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A Special Report For The Southern Association of Colleges and Schools on Midwestern State University

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State Auditor's Report

May 19, 1997

Dr. Louis J. Rodriguez, President
Midwestern State University
3410 Taft Boulevard
Wichita Falls, Texas 76308-2099

Dear Dr. Rodriguez:

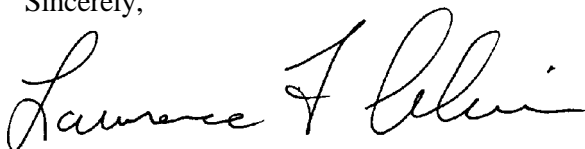
We have applied certain agreed-upon procedures (as discussed on page 3) to the Current Funds Balance Sheet of Midwestern State University (University) as of August 31, 1996, and August 31, 1995; the Statement of Current Funds Expenditures for the years then ended; and the related Notes (Financial Statements). The procedures were performed solely to assist the Southern Association of Colleges and Schools (Southern Association) with its accreditation review of the University, in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is the responsibility of the Southern Association and the University. All information in the above-mentioned items is the representation of the management of the University.

In connection with the procedures referred to above, we noted that student tuition and fees owed the University through the installment plan were not reported in accordance with the 1996 and 1995 *Annual Financial Reporting Requirement for Colleges and Universities* published by the Texas Comptroller of Public Accounts. As a result, Accounts Receivable and Deferred Revenues were overstated by \$1.27 million at August 31, 1996, and \$1.14 million at August 31, 1995. The Financial Statements have been adjusted to reflect the proper amounts.

No other exceptions were noted as a result of our agreed-upon procedures. Because the procedures do not constitute an audit conducted in accordance with generally accepted auditing standards, we do not express an opinion on any of the accounts or items referred to above. Had we performed additional procedures or had we conducted an audit of the financial statements in accordance with generally accepted auditing standards, matters might have come to our attention that would have been reported to you. This report relates only to the Current Funds Balance Sheet, the Statement of Current Funds Expenditures, and the related Notes and does not extend to any financial statements of the University taken as a whole. These Financial Statements are not intended to be a complete presentation of the financial position and results of operations of Midwestern State University.

This report is intended for use of the Board of Regents of Midwestern State University, management of the University, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,



Lawrence F. Alwin, CPA
State Auditor

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Agreed-Upon Procedures - Midwestern State University

We performed agreed-upon procedures for the Southern Association of Colleges and Schools for its accreditation review of Midwestern State University (University) for fiscal years 1996 and 1995. The agreed-upon procedures, applied to the Current Funds Balance Sheet of the University as of August 31, 1996, and August 31, 1995; the Statement of Current Funds Expenditures for the years then ended; and the related Notes (Financial Statements), are detailed as follows:

- a. We compiled the accompanying Current Funds Balance Sheet, the Statement of Current Funds Expenditures, and the related Notes to present the financial position and expenditures by function of the University's Current Funds as of August 31, 1996, and August 31, 1995. These statements were prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.
- b. We performed analytical procedures including ratio analyses designed to identify relationships and individual items that appeared to be unusual. We obtained and verified management's explanations for significant fluctuations in accounts for the Current Funds Balance Sheet and the related Statement of Current Funds Expenditures at August 31, 1996, and August 31, 1995, respectively, and confirmed the validity of such explanations as considered necessary.
- c. We reviewed the Financial Statements to determine whether they appeared to conform with applicable requirements described in the *Annual Financial Reporting Requirements for Colleges and Universities* (AFR Requirements) for 1996 and 1995 published by the Texas Comptroller of Public Accounts.
- d. We agreed balances identified as significant per our materiality threshold to the supporting general ledger, and we reviewed significant accounting adjustments made in the current and preceding years by the University.
- e. For the accounts included in Cash and Temporary Investments and Investments, we reviewed year-end reconciliations, agreed them to the respective bank or custodian statements, and traced material/significant or unusual items to subsequent clearing. We inquired as to whether appropriate cutoff of transactions was made (for the current and preceding year) and, additionally for Investments, we inquired as to whether appropriate consideration had been given to the allocation of investments between Current Funds and Noncurrent Funds.
- f. We reviewed, verified, and modified the Notes to the Financial Statements prepared by the University to ensure they were accurate and complete, that they disclosed all necessary items, and that they were in conformity with AFR Requirements.
- g. We inquired of persons responsible for financial accounting matters about questions that have arisen in the course of applying the foregoing procedures, changes in the University's activities, accounting principles and practices, accounting systems, computer systems, key personnel, and events subsequent to the date of the Financial Statements that would have a material effect on them.
- h. We reviewed board minutes for actions that may affect the Financial Statements.

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Current Funds Balance Sheet at August 31, 1996

	Total Current Funds
<u>Assets</u>	
Cash and Temporary Investments	\$ 10,726,562
Balance in State Appropriations	594,029
Students' Accounts Receivable	126,106
Other Accounts Receivable	555,787
Investments	2,566,047
Accrued Interest Receivable	91,501
Prepaid Expenses	1,433,876
Federal Receivables	100,568
Consumable Inventories	365,950
TOTAL ASSETS	<u>\$ 16,560,426</u>
<u>Liabilities and Fund Balances</u>	
Liabilities	
Accounts Payable	\$ 334,267
Accrued Liabilities	2,107,279
Deposits Payable	184,912
Deferred Revenues	5,003,572
Accrued Compensable Absences Payable	386,855
Total Liabilities	<u>\$ 8,016,885</u>
Fund Balances	
Unrestricted	
Reserved for	
Encumbrances	\$ 99,313
Consumable Inventories	365,950
Working Capital	300,000
Unreserved	
Allocated	5,883,582
Restricted	
Encumbrances	197,183
Other	1,697,513
Total Fund Balances	<u>\$ 8,543,541</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 16,560,426</u>

