



MARQUETTE UNIVERSITY

Financial Statements

June 30, 2013 and 2012

(With Independent Auditors' Report Thereon)

MARQUETTE UNIVERSITY

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KPMG LLP
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Independent Auditors' Report

The Board of Trustees
Marquette University:

Report on the Financial Statements

We have audited the accompanying financial statements of Marquette University (the University), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Marquette University as of June 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Milwaukee, Wisconsin
September 4, 2013

MARQUETTE UNIVERSITY

Statements of Financial Position

June 30, 2013 and 2012

(Dollars in thousands)

| Assets | 2013 | 2012 |
|--|---------------------|------------------|
| Cash and cash equivalents | \$ 41,692 | 36,109 |
| Collateral held under securities lending agreement | 20,186 | 33,978 |
| Unexpended bond proceeds | 37,945 | — |
| Contributions receivable, net | 62,897 | 78,895 |
| Accounts receivable, net | 12,277 | 12,772 |
| Prepaid expenses and deferred charges | 7,454 | 6,213 |
| Student loans receivable, net | 41,899 | 43,054 |
| Investments | 481,158 | 423,055 |
| Funds held in trust by others | 21,086 | 23,252 |
| Other assets | 1,458 | 1,423 |
| Net property, buildings, and equipment | 498,853 | 496,795 |
| Total assets | <u>\$ 1,226,905</u> | <u>1,155,546</u> |
| Liabilities and Net Assets | | |
| Liabilities: | | |
| Accounts payable | \$ 9,733 | 7,655 |
| Accrued liabilities | 24,056 | 22,880 |
| Payables under securities lending agreement | 20,186 | 33,978 |
| Student credits and other advance payments | 7,686 | 7,640 |
| Deferred revenue and deposits | 27,821 | 20,349 |
| Payable to beneficiaries under split-interest agreements | 4,282 | 4,424 |
| Refundable federal loan grants | 35,749 | 35,867 |
| Postretirement benefits payable | 4,308 | 4,280 |
| Notes and bonds payable | 243,946 | 206,494 |
| Total liabilities | <u>377,767</u> | <u>343,567</u> |
| Net assets: | | |
| Unrestricted | 202,547 | 195,514 |
| Temporarily restricted | 308,578 | 301,387 |
| Permanently restricted | 338,013 | 315,078 |
| Total net assets | <u>849,138</u> | <u>811,979</u> |
| Total liabilities and net assets | <u>\$ 1,226,905</u> | <u>1,155,546</u> |

See accompanying notes to financial statements.

MARQUETTE UNIVERSITY

Statement of Activities

Year ended June 30, 2013

(Dollars in thousands)

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|--------------|---------------------------|---------------------------|-----------|
| Operating revenues: | | | | |
| Student tuition and fees – gross | \$ 337,783 | — | — | 337,783 |
| Less tuition discounts | (108,975) | — | — | (108,975) |
| Net tuition and fees | 228,808 | — | — | 228,808 |
| Government and private grants | 23,440 | — | — | 23,440 |
| Contributions | 4,298 | 16,806 | 22,803 | 43,907 |
| Auxiliary enterprises | 47,035 | — | — | 47,035 |
| Sales by educational departments | 9,753 | — | — | 9,753 |
| Investment income (loss) | 240 | 333 | (164) | 409 |
| Endowment income used in operations | 4,855 | 14,193 | 297 | 19,345 |
| Other income | 18,459 | — | — | 18,459 |
| Total operating revenues | 336,888 | 31,332 | 22,936 | 391,156 |
| Net assets released from restrictions | 32,372 | (32,372) | — | — |
| Total operating revenues and net assets released from restrictions | 369,260 | (1,040) | 22,936 | 391,156 |
| Operating expenses: | | | | |
| Instruction | 109,971 | — | — | 109,971 |
| Academic support | 42,880 | — | — | 42,880 |
| Research and grants | 22,374 | — | — | 22,374 |
| Libraries | 19,709 | — | — | 19,709 |
| Student services | 53,013 | — | — | 53,013 |
| Auxiliary enterprises | 42,754 | — | — | 42,754 |
| Institutional support | 73,562 | — | — | 73,562 |
| Public services | 4,221 | — | — | 4,221 |
| Total operating expenses | 368,484 | — | — | 368,484 |
| Operating income (loss) | 776 | (1,040) | 22,936 | 22,672 |
| Nonoperating (expenses) income: | | | | |
| Endowment gain in excess of amounts designated for current operations, net | 9,317 | 16,675 | (234) | 25,758 |
| Other, net | (3,060) | (8,444) | 233 | (11,271) |
| Total nonoperating (loss) income, net | 6,257 | 8,231 | (1) | 14,487 |
| Change in net assets | 7,033 | 7,191 | 22,935 | 37,159 |
| Net assets, beginning of year | 195,514 | 301,387 | 315,078 | 811,979 |
| Net assets, end of year | \$ 202,547 | 308,578 | 338,013 | 849,138 |

See accompanying notes to financial statements.

MARQUETTE UNIVERSITY

Statement of Activities

Year ended June 30, 2012

(Dollars in thousands)

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|--|--------------|------------------------|------------------------|-----------|
| Operating revenues: | | | | |
| Student tuition and fees – gross | \$ 328,244 | — | — | 328,244 |
| Less tuition discounts | (102,909) | — | — | (102,909) |
| Net tuition and fees | 225,335 | — | — | 225,335 |
| Government and private grants | 25,147 | — | — | 25,147 |
| Contributions | 1,817 | 27,091 | 13,797 | 42,705 |
| Auxiliary enterprises | 47,377 | — | — | 47,377 |
| Sales by educational departments | 9,479 | — | — | 9,479 |
| Investment income (loss) | 549 | 136 | (209) | 476 |
| Endowment income used in operations | 4,671 | 12,887 | 244 | 17,802 |
| Other income | 16,762 | — | — | 16,762 |
| Total operating revenues | 331,137 | 40,114 | 13,832 | 385,083 |
| Net assets released from restrictions | 31,273 | (31,273) | — | — |
| Total operating revenues and net assets released from restrictions | 362,410 | 8,841 | 13,832 | 385,083 |
| Operating expenses: | | | | |
| Instruction | 107,024 | — | — | 107,024 |
| Academic support | 41,103 | — | — | 41,103 |
| Research and grants | 22,352 | — | — | 22,352 |
| Libraries | 19,227 | — | — | 19,227 |
| Student services | 49,578 | — | — | 49,578 |
| Auxiliary enterprises | 42,918 | — | — | 42,918 |
| Institutional support | 72,144 | — | — | 72,144 |
| Public services | 3,919 | — | — | 3,919 |
| Total operating expenses | 358,265 | — | — | 358,265 |
| Operating income | 4,145 | 8,841 | 13,832 | 26,818 |
| Nonoperating (expenses) income: | | | | |
| Endowment gain in excess of amounts designated for current operations, net | (6,496) | (8,098) | 133 | (14,461) |
| Other, net | (1,100) | (2,090) | 260 | (2,930) |
| Total nonoperating (loss) income, net | (7,596) | (10,188) | 393 | (17,391) |
| Change in net assets | (3,451) | (1,347) | 14,225 | 9,427 |
| Net assets, beginning of year | 198,965 | 302,734 | 300,853 | 802,552 |
| Net assets, end of year | \$ 195,514 | 301,387 | 315,078 | 811,979 |

See accompanying notes to financial statements.

