

KNAU – A PUBLIC TELECOMMUNICATIONS ENTITY

OPERATED BY NORTHERN ARIZONA UNIVERSITY

FINANCIAL STATEMENTS

JUNE 30, 2005 AND 2004

**KNAU – A PUBLIC TELECOMMUNICATIONS ENTITY
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Independent Auditors' Report

The Arizona Board of Regents

Management of KNAU Radio

We have audited the accompanying financial statements of KNAU Radio (KNAU), a Public Telecommunications Entity operated by Northern Arizona University, as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of KNAU's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our 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 opinion.

As discussed in Note 2(a), the financial statements of KNAU are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of Northern Arizona University that is attributable to the transactions of KNAU. They do not purport to, and do not, present fairly the financial position of Northern Arizona University as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of KNAU as of June 30, 2005 and 2004, and its changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 7 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Nordstrom & Associates, P.C.

January 6, 2006

KNAU RADIO – A PUBLIC TELECOMMUNICATIONS ENTITY
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Management's Discussion and Analysis

Introduction

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial position and activities of KNAU for the year ended June 30, 2005. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

KNAU is located on the campus of Northern Arizona University. KNAU broadcasts National Public Radio and Public Radio International and local programs that inform, enrich and entertain the public. KNAU serves listeners with comprehensive music and information programs that reflect current affairs, history and cultures.

Balance Sheet

The balance sheet presents a financial picture of KNAU's financial condition at the end of the fiscal year by reporting assets (current and non-current), liabilities (current and non-current), and net assets.

Assets

Total assets of the Station at the end of 2005 and 2004 were \$1,232,128 and \$1,354,890 respectively. Unrestricted cash was \$709,329 or 58% of total assets in 2005 and \$712,828 or 53% of total assets in 2004. Net receivables increased from \$86,807 in 2004 to \$90,695 in 2005 for an increase of 4%. Net capital assets decreased by \$92,536 from \$471,683 to \$379,147 attributable to the depreciation expense of \$96,551 and \$4,015 in capital asset additions.

Liabilities

Total liabilities of the Station were \$49,218 and \$55,595 in 2005 and 2004 respectively. Accrued vacation was \$33,688 or 68% of total liabilities in 2005 and \$40,277 or 72% of total liabilities in 2004.

Net Assets

Net Assets are divided into three major categories. The first category, invested in capital assets, net of related debt, reports the station's net equity in property, plant and equipment. The second major category, restricted net assets, reports net assets that are owned by the station, but the use or purpose of the funds is restricted by an external source of entity. The expendable restricted net assets may be expended by the station, but must be spent only for the purpose as determined by a donor or external entity. The third category is unrestricted net assets.

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Condensed Balance Sheets
FY 2005 and 2004

	2005	2004
Assets:		
Current assets	\$ 837,371	\$ 868,013
Noncurrent assets	394,757	486,877
Total Assets	<u>\$ 1,232,128</u>	<u>\$ 1,354,890</u>
Liabilities:		
Current liabilities	<u>\$ 49,218</u>	<u>\$ 55,595</u>
Total Liabilities	<u>\$ 49,218</u>	<u>\$ 55,595</u>
Net Assets:		
Invested in capital assets	\$ 379,147	\$ 471,683
Restricted	46,091	72,033
Unrestricted	<u>757,672</u>	<u>755,579</u>
Total net assets	<u>\$ 1,182,910</u>	<u>\$ 1,299,295</u>
Total liabilities and net assets	<u>\$ 1,232,128</u>	<u>\$ 1,354,890</u>

Statements of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets, which is generally referred to as the activities statement, presents the total revenues (operating and non-operating) received and earned by the Station and expenses (operating and non-operating) paid and owed by the Station and income or loss from operations for the current fiscal year.

Revenues

Total operating revenues of the Station, which exclude University appropriations, for the fiscal years 2005 and 2004 were \$816,534 and \$886,967. The primary source of operating revenue was from underwriting. Underwriting revenue increased by 4% or \$16,371 in fiscal year 2005.

Operating revenues from grants and contracts totaled \$321,204 and \$395,057 in 2005 and 2004 respectively. Grant and contract revenues related to non-exchange type agreements that have program-specific restrictions are classified as operating revenues. In a non-exchange agreement, the Station receives dollars from another party without directly giving a service or product of equal value in exchange.