Statement of Current Funds Expenditures for the Fiscal Year Ended August 31, 1996

	Total Current <u>Funds</u>
Educational and General Expenditures	
Instruction	\$ 14,057,991
Research	61,773
Public Service	483,787
Academic Support	1,620,328
Student Services	1,114,474
Institutional Support	3,155,897
Operation and Maintenance of Plant	2,820,964
Scholarships and Fellowships	<u>5,838,034</u>
Total Educational and General Expenditures	\$ 29,153,248
 Auxiliary Enterprises Expenditures	 <u>4,513,882</u>
TOTAL CURRENT FUNDS EXPENDITURES	 <u>\$ 33,667,130</u>

The accompanying Notes to the Financial Statements are an integral part of these Financial Statements.

Notes to the Financial Statements for the Fiscal Year Ended August 31, 1996

General Introduction

This special report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of Midwestern State University for accreditation purposes. This report includes a Current Funds Balance Sheet, a Statement of Current Funds Expenditures, and the related Notes (Financial Statements).

Midwestern State University (University) is an agency of the State of Texas. The University prepares financial statements which are included in the State's *Comprehensive Annual Financial Report*. The State's report is audited by the Texas State Auditor's Office.

Institutions in this category must provide either a separate report or a consolidated balance sheet. The Southern Association requires state colleges and universities audited in this manner to have a Special Report that includes Current Funds expenditure classifications and amounts in accordance with generally accepted principles of institutional accounting and the institution's Current Funds Balance Sheet.

The significant accounting policies followed by the University in maintaining accounts and in preparing financial statements are in accordance with the 1996 *Annual Financial Reporting Requirements for Colleges and Universities* of the Texas Comptroller of Public Accounts. These requirements follow, as nearly as practicable:

- The American Institute of Certified Public Accountants (AICPA) Industry Audit Guide, *Audits of Colleges and Universities*, 1994 Edition
- *Financial Accounting and Reporting by Colleges and Universities*, as modified by applicable Financial Accounting Standards Board (FASB) pronouncements
- Modifications resulting from applicable Governmental Accounting Standards Board (GASB) pronouncements cited in Codification Section Co5, "Colleges and Universities"

The requirements are also in substantial conformity with the *Financial Accounting and Reporting Manual for Higher Education* published by the National Association of College and University Business Officers (NACUBO).

Summary of Significant Accounting Policies

Basis of Accounting

The accompanying Financial Statements present the financial position and expenditures of Northwestern State University on the accrual basis of accounting. The Financial Statements presented are in accordance with the specifications of, and for the use of, the Southern Association. They do not constitute a complete set of Financial Statements and are not designed for general purpose use.

Fund Accounting

In order to ensure observance of limitations and restrictions placed on the use of the resources available to Northwestern State University, accounts are maintained in accordance with the principles of "fund accounting." This is the procedure by which resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with specified activities or objectives. Separate accounts are maintained for each fund; however, in the accompanying Financial Statements, funds that have similar characteristics have been combined into fund groups. Accordingly, all financial transactions have been recorded and reported for the fund group referred to as Current Funds.

The Current Funds fund group used at Northwestern State University in these specific Financial Statements is composed of those funds available for current operating and maintenance purposes as well as those restricted by donors and other outside agencies for specific operating purposes. Current Funds are segregated by the University into separate balanced fund groups as follows:

- **Educational and General** - Funds for administration, institutional expense, instruction and departmental research, physical plant operation, libraries, and other items relating to the primary function of the institution.
- **Designated** - Funds arising from sources that have been designated by the Board of Regents or management to be used for special purposes. This fund distinguishes such internally designated funds from externally restricted funds as well as other current funds.
- **Auxiliary Enterprises** - Funds for activities which furnish a service to students, faculty, staff, or the public for which charges are made that are directly related to, although not necessarily equal to, the cost of the service, such as residence halls, food services, bookstores, and athletics.
- **Restricted** - Funds available for current purposes, the use of which has been restricted by outside agencies or persons. Revenues are reported only to the extent of expenditures for the current year.

Other fund groups used by Northwestern State University, but not included in these specific Financial Statements because they are for noncurrent purposes or funds held in custody for others, are as follows:

- **Loan Funds** - Funds available for loans to students.
- **Endowment Funds** - Funds subject to restrictions of endowment and trust instruments requiring that principal be maintained and that only the income be used.
- **Plant Funds** - Plant Funds are segregated into the following balanced fund groups:
 - **Unexpended Plant Funds** - Funds to be used for construction, rehabilitation, and acquisition of physical properties for institutional purposes.
 - **Renewals and Replacements** - Funds to be used for renewal and replacement of existing physical properties for institutional purposes.
 - **Retirement of Indebtedness** - Funds accumulated for payment of interest on debt and retirement of the principal indebtedness on physical properties.
 - **Investment in Plant** - Funds already expended for plant properties. Physical properties are stated at cost at date of acquisition or estimated fair market value at date of donation in the case of gifts, without provisions in the accounts for depreciation.
- **Agency Funds** - Funds held by the University as custodial or fiscal agent for students, faculty members, and others.

The terms and definitions, as subsequently presented, are used to enhance the information provided in reporting of fund balances. The presentation format for fund balances is not required by generally accepted accounting principles (GAAP); however, it is considered useful as it provides further insights into the availability and anticipated use of funds.

- **Unrestricted Fund Balances** - These represent the net accumulation of the excess revenues and other additions over expenditures, other deductions, and transfers for specific fund groups. As a general rule, they are available for future operating purposes and their use is determined by the Board of Regents.

