financed this year and is expected to cost $2,294,857. The borrowing is reflected in notes payable. The asset is reflected as construction-in-progress. The unspent funds are held in trust at LaSalle Bank, pending payment to the vendors. These funds are presented as an asset titled "Trust Escrow" on the Statement of Net Assets. The funds will be paid out

12. NON-CASH TRANSACTIONS (continued)

directly to the vendors as the goods and services are provided. Interest earned on the "Trust Escrow" totaled $11,394 in FY 05.

Non-cash transactions have been excluded on the Foundation's Statement of Cash Flows. During the year ended June 30, 2005, the Foundation received donations of two works of art with an estimated value of $50,000.