The Station received \$409,915 and \$397,899 in 2005 and 2004 of University appropriation. The Station received \$375,796 and \$477,075 in 2005 and 2004 in subscriptions and memberships, a decrease of \$101,279 or 21% due primarily to transition in development management.

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Expenses

Total operating expenses of the Station for the fiscal year were \$2,016,589 and \$2,089,530 for 2005 and 2004. Total program services were \$1,114,418 and \$1,184,563 for 2005 and 2004 respectively. Depreciation expense totaled \$96,551 and \$107,750 for 2005 and 2004. In response to declining revenues during 2005, the station concentrated on decreasing expenses through staff reduction, both temporary and permanent.

Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	2005	2004
Operating revenues		
Underwriting	\$ 460,025	\$ 443,654
In-kind contributions	35,305	48,256
Grants and contracts	<u>321,204</u>	<u>395,057</u>
Total operating revenue	816,534	886,967
 Operating Expenses		
Program services	1,114,418	1,184,563
Supporting services	<u>902,171</u>	<u>904,967</u>
Total operating expenses	<u>2,016,589</u>	<u>2,089,530</u>
 Operating loss	<u>(1,200,055)</u>	<u>(1,202,563)</u>
 Non-operating revenues		
General appropriation from NAU	409,915	397,899
Donated facilities and admin support	261,259	216,342
Subscriptions and membership	375,796	477,075
Other non-operating revenue	<u>36,700</u>	<u>25,368</u>
Total non-operating revenues	<u>1,083,670</u>	<u>1,116,684</u>
 Decrease in net assets	(116,385)	(85,879)
 Net assets – beginning of year	<u>1,299,295</u>	<u>1,385,174</u>
 Net assets – end of year	<u>\$ 1,182,910</u>	<u>\$1,299,295</u>

Statement of Cash Flows

The Statement of Cash Flows provides a summary of the sources and uses of cash by categories. The primary purpose of the Statement of Cash Flows are to provide information about the Station’s cash receipts and payments during the year and to help assess the Station’s ability to generate future net cash flows and meet future obligations.

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Management's Discussion and Analysis

Economic Factors That Will Affect the Future

Overall KNAU's financial position is strong. The station has considerable cash reserves. Revenue from Northern Arizona University, and program underwriting was steady. New development management is in place for 2006 and membership is expected to increase substantially over 2005.

Revenue appropriations from Northern Arizona University have stabilized. It appears that the University has weathered a rocky few years and possibility of rescission of the Station's NAU appropriations has considerably diminished. University finances are primarily driven by the financial health of Arizona state government and the University's student enrollment. State of Arizona government is now generating a financial surplus and the University's trend of declining enrollment has leveled. The Station will continue to monitor the University's economic condition.

Station underwriting stabilized in fiscal year 2005 after decreasing the previous year. Management hired additional underwriting sales staff in fiscal year 2005 to guard against attrition.

Revenue from membership, listener contributions, decreased from fiscal year 2004. This is attributable primarily to staff transition with KNAU's longtime development director departing the radio station mid-year. The Station has taken steps to strengthen membership by hiring a well qualified development director and extending station on-air fundraising.

KNAU formally created "The RadioActives", a station support group comprised of community leaders. The principle mission of The RadioActives is fundraising activities. With the successful launch of the group, the Station is poised to increase revenues from major donors in amounts in excess of \$1,000.

KNAU possesses valuable FM translator construction permits issued by the Federal Communications Commission. (FCC.) The permits authorize the Station to construct additional transmitters serving populated areas such as Prescott, Cottonwood, Payson, and Page, Arizona. The additional service may result in additional membership and underwriting support. The Station may have excess FM translator construction permit capacity which can be sold to other broadcasters for cash.