Unrestricted fund balances are further classified as reserved or unreserved as follows:

- **Reserved** - That portion of the unrestricted fund balances that is allocated for third-party claims against resources that have not materialized as of balance sheet date. Assets identified as reserved are of a nonmonetary nature or lack liquidity; therefore, they are not available for current appropriations or expenditure.
- **Unreserved** - All unrestricted fund balances that are not reserved. Unreserved fund balances are classified as allocated or unallocated as follows:
 - Allocated - That portion of the unrestricted fund balances that has been identified for specific future use by the Board or institutional management.

Also classified as allocated are unencumbered balances of legislative appropriations from the State's general revenue that have been reappropriated to the University for use in the subsequent year.
 - Unallocated - Fund balances that are available for future operating purposes as determined by subsequent Board or institutional management directives.

Financing of Plant Assets

To the extent that Current Funds are used to finance plant assets, the amounts so provided are accounted for as expenditures in the case of normal replacement of movable equipment and library books.

Other Significant Accounting Policies

Other significant accounting policies are set forth in the Financial Statements and the Notes thereto.

Note 1: Authorized Investments

The University is authorized to invest in obligations and instruments as defined in the Public Funds Investment Act of 1995 (Government Code, Chapter 2256). Such investments include (1) obligations of the United States or its agencies, (2) direct obligations of the State of Texas or its agencies, (3) obligations of political subdivisions rated not less than A by a national investment rating firm, (4) certificates of deposit, and (5) other instruments and obligations authorized by statute.

Note 2: Deposits and Investments

DEPOSITS OF CASH IN BANK

The carrying amount of \$1,465,242 for Cash in Bank (including restricted assets) is presented in Exhibit A below.

The bank balance of Midwestern State University has been classified according to the following risk categories:

- Category 1:** Insured or collateralized with securities held by the governmental entity or by its agent in the name of the governmental entity.
- Category 2:** Collateralized with securities held by the pledging institution's trust department or agent in the governmental entity's name.
- Category 3:** Uncollateralized (which would include any deposits collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the governmental entity's name).

Exhibit A

<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>
\$ 1,465,242	\$ 888,911	\$ 100,000	\$ 788,911	

Cash and Deposits

Bank Deposits				
Demand Deposits				\$ 1,465,242
Cash and Cash Equivalents				
Petty Cash			\$ 19,525	
Local Funds in State Treasury			2,123,556	
Reimbursements in Transit			<u>35,787</u>	
Total Cash and Cash Equivalents				<u>2,178,868</u>
Total Current Funds Cash and Deposits				<u><u>\$ 3,644,110</u></u>

INVESTMENTS

To comply with the reporting requirements of GASB Statement No. 3, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements, Midwestern

State University's investments are categorized in the tabulation titled "Investment Categories" to give an indication of credit risk assumed by the University at year end.

Credit risk is the risk that another party to a deposit or investment transaction will not fulfill its obligations. This is not to be confused with market risk, which is the risk that the market value of an investment, collateral protecting a deposit, or securities underlying a repurchase agreement will decline. Market risk is not depicted in this note.

The following categories of credit risk are included:

- Category 1:** Investments that are insured or registered or for which the securities are held by the University or its agent in the University's name.
- Category 2:** Uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or University in the University's name.
- Category 3:** Uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent, but not in the University's name.

Investment Categories					
Type of Security	Category			Carrying Amount	Market Value
	1	2	3		
<u>Categorized Investments</u>					
U.S. Treasury Notes and Bills	\$1,069,806			\$ 1,069,806	\$ 1,069,817
U.S. Government and Agency Securities	7,035,102			7,035,102	5,682,604
Uncategorized Investments:					
TexPool				693,300	693,251
LOGIC				850,291	850,180
TOTAL INVESTMENTS				<u>\$ 9,648,499</u>	<u>\$ 8,295,852</u>
Total Cash and Deposits				\$ 3,644,110	
Total Investments				<u>9,648,499</u>	
TOTAL DEPOSITS AND INVESTMENTS				<u>\$ 13,292,609</u>	
<u>Balance Sheet Presentation</u>					
Cash and Temporary Investments				\$ 10,726,562	
Investments				<u>2,566,047</u>	
TOTAL DEPOSITS AND INVESTMENTS				<u>\$ 13,292,609</u>	

Prior to the 1995 amendments to the Public Funds Investment Act, the University had invested in various real estate derivatives (Collateralized Mortgage Obligations or CMOs), primarily inverse floaters, which are backed by U.S. Government agencies. These investments were made to maximize yields when interest rates were falling. These securities have a high degree of market risk and are sensitive to rising interest rates. Subsequent to the balance sheet date, seven CMOs were sold in an effort to reduce the University's investment in derivatives that float inversely to market rates. This resulted in a realized loss to Current Funds in the amount of \$255,152. It is the intent of the University to continue to divest itself of the remaining CMOs held in Current Funds in the amount of \$3,971,543 as market values improve.

Note 3: Employee Benefits

A. Employees' Retirement Plan

The University participates in the State of Texas joint contributory retirement plans, and thereby provides retirement plans for substantially all of its employees. One of the primary plans in which the University participates is administered by the Teacher Retirement System of Texas (TRS). TRS is a multiple-employer public employee retirement system (PERS). By statute, the State of Texas contributes to the retirement system an amount equal to the current authorized rate times the aggregate annual compensation of all members of the retirement system during that fiscal year. The State of Texas contribution rate is 6 percent for fiscal years 1996 and 1997. The employee contribution rate is 6.4 percent for fiscal years 1996 and 1997. These rates are set by state statutes.

