

***KCTS TELEVISION
AND SUBSIDIARIES***

Consolidated Financial Statements
with Independent Auditors' Report

For the Year Ended
June 30, 2008

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Independent Auditors' Report***Board of Directors
KCTS Television
Seattle, Washington***Certified Public
Accountants
and Consultants

We have audited the accompanying consolidated statement of financial position of KCTS Television and subsidiaries (collectively, the Organization) as of June 30, 2008, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from the Organization's 2007 audited financial statements and, in our report dated October 8, 2007, we expressed an unqualified opinion on those financial statements.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of KCTS Television and subsidiaries at June 30, 2008, and the consolidated changes in their net assets and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic 2008 consolidated financial statements, taken as a whole. The supplemental information for the year ended June 30, 2008, presented on page 15, is presented for additional analysis and is not a required part of the basic financial statements. This supplemental information is the responsibility of the Organization's management. Such information has been subjected to the auditing procedures applied in the audit of the basic 2008 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Certified Public Accountants
October 15, 2008

KCTS TELEVISION AND SUBSIDIARIES

Consolidated Statement of Financial Position

June 30, 2008

(With Comparative Totals for 2007)

| | <u>2008</u> | <u>2007</u> |
|--|----------------------|----------------------|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 3,382,320 | \$ 5,087,171 |
| Investments designated for debt retirement | 7,000,000 | |
| Accounts, grants and contributions receivable, net | 956,586 | 625,332 |
| Inventories and other current assets | 409,275 | 295,911 |
| Costs incurred for programs not yet telecast | 124,630 | 135,584 |
| Total Current Assets | 11,872,811 | 6,143,998 |
| Long-term grants receivable | 122,371 | 15,160 |
| Investments held for long-term purposes | 2,742,848 | 5,745,283 |
| Beneficial interest in trusts | 91,286 | 107,404 |
| Land, property and equipment, net | 8,194,542 | 9,486,803 |
| Other assets | 61,350 | 79,397 |
| Total Assets | \$ 23,085,208 | \$ 21,578,045 |
| Liabilities and Net Assets | | |
| Current Liabilities: | | |
| Accounts payable and accrued expenses | \$ 2,768,186 | \$ 2,385,348 |
| Deferred revenue | 1,182,647 | 1,447,579 |
| Consortium liabilities | 255,876 | 253,815 |
| Current portion of long-term debt | 7,000,000 | |
| Total Current Liabilities | 11,206,709 | 4,086,742 |
| Gift annuities payable | 140,336 | 139,674 |
| Accrued expenses | 164,847 | 159,808 |
| Long-term debt | | 7,000,000 |
| Total Liabilities | 11,511,892 | 11,386,224 |
| Net Assets: | | |
| Unrestricted | 9,183,469 | 7,428,212 |
| Temporarily restricted | 1,952,002 | 2,353,764 |
| Permanently restricted | 437,845 | 409,845 |
| Total Net Assets | 11,573,316 | 10,191,821 |
| Total Liabilities and Net Assets | \$ 23,085,208 | \$ 21,578,045 |

