



WILLAMETTE UNIVERSITY

Financial Statements

May 31, 2012 and 2011

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The Board of Trustees
Willamette University:

We have audited the accompanying statements of financial position of Willamette University (the University) (an Oregon nonprofit corporation) as of May 31, 2012 and 2011, and the related statements of activities and cash flows for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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 Willamette University as of May 31, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 9, 2012 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

KPMG LLP

October 9, 2012

WILLAMETTE UNIVERSITY

Statements of Financial Position

May 31, 2012 and 2011

(Dollars in thousands)

Assets	2012	2011
Cash and cash equivalents	\$ 23,801	16,340
Accounts receivable, net of allowances of \$407 and \$400 in 2012 and 2011, respectively	1,924	1,863
Pledges receivable, net of allowances of \$185 and \$178 in 2012 and 2011, respectively	8,986	8,766
Inventories and prepaid expenses	875	1,302
Student loans receivable, net of allowances of \$29 in 2012 and 2011	8,395	8,685
Notes receivable and other assets	1,269	1,346
Investments	227,385	253,383
Assets held in remainder trusts by others	906	767
Plant facilities, net	141,109	142,124
Total assets	<u>\$ 414,650</u>	<u>434,576</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued liabilities	\$ 18,582	16,056
Deferred revenue	2,517	2,424
U.S. government loan advances refundable	6,927	6,858
Annuities and trusts payable	8,524	8,569
Note payable	68	106
Bonds payable	63,480	64,510
Total liabilities	<u>100,098</u>	<u>98,523</u>
Net assets:		
Unrestricted:		
Available for operations	599	(328)
Designated for endowment	11,819	21,463
Invested in plant facilities	28,220	27,636
Total unrestricted net assets	<u>40,638</u>	<u>48,771</u>
Temporarily restricted:		
Accumulated endowment gains	75,539	93,711
Trusts and annuities	1,574	1,665
Invested in plant facilities	53,582	54,711
Unexpended funds received for specific purposes	12,193	8,567
Total temporarily restricted net assets	<u>142,888</u>	<u>158,654</u>
Permanently restricted:		
Endowment	124,662	121,618
Endowment – assets held in perpetual trust by others	1,745	1,847
Trusts and annuities	4,263	4,017
Student loans	356	1,146
Total permanently restricted net assets	<u>131,026</u>	<u>128,628</u>
Total net assets	<u>314,552</u>	<u>336,053</u>
Total liabilities and net assets	<u>\$ 414,650</u>	<u>434,576</u>

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statement of Activities

Year ended May 31, 2012

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, and other support:				
Student charges:				
Tuition and fees	\$ 101,727	—	—	101,727
Less student scholarships	(42,669)	—	—	(42,669)
Net tuition and fees	59,058	—	—	59,058
Room and board fees	13,084	—	—	13,084
Contributions	1,887	5,951	2,340	10,178
Endowment income distributed	7,248	6,245	—	13,493
Auxiliary enterprises	2,435	—	—	2,435
U.S. government grants	763	1,898	—	2,661
Other income	873	236	—	1,109
Net assets released from restrictions	11,637	(11,637)	—	—
Total revenues, gains, and other support	<u>96,985</u>	<u>2,693</u>	<u>2,340</u>	<u>102,018</u>
Expenses:				
Instruction	40,272	—	—	40,272
Research	2,421	—	—	2,421
Academic support	17,500	—	—	17,500
Student services	10,901	—	—	10,901
General institutional support	10,695	—	—	10,695
Room and board program	11,255	—	—	11,255
Auxiliary enterprises	2,493	—	—	2,493
Total expenses	<u>95,537</u>	<u>—</u>	<u>—</u>	<u>95,537</u>
Change in net assets before other changes	1,448	2,693	2,340	6,481
Other changes:				
Endowment (loss) income, net of distributions	(9,644)	(18,172)	222	(27,594)
Adjustment related to annuities and trusts	—	(123)	(276)	(399)
Other	63	(164)	112	11
Changes in net assets	<u>(8,133)</u>	<u>(15,766)</u>	<u>2,398</u>	<u>(21,501)</u>
Net assets at beginning of year	<u>48,771</u>	<u>158,654</u>	<u>128,628</u>	<u>336,053</u>
Net assets at end of year	<u>\$ 40,638</u>	<u>142,888</u>	<u>131,026</u>	<u>314,552</u>

