Financial Statements and Report of Independent Certified Public Accountants

Abilene Christian University

May 31, 2005

Grant Thornton

Accountants and Business Advisors

Report of Independent Certified Public Accountants

Board of Trustees
Abilene Christian University

We have audited the accompanying consolidated statement of financial position of Abilene Christian University (the University) as of May 31, 2005, and the related consolidated statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of the University as of and for the year ended May 31, 2004, were audited by other auditors whose report dated July 15, 2004 expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Abilene Christian University as of May 31, 2005, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued our report dated July 22, 2005 on our consideration of the 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.

GRANT THORNTON LLP

Dallas, Texas
July 22, 2005

1717 Main Street
Suite 500
Dallas, TX 75201
T 214.561.2300
F 214.561.2370
W www.grantthornton.com

Grant Thornton LLP
US member of Grant Thornton International

Abilene Christian University

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

May 31,

ASSETS	2005	2004
Cash and cash equivalents	$ 1,228,407	$ 4,806,828
Short-term investments	126,064,300	107,123,648
Accounts and notes receivable, net	6,487,959	6,538,414
Contributions receivable, net	3,334,518	6,800,442
Inventories	3,532,361	3,192,958
Prepaid expenses and other assets	1,150,435	1,074,912
Contributions and beneficial interest receivable from split-interest agreements	3,974,532	4,184,772
Long-term investments	94,090,938	91,127,595
Property and equipment, net of accumulated depreciation	94,849,695	91,903,699
Total assets	$334,713,145	$316,753,268
LIABILITIES AND NET ASSETS		
Accounts payable	$ 1,574,184	$ 657,908
Accrued interest payable	353,738	333,103
Accrued salaries and expenses	11,674,822	11,138,978
Current portion - long-term obligations payable	3,065,465	2,715,090
Advance on lines of credit	7,789,867	4,422,261
Deposits and other liabilities	4,135,060	4,815,516
Liabilities related to split-interest agreements	27,689,044	26,389,045
Long-term obligations payable	43,801,389	49,541,354
Total liabilities	100,083,569	100,013,255
COMMITMENTS AND CONTINGENCIES	-	-
Net assets		
Unrestricted	102,906,053	89,320,654
Temporarily restricted	4,749,977	8,710,601
Permanently restricted	126,973,546	118,708,758
Total net assets	234,629,576	216,740,013
Total liabilities and net assets	$334,713,145	$316,753,268

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

Abilene Christian University

CONSOLIDATED STATEMENTS OF ACTIVITIES

Year ended May 31, 2005

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains and other support				
Tuition and fees	$ 59,387,685	$ -	$ -	$ 59,387,685
Less- scholarship allowances				
Unfunded scholarships	(11,593,232)	-	-	(11,593,232)
Funded scholarships	(3,779,702)	-	-	(3,779,702)
Net tuition and fees	44,014,751	-	-	44,014,751
Contributions	1,234,810	3,124,518	7,040,390	11,399,718
Investment income	9,136,261	3,331	149,104	9,288,696
Net unrealized and realized gains on investments	11,719,682	113,350	37,642	11,870,674
Government appropriations	2,230,474	-	-	2,230,474
Sales of educational services	418,752	-	-	418,752
Auxiliary enterprises sales and services	16,687,547	-	-	16,687,547
Other revenues	3,028,399	92,009	-	3,120,408
Net assets released from restrictions:				
Satisfaction of program restrictions	7,409,441	(7,055,508)	(353,933)	-
Total revenues, gains, and other support	95,880,117	(3,722,300)	6,873,203	99,031,020
Expenses				
Program:				
Instruction	23,383,147	-	-	23,383,147
Research	279,084	-	-	279,084
Public services	2,559,336	-	-	2,559,336
Academic support	6,367,841	-	-	6,367,841
Student services	7,256,157	-	-	7,256,157
Expenses of auxiliary enterprises	20,933,239	-	-	20,933,239
Support:				
Institutional support	21,510,661	-	-	21,510,661
Total program and support expenses	82,289,465	-	-	82,289,465
Changes in value of split-interest agreements	5,253	238,324	(1,391,585)	(1,148,008)
Total expenses	82,294,718	238,324	(1,391,585)	81,141,457
Change in net assets	13,585,399	(3,960,624)	8,264,788	17,889,563
Net assets at beginning of year	89,320,654	8,710,601	118,708,758	216,740,013
Net assets at end of year	$102,906,053	$ 4,749,977	$126,973,546	$234,629,576