MARQUETTE UNIVERSITY

Statements of Cash Flows

Years ended June 30, 2013 and 2012

(Dollars in thousands)

| | <u>2013</u> | <u>2012</u> |
|---|------------------|-----------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ 37,159 | 9,427 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation | 32,652 | 30,993 |
| Discount amortization | (345) | 86 |
| Net realized and unrealized (appreciation) depreciation on investments | (38,710) | 1,863 |
| Bad debt expense | (108) | 504 |
| Contributions for major capital projects including gifts in kind | (12,000) | (13,713) |
| Contributions restricted for long-term endowments | (22,803) | (13,797) |
| Permanently restricted endowment income used in operations | (297) | (244) |
| Loss (gain) on sale of property, buildings, and equipment | 41 | (11) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 612 | 2,173 |
| Contributions receivable | 11,056 | 2,885 |
| Funds held in trust by others | 2,166 | (1,344) |
| Other assets, net | (697) | 249 |
| Payables and other liabilities | 1,403 | (2,689) |
| Deferred revenue and deposits | 7,472 | 59 |
| Net cash provided by operating activities | <u>17,601</u> | <u>16,441</u> |
| Cash flows from investing activities: | | |
| Purchases of property, buildings, and equipment | (32,329) | (39,772) |
| Proceeds from sale of property, buildings, and equipment | 16 | 11 |
| Student loan repayments | 7,339 | 6,747 |
| Student loans issued | (6,192) | (5,645) |
| Decrease in payables under securities lending agreement | (13,792) | (8,090) |
| Decrease in cash collateral held under securities lending agreement | 13,792 | 7,842 |
| Purchase of investments | (261,748) | (295,534) |
| Proceeds from the sale of investments | 204,410 | 306,165 |
| Net cash used in investing activities | <u>(88,504)</u> | <u>(28,276)</u> |
| Cash flows from financing activities: | | |
| Contributions received for major capital projects | 11,345 | 13,310 |
| Contributions restricted for long-term endowments | 27,745 | 15,536 |
| Permanently restricted endowment income used in operations | 297 | 244 |
| Decrease in refundable federal loan grants | (118) | (1,303) |
| Proceeds from issuance of long-term debt | 96,596 | 1,067 |
| Payment of bond issuance costs | (749) | — |
| Repayment of notes and bonds payable | (58,630) | (9,530) |
| Net cash provided by financing activities | <u>76,486</u> | <u>19,324</u> |
| Net increase in cash and cash equivalents | 5,583 | 7,489 |
| Cash and cash equivalents, beginning of year | <u>36,109</u> | <u>28,620</u> |
| Cash and cash equivalents, end of year | <u>\$ 41,692</u> | <u>36,109</u> |

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

(1) Organization

Marquette University (the University) is an independent, coeducational, not-for-profit institution of higher learning and research located in Milwaukee, Wisconsin, formally opened in 1881 and conducted under the auspices of the Society of Jesus. Through its 12 separate colleges and schools, the University offers bachelor's degree programs, master's degree programs, doctoral degree programs, and post-baccalaureate first professional degree programs.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The financial statements of the University have been prepared, in all material respects, on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles (GAAP).

Net assets of the University, and changes therein, are classified and reported as follows:

Unrestricted Net Assets are not subject to donor-imposed restrictions. All revenues, gains, and losses that are not temporarily or permanently restricted by donors are included in this classification. All expenses are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with donors' stipulations results in the net assets being released from restriction.

Temporarily Restricted Net Assets are subject to donor-imposed restrictions that will be met either by actions of the University, the passage of time, or both. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions. Contributions of property and equipment are recorded at fair value at the date of donation. In the absence of donor stipulations detailing how long the contributed assets must be used, the University has adopted a policy of implying a time restriction on contributions of such assets that expire over the assets' useful lives. As a result, all contributions of property and equipment, and assets contributed to acquire property and equipment, are recorded as temporarily restricted net assets.

Permanently Restricted Net Assets are subject to donor-imposed restrictions to be maintained permanently by the University. Items that are included are gifts and contributions for which donors stipulate that the corpus be held in perpetuity and the income from those assets be made available for scholarships or program operations and annuity or life income gifts for which the ultimate purpose is permanently restricted.

(b) Use of Estimates

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

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Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

(c) *Cash and Cash Equivalents*

Cash on deposit for operations and all highly liquid financial instruments with original maturities of three months or less are classified as cash equivalents, except those amounts held by investment managers, which are classified as investments. The fair value of cash equivalents is estimated to be the same as book value due to the short maturity of these instruments.

(d) *Unexpended Bond Proceeds*

Unexpended bond proceeds represent the amount of unspent revenue bond proceeds that remain available for their specified purpose and are reported at fair value based upon market quotes. These amounts are maintained in a trust and invested by the trustee primarily in short-term U.S. government securities. Under the terms of the trust, proceeds are not released to the University until expenditures related to the specific purpose of the bond indenture are incurred.

(e) *Prepaid Expenses and Deferred Charges*

Prepaid expenses and deferred charges consist of deferred financing costs and prepaid insurance, maintenance and other costs associated with future periods. Deferred financing costs are being amortized using the straight-line method, which approximates the interest method, over the lives of the respective debt issues.

(f) *Investments*

Investments are reported at fair value based on market quotes with unrealized gains and losses thereon included in the statements of activities. When a ready market for the investments does not exist, management's valuations for certain commingled funds, real estate, multistrategy hedge funds and private equity partnerships are recorded using net asset value as a practical expedient in estimating fair value, based on information provided by fund managers or general partners. The estimated values are reviewed and evaluated by the University.

(g) *Funds Held in Trust by Others*

Funds held in trust by others represent amounts held by third-party trustees for the benefit of the University under trust agreements created by donors. Amounts held in trust are stated at fair value. These agreements stipulate the length of the trust and the intended purpose of the funds.

(h) *Student Loans Receivable, Net*

The University makes uncollateralized loans to students based on financial need. Student loans receivable consist of both federal and institutional loans.

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Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

At June 30, student loans consisted of the following:

| | | 2013 | 2012 |
|---------------------------------------|----|----------------------|----------------------|
| Federal government loan programs | \$ | 40,130 | 41,110 |
| Institutional loan programs | | 1,863 | 2,036 |
| Subtotal | | <u>41,993</u> | <u>43,146</u> |
| Less allowance for doubtful accounts: | | | |
| Beginning of year | | (92) | (90) |
| Increases | | (45) | (91) |
| Write-offs | | 43 | 89 |
| End of year | | <u>(94)</u> | <u>(92)</u> |
| Student loans receivable | \$ | <u><u>41,899</u></u> | <u><u>43,054</u></u> |

The University participates in the Perkins, Health Professionals Student, Nursing Student, Nurse Faculty, ARRA-Nurse Faculty, and Loans for Disadvantaged Student federal revolving loan programs. The availability of funds for loans under the program, is dependent on reimbursements to the pool from repayments on outstanding loans. At June 30, 2013 and 2012, the U.S. government had provided 88% of the funds for the federal student loan programs, and the University provided the remaining 12%. The initial receipt of U.S. government funds is recorded as a liability on the statements of financial position. A portion of the student loan may be canceled if the student meets certain criteria. The University will either be reimbursed by the U.S. government for its portion of the canceled loan or will reduce the refundable federal loan liability.

At June 30, 2013 and 2012, the following amounts were past due under student loan programs:

| June 30 | | 1–240 days | 241 days to 2 years | over 2 years | Total |
|----------------|----|-------------------|--------------------------------|---------------------|--------------|
| 2013 | \$ | 1,866 | 1,039 | 1,403 | 4,308 |
| 2012 | | 2,005 | 1,032 | 1,128 | 4,165 |

The University records an allowance for uncollectible accounts for its portion of the student loans when, in management's judgment, it is probable a portion of the loan will not be collected. Allowances for doubtful accounts are established based on prior collections. Institutional loan balances are written off only when they are deemed to be permanently uncollectible.

