PACIFIC UNIVERSITY

Financial Statements

June 30, 2012

(With Independent Auditors' Report Thereon)

KPMG

KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Trustees
Pacific University:

We have audited the accompanying statement of financial position of Pacific University (the University) as of June 30, 2012, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The accompanying 2011 summarized comparative information has been derived from the University's 2011 financial statements, and in our report dated October 19, 2011, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

KPMG LLP

October 10, 2012

PACIFIC UNIVERSITY

Statement of Financial Position

June 30, 2012
(with comparative financial information as of June 30, 2011)

Assets		Operations	Long-term investment	Capital	Totals 2012	Totals 2011
Cash and cash equivalents	$	16,373,663	4,527,036	2,159,784	23,060,483	18,500,646
Accounts, contributions, and notes receivable, net (note 10)		9,509,299	566,936	59,754	10,135,989	12,612,021
Inventories		396,960	—	—	396,960	288,359
Prepaid expenses and other assets		671,516	—	2,987,186	3,658,702	3,090,122
Deposits		48,948	—	6,805,045	6,853,993	6,896,686
Investments (note 8)		2,539	34,025,057	—	34,027,596	35,714,544
Funds held in trust by others (note 16)		—	18,129,649	—	18,129,649	19,096,179
Restricted cash		—	—	—	—	262,607
Property, plant, and equipment, net (note 11)		—	—	121,371,391	121,371,391	122,513,475
Total assets	$	27,002,925	57,248,678	133,383,160	217,634,763	218,974,639
Liabilities and Net Assets						
Accounts payable and accrued liabilities	$	4,922,152	10,000	1,125,801	6,057,953	6,228,711
Notes payable to bank (note 13)		—	—	5,059,567	5,059,567	5,809,581
Salaries payable and compensated absences		2,465,111	—	—	2,465,111	2,649,342
Deferred revenues		4,462,938	—	431,556	4,894,494	4,431,667
Refundable deposits		662,234	—	—	662,234	723,242
Capital lease obligations (note 19)		—	—	82,888	82,888	191,676
Asset retirement obligation		—	—	1,273,406	1,273,406	1,302,808
Annuities payable		—	903,122	—	903,122	1,137,125
Accrued postretirement benefits obligation		690,808	—	—	690,808	671,700
Long-term debt (note 13)		—	—	75,874,890	75,874,890	77,539,342
U.S. government grants refundable		7,116,106	—	—	7,116,106	7,028,974
Net asset borrowings (note 17)		74,565	(74,565)	—	—	—
Total liabilities		20,393,914	838,557	83,848,108	105,080,579	107,714,168
Net assets:						
Unrestricted		3,164,000	12,793,871	49,158,390	65,116,261	61,586,267
Temporarily restricted (note 3)		3,445,011	9,061,456	376,662	12,883,129	14,972,222
Permanently restricted (note 4)		—	34,554,794	—	34,554,794	34,701,982
Total net assets		6,609,011	56,410,121	49,535,052	112,554,184	111,260,471
Total liabilities and net assets	$	27,002,925	57,248,678	133,383,160	217,634,763	218,974,639

See accompanying notes to financial statements.

PACIFIC UNIVERSITY

Statement of Activities

Year ended June 30, 2012
(with comparative financial information for the year ended June 30, 2011)