The accompanying notes are an integral part of the financial statements

KCTS TELEVISION AND SUBSIDIARIES

**Consolidated Statement of Activities
For the Year Ended June 30, 2008
(With Comparative Totals for 2007)**

| | 2008 | | | Total 2007 |
|--|---------------------|---------------------------|---------------------------|----------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Revenues: | | | | |
| Memberships | \$ 14,189,198 | \$ - | \$ - | \$ 14,189,198 |
| Underwriting | 770,544 | | | 770,544 |
| Community service grants from the Corporation for Public Broadcasting | 1,611,656 | | | 1,611,656 |
| Other grants and contributions | 1,218,198 | 903,510 | | 2,121,708 |
| Capital additions | | 125,873 | 28,000 | 153,873 |
| Donated professional services, materials, and facilities | 337,926 | | | 337,926 |
| Marketing, teleservices, and production services | 1,293,460 | | | 1,293,460 |
| Other production funding | 34,174 | 77,398 | | 111,572 |
| Other income | 460,001 | 63,328 | | 523,329 |
| Net assets released from restrictions | 1,571,871 | (1,571,871) | | |
| Total Revenues | 21,487,028 | (401,762) | 28,000 | 21,113,266 |
| Expenses: | | | | |
| Program services: | | | | |
| Programming and production | 5,388,329 | | | 5,388,329 |
| Broadcasting | 3,012,524 | | | 3,012,524 |
| Viewer services, information, and promotion | 1,602,892 | | | 1,602,892 |
| Outreach and educational services | 435,469 | | | 435,469 |
| | 10,439,214 | | | 10,439,214 |
| Supporting services: | | | | |
| Development, fund raising, membership, and marketing | 6,479,706 | | | 6,479,706 |
| General and administrative | 2,812,851 | | | 2,812,851 |
| | 9,292,557 | | | 9,292,557 |
| Total Expenses | 19,731,771 | | | 19,731,771 |
| Change in Net Assets | 1,755,257 | (401,762) | 28,000 | 1,381,495 |
| Net assets at beginning of year | 7,428,212 | 2,353,764 | 409,845 | 10,191,821 |
| Net Assets at End of Year | \$ 9,183,469 | \$ 1,952,002 | \$ 437,845 | \$ 11,573,316 |

The accompanying notes are an integral part of the financial statements

KCTS TELEVISION AND SUBSIDIARIES

Consolidated Statement of Cash Flows
For the Year Ended June 30, 2008
(With Comparative Totals for 2007)

| | <u>2008</u> | <u>2007</u> |
|---|---------------------|---------------------|
| Cash Flows from Operating Activities: | | |
| Change in net assets | \$ 1,381,495 | \$ 788,619 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,856,226 | 1,771,828 |
| Contributions restricted for investment in long-term assets | (153,873) | (109,663) |
| Realized and unrealized losses (gains) on investments | 33,238 | (106,869) |
| Unrealized losses (gains) on charitable trusts | 16,118 | (6,662) |
| Loss (gain) on disposal of equipment and LLC interest | (191,375) | 2,548 |
| Changes in operating assets and liabilities: | | |
| Receivables | (438,465) | 140,026 |
| Cost incurred for programs not yet telecast | 10,954 | (33,009) |
| Other assets and inventories | (95,317) | 98,164 |
| Accounts payable and accrued expenses | 387,877 | 162,242 |
| Deferred revenue | (264,932) | 87,752 |
| Consortium liabilities | 2,061 | |
| Annuities payable | 662 | (10,656) |
| Net Cash Provided by Operating Activities | 2,544,669 | 2,784,320 |
| Cash Flows from Investing Activities: | | |
| Purchases of capital equipment | (586,816) | (844,611) |
| Purchases of investments | (10,520,399) | (6,013,162) |
| Proceeds from sale of investments | 6,489,596 | 4,384,905 |
| Proceeds on disposal of equipment and LLC interest | 214,226 | 2,243 |
| Net Cash Used in Investing Activities | (4,403,393) | (2,470,625) |
| Cash Flows from Financing Activities: | | |
| Proceeds from contributions restricted for investment in long-term assets | 153,873 | 109,663 |
| Net Cash Provided by Financing Activities | 153,873 | 109,663 |
| Net Change in Cash and Cash Equivalents | (1,704,851) | 423,358 |
| Cash and cash equivalents, beginning of year | 5,087,171 | 4,663,813 |
| Cash and Cash Equivalents, End of Year | \$ 3,382,320 | \$ 5,087,171 |
| Supplemental Cash Flow Information: | | |
| Cash paid during the year for interest | \$ 385,000 | \$ 210,000 |

The accompanying notes are an integral part of the financial statements

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 1 - Nature of Operations and Significant Accounting Policies

Organization - KCTS Television (KCTS), a nonprofit corporation incorporated in the state of Washington on September 16, 1983, provides service to the community through quality television programs. KCTS has operated continuously as a public television station since 1954.

On September 15, 1987, the Federal Communications Commission's (FCC) broadcast license was transferred from the University of Washington to KCTS, making it the owner and operator of KCTS. The license has been recorded at the nominal value of \$1 to represent ownership.

KCTS provides quality educational and cultural programming through 24-hour program service distributed by transmitter and cable to viewers in the state of Washington and British Columbia, Canada. This service reaches educational and public service institutions, child care providers, and others and provides them with educational tools and outreach programs that expand learning beyond the programs and the classroom. Each week, KCTS broadcasts more than 50 hours of educational, noncommercial, nonviolent programs for children. KCTS is a member of the Public Broadcasting Service (PBS) and American Public Television (APT).