(i) ***Property, Buildings, and Equipment***

Property, buildings, and equipment are recorded at cost at date of acquisition or fair value at date of donation including, where appropriate, capitalized interest. Property and equipment under capital leases are initially valued and recorded on the present value of minimum lease payments. The University depreciates buildings, building improvements, land improvements, equipment, and library

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Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

contents, over the estimated useful lives of the assets (25 to 50, 10 to 20, 10 to 20, 5 to 7, and 20 years, respectively) using the straight-line method. Leasehold improvements are amortized over the shorter of the expected useful life of the asset or term of the related lease. Major renewals and improvements that extend the useful life of an asset are capitalized, while repairs and maintenance costs are expensed as incurred. Depreciation is not calculated on land, art collections, rare books and construction in progress. The University reviews each grouping of assets with separately identifiable cash flows for possible impairment whenever circumstances indicate that the carrying amount may not be recoverable. Measurement of an impairment loss for long-lived assets that the University expects to hold and use is based on the fair value of the asset. Properties that are expected to be disposed are reported at the lower of the carrying amount or estimated fair value less cost to sell. For properties intended for disposal, the useful life is adjusted to reflect the expected remaining period of service.

Property, buildings, and equipment include the following at June 30, 2013 and 2012:

| | 2013 | 2012 |
|--|-------------|-------------|
| Land and improvements | \$ 39,362 | 39,234 |
| Buildings and improvements | 592,262 | 585,846 |
| Construction in progress | 19,222 | 9,130 |
| Furniture, fixtures, and equipment | 143,447 | 132,319 |
| Library contents | 111,025 | 109,308 |
| Less accumulated depreciation | (406,465) | (379,042) |
| Net property, buildings, and equipment | \$ 498,853 | 496,795 |

Construction in progress includes the following as of June 30, 2013 and 2012:

| | 2013 | 2012 |
|--|-------------|-------------|
| School of Dentistry Expansion | \$ 11,464 | — |
| Engineering Hall | 2,646 | — |
| Marquette Financial Systems Upgrade | 492 | 4,451 |
| McCormick Residence Fire Protection | — | 1,236 |
| Nursing Simulation Lab | — | 1,067 |
| Other renovation and construction projects | 4,620 | 2,376 |
| Total construction in progress | \$ 19,222 | 9,130 |

(j) *Asset Retirement Obligations*

The University records all known asset retirement obligations for which the liability's fair value can be reasonably estimated, primarily asbestos removal. The determination of the asset retirement obligation is based upon a number of assumptions that incorporate the University's knowledge of facilities, the asset lives, the estimated timeframes for periodic renovations, the current cost for remediation of asbestos, and the current technology at hand to accomplish the remediation work.

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Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

These assumptions used to determine the asset retirement obligation may be imprecise or be subject to changes in the future. Any change in the assumptions can impact the value of the determined liability and impact future net activities of the University.

(k) Student Tuition and Fees

Student tuition and fees are recorded as revenues during the year the related academic services are rendered. Student deposits and advance payments for tuition related to the next semester have been deferred and will be reported as unrestricted revenue in the year in which the academic services are rendered. Student tuition and fees are reported net of tuition discounts.

(l) Auxiliary Enterprises

Auxiliary enterprises include revenues and expenses of the University for room and board, parking services, and gift shops.

(m) Contributions

Contributions, including unconditional promises to give (pledges), are recorded as operating revenue. Gifts, excluding artwork, are recognized in the appropriate category of net assets in the period received. Temporarily restricted contributions and restricted investment income whose restrictions are met in the same reporting period are reported as temporarily restricted revenues and as net assets released from restrictions in the statements of activities. Contributions are recorded at their estimated fair value at the date the gift is received. Contributions receivable due beyond one year are stated at estimated net present value, net of an allowance, and recorded as temporarily restricted net assets until cash payments are received and donor restrictions are fulfilled. Allowances and revisions to previous year contributions based on donor amendments or clarifications of intent are reflected within the statements of activities as a nonoperating item. Due to an amendment of a donor agreement during fiscal year 2013, a contribution receivable of \$7,021 was reclassified to a grant through temporarily restricted nonoperating activity. Contributions with donor-imposed conditions are not recognized unless it is reasonably expected that the conditions can be met.

(n) Operating Income (Loss)

Operating results (change in unrestricted net assets from operating activity) in the statements of activities reflect all transactions that change unrestricted net assets, except for activity associated with endowment investments and certain other nonrecurring transactions. In accordance with the University's endowment distribution policy as described in note 5, only the portion of total investment return distributed under this policy to meet operating needs is included in operating revenue. Operating investment income consists of dividends, interest, and realized gains and losses on unrestricted nonendowed investments.

The University's primary programs are instruction, research, and public service. Academic support, student services, and auxiliary enterprises are considered integral to the delivery of these programs. Fundraising costs are not material to the University's total program costs. Costs related to the operation and maintenance of physical plant, including depreciation of plant assets, are allocated to

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Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

operating programs and supporting activities based upon periodic facility usage surveys. Interest expense on external debt is allocated to the activities that have most directly benefited from the debt proceeds.

(o) *Income Taxes*

The University is generally exempt from federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code (the Code) and is a tax-exempt organization described in Sections 501(c)(3), 509(a)(1), and 170(b)(1)(A)(ii) of the Code.

The Financial Accounting Standards Board (FASB) issued guidance prescribing how an organization should recognize, measure, present, and disclose in its financial statements uncertain tax positions. The University must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. As of both June 30, 2013 and 2012, the University did not have any uncertain tax positions.

(p) *Art Collection*

The University has various collections of fine arts in museums, libraries, and on loan. The University does not assign or record a value to art works and other collections received as gifts or purchased with contributions restricted for that purpose. Valuations for some collections are updated periodically, and as such, the total value of all fine arts may vary with appraisals and/or auction prices. Accordingly, the value of fine art and other collections has been excluded from the statements of financial position. Proceeds, if any, from deaccessions or insurance recoveries are reflected as increases in the appropriate net asset classes. The art and other collections are subject to a requirement that proceeds from their sales be used to acquire other items for collections. Fine arts are included in insurance coverage for University property and a separate policy is also secured for fine art of high value and where appraised values are listed. As of both June 30, 2013 and 2012, the specific policy covering highly valued works provides for insured coverage of \$79,000 aggregate limit for any one loss or any one occurrence and includes some appraised items from library collections. As of both June 30, 2013 and 2012, additional fine art values covered for loss in other insurance programs are estimated of approximately \$3,800.

(q) *Reclassifications*

Certain prior year financial statement amounts have been reclassified to conform to the current year presentation.

MARQUETTE UNIVERSITY

Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

(r) *New Accounting Pronouncements*

The University adopted the provisions of FASB Accounting Standards Update (ASU) No. 2011-04, Fair Value Measurement (ASC Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS) (ASU No. 2011-04). The new standards do not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is required or permitted under IFRS or U.S. GAAP. For U.S. GAAP, the changes are primarily clarifications of existing guidance or wording changes to align with IFRS. The University implemented ASU No. 2011-04 for the year ended June 30, 2013. Its adoption did not have a significant impact on the University's financial statements.

(3) **Investments**

Cost and estimated fair values of investments as of June 30, 2013 and 2012 were as follows:

| | 2013 | | 2012 | |
|--|------------|------------|---------|------------|
| | Cost | Fair value | Cost | Fair value |
| Money funds and other | \$ 20,353 | 20,351 | 5,884 | 5,884 |
| Federal, state, and local agencies securities | 22,151 | 22,491 | 23,596 | 25,160 |
| Nongovernment bonds and notes | 14,590 | 14,858 | 9,687 | 10,213 |
| Asset and mortgage-backed securities | 3,054 | 2,993 | 4,769 | 4,585 |
| Foreign bonds and notes | 3,707 | 3,833 | 3,241 | 3,409 |
| Common and preferred stocks | 17,733 | 25,265 | 28,529 | 37,350 |
| Mutual funds – bonds | 797 | 793 | 767 | 776 |
| Mutual funds – equity | 61,513 | 67,365 | 60,171 | 57,568 |
| Commingled funds-equity | 50,572 | 54,644 | 54,473 | 56,069 |
| Real estate limited partnership and membership interests | 21,990 | 19,520 | 18,689 | 15,566 |
| Multistrategy hedge funds | 133,120 | 185,554 | 122,695 | 157,452 |
| Private equity partnerships | 58,663 | 63,491 | 46,969 | 49,023 |
| Total investments | \$ 408,243 | 481,158 | 379,470 | 423,055 |

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Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

The University's investments at fair value are categorized as of June 30, 2013 and 2012 as follows:

| | | 2013 | 2012 |
|--|----|-------------|-------------|
| Investments permanently restricted by donors | \$ | 290,037 | 265,825 |
| Investments functioning as endowment | | 150,661 | 125,418 |
| Total investments subject to endowment spending policy | | 440,698 | 391,243 |
| Long-term cash management investments | | 14,434 | 6,309 |
| Trust and other investments | | 26,026 | 25,503 |
| Total investments | \$ | 481,158 | 423,055 |

"Investments functioning as endowment" are investments not restricted by donors, but are designated by the University for endowment purposes.