	Operations	Long-term investment	Capital	Totals 2012	Totals 2011
Changes in unrestricted net assets:					
Revenues and gains:					
Tuition and fees	$ 96,057,055	—	—	96,057,055	92,210,296
Scholarships and fellowships	(23,981,608)	—	—	(23,981,608)	(22,275,527)
Net tuition and fees	72,075,447	—	—	72,075,447	69,934,769
Contributions	549,990	—	—	549,990	585,083
Contracts and other exchange transactions	1,866,926	—	—	1,866,926	1,844,097
Investment income on quasi-endowment and trusts	368,149	—	—	368,149	325,726
Other investment income	35,678		136,564	172,242	179,180
Net realized gains	3,860	299,507	—	303,367	217,514
Net unrealized (losses) gains on quasi-endowment and trusts	—	(472,547)	—	(472,547)	865,116
Sales of services at clinics	2,562,744	—	—	2,562,744	2,581,445
Sales of services of auxiliary enterprises	9,537,860	—	78,000	9,615,860	9,133,547
Other sources	299,621	(36,581)	(2,413)	260,627	80,200
Total unrestricted revenues and gains	87,300,275	(209,621)	212,151	87,302,805	85,746,677
Net assets released from restrictions (note 6)	3,315,641	842,521	400,109	4,558,271	4,051,077
Total revenues and gains and net assets released from restrictions	90,615,916	632,900	612,260	91,861,076	89,797,754
Expenses and losses:					
Education and general:					
Instruction	30,216,961	—	—	30,216,961	28,272,329
Research	1,497,171	—	—	1,497,171	1,297,277
Public service	358,433	—	—	358,433	389,367
Academic support	10,228,288	—	—	10,228,288	9,745,561
Clinics	3,951,594	—	—	3,951,594	3,903,757
Student services	10,004,372	—	—	10,004,372	9,338,632
Institutional support	10,957,065	—	—	10,957,065	13,782,154
Operation and maintenance of plant	3,778,440	—	—	3,778,440	3,614,129
Interest on long-term debt	—	—	4,564,424	4,564,424	3,566,899
Depreciation and amortization	—	—	4,352,557	4,352,557	4,074,432
Other	—	—	94,250	94,250	56,192
Total education and general	70,992,324	—	9,011,231	80,003,555	78,040,729
Auxiliary enterprises	8,327,527	—	—	8,327,527	8,235,633
Total expenses and losses	79,319,851	—	9,011,231	88,331,082	86,276,362
Transfers:					
Debt service	4,751,603	1,300,000	(6,051,603)	—	—
Capital purchases	1,950,461	—	(1,950,461)	—	—
Long-term investment to operations	37,559	(37,559)	—	—	—
Operating to capital	4,536,857	—	(4,536,857)	—	—
Total expenses and losses and transfers	90,596,331	1,262,441	(3,527,690)	88,331,082	86,276,362
Increase (decrease) in unrestricted net assets	19,585	(629,541)	4,139,950	3,529,994	3,521,392
Changes in temporarily restricted net assets:					
Contributions	2,450,637	—	502,860	2,953,497	2,787,098
Investment income on endowments/trusts	477,026	47,522	—	524,548	632,080
Investment income on annuities/life income and other	233,794	146,937	—	380,731	1,301,223
Net realized gains on endowment investments and trusts	—	734,820	—	734,820	538,813
Net realized (losses) gains on other investments	—	(17,058)	—	(17,058)	219,721
Changes in net unrealized (losses) gains on endowment investments and trusts	—	(1,533,231)	—	(1,533,231)	2,977,590
Changes in net unrealized (losses) gains on other investments	—	(220,685)	—	(220,685)	816,813
Net assets released from restrictions (note 6)	(3,315,641)	(842,521)	(400,109)	(4,558,271)	(4,051,077)
Change in distribution	—	—	—	—	(930,759)
Actuarial adjustments	—	(353,444)	—	(353,444)	(587,473)
Increase (decrease) in temporarily restricted net assets	(154,184)	(2,037,660)	102,751	(2,089,093)	3,704,029
Changes in permanently restricted net assets:					
Contributions	—	641,547	—	641,547	422,417
Investment income on trusts and endowment	—	974,782	—	974,782	279,785
Net realized and unrealized (losses) gains on funds held in perpetuity	—	(1,763,517)	—	(1,763,517)	2,160,362
Increase (decrease) in permanently restricted net assets	—	(147,188)	—	(147,188)	2,862,564
Increase (decrease) in net assets	(134,599)	(2,814,389)	4,242,701	1,293,713	10,087,985
Net assets at beginning of year	6,743,610	59,224,510	45,292,351	111,260,471	101,172,486
Net assets at end of year	$ 6,609,011	56,410,121	49,535,052	112,554,184	111,260,471

See accompanying notes to financial statements.

PACIFIC UNIVERSITY

Statement of Cash Flows

Year ended June 30, 2012
(with comparative financial information for the year ended June 30, 2011)

		2012	2011
Cash flows from operating activities:			
Increase in net assets	$	1,293,713	10,087,985
Adjustments to reconcile increase in net assets to cash provided by operating activities:			
Depreciation		4,352,557	4,064,975
Net realized and unrealized loss (gains) on investments		1,894,088	(7,001,300)
Actuarial adjustments		353,444	587,473
Contributions and net gains on investments restricted to long term		(1,144,407)	(456,109)
Decrease in accounts and notes receivable		2,476,032	1,189,631
(Increase) decrease in inventories, prepaid expenses, and other assets		(677,181)	166,179
(Decrease) increase in accounts payable and accrued liabilities		(764,436)	808,480
Increase in deferred revenues		462,827	350,402
(Decrease) increase in refundable deposits		(61,008)	225,293
Decrease in asset retirement obligation		(29,402)	(6,114)
Increase in U.S. government grants refundable		87,132	60,331
Net cash provided by operating activities		8,243,359	10,077,226
Cash flows from investing activities:			
Purchase of property, plant, and equipment		(2,783,807)	(13,900,478)
Purchases of investment securities		(12,695,875)	(12,515,243)
Proceeds from sale and maturity of investment securities		13,455,264	11,089,640
Decrease (increase) in bond deposits		42,693	(463,134)
Decrease in restricted cash		262,607	12,141,292
Net cash used in investing activities		(1,719,118)	(3,647,923)
Cash flows from financing activities:			
Principal payments on note payable		(750,014)	(500,906)
Contributions and net gains on investments restricted to long term		1,144,407	456,109
Principal payments on long-term debt		(1,655,000)	(1,082,545)
Principal payments on capital lease obligations		(116,350)	(359,969)
Annuity disbursements		(587,447)	(610,463)
Net cash used in financing activities		(1,964,404)	(2,097,774)
Net increase in cash and cash equivalents		4,559,837	4,331,529
Cash and cash equivalents at beginning of year		18,500,646	14,169,117
Cash and cash equivalents at end of year	$	23,060,483	18,500,646
Supplemental cash flow disclosure:			
Cash paid for interest	$	4,564,424	4,704,449
Supplemental schedule of noncash investing and financing activities:			
Equipment acquired under capital lease	$	7,562	—

See accompanying notes to financial statements.