KCTS is in the fourteenth largest television market in the United States and when combined with Vancouver BC, serves over 2 million viewers. During the fiscal year 2008, more than 115,000 viewers made a contribution to KCTS. KCTS produces programs for local, regional, national, and international distribution.

The Channel 9 Corporation (the Corporation), a for-profit corporation, was incorporated in the state of Washington by KCTS on September 9, 1991, to provide promotional and financial support for KCTS through the marketing of products related to public television programs. The Corporation operates a retail store in the lobby of KCTS' broadcast facility in Seattle. Retail sales are also made through the Corporation's Web site.

Intris, Inc. (Intris), a for-profit corporation, was incorporated in the state of Washington by KCTS on April 2, 1998 to provide promotional and financial support for KCTS through the development of DTV technology. Intris did not have any profit or loss activity for the years ended June 30, 2008 or 2007.

Principles of Consolidation - The consolidated financial statements include the accounts of KCTS, the Corporation, and Intris (collectively, the "Organization"). All significant interorganization accounts and transactions have been eliminated.

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 1 - Continued

Basis of Presentation - The accounts of the Organization are maintained in conformity with the principles of not-for-profit accounting. The accompanying statements have been prepared on an accrual basis.

Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted Net Assets - Unrestricted net assets include all net assets on which there are no donor-imposed restrictions for use, or such donor-imposed restrictions were temporary and expired or were met during the current or previous years.

Temporarily Restricted Net Assets - Net assets subject to donor-imposed restrictions that will be met either by actions of the Organization or the passage of time.

Permanently Restricted Net Assets - Net assets subject to donor-imposed restrictions that they be maintained permanently by the Organization. The donors of these assets permit the Organization to use the income earned on related investments for general or specific purposes.

Cash and Cash Equivalents - Investments with original maturities of less than 90 days are considered to be cash equivalents, except for cash or cash equivalents associated with investment accounts. The Organization maintains cash balances at financial institutions that at times exceed FDIC insured limits. The Organization has not experienced any losses and believes there is minimal risk associated with these excess balances.

Investments - Investments consist of marketable debt and equity and are stated at fair value, which is determined using quoted market prices.

Receivables - Accounts, grants and contributions receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to change in net assets and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts, grants or contributions receivable. The allowance for doubtful accounts was \$38,849 at June 30, 2008 and 2007.

Inventories - Inventories consist of products for sale related to public television programs. Inventories are stated based on the lower of cost (average cost method) or market.

Costs Incurred for Programs Not Yet Telecast - Costs incurred for programs not yet telecast represent costs of acquired programs that will be telecast subsequent to year-end and costs, excluding overhead, to produce programs for which future funding can reasonably be assured. Such costs are expensed and included in operating expenses when the program is first telecast.

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 1 - Continued

Land, Property and Equipment - Land, property and equipment improvements are recorded at cost or, in the case of donated property, at its estimated fair value at the date of receipt. Depreciation, where applicable, is calculated using the straight-line method over the following estimated useful lives:

| | |
|---|--------------|
| Building and improvements | 40 years |
| Transmitter, antenna, microwave/TVRO | 5 - 20 years |
| Studio and other broadcast and production equipment | 3 - 7 years |
| Furniture and fixtures | 5 - 10 years |

Contributions and Revenue Recognition - A contribution is recognized as revenue when an unconditional promise is made and all donor-imposed restrictions relating to the promise are met. KCTS' contributions are derived from various sources: memberships (individual pledges); underwriting (corporate pledges); nonproduction-related grants (mostly community service grants from the Corporation for Public Broadcasting); donated professional services, materials, and facilities; fund-raising events; and capital additions (funds restricted by donors for the purchase of equipment).

A portion of membership revenues is deferred at year end to cover the cost of providing a monthly program guide to members.

Donated professional services, materials, facilities and other non-cash gifts are recorded as revenue based on their estimated fair value at the date of donation.

Revenue from production-related grants represents amounts earned by the Organization for production-related services performed. These revenues are recorded based on the percentage-of-completion method.