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

Abilene Christian University

CONSOLIDATED STATEMENTS OF ACTIVITIES

Year ended May 31, 2004

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains and other support				
Tuition and fees	$ 54,845,830	$ -	$ -	$ 54,845,830
Less- scholarship allowances				
Unfunded scholarships	(11,037,250)	-	-	(11,037,250)
Funded scholarships	(3,785,743)	-	-	(3,785,743)
Net tuition and fees	40,022,837	-	-	40,022,837
Contributions	1,747,215	7,393,838	2,943,087	12,084,140
Investment income	7,041,937	4,767	327,823	7,374,527
Net unrealized and realized gains on investments	17,685,431	3,421	1,033,529	18,722,381
Government appropriations	2,070,733	-	-	2,070,733
Sales of educational services	344,184	-	-	344,184
Auxiliary enterprises sales and services	14,641,009	-	-	14,641,009
Other revenues	3,075,366	61,127	-	3,136,493
Net assets released from restrictions:				
Satisfaction of program restrictions	4,059,976	(3,350,446)	(709,530)	-
Total revenues, gains, and other support	90,688,688	4,112,707	3,594,909	98,396,304
Expenses				
Program:				
Instruction	23,630,341	-	-	23,630,341
Research	255,370	-	-	255,370
Public services	2,433,254	-	-	2,433,254
Academic support	6,571,087	-	-	6,571,087
Student services	7,533,703	-	-	7,533,703
Expenses of auxiliary enterprises	19,170,040	-	-	19,170,040
Support:				
Institutional support	18,666,652	-	-	18,666,652
Total program and support expenses	78,260,447	-	-	78,260,447
Changes in value of split-interest agreements	-	(71,508)	(1,396,189)	(1,467,697)
Total expenses	78,260,447	(71,508)	(1,396,189)	76,792,750
Change in net assets	12,428,241	4,184,215	4,991,098	21,603,554
Net assets at beginning of year	76,892,413	4,526,386	113,717,660	195,136,459
Net assets at end of year	$ 89,320,654	$ 8,710,601	$118,708,758	$216,740,013

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

Abilene Christian University

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended May 31,

	2005	2004
Cash flows from operating activities		
Change in net assets	$ 17,889,563	$ 21,603,554
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	5,593,151	5,432,244
Depletion	560,000	271,234
Net change in agency accounts	(104,606)	531,044
Noncash contributions	(2,319,677)	(1,826,677)
Contributions restricted for long-term investment	(6,523,852)	(1,447,839)
Investment income restricted for reinvestment	(535,304)	(756,617)
Change in value of split-interest agreements	(1,148,008)	(1,467,697)
Net unrealized and realized gains on investments	(11,870,674)	(18,722,381)
(Increase) decrease in		
Accounts and notes receivable	(147,725)	31,376
Contributions receivable	3,465,924	(3,170,308)
Inventories	(339,403)	224,654
Prepaid expenses and other assets	(75,523)	(13,051)
Increase (decrease) in		
Accounts payable	916,276	228,525
Accrued expenses	556,479	1,326,800
Deposits and other liabilities	(513,199)	56,864
Net cash provided by operating activities	5,403,422	2,301,725
Cash flows from investing activities		
Purchase of property and equipment	(8,623,864)	(5,460,523)
Proceeds from sale of equipment	41,385	-
Disbursement of loans to students, faculty and others	(422,319)	(1,040,930)
Repayment of loans from students, faculty and others	761,160	1,131,917
Proceeds from sale of investments	32,370,466	42,592,864
Purchase of investments	(36,105,555)	(41,723,860)
Net cash used in investing activities	(11,978,727)	(4,500,532)

Abilene Christian University

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

Years ended May 31,

	2005	2004
Cash flows from financing activities		
Proceeds from contributions restricted for:	$ 5,587,752	$ 1,224,336
Investment in endowment	-	8,599
Investment subject to annuity and life income agreements	936,100	214,904
Investment in plant	6,523,852	1,447,839
Other financing activities:		
Interest and dividends restricted for reinvestment	535,304	756,617
Proceeds of split-interest obligations	1,000	32,509
Payment of split-interest obligations	(1,723,728)	(1,314,698)
Proceeds from lines of credit	36,284,448	39,863,954
Payment of lines of credit	(33,174,402)	(40,823,549)
Proceeds from long-term obligations payable	1,270,000	9,477,192
Payment of long-term obligations payable	(6,659,590)	(2,434,229)
	(3,466,968)	5,557,796
Net cash provided by financing activities	3,056,884	7,005,635
Net increase (decrease) in cash and cash equivalents	(3,518,421)	4,806,828
Cash and cash equivalents at beginning of year	4,806,828	-
Cash and cash equivalents at end of year	$ 1,288,407	$ 4,806,828

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The accompanying consolidated financial statements include the financial position, activities, and cash flows of Abilene Christian University (the "University"), a not for profit institution of higher education, and its affiliates, the ACU Foundation and ACU in Oxford (UK). All significant interrelated accounts and transactions have been eliminated in the accompanying consolidated financial statements. The University has majority voting and economic interests in the ACU Foundation and ACU in Oxford (UK).