Contribution requirements are not actuarially determined but are legally established each biennium pursuant to the following state funding policy: (1) The state constitution requires the Legislature to establish a member contribution rate of not less than 6 percent of the member's annual compensation and a state contribution rate of not less than 6 percent and not more than 10 percent of the aggregate annual compensation of all members of the system during that fiscal year. (2) A state statute prohibits benefit improvements or contribution reductions if, as a result of the particular action, the time required to amortize TRS's unfunded actuarial liabilities would be increased to a period that exceeds 31 years, or, if the amortization period already exceeds 31 years, the period would be increased by such action.

Pension benefit obligation, net assets available, unfunded pension benefit obligation, and annual covered payroll for the Teacher Retirement System of Texas as of August 31, 1987, to August 31, 1995, were as follows (in billions):

Fiscal Year	Pension Benefit Obligation	Net Assets Available for Benefits	Unfunded Pension Benefit Obligation	Annual Covered Payroll
1987	\$20.1	\$15.5	\$4.6	\$8.6
1988	\$21.8	\$17.5	\$4.3	\$9.2
1989	\$24.6	\$19.7	\$4.9	\$9.8
1990	\$27.1	\$21.8	\$5.3	\$10.4
1991	\$29.8	\$24.0	\$5.8	\$11.2
1992	\$32.0	\$26.1	\$5.9	\$12.0
1993	\$35.7	\$28.9	\$6.7	\$13.4
1994	\$36.1	\$33.3	\$2.8	\$14.2
1995	\$41.9	*\$37.1	\$4.8	\$14.9
1996	\$45.4	**\$50.1	\$(4.7)	\$16.0

*Market value of net assets available at August 31, 1995, was \$45.7 billion.

** Market value

The State has also established an Optional Retirement Program for institutions of higher education. Participation in the Optional Retirement Program is in lieu of participation in the Teacher Retirement System. The Optional Retirement Program provides for the purchase of annuity contracts. The contributory percentages of participant salaries provided by the State were at 8.5 percent, with the State contributing 6 percent, and the University's institutional funds contributing 2.5 percent. Employee contributions were 6.65 percent. Since these are individual annuity contracts, the State has no additional or unfunded liability for this program.

The total retirement expense to the State for the University was \$592,730 for the fiscal year ended August 31, 1996. This amount represents the portion of expended appropriations made by the Legislature on behalf of the University. The total retirement expense from the University's Institutional Funds was \$507,863.

B. Deferred Compensation Program

State employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. As of August 31, 1996, no University employees were participating in the program. No payroll deductions had been invested in approved plans during the fiscal year.

C. Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provided certain health care and life insurance benefits for retired employees. Substantially all employees may become eligible for those benefits if they reach normal retirement age while working for the State. Midwestern State University participates in the Employees Retirement System (ERS) insurance plans. The information regarding the State's contribution, the number of eligible retirees, and the cost of providing those benefits is included in the notes to the annual financial report of ERS. The cost of providing those benefits for Midwestern State University's 111 retirees was \$299,489; the cost for 373 active employees was \$1,074,460.

Note 4: Compensated Absences

Full-time State employees earn annual leave from 7 to 14 hours per month depending on the respective employee's years of State employment. The State's policy is that an employee may carry his or her accrued leave forward from one fiscal year to another with a maximum number of hours up to 376 for those employees with 20 or more years of state service. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave up to the maximum allowed.

The University recognizes the accrued liability for the unpaid annual leave in the Unrestricted Current Funds. This liability is determined through the summarization of each employee's annual leave balance multiplied by their respective year-end salary rate. The estimated cumulative amount of this liability is \$386,856.

The University has an undetermined and unrecorded liability for employees' earned sick leave. Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is absent due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid. A liability is not recorded because experience indicates the expenditure for sick leave is minimal.

Note 5: Related Parties

Midwestern State University Foundation is a nonprofit organization with the sole purpose of supporting educational and other activities of the University. The Foundation solicits donations and acts as coordinator of gifts made by other parties. The Foundation remitted restricted gifts of \$402,591 to the University during the year ended August 31, 1996.

The Midwestern State University Charitable Trust was established to support funding for scholarships and professorships for University students and faculty. The Charitable Trust remitted restricted gifts of \$93,800 to the University during the year ended August 31, 1996.

Note 6: Funds Held in Trust by Others

The balances, or transactions, of funds held in trust by others on behalf of the University are not reflected in the Financial Statements. At August 31, 1996, there were six such funds for the benefit of the University. Based upon the most recent available information, the assets of these funds are reported by the Trustees at values totaling \$10,656,250.

Note 7: Lease-Purchase Agreements

At August 31, 1996, the University had two lease-purchase agreements relating to the acquisition of equipment. The original capitalized cost of the equipment under capital leases in Current Funds as of August 31, 1996, was \$43,318.

Included in Current Funds expenditures are the following amounts of rent paid under operating leases:

Fund Group	Fiscal Year Ended	
	August 31, 1996	August 31, 1995
Designated	\$ 4,908	\$ 3,272
Auxiliary	5,352	4,906
Total	\$ 10,260	\$ 8,178

The following is a schedule of future minimum lease payments for leased property and the present value of the net minimum lease payments at August 31, 1996:

Minimum Lease Payments for:

Fiscal Year	Minimum Lease Payment
1997	\$ 8,233
1998	4,908
1999	3,272
	<u>\$ 16,413</u>
Less Interest	<u>(2,331)</u>
Total	<u><u>\$ 14,082</u></u>

Note 8: Contract and Grant Awards

Contract and grant awards are accounted for in accordance with the requirements of the American Institute of Certified Public Accountants (AICPA) Industry Audit Guide, *Audits of Colleges and Universities*. Funds received but not expended during the reporting period are shown as additions to fund balance. Revenues are recognized as funds are actually expended. For federal contract and grant awards, funds expended but not collected are reported as Federal Receivables. Non-federal contract and grant awards for which funds are expended, but not collected, are reported as Accounts Receivable. Contract and grant awards that are not yet funded and for which the institution has not yet performed services are not included in the Financial Statements. Contract and grant award funds already committed, or funds awarded during fiscal year 1996 for which monies have not been received or funds expended totaled \$922,401, all of which was from the Federal Government.