Marketing and other revenues are derived from royalties, advertising, and product sales. These revenues are recognized as earned. Allowances for estimated sales returns are provided when the related revenue is recorded.

Programming and Production Expenses - Program production costs are expensed based on the percentage-of-completion method.

Advertising Costs - The Organization expenses advertising costs as they are incurred. Advertising costs totaled approximately \$154,000 and \$61,000 for the years ended June 30, 2008 and 2007, respectively.

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 1 - Continued

Functional Allocation of Expenses - The costs of providing the various program services and other activities have been summarized on a functional basis in the consolidated statement of activities and changes in net assets and consolidated statement of functional expenses. Accordingly, certain costs have been allocated among the program and supporting services on the basis of benefits received.

Income Taxes - KCTS has received a determination letter from the Internal Revenue Service approving its tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. The Corporation and Intris are wholly owned subsidiaries of KCTS and are for-profit taxable companies that file their own federal income tax returns each year.

The Corporation and Intris account for federal income taxes using the liability method, whereby deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. At June 30, 2008 and 2007, the Corporation had deferred tax assets aggregating approximately \$551,000, which have been fully offset by a valuation allowance. For federal income tax purposes, the Corporation had net operating loss carryforwards of approximately \$1,604,000 at June 30, 2008, which expires between 2018 and 2028.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Employees - As of June 30, 2008, KCTS employed 109 employees of whom approximately 25% are represented by a union under a collective bargaining agreement. The most recent contract was executed in June 2006, and is effective May 9, 2006 through March 31, 2009.

Prior Year Comparative Information - The consolidated financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a complete presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with KCTS' consolidated financial statements for the year ended June 30, 2007, from which the summarized information was derived.

Reclassifications - Certain reclassifications have been made to 2007 amounts to conform to the 2008 presentation. The reclassifications had no effect on the change in net assets or net asset balances as previously reported.

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 2 - Investments

Investments consisted of the following at June 30:

| | <u>2008</u> | <u>2007</u> |
|---------------------------|----------------------------|----------------------------|
| Cash and cash equivalents | \$ 4,110,669 | \$ 2,296,970 |
| Certificates of deposit | 2,753,736 | 2,285,116 |
| U.S. treasuries and bonds | 2,250,135 | 534,681 |
| Corporate bonds | 117,218 | 99,975 |
| Equity securities | <u>511,090</u> | <u>528,541</u> |
| | <u>\$ 9,742,848</u> | <u>\$ 5,745,283</u> |

Included in investments is \$7 million designated for the retirement of the long-term debt described in Note 6.

Investment income consisted of the following for the years ended June 30:

| | <u>2008</u> | <u>2007</u> |
|--|--------------------------|--------------------------|
| Interest and dividends | \$ 381,307 | \$ 389,344 |
| Net realized gains | 44,283 | 29,986 |
| Net unrealized gains (losses) on investments | <u>(77,521)</u> | <u>76,883</u> |
| | <u>\$ 348,069</u> | <u>\$ 496,213</u> |

Note 3 - Land, Property and Equipment

Land, property and equipment are summarized as follows:

| | <u>2008</u> | <u>2007</u> |
|---|----------------------------|----------------------------|
| Land | \$ 128,371 | \$ 128,371 |
| Building and improvements | 8,823,591 | 8,823,591 |
| Transmitter, antenna, microwave/TVRO | 4,122,373 | 4,680,377 |
| Studio and other broadcast and production equipment | 19,840,192 | 20,250,303 |
| Furniture and fixtures | <u>397,316</u> | <u>365,139</u> |
| | 33,311,843 | 34,247,781 |
| Less accumulated depreciation | <u>(25,251,738)</u> | <u>(24,799,828)</u> |
| | 8,060,105 | 9,447,953 |
| Construction-in-progress | <u>134,437</u> | <u>38,850</u> |
| | <u>\$ 8,194,542</u> | <u>\$ 9,486,803</u> |

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 3 - Continued

The FCC has required that all noncommercial television stations be equipped to transmit digitally by February 2009. KCTS will be purchasing a second digital transmitter to service Channel 9 when this FCC mandate takes effect. The estimated cost of the digital transmitter is \$270,000 and has been included in KCTS' current capital campaign budget estimate for 2009.