(1) Organization and History

Pacific University (the University) was established through an act passed by the Legislative Assembly of the Territory of Oregon on September 26, 1849, for the purpose of establishing a seminary of learning, in Washington County, for the instruction of persons of both sexes in science and literature. The University consists of an undergraduate College of Arts and Sciences, graduate and/or professional schools including the College of Education, College of Optometry, and the College of Health Professions, which include occupational therapy, physical therapy, clinical psychology, physicians' assistant, dental health science, healthcare administration, and pharmacy. The University operates as an independent 501(c)(3) organization.

(2) Summary of Significant Accounting Policies

(a) Accrual Basis

The financial statements of the University have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

(b) Basis of Presentation

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

- ***Unrestricted net assets*** – Net assets that are not subject to donor-imposed restrictions or donor-restricted contributions whose restrictions are met in the same reporting period.
- ***Temporarily restricted net assets*** – Net assets subject to donor-imposed restrictions that will be met either by actions of the University and/or the passage of time.
- ***Permanently restricted net assets*** – Net assets subject to donor-imposed restrictions that they be permanently maintained by the University. Generally, the donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes.

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

The University follows a practice of classifying its assets, liabilities, net assets, revenues, and expenses as operations, long-term investment, or capital. Items classified as long-term investment include accounts and transactions related to annuity and life income funds, endowment funds, and student loan funds. Items classified as capital include accounts and transactions related to plant facilities. All other accounts and transactions are classified as operations.

(Continued)

Contributions, including unconditional promises to give, are recognized as revenues in the period in which the unconditional promise is received. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved, including a factor for estimating credit risk of the donor. Amortization of the discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for uncollectible contributions receivable is provided based upon management's judgment, including such factors as prior collection history, type of contribution, and nature of fund-raising activity. Restrictions related to contributions for the purchase of capital additions are released when the asset is placed in service.

Income and net gains on investments of endowment and similar funds are reported as follows:

- As increases in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanently restricted net asset
- As increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income or net realizable gains, or if endowment income has not yet been appropriated for expenditure
- As increases in unrestricted net assets in all other cases

(c) Board-Designated Reserves

Board-designated reserves represent unrestricted "operating" funds transferred to "long-term investment" for investment in the endowment pool. The University's Board of Trustees must approve all quasi-endowment activity.

(d) Split-Interest Agreements

The University uses an actuarial method of recording certain split-interest arrangements. Under this method, the present value of the payments to beneficiaries is determined based on published actuarial factors for ages of the beneficiaries discounted using the risk-free rate adjusted for mortality uncertainties and are not changed after the date of the gift. The present value of those payments is recorded as a liability and the remainder as temporarily or permanently restricted net assets depending on donor-imposed restrictions. Annual adjustments are made between the liability and the net assets to record actuarial gains and losses. The discount rate used by the University in calculating present value of all split-interest agreements ranged from 4.2% to 8.2% at June 30, 2012.

(e) Cash Equivalents

Cash equivalents of $2,576,239 as of June 30, 2012 consist of short-term, highly liquid investments with original maturities of three months or less.

(f) Investments

Investments in marketable equity securities with readily determinable fair values, all investments in debt securities, and all other investments are carried at fair value. In conjunction with the adoption of

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) No. 820, *Fair Value Measurements*, the University adopted the measurement provisions of ASC No. 820-10, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, and real estate. Net asset value, in many instances, may not equal fair value that would be calculated pursuant to ASC No. 820.

Realized and unrealized gains and losses arising from the sale, collection, or other disposition of investments, as well as all dividends, interest, and other investment income, are shown in the statement of activities. Gains and investment income that are limited to specific uses by donor-imposed restrictions are reported as increases in temporarily restricted net assets, and are released from restriction when appropriated for expenditure. Losses on investments related to gifts that the donor required to be invested in perpetuity (i.e., endowment funds) are classified as decreases in temporarily restricted net assets until accumulated gains are reduced to zero. Further losses reduce unrestricted net assets. Subsequent gains that restore the fair value of the assets of the endowment funds to the required level are classified as increases in unrestricted net assets.

(g) Inventory

Inventory consists primarily of eyeglass frames, which are stated at the lower of cost or market under the first-in, first-out method.

(h) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost at date of acquisition or, in the case of gifts, fair value on the date received. Normal repair and maintenance expenses and equipment replacement costs are expensed as incurred. Estimated useful lives used to calculate depreciation are land improvements and buildings (30 to 50 years), building improvements (10 to 20 years), library books (15 years), and furniture and equipment (3 to 10 years). Depreciation is calculated using the straight-line method. The capitalized cost of assets acquired under capital leases is amortized using the straight-line method over the terms of the related leases or useful life, whichever is shorter. Land and artifacts are not depreciated.