Investment returns as of June 30, 2013 and 2012 comprise the following:

| | | 2013 | | |
|---|----|---------------------|-------------------------------|-------------------------------|
| | | Unrestricted | Temporarily restricted | Permanently restricted |
| Interest and dividends | \$ | 1,845 | 5,023 | (66) |
| Gain (loss) on investments, net | | 12,567 | 26,178 | (35) |
| Return (loss) on investments | \$ | 14,412 | 31,201 | (101) |
| Return on investments are classified on the statement of activities as follows: | | | | |
| Investment income (loss) | \$ | 240 | 333 | (164) |
| Endowment income used in operations | | 4,855 | 14,193 | 297 |
| Endowment (loss) gain in excess of amounts designated for current operations, net | | 9,317 | 16,675 | (234) |
| Return (loss) on investments | \$ | 14,412 | 31,201 | (101) |

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Return on investments is net of investment fees of \$1,936.

| | 2012 | | | |
|---|-------------------|------------------------|------------------------|-----------------|
| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
| Interest and dividends | \$ 1,914 | 3,903 | (137) | 5,680 |
| (Loss) gain on investments, net | (3,190) | 1,022 | 305 | (1,863) |
| Return on investments | <u>\$ (1,276)</u> | <u>4,925</u> | <u>168</u> | <u>3,817</u> |
| Return on investments are classified on the statement of activities as follows: | | | | |
| Investment income (loss) | \$ 549 | 136 | (209) | 476 |
| Endowment income used in operations | 4,671 | 12,887 | 244 | 17,802 |
| Endowment (loss) gain in excess of amounts designated for current operations, net | <u>(6,496)</u> | <u>(8,098)</u> | <u>133</u> | <u>(14,461)</u> |
| (Loss) return on investments | <u>\$ (1,276)</u> | <u>4,925</u> | <u>168</u> | <u>3,817</u> |

Return on investments is net of investment fees of \$1,699.

The University participates in a securities lending arrangement with BMO Harris Bank Securities Lending (BMO) whereby certain marketable securities owned by the University and included in the pooled endowment are loaned to designated counterparties (borrowers) in exchange for acceptable collateral, which is typically cash or short maturity U.S. Treasury securities. The University may recall securities loaned on short notice. The borrower must post collateral that has a market value of at least 102% of the value of the securities loaned. The collateral is held in custody by BMO and pooled with collateral maintained for other participants in this program. BMO indemnifies the University against loss on the securities loaned as a result of the borrower's default. The University receives lending fees and continues to earn interest and dividends on the loaned securities.

As of June 30, 2013 and 2012, the University had loaned securities with a market value of \$19,365 and \$33,182, respectively, that were secured by collateral with a market value of approximately \$20,186 and \$33,978, respectively. The collateral received in connection with the security lending program and the obligation to return such collateral are reported as an asset and liability for financial statement purposes.

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(4) Fair Value Measurements

The following discussion describes the valuation methodologies used for financial assets and liabilities measured at fair value. The techniques utilized in estimating the fair values are affected by the assumptions used. While the University believes that its valuation methods are appropriate and consistent with those of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value at the reporting date.

The carrying amount of student accounts receivable, accounts payable and accrued liabilities approximates fair value due to the short maturity of these financial instruments.

A reasonable estimate of the fair value of student loans receivable under government loan programs could not be made because the notes are not marketable and can only be assigned to the U.S. government or its designees. The fair value of notes receivable from students under the University's loan programs approximates carrying value.

Fair values of cash and cash equivalents are based on observable market quotation prices provided by investment managers and the custodian bank at the reporting date.

Funds held in collateral under the securities lending agreement are based on quoted market prices provided by the custodian bank. The custodian banks use a variety of pricing sources to determine market valuations. Observable market quoted prices and specific pricing services or indexes are used to value investments. The securities portfolio is highly liquid, generally allowing the portfolio to be priced through pricing services.

Unexpended bond proceeds are invested in various securities based on expected risk, returns and maturities that mirror the anticipated timing of construction project payment needs. Fair values of unexpended bond proceeds securities are based on prices provided by the trustee bank. Unexpended bond proceeds include cash equivalents and fixed income securities where their fair values are based on observable market quotation prices. The trustee bank uses a variety of pricing sources to determine market valuations of fixed maturity securities. The specific pricing services or indexes for each sector of the market are based upon the provider's expertise. The fixed maturity securities are highly liquid, allowing the portfolio to be priced through pricing services.

Investments include money funds, federal, state, nongovernment, asset-backed and foreign fixed income securities, stocks, mutual funds, commingled funds, real estate, multistrategy hedge funds and private equity partnerships. Investments are based on valuations provided by external investment managers and the custodian banks. Valuations provided by external investment managers and the custodian bank include observable market quotation prices, observable inputs other than quoted prices such as price services or indexes, estimates, appraisals, assumptions and other methods that are reviewed by management. Real estate, multistrategy hedge funds, commingled funds and private equity partnerships are valued using net asset value as a practical expedient in estimating fair value; however, it is possible that the redemption rights of certain investments may be restricted by the funds in the future in accordance with the underlying fund agreements. Changes in market conditions and the economic environment may impact the net asset value of the funds and consequently the fair value of the University's interests in the funds.

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Funds held in trust by others are based on quoted market prices provided by its investment managers and custodian bank. Both the investment managers and the custodian banks use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider's expertise. The securities portfolio is highly liquid, generally allowing the portfolio to be priced through pricing services.

Payable under the securities lending agreement is based on quoted market prices provided by the custodian bank. The custodian banks use a variety of pricing sources to determine market valuations. Observable market quoted prices and specific pricing services or indexes are used to value investments. The securities portfolio is highly liquid, generally allowing the portfolio to be priced through pricing services.

Based on discounted cash flows using risk free rate and a risk premium of 1.5% that was determined by the University, the estimated fair value of the University's notes and bonds payable at June 30, 2013 and 2012 is approximately \$242,303 and \$221,282, respectively.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurement*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The standard describes three levels of inputs that may be used to measure fair value:

- Level 1: Observable inputs such as quoted prices in active markets that the University has the ability to access at the measurement date.
- Level 2: Inputs other than quoted prices in active markets such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3: Unobservable inputs where there is little or no market data and requires the reporting entity to develop its own assumptions and generally includes multistrategy hedge funds and private equity partnerships, real estate limited partnership and membership interests.

The University's policy is to reflect transfers between levels at the end of the year in which a change in circumstances results in the transfer. There were no transfers of assets or liabilities between Level 1, 2, or 3 during the fiscal years ended June 30, 2013 and 2012, respectively.