Note 4 - Split-Interest Agreements

Gift Annuities - The Organization administers gift annuities for which it is obligated to make periodic distributions to designated beneficiaries. The Organization uses the actuarial method of recording these funds using discount rates ranging from 4.0% to 7.0%. Under this method, when a donation is received, the present value of the guaranteed distributions, based on life expectancy tables, is recorded as a liability, and the remaining interest is recorded as revenue. Periodic adjustments are made between the liability and revenues and expenses to record actuarial gains and losses. Net related losses on gift annuities totaled \$12,125 and \$6,412 for the years ended June 30, 2008 and 2007, respectively, and are included in miscellaneous expense on the statement of activities.

Beneficial Interests Held in Trust - KCTS is named as the beneficiary of two irrevocable charitable remainder unitrusts. Under the trust agreements the trust donors receive annual distributions from trusts during their lifetimes, after which the remaining trust assets will be distributed to KCTS. KCTS has recorded its beneficial interest in these trusts as an asset equal to the present value of the expected funds to be received using a discount rate of 3.8% and 5.6% for the years ended June 30, 2008 and 2007, respectively. The change in value of charitable remainder trusts totaled \$(16,118) and \$6,662 for the years ended June 30, 2008 and 2007, respectively, and is included in other income on the statement of activities.

Note 5 - Consortium Liabilities

The International Public Television Co-Production Consortium (IPTCC) was established in 1988 by a group of 19 U.S. public television stations whose purpose was to encourage co-productions by U.S. public television stations and foreign broadcasters. The IPTCC was supported by dues from its members and by a grant from the Corporation for Public Broadcasting. In January 1997, the members agreed to dissolve the IPTCC. The assets of the former organization have been assigned to KCTS, which acts as the transition member and fiscal agent. It is intended that the assets will be used to acquire programming for broadcast by APT. KCTS will be directed to disburse the funds by majority vote of the former members of the IPTCC. As of June 30, 2008 and 2007, KCTS, as the fiscal agent, held \$152,656 and \$150,595, respectively, of IPTCC funds in its cash and cash equivalents and investments.

The Pacific Rim Co-Production Association (Pacific Rim) was established in 1988 by a group composed of the IPTCC and four foreign broadcasters. The purpose of Pacific Rim was to fund research and development of co-productions of the IPTCC and the foreign broadcasters. Pacific Rim was supported entirely by contributions from its members. In January 1997, the members dissolved the Pacific Rim and formed a new organization, the International Program Development Group (IPDG). The funds from the former Pacific Rim were transferred to the IPDG, with KCTS acting as the fiscal agent. The funds will be used for the purpose of paying the expenses of future meetings and administrative activities of the IPDG. As of June 30, 2008 and 2007, KCTS, as the fiscal agent, held \$103,220 of the IPDG's funds in its cash and cash equivalents and investments.

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 5 - Continued

During 2009, Management of KCTS will be contacting members of both groups to determine a final disposition of the funds being held by KCTS.

Note 6 - Long-Term Debt

In April 2004, the Corporation entered into a long-term loan of \$7,000,000 with an unrelated third party. The loan term is for the period from June 1, 2004 to May 31, 2009. The loan term may be extended to May 31, 2019 if certain conditions are met in the form of an amendment to the long-term lease agreement with the City of Seattle. The loan agreement calls for interest only payments until the maturity date of May 31, 2009, at which time the principal and unpaid interest are due. Interest accrues at 2.5% through May 31, 2006 and at 5.5% thereafter. If the maturity date is extended, then interest only payments continue until May 31, 2019, at which time the principal and unpaid balance are due. KCTS has granted the lender a security interest in the KCTS building and studio facility as well as certain property and equipment. KCTS may prepay the loan at any time without penalty.

The outstanding principle balance on this loan was \$7,000,000 at June 30, 2008 and 2007. Interest expense on long-term debt was \$385,000 and \$210,000 for the years ended June 30, 2008 and 2007, respectively.

Note 7 - Lease Agreements

Building and Studio Facility Land - On December 12, 1984, KCTS entered into a long-term lease agreement with the City of Seattle for a site to locate KCTS' building and studio facility. The lease agreement is for a term of 40 years and called for an initial annual base lease payment of \$130,000. At the end of the lease, KCTS has the option to renew the lease, purchase the land at its appraised value, or sell the building to the lessor at the then-appraised value. The terms of the lease require KCTS to operate a television facility. An escalation clause calls for the annual base payment to be adjusted once every five years, beginning in 1992, to reflect the total percentage change in the Consumer Price Index. Each 5-year adjustment may not exceed 27.63%.