Note 9: Interfund Borrowing

All interfund borrowing is payable within one year without interest.

Note 10: Pending Lawsuits and Claims

At August 31, 1996, no claims involving Midwestern State University were pending.

Note 11: Risk Financing and Related Insurance

The University self-insures in the areas of workers' compensation and unemployment compensation for employees by setting aside budgetary amounts each year based on historical costs. Claims are then paid as incurred.

Property and casualty insurance is purchased commercially to the extent provided by law. Presently, the University does not participate in a public entity risk pool.

Note 12: Subsequent Events

The University issued a new bond series in September 1996. These bonds were issued as Building Revenue and Refunding bonds. Proceeds of the bonds totaled \$5,850,000. \$1,640,313 of the new issue is being used to advance refund the existing Building Revenue Bonds, Series 1965 and 1994. The remainder of the issue is to be used for major remodeling and expansion of the University's student center. These Revenue Bonds will be paid from pledged student center/union fees, general use fees, and pledged revenues of the housing system.

In February 1996 the University entered into a tax exempt municipal lease in the amount of \$1,085,000 for an energy conservation project under Education Code, Section 51.927. This lease will be paid from the energy savings expected to result from the project. The University will record the lease upon completion of construction in fiscal year 1997.

Current Funds Balance Sheet at August 31, 1995

	Total Current Funds
<u>Assets</u>	
Cash and Temporary Investments	\$ 5,543,162
Balance in State Appropriations	933,939
Students' Accounts Receivable	144,318
Other Accounts Receivable	374,807
Investments	4,282,907
Accrued Interest Receivable	42,951
Prepaid Expenses	1,364,637
Federal Receivables	106,516
Consumable Inventories	366,326
TOTAL ASSETS	<u>\$ 13,159,563</u>
<u>Liabilities and Fund Balances</u>	
<u>Liabilities</u>	
Accounts Payable	\$ 298,055
Accrued Liabilities	1,341,182
Deposits Payable	168,517
Deferred Revenues	3,759,295
Accrued Compensable Absences Payable	367,307
Total Liabilities	<u>\$ 5,934,356</u>
<u>Fund Balances</u>	
Unrestricted	
Reserved for	
Encumbrances	\$ 108,806
Consumable Inventories	366,326
Working Capital	300,000
Unreserved	
Allocated	4,593,218
Restricted	
Encumbrances	92,428
Other	1,764,429
Total Fund Balances	<u>\$ 7,225,207</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 13,159,563</u>

**Statement of Current Funds Expenditures for the
Fiscal Year Ended August 31, 1995**

	Total Current Funds
Educational and General Expenditures	
Instruction	\$ 13,545,739
Research	79,860
Public Service	524,568
Academic Support	1,660,586
Student Services	1,114,543
Institutional Support	3,004,459
Operation and Maintenance of Plant	2,808,214
Scholarships and Fellowships	<u>4,857,353</u>
Total Educational and General Expenditures	\$ 27,595,322
Auxiliary Enterprises Expenditures	<u>4,325,045</u>
TOTAL CURRENT FUNDS EXPENDITURES	<u>\$ 31,920,367</u>

The accompanying Notes to the Financial Statements are an integral part of these Financial Statements.

Notes to the Financial Statements for the Fiscal Year Ended August 31, 1995

General Introduction

This special report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of Midwestern State University for accreditation purposes. This report includes a Current Funds Balance Sheet, a Statement of Current Funds Expenditures, and the related Notes (Financial Statements).

Midwestern State University (University) is an agency of the State of Texas. The University prepares financial statements which are included in the State's *Comprehensive Annual Financial Report*. The State's report is audited by the Texas State Auditor's Office.

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The significant accounting policies followed by the University in maintaining accounts and in preparing financial statements are in accordance with the 1995 *Annual Financial Reporting Requirements for Colleges and Universities* of the Texas Comptroller of Public Accounts. These requirements follow, as nearly as practicable:

- The American Institute of Certified Public Accountants (AICPA) Industry Audit Guide, *Audits of Colleges and Universities*, 1973 Edition, as amended
- *Financial Accounting and Reporting by Colleges and Universities*, as modified by applicable Financial Accounting Standards Board (FASB) pronouncements
- Modifications resulting from applicable Governmental Accounting Standards Board (GASB) pronouncements cited in Codification Section Co5, "Colleges and Universities"

The requirements are also in substantial conformity with the *Financial Accounting and Reporting Manual for Higher Education* published by the National Association of College and University Business Officers (NACUBO).

Summary of Significant Accounting Policies

Basis of Accounting

The accompanying Financial Statements present the financial position and expenditures of Northwestern State University on the accrual basis of accounting. The Financial Statements presented are in accordance with the specifications of, and for the use of, the Southern Association. They do not constitute a complete set of Financial Statements and are not designed for general purpose use.

Fund Accounting

In order to ensure observance of limitations and restrictions placed on the use of the resources available to Northwestern State University, accounts are maintained in accordance with the principles of "fund accounting." This is the procedure by which resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with specified activities or objectives. Separate accounts are maintained for each fund; however, in the accompanying Financial Statements, funds that have similar characteristics have been combined into fund groups. Accordingly, all financial transactions have been recorded and reported for the fund group referred to as Current Funds.