Basis of Accounting

The consolidated financial statements of the University have been prepared on the accrual basis of accounting. The focus of these financial statements is to present the University as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of transactions into three classes of net assets - unrestricted, temporarily restricted or permanently restricted.

Unrestricted net assets - Net assets not subject to donor-imposed stipulations.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met by actions of the University and/or the passage of time.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, the donors of these assets permit the institution to use all or part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the temporarily restricted net asset class, and a reclassification to unrestricted net assets is made to reflect the expiration of such restrictions. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. Amortization of discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for uncollectible contributions receivable is provided based upon management's judgment including such factors as prior collection history, type of contribution and nature of fund-raising activity.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Contributions of land, building and equipment without donor stipulations concerning the use of such long-lived assets are reported as revenues of the unrestricted net asset class. Contributions of cash or other assets to be used to acquire land, building and equipment with such donor stipulations are reported as revenues of the temporarily restricted net asset class; the restrictions are considered to be released at the time of acquisition of such long-lived assets. Purchased investments are recorded at cost at acquisition. Investments received by gift are recorded at the market value of the asset as of the date of donation. Non-marketable securities are valued on the date of donation using independent appraisals and are adjusted for subsequent perceived permanent declines in value. Readily marketable investments (investments readily marketable on national exchanges) are adjusted for changes in market value.

Income and realized and unrealized gains on investments of endowments and similar funds are reported as increases in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanent endowment fund; as increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income; as increases in unrestricted net assets in all other cases. Investment income and realized and unrealized gains on endowment funds, whose restrictions are met in the same reporting period, are reported as revenues of the unrestricted net asset class. Investment losses on endowments and similar funds are reported as decreases in unrestricted net assets.

With respect to temporarily restricted net assets, the University has adopted the following accounting policies as permitted by various provisions of Statement of Financial Accounting Standards No. 116 (SFAS 116), "Accounting for Contributions Received and Contributions Made":

From time to time the University enters into derivative transactions, via mutual funds, as part of its overall investment asset allocation. Derivatives used as part of this asset allocation strategy are recorded at fair value with realized and unrealized gains and losses reflected in the consolidated statements of activities. These derivatives are included in the investment portfolio to reduce market volatility. Interest rate hedge derivatives on the University's debt portfolio are described in a later note.

Investments in the physical plant are recorded at cost. Significant renovations to existing buildings are capitalized, while maintenance and repairs are expensed when incurred. Equipment purchases under $1,000 are not capitalized. Provision for depreciation is made on a straight-line basis over the estimated useful life of the asset. Currently, these estimated useful lives are as follows:

Buildings and building improvements	15-55 years
Improvements other than buildings	15 years
Equipment	5-10 years

When disposition is made of plant assets, the cost and accumulated depreciation are removed from the accounting records, and the resulting gain or loss is recognized in the consolidated statements of activities.

Inventories are valued at amounts, which, in the aggregate, approximate the lower of cost or market on the first-in, first-out basis.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Use of Estimates

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

Tax Status

The University is a tax-exempt institution and is not a "private foundation" under the Tax Reform Act of 1969; accordingly, no provision for taxes has been made in the consolidated financial statements. The University is liable for federal income taxes on certain unrelated business income; however, the amount of such tax is insignificant. The ACU Foundation has also been accorded recognition as exempt from income tax under Sections 501(c)(3) and 509(a)(3) of the Internal Revenue Code of 1986.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, the University considers all cash and other highly liquid investments with original maturities of three months or less to be cash equivalents. The University places its cash and cash equivalents with high quality financial institutions, which at times may exceed federally insured limits. The University has not experienced any losses on such accounts.

Accounts and Notes Receivables

Receivables are recorded at the contractual amounts owed by students and others adjusted for unamortized discounts, unearned income, undisbursed funds, deferred loan fees, and an allowance for losses. Interest income is recorded on the accrual basis in accordance with the terms of receivables.