Other Leases - KCTS leases additional office space under a lease with a term ending in 2010 and monthly rent ranging from \$1,400 to \$1,600. KCTS also leases office equipment under leases with terms ending in 2010 and 2012 and total monthly rent of \$2,020.

Future minimum rentals as of June 30 under non-cancelable operating leases are as follows:

| | |
|------------------------------|----------------------------|
| <i>Years Ending June 30,</i> | |
| 2009 | \$ 268,858 |
| 2010 | 261,968 |
| 2011 | 242,718 |
| 2012 | 238,593 |
| 2013 | 226,218 |
| Thereafter | <u>2,601,507</u> |
| | <u>\$ 3,839,862</u> |

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 7 - Continued

Rent expense for operating leases totaled \$292,251 and \$279,155 for the years ended June 30, 2008 and June 30, 2007.

Excess Capacity Lease - KCTS entered into an excess capacity lease agreement with a wholly-owned subsidiary of Sprint Corporation on June 18, 2001. Under the terms of the lease, the lessee paid KCTS a onetime non-refundable incentive payment in the amount of \$500,000 and a prepayment of monthly fees of \$500,000. The incentive payment is recognized as income on a straight-line basis over the term of the lease. Sprint also agreed to pay KCTS a monthly fee equal to the greater of the Monthly Minimum Payment or the Monthly Royalty Fee. The Monthly Minimum Payment starts at \$12,000 per month and increases to \$15,000 per month during the initial term of the lease and increases to \$18,000 per month during the first renewal term of the lease and \$21,000 during the second renewal term of the lease. The Monthly Royalty Fee is 2% of adjusted gross revenue collected from Sprint customers. The initial term of the amended lease is 5 years beginning July 1, 2001, with two renewal terms of 5 years each. The first renewal of the lease took place on July 1, 2006.

Tower Lease - KCTS entered into a tower lease agreement with King County, a municipal corporation and political subdivision of the State of Washington, on December 1, 2005. Under the terms of the lease, KCTS rents space on its transmission tower to King County for installation of communications equipment for the King County Metro Transit system. The lease runs from September 1, 2007 through September 1, 2012, with three automatic 5 year extensions, at a rate of \$1,600 per month, with annual rate adjustments at the lesser of 4% or the increase in the CPI.

Transmission Premises Lease - KCTS entered into a lease agreement with the University of Washington on March 11, 2005. Under terms of the lease, KCTS rents space at its transmission tower location to the University to support the University's FM radio broadcasting activities. The lease runs from April 1, 2005 through March 31, 2010, with 2 automatic 5 year extensions, at a rate of \$1,500 per month, with annual rate adjustments of 3%.

Office Space Lease - KCTS entered into a lease agreement with Lux Worldwide on February 4, 2008. Under the terms of the lease, KCTS rents office space at its building and studio facility to Lux Worldwide. The lease runs from February 1, 2008 through January 31, 2009, with a one year renewal option, at a rate of \$3,208 per month, with a renewal rate option of \$3,354 per month.

Note 8 - Benefit Plans

The Organization has a defined contribution 401(k) plan covering substantially all permanent employees of KCTS Television and Channel 9 Corporation. Under the 401(k) plan, the Organization contributes for each active participant, an amount equal to 5% of the participant's gross annual wages, plus 5% of the participant's gross annual wages in excess of the year's Social Security wage base. Participants become vested in the plan after five years of service with the Organization. The Organization made employer contributions to the 401(k) plan totaling approximately \$302,000 and \$214,000 for the years ended June 30, 2008 and 2007 respectively.

KCTS has a nonqualified deferred compensation plan covered under section 457(f) of the Internal Revenue Code. The plan covers employees designated by the Board of Directors with required contributions by KCTS for fiscal years 2005 and 2006. The Plan permits employee elective contributions on a pre-tax basis up to the amount allowed by Code section 457. All contributions are 100% vested when made.