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statement of Activities

Year ended May 31, 2011

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, and other support:				
Student charges:				
Tuition and fees	\$ 92,270	—	—	92,270
Less student scholarships	(38,862)	—	—	(38,862)
Net tuition and fees	53,408	—	—	53,408
Room and board fees	12,143	—	—	12,143
Contributions	2,046	2,406	4,264	8,716
Endowment income distributed	7,527	6,521	25	14,073
Auxiliary enterprises	2,435	—	—	2,435
U.S. government grants	540	1,185	—	1,725
Other income	1,109	81	—	1,190
Net assets released from restrictions	11,357	(11,357)	—	—
Total revenues, gains, and other support	<u>90,565</u>	<u>(1,164)</u>	<u>4,289</u>	<u>93,690</u>
Expenses:				
Instruction	38,066	—	—	38,066
Research	2,052	—	—	2,052
Academic support	16,377	—	—	16,377
Student services	10,438	—	—	10,438
General institutional support	10,688	—	—	10,688
Room and board program	10,672	—	—	10,672
Auxiliary enterprises	2,575	—	—	2,575
Total expenses	<u>90,868</u>	<u>—</u>	<u>—</u>	<u>90,868</u>
Change in net assets before other changes	(303)	(1,164)	4,289	2,822
Other changes:				
Endowment income, net of distributions	6,218	13,558	238	20,014
Adjustment related to annuities and trusts	2,978	(1,265)	548	2,261
Other	(413)	427	(113)	(99)
Changes in net assets	8,480	11,556	4,962	24,998
Net assets at beginning of year	<u>40,291</u>	<u>147,098</u>	<u>123,666</u>	<u>311,055</u>
Net assets at end of year	<u>\$ 48,771</u>	<u>158,654</u>	<u>128,628</u>	<u>336,053</u>

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statements of Cash Flows

Years ended May 31, 2012 and 2011

(Dollars in thousands)

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Change in net assets	\$ (21,501)	24,998
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	5,126	5,158
Net realized and unrealized loss (gains) on investments	16,024	(31,818)
Contributions restricted for long-term investment	(4,014)	(5,839)
Proceeds subject to annuity and unitrust agreements	(619)	(1,068)
Noncash contributions	(132)	(423)
(Increase) decrease in accounts receivable	(61)	196
Decrease (increase) in interest and dividends receivable	117	(209)
(Increase) decrease in pledges receivable	(220)	674
Decrease (increase) in inventories and prepaid expenses	427	(196)
Decrease in student loans receivable	290	189
Decrease in notes receivable and other assets	77	44
(Increase) decrease in assets held in remainder trusts by others	(139)	1,392
Increase in accounts payable and accrued liabilities	2,543	156
Increase in deferred revenue	93	367
(Decrease) increase in annuities and trusts payable	(45)	1,934
Net cash used in operating activities	<u>(2,034)</u>	<u>(4,445)</u>
Cash flows from investing activities:		
Purchases of investments	(23,118)	(51,952)
Proceeds from maturities/sales of investments	32,975	57,007
Purchase of plant facilities	(4,041)	(3,453)
Net cash provided by investing activities	<u>5,816</u>	<u>1,602</u>
Cash flows from financing activities:		
Cash contributions restricted for:		
Investment in endowment	2,978	4,913
Investment in plant facilities	1,036	926
Investment subject to annuity and unitrust agreement	619	1,068
Payments on note payable	(38)	(37)
Increase in U.S. government loan advances refundable	69	30
Principal payments on bonds	(985)	(730)
Net cash provided by financing activities	<u>3,679</u>	<u>6,170</u>
Net increase in cash and cash equivalents	7,461	3,327
Cash and cash equivalents at beginning of year	<u>16,340</u>	<u>13,013</u>
Cash and cash equivalents at end of year	\$ <u><u>23,801</u></u>	\$ <u><u>16,340</u></u>
Supplemental cash flow information:		
Cash paid for interest	\$ 2,754	2,652
Noncash contributions	132	423

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(1) Organization

Willamette University (the University) is a private institution of higher education accredited by the Northwest Commission on Colleges and Universities. The University offers students a number of graduate and undergraduate degrees in programs covering a wide variety of scholastic disciplines. The University is an Oregon not-for-profit organization funded by student tuition revenue, endowment income, and outside contributions.

(2) Summary of Significant Accounting Policies

(a) General

These financial statements, which are presented on the accrual basis of accounting, have been prepared to focus on the University as a whole and to present transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of net assets and transactions into three classes as follows:

Unrestricted Net Assets – Net assets not subject to donor-imposed restrictions.

Temporarily Restricted Net Assets – Net assets subject to donor-imposed restrictions that will be met by either actions of the University 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 with the exception of activity related to life income agreements. 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 a release from temporarily restricted net assets to unrestricted net assets in the statements of activities. In the event that a donor-imposed restriction is fulfilled in the same reporting period as investment gains and income are recognized, the investment activity is reported as unrestricted in nature.

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

- Increases in permanently restricted net assets if the terms of the gift or the University's interpretation of relevant state law require they be added to the principal of a permanently restricted net asset.
- Increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income.
- Increases in unrestricted net assets in all other cases.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

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 to be received after one year are discounted at a discount rate commensurate with the risks involved. Amortization of the discount is recorded as additional contribution revenue. 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. Contributions of assets other than cash are recorded at their estimated fair value. Contributions for capitalized long-lived assets are released from restriction over the estimated useful lives of the assets using the University's depreciation policies.