The estimated allowances for uncollectible accounts and notes receivable are accounted for using the reserve method. Under this method, allowances are maintained at a level which, in the judgment of management, is adequate to meet the present and potential risks of uncollectibility of the accounts and notes receivable. Management's judgment is based on a variety of factors, which include experience related to charge-offs and recoveries, and scrutiny of individual accounts and notes receivable. Amounts deemed by management to be uncollectible are charged to expenses. Recoveries on receivables previously charged-off are credited to expenses. Provisions for receivable losses are charged to expense and credited to the allowance for uncollectible accounts and notes receivable. At May 31, 2005 and 2004, the allowance for uncollectibles was $592,249.

Reclassifications

Certain reclassifications have been made to the 2004 financial statements to conform to the 2005 presentation.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Early Retirement Plan

The University offered an early retirement plan to qualified employees during the fiscal year ended May 31, 2004. An expense of approximately $1,653,700 is included in the 2004 institutional support expense for the cost of employees accepting an early retirement option, and an expense of approximately $254,000 is included in the 2005 consolidated statements of activities related to the required increase in the post-retirement benefit obligations for these retirees.

NOTE B - CONTRIBUTIONS RECEIVABLE

Contributions receivable are as follows at May 31, 2005 and 2004:

	2005	2004
Unconditional promises expected to be collected in:		
Less than one year	$ 1,694,547	$ 2,073,926
One year to five years	3,676,112	7,305,621
Over five years	-	4,000
	5,370,659	9,383,547
Less discount for net present value	(203,914)	(1,067,050)
Less allowance for uncollectible contributions receivable	(1,832,227)	(1,516,055)
	$ 3,334,518	$ 6,800,442

The contributions are to be utilized for the following purposes:

	2005	2004
Restricted for current operations and scholarships	$ 345,654	$ 1,906,361
Endowment	2,940,385	3,184,334
Acquisition of land, building and equipment	48,479	1,709,747
	$3,334,518	$ 6,800,442

Contributions receivable as of May 31, 2005 have been discounted using rates ranging from 1.89% to 3.91%.

NOTE C - INVESTMENTS

Investments consist of the following at May 31, 2005 and 2004:

	2005	2004
Short-term investments		
Mutual funds managed by third parties, at market	$126,064,300	$107,123,648
Long-term investments		
Mutual funds, at market	58,244,083	51,953,011
Notes receivable	267,652	443,228
Stocks and bonds	23,634,143	26,480,308
Real estate	11,397,344	11,725,589
Other investments	547,716	525,459
	94,090,938	91,127,595
	$220,155,238	$198,251,243

As of May 31, 2005 and 2004 the cost of short-term investments was $112,266,408 and $96,133,813, respectively. The carrying values of $126,064,300 and $107,123,648 represent market value, including gross unrealized gains of $15,871,708 and $12,803,939 and gross unrealized losses of $2,840,947 and $2,534,433 as of May 31, 2005 and 2004, respectively. All investments are classified as long-term when held as investments of trusts managed by the University.

The University maintains an investment pool for use by its endowment funds (excluding assets held in trust by the ACU Foundation). The University's policy allows the pool to invest in domestic equities, international equities, fixed income securities, marketable alternatives, real estate, mineral interests and other investments deemed suitable. The mutual funds are invested by several professional third-party managers with different investment styles to diversify risk and maximize returns. For the year ended May 31, 2005, the spendable income allocated was $5,334,385. The total return for the pool, including interest, dividends and net realized and unrealized investment appreciation, was approximately 9.9% for the year ended May 31, 2005. For the year ended May 31, 2004, the spendable income allocated was $4,407,629. The total return for the pool, including interest, dividends and net realized and unrealized investment appreciation, was approximately 18.5% for the year ended May 31, 2004.

As of May 31, 2005 and 2004, the investment pool was composed of the following:

	2005	2004
Mutual funds managed by third parties, at market	$125,200,907	$106,271,727
Notes receivable	177,365	329,173
Donated stocks	76,832	368,101
Other	6,210	11,000
Cash	245,119	131,591
	$125,706,433	$107,111,592

NOTE D - PROPERTY AND EQUIPMENT

At May 31, 2005 and 2004, property and equipment consisted of the following:

	2005	2004
Land	$ 2,904,699	$ 2,728,034
Buildings and improvements	96,214,048	95,214,469
Improvements other than buildings	21,302,277	20,258,408
Equipment	20,504,073	20,852,851
Construction in progress	2,919,576	23,225
Other	-	231,204
	143,844,673	139,308,191
Less accumulated depreciation	(48,994,978)	(47,404,492)
	$ 94,849,695	$ 91,903,699

Depreciation expense for the years ending May 31, 2005 and 2004, was $5,593,151 and $5,432,244, respectively.