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The following table presents the University's fair value hierarchy for those assets and liabilities measured at fair value as of June 30, 2013. The categorization of financial instruments within the hierarchy is based on price transparency and does not necessarily correspond to the perceived risk of the instruments.

| | <u>Total</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
|----------------------------------|-------------------|----------------|----------------|----------------|
| June 30, 2013: | | | | |
| Assets | | | | |
| Recurring: | | | | |
| Cash and cash equivalents | \$ 41,692 | 41,692 | — | — |
| Collateral held under securities | | | | |
| lending agreement | 20,186 | — | 20,186 | — |
| Unexpended bond proceeds | 37,945 | — | 37,945 | — |
| Investments: | | | | |
| Money funds and other | 20,351 | — | 20,351 | — |
| Federal, state, and local | | | | |
| agency securities | 22,491 | — | 22,491 | — |
| Nongovernment bonds and | | | | |
| notes | 14,858 | — | 14,858 | — |
| Asset and mortgage- | | | | |
| backed securities | 2,993 | — | 2,993 | — |
| Foreign bonds and notes | 3,833 | — | 3,833 | — |
| Common and preferred stocks | 25,265 | 25,265 | — | — |
| Mutual funds – bonds | 793 | 793 | — | — |
| Mutual funds – equity | 67,365 | 67,365 | — | — |
| Commingled funds – equity | 54,644 | — | 54,644 | — |
| Real estate limited partnership | | | | |
| and membership interests | 19,520 | — | — | 19,520 |
| Multistrategy hedge funds | 185,554 | — | 42,959 | 142,595 |
| Private equity partnerships | 63,491 | — | — | 63,491 |
| Total investments | 481,158 | 93,423 | 162,129 | 225,606 |
| Funds held in trust by others | 21,086 | — | 21,086 | — |
| Total recurring assets | <u>\$ 602,067</u> | <u>135,115</u> | <u>241,346</u> | <u>225,606</u> |
| Disclosure: | | | | |
| Student loans receivable | \$ 41,899 | — | 41,899 | — |
| Total disclosed assets | <u>\$ 41,899</u> | <u>—</u> | <u>41,899</u> | <u>—</u> |

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| | <u>Total</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
|--|-------------------|----------------|----------------|----------------|
| June 30, 2013: | | | | |
| Liabilities | | | | |
| Recurring: | | | | |
| Payables under securities lending agreement | \$ 20,186 | — | 20,186 | — |
| Total liabilities | <u>\$ 20,186</u> | <u>—</u> | <u>20,186</u> | <u>—</u> |
| Disclosure: | | | | |
| Notes and bonds payable | \$ 242,303 | — | 242,303 | — |
| Total disclosed liabilities | <u>\$ 242,303</u> | <u>—</u> | <u>242,303</u> | <u>—</u> |

Certain investments classified in Levels 2 and 3 consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Because the net asset value reported by each fund is a practical expedient to estimate the fair value of the University's interest therein, its classification in Level 2 or 3 is based on the University's ability to redeem its interest at or near the date of the statement of financial position. If the interest can be redeemed in the near term, the investment is classified in Level 2. The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

The following table represents additional information for all Level 3 assets measured at fair value on a recurring basis for the fiscal year ended June 30, 2013:

| | <u>Level 3</u> | | | |
|-------------------------------------|-------------------|---|--------------------------------------|--|
| | <u>Total</u> | <u>Real estate limited partnership and membership interests</u> | <u>Multistrategy hedge funds</u> | <u>Private equity partnerships</u> |
| Financial assets: | | | | |
| Beginning balance, June 30, 2012 | \$ 187,994 | 15,566 | 123,405 | 49,023 |
| Net income including realized gains | 3,097 | 1,214 | — | 1,883 |
| Unrealized gains, net | 9,973 | (409) | 9,190 | 1,192 |
| Expenses | (452) | (152) | — | (300) |
| Purchases | 29,619 | 4,113 | 10,000 | 15,506 |
| Sales | (4,625) | (812) | — | (3,813) |
| Ending balance, June 30, 2013 | <u>\$ 225,606</u> | <u>19,520</u> | <u>142,595</u> | <u>63,491</u> |

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Fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent) as of June 30, 2013 are as follows:

| | Net asset value | Unfunded commitments | Redemption frequency | Redemption notice period |
|---|----------------------------|---------------------------------|---------------------------------|-------------------------------------|
| Commingled funds | \$ 54,644 | — | Monthly | 5 – 10 days |
| Real estate limited partnership and membership interests | 19,520 | 9,566 | Quarterly, Annually | 60 – 180 days |
| Multistrategy hedge funds | 185,554 | — | | |
| Private equity partnerships | 63,491 | 40,859 | | |
| Total | <u>\$ 323,209</u> | <u>50,425</u> | | |

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The following table presents the University's fair value hierarchy for those assets and liabilities measured at fair value as of June 30, 2012. The categorization of financial instruments within the hierarchy is based on price transparency and does not necessarily correspond to the perceived risk of the instruments.

| | <u>Total</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
|--|--------------|----------------|----------------|----------------|
| June 30, 2012: | | | | |
| Assets | | | | |
| Recurring: | | | | |
| Cash and cash equivalents | \$ 36,109 | 36,109 | — | — |
| Collateral held under securities lending agreement | 33,978 | — | 33,978 | — |
| Investments: | | | | |
| Money funds and other | 5,884 | — | 5,884 | — |
| Federal, state, and local agency securities | 25,160 | — | 25,160 | — |
| Nongovernment bonds and notes | 10,213 | — | 10,213 | — |
| Asset and mortgage- backed securities | 4,585 | — | 4,585 | — |
| Foreign bonds and notes | 3,409 | — | 3,409 | — |
| Common and preferred stocks | 37,350 | 37,350 | — | — |
| Mutual funds – bonds | 776 | 776 | — | — |
| Mutual funds – equity | 57,568 | 57,568 | — | — |
| Commingled funds – equity | 56,069 | — | 56,069 | — |
| Real estate limited partnership and membership interests | 15,566 | — | — | 15,566 |
| Multistrategy hedge funds | 157,452 | — | 34,047 | 123,405 |
| Private equity partnerships | 49,023 | — | — | 49,023 |
| Total investments | 423,055 | 95,694 | 139,367 | 187,994 |
| Funds held in trust by others | 23,252 | — | 23,252 | — |
| Total recurring assets | \$ 516,394 | 131,803 | 196,597 | 187,994 |
| Disclosure: | | | | |
| Student loans receivable | \$ 43,054 | — | 43,054 | — |
| Total disclosed assets | \$ 43,054 | — | 43,054 | — |

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| | <u>Total</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
|-----------------------------|-------------------|----------------|----------------|----------------|
| June 30, 2012: | | | | |
| Liabilities | | | | |
| Recurring: | | | | |
| Payables under securities | | | | |
| lending agreement | \$ 33,978 | — | 33,978 | — |
| Total recurring liabilities | <u>\$ 33,978</u> | <u>—</u> | <u>33,978</u> | <u>—</u> |
| Disclosure: | | | | |
| Notes and bonds payable | \$ 221,282 | — | 221,282 | — |
| Total disclosed assets | <u>\$ 221,282</u> | <u>—</u> | <u>221,282</u> | <u>—</u> |

Certain investments classified in Levels 2 and 3 consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Because the net asset value reported by each fund is a practical expedient to estimate the fair value of the University's interest therein, its classification in Level 2 or 3 is based on the University's ability to redeem its interest at or near the date of the statements of financial position. If the interest can be redeemed in the near term, the investment is classified in Level 2. The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

The following table represents additional information for all Level 3 assets measured at fair value on a recurring basis for the fiscal year ended June 30, 2012:

| | <u>Level 3</u> | | | |
|-------------------------------------|-------------------|---|--------------------------------------|--|
| | <u>Total</u> | <u>Real estate limited partnership and membership interests</u> | <u>Multistrategy hedge funds</u> | <u>Private equity partnerships</u> |
| Financial assets: | | | | |
| Beginning balance, June 30, 2011 | \$ 156,851 | 13,049 | 114,032 | 29,770 |
| Net income including realized gains | 3,260 | 914 | — | 2,346 |
| Unrealized gains, net | 760 | 241 | 2,373 | (1,854) |
| Expenses | (337) | (128) | — | (209) |
| Purchases | 30,831 | 2,473 | 7,000 | 21,358 |
| Sales | (3,371) | (983) | — | (2,388) |
| Ending balance, June 30, 2012 | <u>\$ 187,994</u> | <u>15,566</u> | <u>123,405</u> | <u>49,023</u> |

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Fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent) as of June 30, 2012 are as follows:

| | <u>Net asset value</u> | <u>Unfunded commitments</u> | <u>Redemption frequency</u> | <u>Redemption notice period</u> |
|---|----------------------------|---------------------------------|---------------------------------|-------------------------------------|
| Commingled funds | \$ 56,069 | — | Monthly | 5 – 10 days |
| Real estate limited partnership and membership interests | 15,566 | 7,316 | Quarterly, Annually | 60 – 180 days |
| Multistrategy hedge funds | 157,452 | — | | |
| Private equity partnerships | <u>49,023</u> | <u>60,050</u> | | |
| Total | <u>\$ 278,110</u> | <u>67,366</u> | | |

Commingled funds consist of assets from several accounts that are blended together. Investors in commingled fund investments benefit from economies of scale, which allow for lower trading costs per dollar of investment, diversification and professional money management. The net asset value of investments in this category has been estimated based on the net asset value per share of the investment.