(i) Revenue Recognition and Deferred Revenue

The University recognizes tuition revenue over the academic year, based on the percentage-of-completion method. Deferred revenue consists primarily of prepayments of tuition and fees related to future academic periods.

(j) Debt Issuance Costs

Legal and accounting fees, printing costs, and other expenses associated with the issuance of the City of Forest Grove, Oregon, Pacific University Campus Improvement and Refunding Bonds, Series 2005, are being amortized on a method that approximates effective yield over the term of the bonds, which is 31 years. Additionally, in July 2009, the University issued new bonds with the City of Forest Grove, Oregon, Pacific University Campus Improvement Revenue Bonds, Series 2009, totaling $35,305,000. The legal, accounting, and other expenses associated with this issuance are being amortized using a method that approximates effective yield over the term of the bonds, which is 30 years. During the current fiscal year, the University amortized $62,887 for Series 2005 and $31,765 for Series 2009 of debt issuance costs and is included in interest expense in the accompanying statement of activities. The remaining unamortized debt issuance costs at June 30, 2012 for both Series totaled $2,366,942 and are included in prepaid expenses and other assets in the accompanying statement of financial position.

(k) Income Taxes

The Internal Revenue Service has recognized the University as exempt from tax under the provisions of Section 501(c)(3) of the Internal Revenue Code except to the extent of unrelated business income under Sections 511 through 515. Management believes that unrelated business income tax, if any, is immaterial, and therefore, no tax provision has been made.

The University accounts for income taxes in accordance with FASB ASC No. 740-10, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109*, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more likely than not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return. ASC 740-10 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure.

(l) Self-Insurance

The University is self-insured for certain medical and dental benefits through a benefit trust. Annual contributions to the trust are recorded as expenses when incurred. Reserves for unpaid claims are estimated using actuarial methods. It is possible that the amounts paid in connection with self-insured risks will vary from amounts accrued as self-insurance reserves as of June 30, 2012.

(m) Postretirement Benefits

The University maintains a postretirement benefit plan and accounts for the plan within the framework of FASB ASC Nos. 715, Compensation – retirement benefits, and 958, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

The University measures the costs of the obligation based on its best estimate. The critical actuarial assumption is the discount rate used to estimate the liability at June 30, 2012. The University evaluates the assumptions annually and modifies them as appropriate. The net periodic costs are recognized as employees render the services necessary to earn the postretirement benefits.

(n) 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, asset retirement obligations, investments, allowances for doubtful accounts, and actuarial estimates. The current economic environment has increased the degree of inherent uncertainty in these estimates and assumptions.

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(o) ***Comparative Information***

The financial statements include only one year of notes to the financial statements. Accordingly, the 2011 financial statements should be read in conjunction with the University's financial statements for the year ended June 30, 2012, from which the information was derived.

(p) ***Recently Adopted Accounting Standards***

The University adopted ASU No. 2010-20, Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (Topic 310), effective June 30, 2012. This ASU is intended to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financial receivables. This ASU amends existing disclosures and provides additional disclosures about its financing receivables on a disaggregated basis.

(3) Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30, 2012 are available for the following:

		Operations	Long-term investment	Capital	Total
Student services	$	700,189	—	—	700,189
Instruction		255,340	—	—	255,340
Research		556,154	—	—	556,154
Public service		224,008	—	—	224,008
Academic support		751,249	—	—	751,249
Clinics		97,472	—	—	97,472
Institutional support		27,220	—	—	27,220
Operation and maintenance of plant		62,064	—	—	62,064
Scholarships and fellowships		771,315	—	—	771,315
Split-interest agreements		—	3,830,158	—	3,830,158
Endowment earnings		—	4,138,154	—	4,138,154
Funds held in trust by others – time restricted		—	1,093,144	—	1,093,144
Capital		—	—	376,662	376,662
	$	3,445,011	9,061,456	376,662	12,883,129

Through December 31, 2007, the University's management and investment of donor-restricted endowment funds were subject to the provisions of the Uniform Management of Institutional Funds Act (UMIFA). In 2006, the Uniform Law Commission approved the model act Uniform Prudent Management of Institutional Funds Act (UPMIFA), which serves as a guideline to states to use in enacting legislation. Among UPMIFA's most significant changes is the elimination of UMIFA's concept of historic dollar-value threshold, the amount below which an organization could not spend from the fund in favor of a more robust set of guidelines about what constitutes prudent spending.

Effective January 1, 2008, the State of Oregon enacted UPMIFA, the provisions of which apply to funds existing on or established after that date. The balance of unappropriated net gains was $4,138,154 and is included in temporarily restricted net assets as of June 30, 2012.

(4) Permanently Restricted Net Assets

Permanently restricted net assets at June 30, 2012 are restricted to the following:

	Long-term investment
Scholarships	$ 20,658,345
Student cultural activities	4,322,435
Endowed chairs and other	4,131,324
Operational use	5,442,690
	$ 34,554,794

(5) Endowments

The University's endowment consists of approximately 168 individual funds, which are both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Trustees of the University have interpreted the UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the College 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 temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with the UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the University and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the University

(Continued)

7. The investment policies of the University

Endowment funds are invested on the basis of a total return policy to provide income and to realize appreciation on invested assets. Under this policy, a portion of realized and unrealized gains, in addition to interest and dividend income, can be used to support operations. The investment policy creates a framework to provide growth and stability consistent with the current needs of the University, while promoting growth of the endowment for the future. The income and appreciation used to support operations are allocated from funds that have a fair value in excess of historical value and are utilized in accordance with donor-imposed restrictions.