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 9 - Unrestricted Net Assets

Unrestricted net assets as of June 30 consisted of the following:

| | <u>2008</u> | <u>2007</u> |
|--|----------------------------|----------------------------|
| KCTS - General Fund | \$ 10,622,966 | \$ 8,800,784 |
| KCTS - Board-Designated Endowment Earnings | 193,286 | 243,804 |
| Channel 9 Corporation | (1,632,824) | (1,616,417) |
| Intris, Inc. | 41 | 41 |
| | <u>\$ 9,183,469</u> | <u>\$ 7,428,212</u> |

Note 10 - Temporarily Restricted Net Assets

Temporarily restricted net assets as of June 30 consisted of the following:

| | <u>2008</u> | <u>2007</u> |
|------------------------------|----------------------------|----------------------------|
| Capital Fund | \$ 1,758,675 | \$ 2,032,067 |
| Production Fund | 102,041 | 136,409 |
| Annuity and Life Income Fund | 91,286 | 185,288 |
| | <u>\$ 1,952,002</u> | <u>\$ 2,353,764</u> |

Capital Fund - The Capital Fund consists of funds that are restricted by donors to be used for the purchase of equipment.

Production Fund - The Production Fund consists of funds that are restricted by donors to be used for the production or acquisition of television programming.

Annuity and Life Income Fund - The Annuity and Life Income Fund represents funds obtained by KCTS subject to obligations for periodic payments of stipulated amounts to the donors or beneficiaries.

Note 11 - Permanently Restricted Net Assets

Permanently restricted net assets as of June 30, 2008 and 2007 consisted of gifts, legacies, and bequests that were accepted with donor restrictions that the funds be permanently invested. Earnings from permanently restricted net assets are to be used for funding educational programming and general operations of KCTS.

Note 12 - Pacific Coast Public Television Association

Pacific Coast Public Television Association ("Pacific Coast") is a Canadian tax-exempt, nonprofit organization that, by contract, provides financial support to KCTS' educational programming. As part of the contractual agreement, KCTS gives Pacific Coast on-air credits, grants KCTS member status to Pacific Coast contributors, and provides fund-raising services on a cost-reimbursement basis. Amounts received from Pacific Coast in support of KCTS' educational programming have been recorded as membership revenue and amounted to approximately \$4,047,000 and \$3,404,000 for the years ended June 30, 2008 and 2007, respectively.

KCTS TELEVISION AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Year Ended June 30, 2008

Note 13 - Partnerships and Joint Ventures

In 1998, KCTS became a non-controlling member in a limited liability company, Public Television Major Market Group, LLC. The limited liability company was formed to take a leadership position within and outside public television in developing positions and taking actions to affect the outcome of major public television issues. Among the other purposes was to provide a forum for evaluating proposals for collaborative and other ventures with third parties for revenue generating and other opportunities for the use of digital technology. The company is funded by yearly capital contributions from the members. Such contributions are recorded as an expense in the Organization's financial statements when made. Contributions were \$5,500 for both 2008 and 2007.

In 1997, KCTS, along with a group of public television and public radio stations, formed a limited liability company, National Public Television, LLC. KCTS is a non-controlling member in this limited liability company. The primary purpose of the company is to develop the assets, properties, and business associated with engaging in the representation of public television and public radio stations with national spot underwriters. The company is funded by periodic capital contributions from the members. Such contributions are recorded as an expense in the Organization's financial statements when made. There were no contributions for 2008 or 2007. In October 2007 the assets of the company were sold. KCTS received \$115,660 from the sale and included the proceeds in other income on the statement of activities for the year ended June 30, 2008.

In 2000, KCTS joined a PBS owned and operated for profit limited liability company, National Datacast, Inc. The primary purpose of the company is to provide a nationwide data transmission network for member broadcasting stations, and customers alike. KCTS is a non-controlling member of this limited liability company. In October 2007 KCTS received notification that the company was dissolved. In 2005, KCTS joined a limited liability company formed by National Datacast, Inc.; entitled Moviebeam. The primary purpose of which is to provide data transmission services similar to NDI, with special emphasis on title films. KCTS is a non-controlling member of this limited liability company. The companies are funded by periodic capital contributions from the members. Such contributions are recorded as an expense in the Organization's financial statements when made. There were no contributions for 2008 or 2007.