The Current Funds fund group used at Northwestern State University in these specific Financial Statements is composed of those funds available for current operating and maintenance purposes as well as those restricted by donors and other outside agencies for specific operating purposes. Current Funds are segregated by the University into separate balanced fund groups as follows:

- **Educational and General** - Funds for administration, institutional expense, instruction and departmental research, physical plant operation, libraries, and other items relating to the primary function of the institution.
- **Designated** - Funds arising from sources that have been designated by the Board of Regents or management to be used for special purposes. This fund distinguishes such internally designated funds from externally restricted funds as well as other current funds.
- **Auxiliary Enterprises** - Funds for activities which furnish a service to students, faculty, staff, or the public for which charges are made that are directly related to, although not necessarily equal to, the cost of the service, such as residence halls, food services, bookstores, and athletics.
- **Restricted** - Funds available for current purposes, the use of which has been restricted by outside agencies or persons. Revenues are reported only to the extent of expenditures for the current year.

Other fund groups used by Northwestern State University, but not included in these specific Financial Statements because they are for noncurrent purposes or funds held in custody for others, are as follows:

- **Loan Funds** - Funds available for loans to students.
- **Endowment Funds** - Funds subject to restrictions of endowment and trust instruments requiring that principal be maintained and that only the income be used.
- **Plant Funds** - Plant Funds are segregated into the following balanced fund groups:
 - **Unexpended Plant Funds** - Funds to be used for construction, rehabilitation, and acquisition of physical properties for institutional purposes.
 - **Renewals and Replacements** - Funds to be used for renewal and replacement of existing physical properties for institutional purposes.
 - **Retirement of Indebtedness** - Funds accumulated for payment of interest on debt and retirement of the principal indebtedness on physical properties.
 - **Investment in Plant** - Funds already expended for plant properties. Physical properties are stated at cost at date of acquisition or estimated fair market value at date of donation in the case of gifts, without provisions in the accounts for depreciation.
- **Agency Funds** - Funds held by the University as custodial or fiscal agent for students, faculty members, and others.

The terms and definitions, as subsequently presented, are used to enhance the information provided in reporting of fund balances. The presentation format for fund balances is not required by generally accepted accounting principles (GAAP); however, it is considered useful as it provides further insights into the availability and anticipated use of funds.

- **Unrestricted Fund Balances** - These represent the net accumulation of the excess revenues and other additions over expenditures, other deductions, and transfers for specific fund groups. As a general rule, they are available for future operating purposes and their use is determined by the Board of Regents.

Unrestricted fund balances are further classified as reserved or unreserved as follows:

- **Reserved** - That portion of the unrestricted fund balances that is allocated for third-party claims against resources that have not materialized as of balance sheet date. Assets identified as reserved are of a nonmonetary nature or lack liquidity; therefore, they are not available for current appropriations or expenditure.
- **Unreserved** - All unrestricted fund balances that are not reserved. Unreserved fund balances are classified as allocated or unallocated as follows:
 - Allocated - That portion of the unrestricted fund balances that has been identified for specific future use by the Board or institutional management.

Also classified as allocated are unencumbered balances of legislative appropriations from the State's general revenue that have been reappropriated to the University for use in the subsequent year.
 - Unallocated - Fund balances that are available for future operating purposes as determined by subsequent Board or institutional management directives.

Financing of Plant Assets

To the extent that Current Funds are used to finance plant assets, the amounts so provided are accounted for as expenditures in the case of normal replacement of movable equipment and library books.

Other Significant Accounting Policies

Other significant accounting policies are set forth in the Financial Statements and the Notes thereto.

Note 1: Authorized Investments

The University is authorized to invest in obligations and instruments as defined in the Public Funds Investment Act of 1987 (Article 842a-2, Texas Revised Civil Statutes). Such investments include (1) obligations of the United States or its agencies, (2) direct obligations of the State of Texas or its agencies, (3) obligations of political subdivisions rated not less than A by a national investment rating firm, (4) certificates of deposit, and (5) other instruments and obligations authorized by statute.

Note 2: Deposits and Investments

DEPOSITS OF CASH IN BANK

The carrying amount of \$609,458 for Cash in Bank (including restricted assets) is presented in Exhibit A below.

The bank balance of Midwestern State University has been classified according to the following risk categories:

- Category 1:** Insured or collateralized with securities held by the governmental entity or by its agent in the name of the governmental entity.
- Category 2:** Collateralized with securities held by the pledging institution's trust department or agent in the governmental entity's name.
- Category 3:** Uncollateralized (which would include any deposits collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the governmental entity's name).

Exhibit A

<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>
\$ 609,458	\$ 305,526	\$ 200,000	\$ 105,526	

Cash and Deposits

Bank Deposits				
Demand Deposits				\$ 609,458
Cash and Cash Equivalents				
Petty Cash			\$ 18,930	
Local Funds in State Treasury			571,260	
Reimbursements in Transit			206,259	
Total Cash and Cash Equivalents				<u>796,449</u>
Total Current Funds Cash and Deposits				<u>\$ 1,405,907</u>

INVESTMENTS

To comply with the reporting requirements of GASB Statement No. 3, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements, Midwestern

State University's investments are categorized in the tabulation titled "Investment Categories" to give an indication of credit risk assumed by the University at year end.

Credit risk is the risk that another party to a deposit or investment transaction will not fulfill its obligations. This is not to be confused with market risk, which is the risk that the market value of an investment, collateral protecting a deposit, or securities underlying a repurchase agreement will decline. Market risk is not depicted in this note.

The following categories of credit risk are included:

- Category 1:** Investments that are insured or registered or for which the securities are held by the University or its agent in the University's name.
- Category 2:** Uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or University in the University's name.
- Category 3:** Uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent, but not in the University's name.