The University spends endowment income and appreciation within a spending policy that preserves principal in accordance with the UPMIFA. The policy of spending endowment income is to spend 5% of the average net assets using a three-year moving average value at July 1, each year. If losses reduce the assets of a donor-restricted endowment fund, temporarily restricted net assets will be reduced until the accumulated gains associated with a fund are reduced to zero. At that point, further losses reduce unrestricted net assets. The value of donor-restricted endowment funds with a fair value of associated assets that is less than the original gift amount is $48,802 at June 30, 2012. Gains that restore the corpus value will be recorded as increases in temporarily restricted net assets after replacing any losses charged to unrestricted net assets.

Endowment net asset composition by fund type, excluding funds held in trust, as of June 30, 2012:

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$	(48,802)	4,138,154	17,292,449	21,381,801
Board-designated endowment funds		12,837,134	—	—	12,837,134
Total funds	$	12,788,332	4,138,154	17,292,449	34,218,935

Changes in endowment net assets for the year ended June 30, 2012 are as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, July 1, 2011	$ 13,417,874	5,375,544	16,631,948	35,425,366
Investment return:				
Net investment income	96,611	292,801	5,280	394,692
Net (depreciation) appreciation of investments	(173,040)	(798,411)	16,440	(955,011)
Contributions	—	—	638,781	638,781
Other reclassifications and transfers	32,017	214,583	—	246,600
Appropriation of endowment assets for expenditure	(296,646)	(946,363)	—	(1,243,009)
Transfers relating to board-designated endowment fund	(288,484)	—	—	(288,484)
Endowment net assets, June 30, 2012	$ 12,788,332	4,138,154	17,292,449	34,218,935

(6) Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors. Net assets released from restriction during the year ended June 30, 2012 are as follows:

	Operations	Long-term investment	Capital	Total
Purpose restrictions accomplished:				
Instruction	$ 79,392	—	—	79,392
Research	472,130	—	—	472,130
Public service	247,861	—	—	247,861
Academic support	279,614	—	—	279,614
Clinics	50,481	—	—	50,481
Student services	624,572	—	—	624,572
Institutional support	24,215	—	—	24,215
Scholarships and fellowships	1,537,376	—	—	1,537,376
Endowment and split-interest agreements	—	842,521	—	842,521
Capital	—	—	400,109	400,109
	$ 3,315,641	842,521	400,109	4,558,271

(7) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents, student and contributions receivable, other assets, accounts payable, and accrued expenses: The carrying amount approximates fair value, based on the short maturity of those instruments.

Contributions receivable and funds held in perpetuity: The fair value is determined by the present value of future contractual cash flows, discounted at an interest rate that reflects the risks inherent in these cash flows.

Long-term debt: The fair value of the University's notes payable and long-term debt is estimated based on the stream of principal payments represented by the 2005 Series bonds. Taking into account current borrowing rates as of June 30, 2012, the fair value of the University's bonds approximates $39,766,528 as compared to its carrying value of $41,082,613 (note 13). The University issued additional debt in July 2009. Using the borrowing rates as of June 30, 2012, the fair value of the new debt approximates $36,941,034 as compared to its carrying value of $34,792,277 (note 13).

(8) Investments

Investments presented by type at fair value were as follows:

Equity securities	$	2,788,091
Mutual funds:		
Fixed income		8,160,406
Large cap		4,770,541
Small cap		2,655,059
International		5,672,927
Commodities		1,074,366
Real estate investment trusts		777,119
Private equity		955,057
Hedge funds		6,816,393
Real estate		357,637
Total investments	$	34,027,596

The University adopted FASB ASC No. 820 on July 1, 2008 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. FASB ASC No. 820 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 three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the University has the ability to access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Equity securities	$ 2,788,091	2,788,091	—	—
Mutual funds:				
Fixed income	8,160,406	8,160,406	—	—
Large cap	4,770,541	4,770,541	—	—
Small cap	2,655,059	2,655,059	—	—
International	5,672,927	5,672,927	—	—
Commodities	1,074,366	1,074,366	—	—
REITS	777,119	777,119	—	—
Private equity	955,057	—	—	955,057
Hedge funds	6,816,393	—	—	6,816,393
Real estate	357,637	—	—	357,637
Funds held in trust by others	18,129,649	—	—	18,129,649
Total assets	$ 52,157,245	25,898,509	—	26,258,736

Changes in Level 3 investments for the year ended June 30, 2012 are as follows:

Beginning balance at June 30, 2011	$ 27,293,009
Net realized and unrealized losses	(941,278)
Purchases	685,326
Sales	(778,321)
Ending balance at June 30, 2012	$ 26,258,736
Gains for 2012 included in income related to assets held at June 30, 2012	$ 161,633