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Statements of Net Assets

June 30, 2005 and 2004

ASSETS	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and cash equivalents	\$ 709,329	\$ 712,828
Restricted cash	31,996	55,054
Accounts receivable, net	90,695	86,807
Other current assets	<u>5,351</u>	<u>13,324</u>
Total current assets	<u>837,371</u>	<u>868,013</u>
Noncurrent assets:		
Capital assets, net	379,147	471,683
Restricted investments	<u>15,610</u>	<u>15,194</u>
Total noncurrent assets	<u>394,757</u>	<u>486,877</u>
Total assets	<u>\$ 1,232,128</u>	<u>\$ 1,354,890</u>
 LIABILITIES		
Current liabilities:		
Accounts payable	\$ 9,005	\$ 4,460
Accrued vacation	33,688	40,277
Deferred revenue	<u>6,525</u>	<u>10,858</u>
Total liabilities	<u>49,218</u>	<u>55,595</u>
 NET ASSETS		
Invested in capital assets	379,147	471,683
Restricted		
Nonexpendable	14,439	14,399
Expendable:		
Programming and production	31,652	47,386
Fundraising	-	10,248
Unrestricted	<u>757,672</u>	<u>755,579</u>
Total net assets	<u>1,182,910</u>	<u>1,299,295</u>
Total liabilities and net assets	<u>\$ 1,232,128</u>	<u>\$ 1,354,890</u>

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Statements of Revenues, Expenses, and Changes in Net Assets

For the Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
REVENUES		
Operating Revenues:		
Underwriting	\$ 460,025	\$ 443,654
In-kind contributions	35,305	48,256
Grants and contracts	<u>321,204</u>	<u>395,057</u>
Total Operating Revenues	<u>816,534</u>	<u>886,967</u>
EXPENSES		
Operating expenses:		
Program services:		
Programming and production	912,262	977,371
Broadcasting	<u>202,156</u>	<u>207,192</u>
Total program services	<u>1,114,418</u>	<u>1,184,563</u>
Supporting services:		
Management and general	488,577	528,029
Fundraising	137,850	144,557
Underwriting and grant support	<u>275,744</u>	<u>232,381</u>
Total supporting services	<u>902,171</u>	<u>904,967</u>
Total Operating Expenses	<u>2,016,589</u>	<u>2,089,530</u>
Operating Loss	(1,200,055)	(1,202,563)
NONOPERATING REVENUES		
General appropriation from Northern Arizona University	409,915	397,899
Donated facilities and administrative support from NAU	261,259	216,342
Subscriptions and memberships	375,796	477,075
Other income	<u>36,700</u>	<u>25,368</u>
Total Nonoperating Revenues	<u>1,083,670</u>	<u>1,116,684</u>
Decrease in Net Assets	(116,385)	(85,879)
Net Assets - Beginning of Year	<u>1,299,295</u>	<u>1,385,174</u>
Net Assets- End of Year	<u>\$ 1,182,910</u>	<u>\$ 1,299,295</u>

**KNAU PUBLIC RADIO - A PUBLIC TELECOMMUNICATIONS ENTITY
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Statements of Cash Flows

For the Years Ended June 30, 2005 and 2004

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Underwriting	\$ 454,648	\$ 460,817
Grants and contracts	342,667	361,680
Payments to employees	(939,941)	(949,635)
Payments to suppliers	(677,604)	(774,726)
Net cash used by operating activities	(820,230)	(901,864)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
General appropriation from Northern Arizona University	409,915	397,899
Subscriptions and memberships	377,547	460,629
Other income	33,284	24,713
Net cash provided by noncapital financing activities	820,746	883,241
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(4,015)	(6,000)
Sale of capital assets	-	368
Net cash used by capital and related financing activities	(4,015)	(5,632)
Net decrease in cash and cash equivalents	(3,499)	(24,255)
Cash and cash equivalents - beginning of year	712,828	737,083
Cash and cash equivalents - end of year	\$ 709,329	\$ 712,828
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES:		
Operating Loss	\$ (1,200,055)	\$ (1,202,563)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Donated facilities and administrative support	261,259	216,342
Depreciation expense	96,551	107,750
Change in assets and liabilities:		
Restricted cash	23,058	(52,128)
Accounts receivable, net	(2,639)	39,742
Other current assets	7,973	(13,324)
Accounts payable	4,545	(3,559)
Accrued vacation	(6,589)	9,704
Deferred revenue	(4,333)	(3,828)
Net cash used by operating activities	\$ (820,230)	\$ (901,864)

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Statements of Cash Flows

For the Years Ended June 30, 2005 and 2004

(continued)

	<u>2005</u>	<u>2004</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES:		
Donated facilities and administrative support	\$ <u>261,259</u>	\$ <u>216,342</u>
In-kind contributions	\$ <u>35,305</u>	\$ <u>48,256</u>

**KNAU RADIO – A PUBLIC TELECOMMUNICATIONS ENTITY
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Notes to Financial Statements

June 30, 2005 and 2004

(1) Organization and Nature of Activities

KNAU Radio (KNAU) is a non-commercial, educational radio station operated by Northern Arizona University in Flagstaff, Arizona, under a license granted by the Federal Communications Commission. KNAU's licensee is the Arizona Board of Regents acting for and on behalf of Northern Arizona University (the University).