Investment Categories					
Type of Security	Category			Carrying Amount	Market Value
	1	2	3		
<u>Categorized Investments</u>					
U.S. Treasury Notes and Bills	\$426,467			\$ 426,467	\$ 447,014
U.S. Government and Agency Securities	5,440,086			5,440,086	3,703,556
Uncategorized Investments:					
TexPool				164,787	164,787
LOGIC				2,388,822	2,388,822
TOTAL INVESTMENTS				<u>\$ 8,420,162</u>	<u>\$ 6,704,179</u>
Total Cash and Deposits				\$ 1,405,907	
Total Investments				<u>8,420,162</u>	
TOTAL DEPOSITS AND INVESTMENTS				<u>\$ 9,826,069</u>	
<u>Balance Sheet Presentation</u>					
Cash and Temporary Investments				\$ 5,543,162	
Investments				<u>4,282,907</u>	
TOTAL DEPOSITS AND INVESTMENTS				<u>\$ 9,826,069</u>	

Prior to the 1995 amendments to the Public Funds Investment Act, the University had invested in various real estate derivatives (Collateralized Mortgage Obligations), primarily inverse floaters, which are backed by U.S. Government agencies. These investments were made to maximize yields when interest rates were falling. These securities have a high degree of market risk and are sensitive to rising interest rates. The intent of the University is to hold the securities until they pay out or mature unless market value improves, at which time the securities will be sold. CMOs in the amount of \$4,620,255 were held in Current Funds at August 31, 1995.

Note 3: Employee Benefits

A. Employees' Retirement Plan

The University participates in the State of Texas joint contributory retirement plans, and thereby provides retirement plans for substantially all of its employees. One of the

primary plans in which the University participates is administered by the Teacher Retirement System of Texas (TRS). TRS is a multiple-employer public employee retirement system (PERS). By statute, the State of Texas contributes to the retirement system an amount equal to the current authorized rate times the aggregate annual compensation of all members of the retirement system during that fiscal year. The State of Texas contribution rate is 7.31 percent for fiscal years 1994 and 1995. The employee contribution rate is 6.4 percent for fiscal years 1994 and 1995. These rates are set by state statutes.

Contribution requirements are not actuarially determined but are legally established each biennium pursuant to the following state funding policy: (1) The state constitution requires the Legislature to establish a member contribution rate of not less than 6 percent of the member's annual compensation and a state contribution rate of not less than 6 percent and not more than 10 percent of the aggregate annual compensation of all members of the system during that fiscal year. (2) A state statute prohibits benefit improvements or contribution reductions if, as a result of the particular action, the time required to amortize TRS's unfunded actuarial liabilities would be increased to a period that exceeds 31 years, or, if the amortization period already exceeds 31 years, the period would be increased by such action.

Pension benefit obligation, net assets available, unfunded pension benefit obligation, and annual covered payroll for the Teacher Retirement System of Texas as of August 31, 1987 to August 31, 1995, were as follows (in billions):

Fiscal Year	Pension Benefit Obligation	Net Assets Available for Benefits	Unfunded Pension Benefit Obligation	Annual Covered Payroll
1987	\$20.1	\$15.5	\$4.6	\$8.6
1988	\$21.8	\$17.5	\$4.3	\$9.2
1989	\$24.6	\$19.7	\$4.9	\$9.8
1990	\$27.1	\$21.8	\$5.3	\$10.4
1991	\$29.8	\$24.0	\$5.8	\$11.2
1992	\$32.0	\$26.1	\$5.9	\$12.0
1993	\$35.7	\$28.9	\$6.7	\$13.4
1994	\$36.1	\$33.3	\$2.8	\$14.2
1995	\$41.9	*\$37.1	\$4.8	\$14.9

*Market value of net assets available at August 31, 1995, was \$45.7 billion.

The State has also established an Optional Retirement Program for institutions of higher education. Participation in the Optional Retirement Program is in lieu of participation in the Teacher Retirement System. The Optional Retirement Program provides for the purchase of annuity contracts. The contributory percentages of participant salaries provided by the State were at 8.5 percent, with the State contributing 7.31 percent, and the University's institutional funds contributing 1.19 percent. Employee contributions were 6.65 percent. Since these are individual annuity contracts, the State has no additional or unfunded liability for this program.

The total retirement expense to the State for the University was \$987,976 for the fiscal year ended August 31, 1995. This amount represents the portion of expended appropriations made by the Legislature on behalf of the University.

B. Deferred Compensation Program

State employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. As of August 31, 1995, no University employees were participating in the program. No payroll deductions had been invested in approved plans during the fiscal year.

C. Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provided certain health care and life insurance benefits for retired employees. Substantially all employees may become eligible for those benefits if they reach normal retirement age while working for the State. Midwestern State University participates in the Employees Retirement System (ERS) insurance plans. The information regarding the State's contribution, the number of eligible retirees, and the cost of providing those benefits is included in the notes to the annual financial report of ERS. The cost of providing those benefits for Midwestern State University's 104 retirees was \$296,250; the cost for 385 active employees was \$1,183,735.

Note 4: Compensated Absences

Full-time State employees earn annual leave from 7 to 14 hours per month depending on the respective employee's years of state employment. The State's policy is that an employee may carry his or her accrued leave forward from one fiscal year to another with a maximum number of hours up to 376 for those employees with 20 or more years of state service. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave up to the maximum allowed.

The University recognizes the accrued liability for the unpaid annual leave in the Unrestricted Current Funds. This liability is determined through the summarization of each employee's annual leave balance multiplied by their respective year-end salary rate. The estimated cumulative amount of this liability is \$367,307.