Real estate limited partnerships and membership interests include a direct investment in partnerships that invest in global real estate. The net asset value of this investment has been estimated by the ownership interest in the partnership. Investments in this category are intended to be illiquid for the duration of the respective partnership. Partnership duration periods range from 7 to 13 years.

Multistrategy hedge funds include investments in hedge funds that pursue multiple strategies to diversify risk and reduce volatility. The value of the investments in this category has been estimated using the net asset value of the ownership interest in the partnership.

Private equity partnerships consist of equity securities in operating companies that are not publicly traded on a stock exchange. This category includes various investments as part of a strategy to diversify risk and reduce volatility. Investments in private equity most often involve either an investment of capital into an operating company or the acquisition of an operating company. The net asset value of this investment has been estimated by the ownership interest in the partnership. The direct investment fund provides full disclosure of the underlying holdings and ownership interest, which allows the University to verify the account balances. Investments in this category are intended to be illiquid for the duration of the respective partnership. Partnership duration periods range from 7 to 13 years.

(5) Endowments and Endowment Income

(a) *Interpretation of Relevant Law Governing Endowments*

The State of Wisconsin enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) on July 20, 2009. This law provides, among other things, expanded spending flexibility by allowing, subject to a standard of prudence, the University to spend from an endowment fund without regard to the book value of the corpus. The Board of Trustees (the Board) of the University

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has interpreted UPMIFA as allowing the University to appropriate for expenditure or accumulate so much of an endowment fund as the University determines is prudent for the uses, benefits, purposes and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift investment. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as unrestricted or temporarily restricted in accordance with UPMIFA and donor stipulations. Absent donor stipulations, the Board may appropriate for expenditure, for the uses and purposes of the endowment fund, the net appreciation, realized and unrealized, in the fair value of the assets of the endowment established by UPMIFA.

From time to time, the value of assets associated with a permanently restricted fund may fall below the historical cost. Deficiencies of this nature are reported in the unrestricted net assets and totaled \$2,415 and \$6,789 as of June 30, 2013 and 2012, respectively. These deficiencies resulted from unfavorable market conditions that occurred after the investment of permanently restricted contributions and from appropriations to certain programs. Subsequent gains that restore the market value of such funds to the historical cost will be classified as unrestricted net assets.

UPMIFA also impacts the adoption of FASB guidance, which provides direction on the net asset classification of donor-restricted endowment funds for not-for-profit organizations. The portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those funds are appropriated for expenditure. The amounts appropriated for expenditure are based on the University's endowment spending policy. The spending is approved by the Board through the University's annual budget approval process.

(b) *Endowment Spending Policy*

The primary objective of the spending policy is to provide a steady cash flow stream while at the same time protecting the purchasing power of the endowment fund's principal. Adopting the target rate approach provides the University with a level-spending plan. Spending allotments will begin with the flat amount allocated to each individual endowment fund balance as of June 30, 2004 that may grow each year by an inflationary amount not to exceed 3%. Spending allotments will be increased by new gift additions to the individual endowment funds receiving spending authority equal to 5% of the new gift amount.

The cash required for spending, as determined above, may be drawn from both ordinary income earned (i.e., dividends and interest) and capital appreciation, both realized and unrealized of both current and prior years. Compliant with UPMIFA, the University will be allowed to prudently withdraw spendable funds even if an endowment's market value is less than its historical book value. Any "return" that is not required to meet spending shall be retained in the endowment funds and invested in accordance with the investment policy statement.

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A risk control mechanism will be employed that keeps spending within a range of 4 – 6% of market value in order for the asset allocation policy to work with a minimum target rate of return of 8% (5% average spending and 3% inflation).

(c) Endowment Investment Policy

The endowment fund's investment objective is to preserve its purchasing power, while providing a continuing and stable funding source to support the overall mission of the University. To accomplish this objective, the endowment fund seeks to generate a total return that will exceed its annual spendable amount, all expenses associated with managing the endowment fund, and the eroding effects of inflation. It is the intention that any excess return (interest income, dividends, realized gains, and unrealized gains), above and beyond the amount approved for expenditure or distribution, will be reinvested in the endowment fund. The endowment fund will be managed on a total return basis, consistent with the applicable standard of conduct set forth in UPMIFA.

Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for donor-specified periods, as well as quasi-endowment funds. Under this policy, as approved by the Board, the endowment fund has a long-term investment horizon with relatively low liquidity needs. For this reason, the endowment fund can tolerate short- and intermediate-term volatility provided that long-term returns meet or exceed its investment objective. Consequently, the endowment fund may take advantage of less liquid investments, such as private equity, hedge funds, and other partnership vehicles, which typically offer higher risk-adjusted return potential as compensation for forfeiture of liquidity. To ensure adequate liquidity for distributions and to facilitate rebalancing, the University will conduct ongoing reviews of total fund liquidity.

To achieve its investment objective, the endowment fund will allocate among several asset classes with a bias toward equity and equity-like investments. An equity bias is desirable as it provides a viable long-term hedge against inflation and has historically outperformed fixed income over longer periods of time. Other asset classes may be added in an attempt to enhance returns, reduce volatility through diversification, and/or offer a broader investment opportunity set. Benchmarks are used for assessing the risk and return characteristics of the fund over longer periods, generally three to five years.

The following represents the endowment net assets composition by type of fund as of June 30, 2013:

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|----------------|
| Donor-restricted endowment funds | \$ (2,415) | 60,048 | 338,013 | 395,646 |
| Quasi-/board-designated endowment funds | 97,865 | — | — | 97,865 |
| Total funds | <u>\$ 95,450</u> | <u>60,048</u> | <u>338,013</u> | <u>493,511</u> |

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The following represents the changes in endowment net assets for the year ended June 30, 2013:

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|----------------|
| Endowment net assets, beginning of year | \$ 82,899 | 44,909 | 315,078 | 442,886 |
| Investment return: | | | | |
| Investment loss | — | — | (164) | (164) |
| Endowment income used for spending policy | 4,855 | 14,193 | 297 | 19,345 |
| Net realized and unrealized gains | <u>9,874</u> | <u>15,139</u> | <u>(1)</u> | <u>25,012</u> |
| Total investment return | <u>14,729</u> | <u>29,332</u> | <u>132</u> | <u>44,193</u> |
| Appropriation of endowment assets for expenditure | (4,855) | (14,193) | — | (19,048) |
| Contributions | <u>2,677</u> | <u>—</u> | <u>22,803</u> | <u>25,480</u> |
| Endowment net assets, end of year | <u>\$ 95,450</u> | <u>60,048</u> | <u>338,013</u> | <u>493,511</u> |

The following represents endowment net assets composition by type of fund as of June 30, 2012:

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|----------------|
| Donor-restricted endowment funds | \$ (6,789) | 44,909 | 315,078 | 353,198 |
| Quasi-/board-designated endowment funds | <u>89,688</u> | <u>—</u> | <u>—</u> | <u>89,688</u> |
| Total funds | <u>\$ 82,899</u> | <u>44,909</u> | <u>315,078</u> | <u>442,886</u> |