SUPPLEMENTAL INFORMATION

KCTS TELEVISION AND SUBSIDIARIES

**Consolidated Statement of Functional Expenses
For the Year Ended June 30, 2008
(With Comparative Totals for 2007)**

| | Program Services | | | | Supporting Services | | | Total Expenses | | |
|--|----------------------------|---------------------|---|-----------------------------------|------------------------|--|----------------------------|---------------------------|----------------------|----------------------|
| | Programming and Production | Broadcasting | Viewer Services, Information, and Promotion | Outreach and Educational Services | Total Program Services | Development, Fund Raising, Membership, and Marketing | General and Administrative | Total Supporting Services | 2008 | 2007 |
| Salaries, payroll taxes, and benefits | \$ 1,497,354 | \$ 1,331,453 | \$ 690,276 | \$ 167,294 | \$ 3,686,377 | \$ 1,768,740 | \$ 1,498,798 | \$ 3,267,538 | \$ 6,953,915 | \$ 6,752,859 |
| Professional services | 331,786 | 22,753 | 259,894 | 66,249 | 680,682 | 832,506 | 281,367 | 1,113,873 | 1,794,555 | 1,836,248 |
| Advertising and promotion | 10,576 | | 57,776 | 69,203 | 137,555 | 1,528,625 | 22,007 | 1,550,632 | 1,688,187 | 1,724,671 |
| Cost of goods sold | | | | | | 156,978 | | 156,978 | 156,978 | 193,876 |
| Program acquisition | 2,098,137 | | | | 2,098,137 | | | | 2,098,137 | 1,967,511 |
| Printing and postage | 8,102 | 4,432 | 459,544 | 25,984 | 498,062 | 1,289,649 | 58,154 | 1,347,803 | 1,845,865 | 1,752,066 |
| Depreciation and amortization | 653,585 | 1,049,234 | 14,035 | 3,023 | 1,719,877 | 62,793 | 73,556 | 136,349 | 1,856,226 | 1,771,828 |
| Supplies, rental, and maintenance of equipment | 57,849 | 235,163 | 16,134 | 16,079 | 325,225 | 42,316 | 343,123 | 385,439 | 710,664 | 728,130 |
| Occupancy | 160,137 | 179,472 | 26,353 | 8,016 | 373,978 | 111,713 | 74,223 | 185,936 | 559,914 | 556,004 |
| Membership and dues | 439,966 | 175 | 579 | 228 | 440,948 | 666 | 58,235 | 58,901 | 499,849 | 523,442 |
| Insurance | | | | | | | 233,470 | 233,470 | 233,470 | 239,679 |
| Travel, conferences, and training | 14,484 | 19,887 | 11,786 | 12,948 | 59,105 | 76,854 | 28,573 | 105,427 | 164,532 | 163,449 |
| Interest | 149,130 | 74,692 | 24,535 | 4,599 | 252,956 | 94,189 | 47,929 | 142,118 | 395,074 | 225,363 |
| Telephones | 6,389 | 92,512 | 1,035 | 230 | 100,166 | 45,507 | 46,593 | 92,100 | 192,266 | 178,966 |
| Donated professional services, materials, and facilities | 167,231 | 2,362 | 39,837 | 49,169 | 258,599 | 60,183 | 19,144 | 79,327 | 337,926 | 367,384 |
| Licenses, permits, and fees | 11,176 | 51 | 767 | 3,545 | 15,539 | 132,174 | 5,085 | 137,259 | 152,798 | 156,818 |
| Miscellaneous | 1,827 | 338 | 341 | 8,902 | 11,408 | 57,413 | 22,594 | 80,007 | 91,415 | 89,929 |
| Total before allocations | 5,607,729 | 3,012,524 | 1,602,892 | 435,469 | 10,658,614 | 6,260,306 | 2,812,851 | 9,073,157 | 19,731,771 | 19,228,223 |
| Pledge events | (219,400) | | | | (219,400) | 219,400 | | 219,400 | | |
| Total Expenses | \$ 5,388,329 | \$ 3,012,524 | \$ 1,602,892 | \$ 435,469 | \$ 10,439,214 | \$ 6,479,706 | \$ 2,812,851 | \$ 9,292,557 | \$ 19,731,771 | \$ 19,228,223 |

See independent auditors' report.