The University has an undetermined and unrecorded liability for employees' earned sick leave. Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is absent due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid. A liability is not recorded because experience indicates the expenditure for sick leave is minimal.

Note 5: Related Parties

Midwestern State University Foundation is a nonprofit organization with the sole purpose of supporting educational and other activities of the University. The Foundation solicits donations and acts as coordinator of gifts made by other parties. The Foundation remitted restricted gifts of \$371,541 to the University during the year ended August 31, 1995.

The Midwestern State University Charitable Trust was established to support funding for scholarships and professorships for University students and faculty. The Charitable Trust remitted restricted gifts of \$50,000 to the University during the year ended August 31, 1995.

Note 6: Funds Held in Trust by Others

The balances, or transactions, of funds held in trust by others on behalf of the University are not reflected in the Financial Statements. At August 31, 1995, there were six such funds for the benefit of the University. Based upon the most recent available information, the assets of these funds are reported by the Trustees at values totaling \$10,106,589.

Note 7: Lease-Purchase Agreements

At August 31, 1995, the University had two lease-purchase agreements relating to the acquisition of equipment. The original capitalized cost of the equipment under capital leases in Current Funds as of August 31, 1995, was \$43,318.

Included in Current Funds expenditures are the following amounts of rent paid under operating leases:

Fund Group	Fiscal Year Ended	
	August 31, 1995	August 31, 1994
Designated	\$ 3,272	\$ 3,272
Auxiliary	4,906	12,676
Total	<u>\$ 8,178</u>	<u>\$ 15,948</u>

The following is a schedule of future minimum lease payments for leased property and the present value of the net minimum lease payments at August 31, 1995:

Minimum Lease Payments for:

Fiscal Year	Minimum Lease Payment
1996	\$ 10,260
1997	8,233
1998	4,908
1999	3,272
	<u>\$ 26,673</u>
Less Interest	<u>(4,177)</u>
Total	<u>\$ 22,496</u>

Note 8: Contract and Grant Awards

Contract and grant awards are accounted for in accordance with the requirements of the AICPA Industry Audit Guide, *Audits of Colleges and Universities*. Funds received but not expended during the reporting period are shown as additions to fund balance. Revenues are recognized as funds are actually expended. For federal contract and grant awards, funds expended but not collected are reported as Federal Receivables. Non-federal contract and grant awards for which funds are expended, but not collected, are reported as Accounts Receivable. Contract and grant awards that are not yet funded and for which the institution has not yet performed services are not included in the Financial Statements. Contract and grant award funds already committed, or funds awarded during fiscal year 1995 for which monies have not been received or funds expended totaled \$1,407,521, all of which was from the Federal Government.

Note 9: Interfund Borrowing

All interfund borrowing is payable within one year without interest.

Note 10: Pending Lawsuits and Claims

At August 31, 1995, only one claim involving Midwestern State University was pending.

While the ultimate liability with respect to the claim asserted against the University cannot be reasonably estimated at this time, such liability, to the extent not provided for by insurance or otherwise, is not likely to have a material effect on the University.

Note 11: Risk Financing and Related Insurance

The University self-insures in the areas of workers' compensation and unemployment compensation for employees by setting aside budgetary amounts each year based on historical costs. Claims are then paid as incurred.

Property and casualty insurance is purchased commercially to the extent provided by law. Presently, the University does not participate in a public entity risk pool.

Note 12: Subsequent Events

The University intends to issue two new bond series in fiscal year 1996. The first bond issue, which is scheduled for issuance in February of 1996, will be for a major remodeling project on the University's science building in the amount of \$4,035,000. These bonds will be Constitutional Appropriation bonds payable from Higher Education Assistance Funds (HEAF) appropriations. The second bond issue is scheduled for issuance in June or July of 1996, and the proceeds will be used for major remodeling and expansion of the University's student center in the approximate amount of \$3,000,000. These revenue bonds will be paid from pledged student center/union fee revenues.

The University will also enter into a tax exempt municipal lease in the amount of \$1,085,000 for an energy conservation project under Senate Bill 726, 74th Legislature. This lease will be paid from the energy savings expected to result from the project.

Detailed Finding with Management's Response

Finding:

Properly Report Student Receivables and Deferred Revenues

Since Midwestern State University recognizes deferred revenues for the subsequent fall term as each student registers whether or not cash has been received, the University's 1996 and 1995 *Annual Financial Reports* overstated Student Receivables and Deferred Revenues by \$1,265,009 and \$1,144,658, respectively.

The 1996 and 1995 *Annual Reporting Requirements for Colleges and Universities* published by the Comptroller of Public Accounts state that student receivables for tuition and fees should not be reported as Accounts Receivable and Deferred Revenues on the balance sheet. Deferred Revenues for the next semester tuition and fees are reported only for the amount of cash received.

The Financial Statements in this special report have been adjusted to properly reflect Student Accounts Receivable and Deferred Revenues. There was no change in Fund Balance.

Recommendation:

The University should properly report Student Receivables and Deferred Revenues at fiscal year end.

Management's Response:

Management has not believed this to be a significant problem in reporting and has remained on a full accrual basis with student receivables. Several of the universities are recognizing student revenue (or deferred revenue) only when cash is received, but Midwestern's system sets up a full receivable from each student at the time of registration. This receivable is usually in the form of a student loan or a student installment plan. Since student loans reside in "loan funds" on our accounts and have technically paid cash to the current operating funds, they are considered to be reported correctly and don't require any adjustment at year end. But our system also sets up a student receivable for installment plans, which reside in our designated funds.

For future reporting purposes we will attempt to "net" the student receivable and deferred revenue against each other within the current funds to the extent practicable.