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The following represents the changes in endowment net assets for the year ended June 30, 2012:

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|-----------------|
| Endowment net assets, beginning of year | \$ 87,840 | 53,266 | 300,853 | 441,959 |
| Investment return: | | | | |
| Investment loss | — | — | (209) | (209) |
| Endowment income used for spending policy | 4,671 | 12,887 | 244 | 17,802 |
| Net realized and unrealized gains | <u>(6,492)</u> | <u>(8,357)</u> | <u>393</u> | <u>(14,456)</u> |
| Total investment return | <u>(1,821)</u> | <u>4,530</u> | <u>428</u> | <u>3,137</u> |
| Appropriation of endowment assets for expenditure | (4,671) | (12,887) | — | (17,558) |
| Contributions | <u>1,551</u> | <u>—</u> | <u>13,797</u> | <u>15,348</u> |
| Endowment net assets, end of year | <u>\$ 82,899</u> | <u>44,909</u> | <u>315,078</u> | <u>442,886</u> |

(6) Irrevocable Split-Interest Agreements

The University's split-interest agreements with donors consist of charitable gift annuities, pooled income funds, and charitable remainder trusts for which the University may or may not serve as trustee. Assets are invested and payments are made to beneficiaries in accordance with the respective agreements.

For those agreements where the University is the trustee, contribution revenue is recognized at the date the agreement is established, net of the liability that is recorded for the present value of the estimated future payments to be made to the beneficiaries. The present value of payments to beneficiaries is calculated using discount rates that range from 1.5% to 5.5%. Gains or losses resulting from changes in actuarial assumptions are recorded as changes in the respective net asset class in the statements of activities as incurred. Investments and other assets maintained in trusteeship by the University totaled \$8,865 and \$8,997 at June 30, 2013 and 2012, respectively.

The University is the sole beneficiary of two trusts that, in accordance with the decedent's instructions, are managed and maintained by separate trustees not affiliated with the University. In both instances, the University is to receive distributions from the trusts. One of the trusts provides for the distribution of only its annual income and is accounted for as a permanently restricted asset. The fair value of this trust was \$1,429 and \$1,340 as of June 30, 2013 and 2012, respectively. The other trust permits the trustee to determine the amount of distribution and allows for the payout of both income and principal. This trust, valued at fair value, is being accounted for as a temporarily restricted asset and totaled \$15,208 and \$14,342 as of June 30, 2013 and 2012, respectively.

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For those agreements where the University does not serve as trustee, but is designated as an irrevocable beneficiary of the trust, temporarily or permanently restricted funds held in trust and revenue are recognized for the present value of the estimated future benefits due to the University over the life of the trust and when the trust is distributed. The present value calculation of the trust considers both the contribution revenue discount rate and, if applicable, the estimated life expectancy of the trust originator.

Irrevocable trusts for which the University is not the trustee totaled \$21,086 and \$23,252 at June 30, 2013 and 2012, respectively.

(7) Contributions Receivable

Contributions receivable expected to be collected within one year are recorded at net realizable value. Contributions receivable expected to be collected in future years are recorded at the present value of estimated future cash flows. The discounts on those amounts are computed using an appropriate risk-free rate of return ranging from 0.13% to 1.18% on the date the promise to give is received. Amortization of the discount is included in contribution revenues.

As of June 30, 2013 and 2012, the contributions receivable are due as follows:

| | 2013 | 2012 |
|--------------------------------------|-------------|-------------|
| Less than one year | \$ 6,520 | 5,929 |
| One to five years | 40,363 | 48,055 |
| Over five years | 35,050 | 50,566 |
| | 81,933 | 104,550 |
| Less unamortized discount | (17,112) | (23,242) |
| Allowance for uncollectible accounts | (1,924) | (2,413) |
| Total contributions receivable | \$ 62,897 | 78,895 |

The University has received certain conditional promises to give that are in the form of revocable trusts and bequests, which are not included in the financial statements. As of June 30, 2013 and 2012, the fair value of these conditional promises is approximately \$3,250 and \$19,429, respectively.

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(8) Notes and Bonds Payable

As of June 30, 2013 and 2012, notes and bonds payable consisted of the following:

| | 2013 | 2012 |
|--|-------------------|----------------|
| Revenue Bonds, Series 1998, payable with fixed interest rates ranging from 4.75% to 5.25%, maturing through 2028 | \$ — | 25,486 |
| Revenue Bonds, Series 2002A, payable with fixed interest rates ranging from 3.75% to 4.85%, maturing through 2032 | — | 17,070 |
| RACM, Series 2002, payable with fixed interest rates ranging from 3.60% to 4.35%, maturing through 2014 | — | 9,970 |
| Revenue Bonds, Series 2007A, payable with fixed interest rates ranging from 4.00% to 5.00%, maturing through 2023 | 21,141 | 22,608 |
| Revenue Bonds, Series 2007B, payable with fixed interest rates ranging from 4.50% to 5.00%, maturing through 2032 | 27,603 | 27,608 |
| Revenue Bonds, Series 2008B1, payable with fixed interest rates ranging from 2.00% to 5.00%, maturing through 2033 | 29,676 | 30,557 |
| Revenue Bonds, Series 2008B2, payable with fixed interest rates ranging from 2.25% to 5.00%, maturing through 2033 | 17,141 | 17,684 |
| Revenue Bonds, Series 2008B3, payable with fixed interest rates ranging from 2.00% to 5.00%, maturing through 2033 | 30,893 | 31,811 |
| Revenue Bonds, Series 2011A, payable with fixed interest rates ranging from 2.00% to 5.00%, maturing through 2020 | 20,554 | 22,751 |
| Revenue Bonds, Series 2012, payable with fixed interest rates ranging from 2.00% to 5.00%, maturing through 2032 | 96,197 | — |
| Capitalized lease, payable with variable interest rate, maturing through 2012 | 741 | 949 |
| Total notes and bonds payable | \$ <u>243,946</u> | <u>206,494</u> |

In September 2012, the WHEFA issued \$85,955 of its Revenue Bonds, Series 2012. The proceeds from the sale of these bonds were loaned to the University and used to defease the WHEFA Series 1998, WHEFA Series 2002A, RACM Series 2002 Revenue Bonds, and to fund Historic Core renovations and various other construction and renovation projects.

All of the revenue bonds are unsecured. The principal and interest on the revenue bonds are insured pursuant to a municipal bond insurance policy.

The notes and bonds payable are subject to various covenants. Management confirms the University is in compliance with all covenants as of and for the years ended June 30, 2013 and 2012.

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Maturities of notes and bonds payable based on scheduled repayments at June 30, 2013 are as follows:

| | | |
|-------------------------------|----|-------------------|
| 2014 | \$ | 8,638 |
| 2015 | | 9,046 |
| 2016 | | 8,993 |
| 2017 | | 9,337 |
| 2018 | | 9,687 |
| Thereafter | | 198,245 |
| Total notes and bonds payable | | <u>\$ 243,946</u> |

As of June 30, 2013, the University has two secured letters of credit with banks under which it may borrow up to \$2,748. There were no borrowings outstanding under these letters of credit as of June 30, 2013 and 2012.

Cash utilized for the payment of interest on notes and bonds payable was \$10,004 and \$9,483 during fiscal years 2013 and 2012, respectively.

(9) Retirement Plan

All eligible full-time personnel may elect to participate in a defined contribution individual annuity plan. Under the provisions of the plan, participants are required to contribute 5% of their annual wages to the plan. The University has neither administrative responsibilities nor any financial liabilities under this plan except to make contributions, currently limited to 8% of the annual wages of participants, up to defined limits. In addition, voluntary contributions by participants may be made subject to Internal Revenue Service limitations. Payments for contributions to this plan totaled \$9,901 and \$9,483 in fiscal years 2013 and 2012, respectively.