(9) Split-Interest Agreements

The following schedule summarizes the change in value of split interest agreements and its presentation in the statement of activities investment returns applicable to split-interest agreements presented as part of Investments:

Dividends and interest	$	146,937
Net realized loss		(17,058)
Change in cumulative net unrealized loss		(220,685)
Total	$	(90,806)

(10) Accounts, Contributions, and Notes Receivable

Accounts, contributions, and notes receivable consist of the following at June 30, 2012:

	Operations	Long-term investment	Capital	Total
Student accounts receivable	$ 1,304,375	—	—	1,304,375
Accounts in collections	516,648	—	—	516,648
Clinic receivable	291,368	—	—	291,368
Perkins loans	4,279,782	—	—	4,279,782
Health professional loans	2,175,821	—	—	2,175,821
Grants and contracts receivable	899,578	—	—	899,578
Pledges and contributions receivable, net of discounts of $222,635	216,232	606,024	63,379	885,635
Other receivables	45,355	1,500	—	46,855
	9,729,159	607,524	63,379	10,400,062
Less allowance for doubtful accounts	(219,860)	(40,588)	(3,625)	(264,073)
	$ 9,509,299	566,936	59,754	10,135,989

The Perkins and Health Professional Loan Funds (HPL) generally are payable, including interest at 5% over approximately 10 years following university attendance. Principal payments, interest, and losses due to cancellation are shared by the University and the U.S. government in proportion to their share of funds provided. The Perkins program provides for cancellation of loans if the student is employed in certain occupations following graduation (employment cancellations). Such employment cancellations are absorbed in full by the U.S. government.

(Continued)

Contributions Receivable

Included in accounts receivable are the following unconditional promises to give as of June 30, 2012:

Unconditional promises to give before unamortized discount and allowance for uncollectibles	$	1,108,270
Less unamortized discount		(222,635)
Allowance for uncollectibles		(55,413)
Net unconditional promises to give	$	830,222

Amounts due in:		
Amounts receivable in less than one year	$	337,104
Amounts receivable in one to five years		271,166
Amounts receivable in more than five years		500,000
	$	1,108,270

Contributions receivable due in excess of one year are discounted between 0.21% and 5.00% at June 30, 2012.

(11) Financing Receivables

The University's financing receivables consist of a revolving loan fund for Federal Perkins Loans and Health Professions Loans (HPL) for which the University acts as an agent for the federal government and institutional loan funds created by the University to assist students in funding their education. The institutional loans are valued based on the outstanding principal balance, less an allowance for estimated losses. For Federal Perkins Loans and Health Professions Loans, interest earned on outstanding loan balances is recorded based on the terms of the individual loan agreements and continues to accrue even when past due. Interest is not assessed on institutional loans.

The availability of funds for loans under the Federal Perkins Loan program and the Health Professions Loan program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds held in the Federal loan programs of $7,116,106 are ultimately refundable to the government and are classified as a liability in the statement of financial position.

Balances of financing receivables as of June 30, 2012 consist of the following:

		Perkins Loans	HPL Loans	Institutional Loans	Total
Receivable	$	4,279,782	2,175,821	1,821,023	8,276,626
Less: Allowance		—	—	(116,391)	(116,391)
Balance at June 30, 2012	$	4,279,782	2,175,821	1,704,632	8,160,235

For each class of financing receivables, the following table presents the credit quality indicator as determined by the delinquency status of the loan as of June 30, 2012. The delinquency status is updated monthly by the University's loan servicer.

		Perkins	HPL	Institutional	Total
Performing	$	4,021,462	2,017,413	1,304,375	7,343,250
Non-performing (defaulted)		258,320	158,408	516,648	933,376
Balance at June 30, 2012	$	4,279,782	2,175,821	1,821,023	8,276,626

The aging of financing receivables as of June 30, 2012 is presented as follows:

Aging		31-60	61-90	91+	Total past due	Total current	Total
Perkins	$	—	4,688	262,253	266,941	4,012,841	4,279,782
HPL		—	—	158,408	158,408	2,017,413	2,175,821
Institutional		109,447	419,999	1,199,608	1,729,054	91,969	1,821,023
Total	$	109,447	424,687	1,620,269	2,154,403	6,122,223	8,276,626

Allowances for estimated losses are established based on prior collection experience and observed trends in the rate of default, as well as a consideration of current economic trends and indicators. For Institutional loans, loan balances are written off when they are deemed to be ultimately uncollectible. Since student loans under the Perkins loan program and Health Professions loan program can be assigned back to the government when no longer collectible, in these cases a loan write off will reduce the amount refundable to the government. Due to this reduction of the liability, the University does not maintain an allowance for doubtful accounts for Perkins or Health Professions loans.