Construction in progress as of May 31, 2005 consists primarily of the construction of A.B. Barret Hall, a 43,380 square foot residence hall scheduled for occupancy in August 2005. When completed the cost of this project will be $6,700,000 and will be able to house 176 students.

NOTE E - LONG-TERM OBLIGATIONS PAYABLE

Long-term obligations as of May 31, 2005 and 2004, were as follows:

	2005	2004
Miscellaneous notes payable	$ 55,500	$ 82,500
1995 - Higher Education Revenue Refunding and Improvement Bonds; payable in annual installments; maturing in fiscal year 2012; interest rates ranging from 4.6% to 6.25%; secured by revenues.	12,885,000	14,655,000
1998 - Higher Education Revenue Refunding and Improvement Bonds; payable in annual installments; maturing in fiscal year 2019; interest rate of 4.75%; secured by revenues subordinate to the series 1995 debt.	9,220,000	9,430,000

NOTE E - LONG-TERM OBLIGATIONS PAYABLE - Continued

2001 - Higher Education Revenue Improvement Bonds; payable in semi-annual installments; maturing in fiscal year 2021; interest rate of 5.0%; secured by revenues.	$ 8,440,542	$ 8,778,411
2002 - Higher Education Revenue Bonds; variable interest rate; all principal due at maturity on July 17, 2006; secured by revenues.	6,000,000	10,000,000
2003 - Higher Education Revenue Bonds; payable in semi-annual installments; maturing in fiscal year 2024; variable interest rate; secured by revenues.	8,995,812	9,310,533
2005 - Tax-exempt Lease; payable in semi-annual installments; maturing in fiscal year 2010; interest rate of 3.59%; secured by leased technology equipment.	1,270,000	-
	$46,866,854	$52,256,444

On September 10, 1998, the University issued $10,000,000 in revenue improvement and refunding bonds through the Stamford Higher Education Facilities Corporation. All bonds were subsequently placed privately with Bank of America. Proceeds from the bonds were utilized to refinance $4,505,000 of the Series 1995 Abilene Higher Education Facilities Corporation Revenue Improvement and Refunding Bonds (the prior bonds) in addition to providing funding for various projects of the University. The proceeds for the refinancing were placed in trust with an escrow agent for the purpose of providing for all future debt service payments on the prior bonds.

For the purposes of financial accounting, the principal amount of the prior bonds is still considered to be a liability of the University, and is reflected accordingly in the University's consolidated statements of financial position. Likewise, the assets placed in escrow for the purpose of providing for future debt service requirements on the prior bonds is reflected as an asset (long-term investment) in the University's consolidated statements of financial position. The market value of the assets placed in escrow to defease the 1995 debt at May 31, 2005 and 2004 was $2,784,892 and $2,968,129, respectively.

The Series 2002 and 2003 obligations have variable interest rates equal to 65% of the 30-day, 60-day, 90-day or 180-day Libor rate plus 1.00%.

A schedule of future fiscal year principal payments of long-term debt follows:

2006	$ 3,065,465
2007	9,148,823
2008	3,251,209
2009	3,450,497
2010	3,091,778
Thereafter	24,859,082
	$46,866,854

NOTE E - LONG-TERM OBLIGATIONS PAYABLE - Continued

At May 31, 2005, the University has two line of credit agreements to provide operating cash flows. These lines have been established to maximize endowment earnings and facilitate cash management. These agreements have maximum available lines of credit totaling $7,000,000 with First National Bank of Abilene and $6,000,000 with Bank of America, N.A. At May 31, 2005, $1,789,867 and $6,000,000 were outstanding on the First National Bank of Abilene line of credit and the Bank of America line of credit, respectively. At May 31, 2004, there was $4,422,261 outstanding on the Bank of America line of credit. No amount was outstanding on the First National Bank of Abilene line of credit. The lines are unsecured with interest payable at prime minus 1.0% or LIBOR plus 1.75%, respectively.

Total interest expense for commercial lines of credit and notes and bonds payable for the years ended May 31, 2005, and 2004, was $2,399,141 and $2,388,124, respectively.