(2) Summary of Significant Accounting Principles

(a) Financial Statement Presentation

The accounting policies of KNAU conform to U.S. generally accepted accounting principles applicable to public institutions of higher education engaged only in business-type activities adopted by the Governmental Accounting Standards Board (GASB).

The financial statements of KNAU include all funds for which KNAU has oversight responsibility. Fiscal responsibility for KNAU remains with the University; therefore, KNAU is considered part of the reporting entity for the University's reporting process.

(b) Basis of Accounting

KNAU is engaged only in business-type activities. Accordingly, KNAU's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. The general appropriation from the University is recorded when expended. Grants and donations are recognized as revenue as soon as all eligibility requirements imposed by the provider are met. In-kind contributions, other than the contribution from the University, are recognized as revenue at the estimated fair market value at the date of gift. The portion of the University's indirect costs attributable to KNAU's operations and the value of space provided to KNAU by the University are included as revenues and expenses, and are computed in accordance with guidelines established by the Corporation for Public Broadcasting, which is consistent with generally accepted accounting principles.

KNAU follows Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements.

The financial statements include a statement of net assets; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows.

The statement of net assets provides information about the assets, liabilities, and net assets of KNAU at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to external donor restrictions. Invested in capital assets net of related debt, represents the value of capital assets, net of accumulated depreciation, less any outstanding debt incurred to acquire or construct the assets. Nonexpendable restricted net assets are gifts that have been received for endowment purposes, the corpus of which cannot be expended. Expendable restricted net assets represent grants, contracts, gifts, and other resources that have been externally restricted for specific purposes. Unrestricted net assets include all other net assets.

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(2) Summary of Significant Accounting Principles, continued

(b) Basis of Accounting, continued

The statement of revenues, expenses, and changes in net assets provides information about KNAU's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and additions to endowments. Generally, revenues generated by KNAU for programming and production and broadcasting are considered to be operating revenues. Other revenues used for KNAU, such as the appropriation from the University, are not generated from operations and are considered to be nonoperating revenues.

The statement of cash flows provides information about KNAU's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as operating, noncapital financing, capital financing, and investing activities.

KNAU has both restricted and unrestricted resources available for its operations. When both restricted and unrestricted resources are available for use, restricted resources are used first.

(c) Cash and Cash Equivalents

For administrative purposes, cash balances of KNAU are included in bank accounts maintained by the University or by the Northern Arizona University Foundation (the Foundation). For purposes of the statement of cash flows, the University and the Foundation consider all highly liquid investments with an original maturity of three months or less to be cash equivalents and are stated at fair value. As of June 30, 2005, the University held \$236,375 of KNAU's cash balances and the Foundation held \$504,950. As of June 30, 2004, the University held \$191,768 of KNAU's cash balances and the Foundation held \$576,114.

The University and the Foundation currently use commercial banks as depositories. Deposits with commercial banks are covered by Federal depository insurance of \$100,000. Any cash balances held by the University in excess of Federal depository insurance are collateralized by U.S. Government obligations held by the counter party's agent in the agent's account with the Federal Reserve in the University's name. The Foundation may have cash balances in excess of the Federal depository insurance. However, due to the fact that the Foundation's cash is commingled, KNAU cannot determine the uninsured or uncollateralized portion of its balances held by the Foundation.

The restricted cash balances represent monies received from restricted grants that have not been used for the purpose stated in the grant agreements.

(d) Accounts Receivable

Accounts receivable at June 30, 2005 and 2004 are reported net of allowance for uncollectible amounts of \$22,561 and \$22,328, respectively.

(e) Restricted Investments

The restricted investments balance consists of an endowed fund held and managed by the Northern Arizona University Foundation, Inc. (the Foundation) for the benefit of KNAU. The earnings on the endowment are to be used for carrying out the mission of KNAU. The balance is reported at fair market value, as reported to KNAU by the Foundation.