(Continued)

Changes in allowance for estimated losses on financing receivables held under Institutional loans (receivables) as of June 30, 2012 are presented as follows:

Beginning balance	$	116,391
Writeoff		58,184
Recovery		—
Provision		58,184
Ending balance	$	116,391

(12) Property, Plant, and Equipment

The University's property, plant, and equipment consist of the following at June 30, 2012:

		Cost	Accumulated depreciation	Net carrying value
Land	$	6,496,765	—	6,496,765
Land improvements		2,635,494	(518,693)	2,116,801
Building and improvements		136,821,597	(30,615,109)	106,206,488
Furniture and equipment		16,148,587	(11,952,381)	4,196,206
Library books		4,865,149	(3,209,840)	1,655,309
Artifacts		260,849	—	260,849
Construction in progress		438,973	—	438,973
	$	167,667,414	(46,296,023)	121,371,391

Depreciation expense amounted to $4,352,557.

Leased property included above and recorded under capital leases as of June 30, 2012:

Classes of property:		
Furniture and equipment	$	2,348,928
Less accumulated amortization		(1,494,682)
	$	854,246

(13) Asset Retirement Obligation

The University has asset retirement obligations arising from regulatory requirements to perform cleanup related to asbestos found in buildings owned by the University. The liability was initially measured at fair value and subsequently is adjusted for accretion expense and changes in the amount or timing of estimated cash flows. The corresponding asset retirement costs are capitalized as a part of the carrying amount of the related long-lived asset and depreciated over the asset's remaining useful life. The University has recorded approximately $1,273,406 as of June 30, 2012 related to asset retirement obligations.

(14) Notes Payable and Long-Term Debt

Long-term debt consists of the following at June 30, 2012:

City of Forest Grove, Oregon, Pacific University Campus Improvement and Refunding Revenue Bonds, Series 2005, principal due yearly (in varying amounts) through May 1, 2036, with fixed interest rates averaging 4.86%, secured by unrestricted revenues and a trust deed on the Hillsboro property	$	40,400,000
Unamortized premium on 2005 Campus Improvement and Refunding Revenue Bonds		682,613
City of Forest Grove, Oregon, Pacific University Campus Improvement Revenue Bonds, Series 2009, principal due yearly (in varying amounts) through May 1, 2039, with fixed interest rates averaging 6.54%, secured by unrestricted revenues and a trust deed on the Hillsboro property		35,305,000
Unamortized discount on 2009 Campus Improvement Revenue Bonds		(512,723)
	$	75,874,890

In August 2005, the University issued Campus Improvement and Refunding Revenue Bonds totaling $46,625,000 with the City of Forest Grove, Oregon. The bond proceeds were used to construct a new Health Professions Campus in Hillsboro and to refund the Series 2000 bonds. In July 2009, the University issued Campus Improvement Revenue Bonds totaling $35,305,000. The bond proceeds were used to construct a second building in Hillsboro at the Health Professions Campus.

The following table shows principal payment requirements subsequent to June 30, 2012:

Year ending June 30:		
2013	$	1,365,000
2014		1,425,000
2015		1,485,000
2016		1,550,000
2017		1,630,000
Thereafter		68,250,000
		75,705,000
Unamortized bond premium		682,613
Unamortized bond discount		(512,723)
	$	75,874,890

The 2005 Campus Improvement and Refunding Revenue Bonds and the 2009 Campus Improvement Revenue Bonds are subject to certain restrictive covenants. Required deposits held by the trustee at June 30, 2012 for future debt service payments were $6,805,045. No interest was capitalized in the current fiscal year.

The University has a revolving line of credit in the amount of $6,000,000, which expires in February 2013. Use of the borrowings is used for general operating expenses. Borrowings pursuant to the revolving line of credit bear interest at a fully floating variable interest rate equal to each bank's prime lending rate. The line of credit has a commitment fee of 0.1%. As of June 30, 2012, the University had no amounts outstanding under this line of credit.

The University has a term note payable with an aggregate amount of $5,059,567 outstanding. The note requires monthly principal and interest payments and matures March 10, 2018. The use of the borrowings was for capital projects. The interest rate on the amounts outstanding as of June 30, 2012 is 4.57%.

(15) Related-Party Transactions

In March 2006, the University entered into a 30-year lease agreement with the Oak Tree Foundation (the Foundation), an Oregon nonprofit corporation formed in 1994 to benefit the University by providing financing and management assistance in on-campus and off-campus housing for University students, to lease a newly constructed residence hall. The Foundation has leased from the University the ground on which the residence hall was constructed for a term of 99 years.

In June 2007, the University entered into a second 30-year lease agreement with the Foundation, to lease a second residence hall. The Foundation has leased from the University the ground on which the residence hall was constructed for a term of 99 years.

The Foundation is governed by a seven-member board of which there are four independent members and three members from the University. In accordance with FASB ASC No. 985-810-15, *Omnibus Changes to Consolidation and Equity Method Guidance for Not-for-Profit Organizations*, the University is not required to consolidate the Foundation but has chosen to disclose certain summarized financial data.