(10) Self-Funded Health and Dental Benefit Plans

The University has self-funded benefit plans covering all active and certain retired employees' health and dental costs. Under the plans, the University's losses are limited, through the use of excess loss insurance, to \$150 per claim. Claims paid under the plans for fiscal years 2013 and 2012 totaled \$25,049 and \$21,481, respectively. The University has also contracted with a third-party administrator to provide administrative services for the plans. Accrued liabilities include an estimate of the University's liability for claims incurred but not paid through June 30, 2013 and 2012.

(11) Postretirement Benefits

The University provides retired employees access to certain healthcare and life insurance benefits. All University employees become eligible to access these benefits when their years of service plus age equal 70. Qualified retired employees under the age of 65 are eligible to participate in the University's healthcare plan. Retirees are expected to pay the full cost of their premiums, based on the claims experience associated with that defined group of retired employees. The University also pays group life insurance premiums for active or future retired employees hired prior to February 1, 1982 that provide for limited

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death benefits. The premiums paid are based on the group community rate associated with death claims filed for the entire population of employees and retirees participating in the program.

Summary information regarding the accounting for both plans for the years ended June 30, 2013 and 2012 is presented in the following:

| | 2013 | 2012 |
|--|-----------------|--------------|
| Change in benefit obligation: | | |
| Benefit obligation, beginning of year | \$ 4,280 | 3,836 |
| Service cost | 3 | 2 |
| Interest cost | 188 | 205 |
| Actuarial loss (gain) | (58) | 307 |
| Benefits paid | (105) | (70) |
| Benefit obligation, end of year | <u>\$ 4,308</u> | <u>4,280</u> |
| Change in plan assets: | | |
| Fair value of plan assets, beginning of year | \$ — | — |
| Employer contributions | 105 | 70 |
| Actual benefits paid | (105) | (70) |
| Fair value of plan assets, end of year | <u>\$ —</u> | <u>—</u> |
| Change in postretirement benefits: | | |
| Change in postretirement benefits other than net periodic benefit cost | \$ — | — |
| Prior service credits | — | (36) |
| Net gain (loss) | (6) | 55 |
| Change in postretirement benefits | <u>\$ (6)</u> | <u>19</u> |

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| | <u>2013</u> | <u>2012</u> |
|---|---------------|-------------|
| Measurement date | June 30 | June 30 |
| Weighted average assumptions for liability: | | |
| Discount rate | 4.75% | 5.00% |
| Salary increase | 3.50 | 4.00 |
| Assumed healthcare cost trend rates:* | | |
| Current year rate | N/A | 8.00% |
| Ultimate rate | N/A | 6.00 |
| Year rate reaches ultimate rate | N/A | 2016 |
| Components of net periodic benefit cost: | | |
| Service cost | \$ 3 | 2 |
| Interest cost | 187 | 205 |
| Amortization of: | | |
| Unrecognized prior service cost | (36) | (73) |
| Unrecognized actuarial loss | 3 | (3) |
| Net periodic cost | <u>\$ 157</u> | <u>131</u> |

*Trend rates not applicable in 2013 as the one Grandfathered retiree deceased before 2013.

The projected postretirement benefit payments for the fiscal years subsequent to June 30, 2013 are as follows:

| | |
|--------------|--------|
| 2014 | \$ 269 |
| 2015 | 271 |
| 2016 | 274 |
| 2017 | 277 |
| 2018 | 279 |
| 2019 to 2021 | 1,412 |

(12) Temporarily Restricted Net Assets

Temporarily restricted net assets consist of the following as of June 30, 2013 and 2012:

| | <u>2013</u> | <u>2012</u> |
|---|-------------------|----------------|
| Physical assets | \$ 146,009 | 141,941 |
| General operations and education | 88,086 | 76,342 |
| Pledge receivable, net | 30,875 | 46,493 |
| Scholarships | 32,426 | 24,297 |
| Life income and annuity funds | 11,182 | 12,314 |
| Total temporarily restricted net assets | <u>\$ 308,578</u> | <u>301,387</u> |

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(13) Permanently Restricted Net Assets

Permanently restricted net assets consist of the following as of June 30, 2013 and 2012, the income from which is expendable to support:

| | <u>2013</u> | <u>2012</u> |
|---|-------------------|----------------|
| Scholarships | \$ 159,996 | 148,241 |
| General operations and education | 131,470 | 118,923 |
| Pledge receivable, net | 32,029 | 32,402 |
| Life income and annuity funds | 14,518 | 15,512 |
| Total permanently restricted net assets | <u>\$ 338,013</u> | <u>315,078</u> |

(14) Related Parties

The University contracts with certain related parties for the purchase of goods, performance of construction activities, and provisions of other services. Construction activities represent the majority of related-party transactions. Generally, members of the University's Board serve in a management role for a related party or an affiliate of the related party. During fiscal years 2013 and 2012, the University had related-party transactions approximating \$10,477 and \$21,726, respectively.

(15) Commitments and Contingencies

The University is involved in various litigation arising in the normal course of operations. On the basis of information presently available and the advice of legal counsel, management is of the opinion that any liability, to the extent not provided for through reserves or otherwise, for pending litigation is not expected to be material in relation to the University's financial position or activities.

As of June 30, 2013, the University has outstanding commitments for the following construction projects:

| | |
|--------------------------------------|-----------------|
| School of Dentistry Expansion | \$ 1,667 |
| Biomedical Lab | 533 |
| Engineering Hall – Visualization Lab | 695 |
| Total commitments | <u>\$ 2,895</u> |

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(16) Tuition Discounts

Tuition discounts, as reported in the statements of activities as a reduction of student tuition and fees, were funded in fiscal years 2013 and 2012 from the following revenue sources:

| | 2013 | 2012 |
|---------------------------------------|-------------------|----------------|
| Institutional revenue sources | \$ 91,386 | 85,034 |
| Gifts, grants, and endowment earnings | 17,589 | 17,875 |
| Total tuition discount | <u>\$ 108,975</u> | <u>102,909</u> |

(17) Natural Expenses

The University's classification of unrestricted expenses in the statements of activities is classified by natural expenses as of June 30, 2013 and 2012 as follows:

| | 2013 | 2012 |
|---------------------------------------|-------------------|----------------|
| Salaries and fringe benefits | \$ 235,146 | 227,098 |
| Supplies | 17,842 | 18,075 |
| Telephone | 759 | 795 |
| Professional fees | 9,406 | 8,525 |
| Administrative expenses | 12,002 | 11,833 |
| Meal plans and promotional items | 12,100 | 12,117 |
| Repairs and maintenance | 12,675 | 12,756 |
| Travel | 11,743 | 11,006 |
| Advertising and public relations | 1,658 | 1,792 |
| Utilities | 9,990 | 9,531 |
| Insurance (property, liability, etc.) | 2,953 | 3,119 |
| Interest | 8,724 | 9,673 |
| Depreciation | 32,652 | 30,993 |
| Miscellaneous expense | 834 | 952 |
| Total operating expenses | <u>\$ 368,484</u> | <u>358,265</u> |

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(18) Research and Grant Costs

The University receives grant and contract revenue from various government agencies and private sources for the support of research, training, and other sponsored programs. Revenues associated with the direct costs of these programs are recognized as the related costs are incurred. Indirect cost reimbursements from federal agencies are based on negotiated predetermined rates. Research and grant costs reported for fiscal years 2013 and 2012 comprise of the following:

| | <u>2013</u> | <u>2012</u> |
|---------------------------|------------------|---------------|
| Sponsored research | \$ 13,142 | 12,828 |
| Teaching and training | 6,037 | 6,626 |
| Development and others | <u>3,195</u> | <u>2,898</u> |
| Total research and grants | <u>\$ 22,374</u> | <u>22,352</u> |

(19) Subsequent Events

The University evaluated events after the statement of financial position date of June 30, 2013 through September 4, 2013, which was the date the financial statements were issued. No significant subsequent events were noted.