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(2) Summary of Significant Accounting Principles, continued

(f) Capital Assets

Capital assets are stated at cost or fair value at the date of donation and are depreciated using the straight-line method over the assets useful lives. KNAU capitalizes all assets purchased with a cost of \$2,500 or more. The following useful lives are used in computing depreciation expense:

	<u>Useful Life</u>
Broadcast and programming equipment	7-10 years
Computers and office equipment	5-8 years
Vehicles	3 years
Leasehold improvements	10-20 years

(3) Capital Assets

Capital asset activity for the year ended June 30, 2005 was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Broadcast and programming equipment	\$ 844,041	\$ -	\$ -	\$ 844,041
Computers and office equipment	125,599	4,015	-	129,614
Vehicles	13,000	-	-	13,000
Leasehold improvements	230,000	-	-	230,000
	1,212,640	4,015	-	1,216,655
Accumulated depreciation	(740,957)	(96,551)	-	(837,508)
Capital assets, net	\$ 471,683	\$ (92,536)	\$ -	\$ 379,147

Depreciation expense is charged to its appropriate functional classification based on estimated percentage of the use of the related assets. For the years ended June 30, 2005 and 2004, the allocation of depreciation expense to functional classifications was as follows:

	2005	2004
Programming and production	\$ 39,586	\$ 44,177
Broadcasting	39,586	44,177
Underwriting and grant support	4,828	-
Fundraising	3,861	-
Management and general	8,690	19,396
Total depreciation expense	\$ 96,651	\$ 107,750

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(4) Donated Facilities and Administrative Support

Donated facilities and administrative support from the University totaled \$261,259 and \$216,342 for the years ended June 30, 2005 and 2004, respectively, and are comprised of donated office and studio space and costs for institutional support and physical plant operations. Donated office and studio space of \$13,258 for each of the years ended June 30, 2005 and 2004 is based on the historical cost of facilities used by KNAU, depreciated over a useful life of 20 years. Donated costs for institutional support were \$227,778 and \$184,347 for the years ended June 30, 2005 and 2004, respectively. Donated costs for physical plant operations were \$20,223 and \$18,737 for the years ended June 30, 2005 and 2004, respectively. These costs are allocated financial costs incurred by the University on behalf of KNAU. These amounts are recorded in the accompanying statement of revenues, expenses, and changes in net assets as revenue and expenses and were calculated based on Corporation for Public Broadcasting guidelines, which is consistent with generally accepted accounting principles.

(5) Retirement Plan

All KNAU employees are employees of the University and participate in the University retirement programs. KNAU's administrative officers have the option to participate in defined contribution pension plans. These plans are administered by independent insurance and annuity companies approved by the Arizona Board of Regents. All other KNAU employees participate in the Arizona State Retirement System, which is a cost-sharing multiple-employer defined benefit pension plan. The costs of the retirement programs are allocated to KNAU on a percentage basis by employee and charged to the appropriate functional classification. Retirement plan contributions for the years ended June 30, 2005 and 2004 were \$41,897 and \$39,544, respectively.

(6) Leases

KNAU has entered into two non-cancelable lease agreements for towers used to transmit KNAU's programs. The lease agreements expire through October 31, 2007. In addition to the non-cancelable agreements discussed above, KNAU has various cancelable and month-to-month leases. For the years ended June 30, 2005 and 2004, rent expense was \$40,694 and \$38,449, respectively. The future minimum lease payments under these agreements are as follows:

Fiscal years ended June 30:	
2006	\$ 7,457
2007	1,800
2008	<u>600</u>
	<u>\$ 9,857</u>

(7) Economic Dependency

KNAU is economically dependent on appropriations from the State of Arizona and the annual grants from the Corporation for Public Broadcasting in order to continue service at current levels. A decline in funding from the State or the Corporation for Public Broadcasting could significantly effect the operations of KNAU.

(8) Risk Management

Risks of loss due to torts; theft of, damage to, and destruction of assets; errors or omissions; injuries to employees; and natural disasters are covered by the University's risk management program. The University participates in a self-insurance program administered by the state of Arizona, Department of Administration, Risk Management Section.

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(9) Related Party Transactions

In the regular course of business, KNAU purchases various goods and services from University departments. Additionally, there are many expenses that are processed on a university-wide basis and allocated to KNAU, for example telephone and postal charges.