The Foundation's financial data as of and for the year ended June 30, 2012 is as follows:

Total assets	$	29,953,820
Total liabilities		32,617,689
Net deficit		(2,663,869)
Total revenues		2,036,476
Total expenses		2,398,021

The future aggregate minimum operating lease payments the University has committed to pay the Foundation under the 2006 and 2007 lease agreements are as follows:

Year ending June 30:		
2013	$	2,243,107
2014		2,337,433
2015		2,433,586
2016		2,473,326
2017		2,475,881
Thereafter		49,559,765
	$	61,523,098

The University's future aggregate minimum lease receipts from the Foundation under both 99-year ground lease agreements are as follows:

Year ending June 30:		
2013	$	94,208
2014		97,034
2015		99,946
2016		102,945
2017		106,032
Thereafter		45,713,762
	$	46,213,927

(16) Expenses by Function

Expenses by functional classification after allocating depreciation, operation and maintenance of plant, and interest are as follows for the year ended June 30, 2012:

Instruction	$	35,332,898
Research		1,750,652
Public service		419,118
Academic support		11,960,006
Clinics		4,620,625
Student services		11,698,180
Institutional support		12,812,170
Auxiliary		9,737,433
	$	88,331,082

(17) Funds Held in Trust by Others

Funds held in trust by others represent assets held and administered by trustees other than the University. The University as a beneficiary derives income or a residual interest from the assets of such funds after the passage of time or occurrence of specified future events. When the University is notified that funds have been put in a trust held by others and is designated as beneficiary, contribution income is recognized as an increase in temporarily or permanently restricted net assets, depending on the nature of restriction imposed by the donor, at the estimated present value of future cash flows to be received by the University.

The University has an irrevocable interest in six trusts held by others held in perpetuity with the University receiving income distributions annually. The fair value at June 30, 2012 was $17,036,505. In addition, there are five trusts held by others in life income annuities with assets with a fair value of $1,093,144 at June 30, 2012.

(18) Net Asset Borrowings

Net asset borrowings at June 30, 2012 represent temporarily unfunded transfers, which will be eliminated principally through collections of accounts and pledges receivable, appropriation of other receipts, or charges to "operations." University management believes that the University has the ability and intent to repay the net asset borrowings.

(19) Employee Retirement Plan

The University makes contributions to employee's retirement plan covering substantially all full-time personnel. The University contributes a rate of 9% towards employees' monthly compensation. Aggregate expense for the year ended June 30, 2012 under the plan was $3,210,641.

(20) Leases

(a) Operating Leases and Lease Commitments

The University has several noncancelable operating leases for office space for various instructional activities and certain equipment in addition to the leases discussed in note 14. Total rental expense amounted to $3,264,652 for the year ended June 30, 2012.

The future aggregate minimum operating lease payments (including 2006 and 2007 related-party leases with the Foundation) are as follows:

Year ending June 30:		
2013	$	3,308,299
2014		3,394,404
2015		3,007,191
2016		3,013,383
2017		2,997,212
Thereafter		50,482,121
	$	66,202,610

The University is leasing its bookstore to Barnes & Noble. Barnes & Noble is providing all bookstore services for the University under the terms of a lease agreement ending in November 2016. The University sold the bookstore inventory at cost to Barnes & Noble with the agreement that Barnes & Noble will sell the remaining inventory back to the University at cost at the end of this lease agreement. During the term of the lease, Barnes & Noble will pay the University a percentage of bookstore sales for the use of the University's property. The University received $50,833 during the year ended June 30, 2012.

(b) Capital Leases

The future minimum lease payments under capital leases are as follows:

Year ending June 30:		
2013	$	83,444
2014		4,837
2015		4,837
Total minimum lease payments		93,118
Less amount representing interest		(10,230)
Present value of net minimum lease payment	$	82,888

(21) Liquidity

Summarized information regarding the classification of assets and liabilities of the University as of June 30, 2012 is as follows:

Total current assets	$	30,563,652
Total long-term assets		187,071,111
Total assets	$	217,634,763
Total current liabilities	$	14,692,418
Total long-term liabilities		90,388,161
Total liabilities		105,080,579
Net assets		112,554,184
Total liabilities and net assets	$	217,634,763

(22) Commitments and Contingencies

The University receives and expends moneys under federal grant programs and is subject to audits by cognizant governmental agencies. Management believes that any liabilities arising from such audits will not have a material effect on the University.

The University has placed certain of its medical and dental insurance coverage with Pioneer Educators Health Trust (PEHT), formulated by seven similar western colleges and universities for the purpose of providing medical and dental insurance to higher education institutions. Under the agreement, member institutions are required to make contributions to the fund at such times and in an amount as determined by the trustees for the various benefit programs sufficient to provide the benefits, pay the administrative expenses of the plan, which are not otherwise paid by the University directly, and to establish and maintain a minimum reserve as determined by the trustees. In no event shall the total contributions paid by any college in any month to the fund be less than the amount of contributions to the cost of the benefit program that employees of such college have paid during the period. In the event losses of PEHT exceed its capital and secondary coverages, the maximum contingent liability exposure to the University is approximately $912,344. This exposure will fluctuate based on factors including changes in actuarial assumptions, medical trend rates, and reinsurance amounts. The level of reinsurance is not expected to fluctuate significantly in the future.

(23) Subsequent Events

The University evaluated subsequent events after the balance sheet date of June 30, 2012 through October 10, 2012, which was the date the financial statements were issued.