NOTE F - RESTRICTIONS AND LIMITATIONS ON NET ASSET BALANCES

Permanently restricted net assets consist of the following at May 31, 2005 and 2004, the income from which is to be used for the following:

	2005	2004
Student loan	$ 1,216,754	$ 1,164,912
Scholarships	72,767,579	71,706,311
Instruction, research, and divisional support	27,420,066	21,646,297
General operations	5,157,305	4,769,805
Pledges receivable	2,940,385	3,184,335
	109,502,089	102,471,660
Life income, student loan funds and other accounts	17,471,457	16,237,098
	$126,973,546	$118,708,758

Temporarily restricted net assets consist of the following at May 31, 2005 and 2004:

	2005	2004
Gifts and other unexpended revenues and gains available for:		
Scholarships	$ 184,657	$2,557,746
Instruction, research, and divisional support	97,584	278,372
General operations	2,050,790	2,070,516
Acquisition of buildings and equipment	694,341	1,914,354
	3,027,372	6,820,988
Life income, student loan funds and other accounts	1,722,605	1,889,613
	$4,749,977	$8,710,601

NOTE G - NET ASSETS RELEASED FROM RESTRICTIONS

The sources of net assets released from temporary and permanent donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors were as follows for the years ended May 31, 2005 and 2004:

	2005	2004
Scholarships	$1,228,968	$ 714,077
Instruction, research and divisional support	3,025,971	1,705,658
Annuity, life income and other accounts	631,973	1,107,519
Acquisition of land, buildings and equipment	2,522,529	532,722
	$7,409,441	$4,059,976

Restrictions on these assets were released for:

	2005	2004
Operations	$4,886,912	$3,527,254
Capital transactions	2,522,529	532,722
	$7,409,441	$4,059,976

NOTE H - ENDOWMENT FUNDS

As of May 31, 2005 and 2004, the University's net assets from endowment accounts were composed of the following:

	2005	2004
Permanently restricted endowment:		
Managed by the University or the ACU Foundation	$106,667,168	$100,292,380
Managed by third party trusts	2,837,021	2,179,280
Total permanently restricted endowment	109,504,189	102,471,660
Temporarily restricted endowment:		
Managed by the University	1,717,921	1,611,703
Unrestricted endowment	63,815,134	53,997,703
Total endowment accounts	$175,037,244	$158,081,066

While readily marketable investments (investments readily marketable on national exchanges) are adjusted for changes in market value, real estate and mineral interests are carried at the estimated market value on the date the asset was gifted to or purchased into the endowment (adjusted for depletion). Based on internal evaluations, management believes the market value of the underlying assets to be substantially greater than the carrying value. If adjusted based on management's estimates, the total market value of the endowment as of May 31, 2005 and 2004 would be $189,786,539 and $168,251,361, respectively.

NOTE I - SPLIT-INTEREST AGREEMENTS

The University has a variety of split-interest agreements including charitable gift annuities and charitable remainder unitrusts for which the University, or the University through its affiliate Foundation, is the trustee and various perpetual trusts and charitable remainder trusts for which the University is not the trustee. For gift annuities and unitrusts for which the University is trustee, a liability has been recorded representing the discounted future cash flows expected to be paid to the specified beneficiary designated by the donor. The estimated liability of future cash flows is based upon the life expectancy of the donor and a 6% discount rate. The total payments to annuitants and income beneficiaries during the years ended May 31, 2005, and 2004, were $1,481,960 and $1,098,896, respectively. The estimated liability of the future cash flows, as of May 31, 2005 and 2004, was $27,178,244 and $25,953,589, respectively.

Investments related to these agreements are recorded at fair value on the date of the agreement and are reflected as long term investments in the accompanying consolidated financial statements. For gift annuities, contributions are recorded in the year of the agreement with subsequent payments and adjustments to the liability reflected as changes in value of split-interest agreements in the consolidated statements of activities. Income on the donated assets is classified as unrestricted unless a restriction is stipulated in the agreement. For charitable remainder trusts, contributions are recorded in the year of the agreement with investment income, subsequent payments and adjustments to the liability reflected as changes in value of split-interest agreements in the consolidated statements of activities. For the years ending May 31, 2005 and 2004, $517,825 and $295,881, respectively, was recorded as contribution revenue related to these types of agreements.

In addition to the annuity and unitrust agreements noted above, the University is the irrevocable income or remainder beneficiary for various perpetual and charitable remainder trusts for which the University is not the trustee. These agreements have been valued at the discounted present value of expected future cash flows. The expected future cash flows have been discounted at a rate of 6% over the life expectancy of the parties involved and calculated based upon the current market value of the trust's assets and other factors stipulated in the agreements. The expected future cash flows are estimated to be received over periods of 5-27 years based upon life expectancy of the parties involved.

The present value of the expected future cash flows has been reflected as contributions and beneficial interest receivable from split-interest agreements in the consolidated statements of financial position. A contribution is recognized in the year the University becomes aware of the existence of the agreement. The change in estimated present value is reflected as a change in value of split-interest agreements in the consolidated statements of activities.

NOTE J - RETIREMENT PLAN

The University has two defined contribution retirement plans, a 401(a) and 401(k) covering substantially all full and part-time personnel. The University contributes 4% of the employee's salary as a match to the employee's contribution of 2% in the 401(a). In addition, employees are required to contribute 2% of salary to participate in the 401(k) plan for which the University will contribute up to 4% of the employee's salary. University contributions under both plans totaled $2,208,066 and $2,668,117, respectively, for the years ended May 31, 2005 and 2004.

NOTE K - POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

In addition to the University's defined contribution pension plan, the University sponsors a defined benefit health care plan that provides post-retirement medical benefits to currently retired employees and current full-time employees who have worked 10 years and attained age 55 while in service with the University as of May 31, 1995.

The following presents the plan's funded status as of May 31:

	2005	2004
Accumulated postretirement benefit obligation	$(4,851,500)	$(4,665,400)
Plan assets at fair value	-	-
Funded status	$(4,851,500)	$(4,665,400)
Accrued postretirement benefit cost	$(4,714,400)	$(4,128,300)
Annual benefit costs for the year ended May 31:		
Net periodic postretirement benefit cost	$ 254,100	$ 282,100
Employer contributions	$ 190,700	$ 215,500
Plan participant contributions (estimated)	-	5,000
Benefits paid	$ 190,700	$ 220,500

The weighted average annual assumed rate of increase in the per capita cost of covered medical benefits is 11% as of May 31, 2005 and is assumed to decrease gradually to 5% after seven years and remain at that level thereafter. The weighted average discount rate used in determining the accumulated post-retirement benefit obligation was 5% at May 31, 2005.

The weighted average annual assumed rate of increase in the per capita cost of covered medical benefits was 12% as of May 31, 2004 and was assumed to decrease gradually to 5.5% after seven years and remain at that level thereafter. The weighted average discount rate used in determining the accumulated post-retirement benefit obligation was 6% at May 31, 2004.

The University expects to contribute $443,400 to the post-retirement benefit plan in fiscal year 2006. Benefits expected to be paid over the next five years and thereafter are as follows:

2006	$ 443,400
2007	469,000
2008	478,600
2009	459,500
2010	444,500
2011-2015	1,963,300

NOTE L - HEALTH INSURANCE

On May 31, 2003, the University changed its health insurance plan and began using a fully-funded carrier. Effective June 1, 2003, a dual option plan with a third party carrier to which the University pays monthly premiums went into effect. Claims arising from pre-June 1, 2003 services were covered by the remaining reserves from the self-funded plan.

The University discontinued the partially self-funded, health insurance plan on May 31, 2003. The total reserve for outstanding health claims was $254,000 and $36,000 at May 31, 2005 and 2004, respectively.

NOTE M - COMMITMENTS AND CONTINGENCIES

In the normal course of operations, the University is named as a defendant in lawsuits and is subject to periodic examinations by regulatory agencies. After consultation with legal counsel, management is of the opinion that liabilities, if any, arising from such litigation and examinations would not have a material effect on the University's financial position or results of operations.

NOTE N - SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

The University grants credit in the form of accounts and notes receivable to students and others, a substantial portion of which are enrolled at the University. The University does not require collateral for the extension of credit with the exception of notes made to facilitate real estate sales, in which case, the collateral is typically the real estate being sold. Management periodically monitors credit risk through the evaluation of the account's status and ability to repay.

NOTE O - DISCLOSURES RELATED TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS

The University had the following non-cash transactions during the years ending May 31, 2005 and 2004:

	2005	2004
Improvements capitalized reflected in accounts payable	$ -	$ 15,906
Non-cash contributions	2,319,677	1,826,677

Other required disclosures related to the consolidated statements of cash flows:

Interest paid	$2,378,506	$2,319,178

NOTE P - FAIR VALUE OF FINANCIAL INSTRUMENTS

In fiscal year 1996, the University adopted Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments", which requires entities to disclose the estimated fair value of its financial instrument assets and liabilities. Many of the University's financial instruments, however, lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. It is also the University's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities with the exception of investments.

Estimated fair values have been determined by the University using the most relevant available data. The estimated fair values and recorded book balances at May 31, 2005 and 2004, are as follows:

Financial instruments actively traded in a secondary market have been valued using quoted available market prices.

	2005		2004	
	Recorded balance	Estimated fair value	Recorded balance	Estimated fair value
Financial assets				
Cash and cash equivalents	$ 1,228,407	$ 1,228,407	$ 4,806,828	$ 4,806,828
Short-term investments	126,064,300	126,064,300	107,123,648	107,123,648
Contributions receivable	3,334,518	3,334,518	6,800,442	6,800,442
Contributions and beneficial interest receivable from split-interest agreements	3,974,532	3,974,532	4,184,772	4,184,772
Long-term investments:				
Stocks and bonds	23,634,163	23,634,163	26,480,308	26,480,308
Mutual funds	58,244,062	58,244,062	51,953,011	51,953,011
Total financial assets	$216,479,982	$216,479,982	$201,349,009	$201,349,009
Financial liabilities:				
Advance on lines of credit	$ 7,789,867	$ 7,789,867	$ 4,422,261	$ 4,422,261
Long-term obligations payable	46,866,854	46,915,540	52,256,444	52,256,444
Total financial liabilities	$ 54,656,721	$ 54,705,407	$ 56,678,705	$ 56,678,705

Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values. The University's remaining assets and liabilities, which are not considered financial instruments have not been valued differently than has been customary with historical cost accounting.

NOTE P - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The University has determined that it is not practicable to estimate the fair value of notes receivable, donated stocks and bonds, and other investments and their related effective interest rates and maturity because there is no readily tradable market for such assets and the cost of developing a valuation model to estimate the fair value or obtaining an independent valuation of those financial instruments would exceed the benefit derived. The carrying amount of such assets at May 31, 2005 and 2004, are as follows:

	2005	2004
Notes receivable - student accounts	$3,693,603	$3,830,166
Long-term investments:		
Notes receivable - other	267,652	443,228
Other investments	547,716	525,459

NOTE Q - FUND RAISING COSTS

During the year, the University conducted activities that included requests for contributions. Those activities included direct mail campaigns, special events and personal solicitation. The total costs of conducting those activities for the years ended May 31, 2005 and 2004 was $3,189,150 and $3,284,651, respectively.

NOTE R - DERIVATIVE INSTRUMENTS

The University entered into three interest rate swap agreements during fiscal year 2004-05. The Financial Accounting Standards Board Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* requires that the University disclose these swaps as fair value hedges. The primary reason for swapping from a variable to fixed rate is to stabilize the university's operating budget vis-à-vis interest expense.

Management has completed variable to fixed rate swaps on three debt issues: 1) Series 2003 $8.9 million has been swapped to a fixed rate of 4.59%, 2) Series 2005 for $6.7 million (see Note S) has been swapped to a fixed rate of 4.59%, and 3) a forward swap to a fixed rate of 4.39% on a proposed refunding of Series 1995 for $8.8 million.

NOTE R - DERIVATIVE INSTRUMENTS - Continued

Management has identified the following benefits of using swap agreements to accomplish the above objectives:

1. Lower fixed rate is available using a swap than by refunding at a fixed rate.
2. Less paperwork and due diligence is involved in executing a swap than in a refunding. A swap is an agreement separate from the debt, but mimicking the debt repayment structure.
3. A swap does not affect the University's bank qualified debt limit of $10 million per calendar year. This has allowed the University to issue additional debt for new construction and new network technology at the same time it restructures the variable rate debt.
4. The University can purchase the right to cancel the swap at predefined points.

Risks of using the proposed interest rate swaps:

1. Credit risk - risk that the counterparty will not fulfill its obligation on the swap contract.
2. Basis risk - mismatch between the interest rate received from the swap contract and the interest actually owed on the debt.
3. Opportunity cost - if the floating rate that the University can pay on the debt averages below the fixed rate the University pays on the swap, then the University has the opportunity cost associated with locking in the higher interest rate.

The effectiveness of the swaps is judged by comparing the interest rates of the swaps with the interest rates on the underlying debt. The swap terms should identically match the critical terms of the floating rate debt, and thus would be expected to perfectly offset the hedged cash flows of the debt. Management believes the swaps are effective as of May 31, 2005 and, thus, no gain or loss relating to the swaps is reflected in the consolidated statements of activities.

NOTE S - SUBSEQUENT EVENTS

On June 1, 2005 the University issued $6,700,000 in tax-exempt debt through the Stamford, Texas Higher Education Authority for the purpose of financing the construction of a new residence hall. The note matures on June 1, 2025 and has a variable interest rate of 65% of the LIBOR rate plus 100 basis points. Principal and interest are amortized over the life of the debt and are payable semiannually. As described in Note R, this variable rate debt underlies a variable to fixed rate swap fixing the interest rate on this debt at 4.59%.