(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 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 these estimates.

(c) *Assets Held in Charitable Trusts*

The University serves as the trustee for various charitable trusts. Under the terms of these trust agreements, the University makes distributions to income beneficiaries for a given term or for the life of the income beneficiaries. Assets remaining in the trusts will be transferred to the University at the end of the term or upon death of the income beneficiaries. The University carries the assets held in charitable trusts as investments at their estimated fair values. The related liability is recorded at the estimated discounted value of the amounts due to the income beneficiaries, at the end of the reporting period.

Assets held in trust by others represent resources neither in the possession nor under the control of the University, but held and administered by outside trustees, from which the University derives income or has a residual interest in the related assets. Assets held in trust by others are recognized at the estimated fair value of the assets or the present value of the estimated future cash flows when the trust is established and/or the University is notified of its existence. Changes in the fair value of these assets and changes in their related liabilities are reflected in adjustment related to annuities and trusts in the statements of activities.

(d) *Cash and Cash Equivalents*

Cash and cash equivalents include bank demand deposits, petty cash, and money market accounts with original maturities of three months or less at the date of purchase, which are not considered restricted long-term investments. For valuation purposes, cash and cash equivalents have observable inputs. Federal depository insurance coverage was expanded effective January 1, 2011 to provide unlimited insurance coverage to all depositors on noninterest-bearing accounts.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(e) Investments

Investments in marketable equity securities and all debt securities are stated at fair value. The alternative investments, which are not readily marketable, are carried at estimated fair values. The University reviews and evaluates the values provided by the investment managers and estimates the fair value of the alternative investments. When allowable, the University uses the reported net asset value (NAV) as a practical expedient to fair value. Those estimated fair values may differ significantly from the values that would have been used had a ready market for those securities existed. Realized and unrealized gains and losses on investments are reflected in the statements of activities as endowment income (loss).

(f) Charitable Gift Agreements

The University uses an actuarial method of recording certain split-interest agreements. Under this method, the present value of the payments to beneficiaries is determined based upon life expectancy tables when the gift is received. The estimated 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. Periodic adjustments are made between the liability and the net assets to record actuarial gains or losses. The discount rate used by the University in calculating the present value of all split-interest agreements is 6% at May 31, 2012 and 2011.

(g) Plant Facilities, Net

Plant facilities are stated at cost at the date of acquisition, or fair value at the date of receipt, if contributed. Routine repair and maintenance expenses and replacement costs are expensed as incurred.

The University computes depreciation using the straight-line method over the estimated useful lives of plant facilities, except land, as follows:

Land improvements	25 years
Buildings	50 years
Furniture, fixtures, and equipment	5 – 15 years
Library holdings	25 years

(h) Inventory

Inventory consists primarily of books and supplies and is recorded at the lower of cost (first-in, first-out) or market.

(i) Bond Issuance Costs

Bond issuance costs include amounts paid by the University in connection with the issuance of the 2007 and 2010 Oregon Facilities Authority Revenue Bonds. Bond issuance costs are classified as a component of notes receivable and other assets in the statements of financial position. Amortization of the bond issuance costs is calculated using a method that approximates the effective yield over the life of the bonds.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(j) *Income Taxes*

The Internal Revenue Service (IRS) 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. Unrelated business income is insignificant, and therefore, no tax provision has been made.

U.S. generally accepted accounting principles require the University's management to evaluate tax positions taken by the University and recognize a tax liability (or asset) if the University has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS. Management has analyzed tax positions taken by the University and has concluded that as of May 31, 2012, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The University is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The University's management believes it is no longer subject to income tax examinations for years prior to fiscal 2008.

(k) *Deferred Revenue*

Deferred revenue consists primarily of prepayments of tuition and fees related to future academic terms.

(l) *Fair Value Measurements*

The University follows the provisions of Accounting Standards Codification (ASC) 820, *Fair Value Measurements*, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value.

ASC 820 establishes a three-level valuation hierarchy for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data.

Level 3 – Inputs are unobservable for the asset or liability. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

(3) Pledges Receivable

The University records pledges receivable at the present value of estimated future cash flows using discount rates ranging from 1.4% to 6.0% for pledges receivable outstanding at May 31, 2012 and 2011. Annual payments are scheduled to be received as follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Less than one year	\$ 6,626	4,921
One to five years	2,611	4,064
More than five years	—	100
	<u>9,237</u>	<u>9,085</u>
Less discount	(66)	(141)
Less reserve for uncollectible accounts	<u>(185)</u>	<u>(178)</u>
Total pledges receivable	<u>\$ 8,986</u>	<u>8,766</u>

As of May 31, 2012, conditional promises in the amount of \$2,282,000 were received, but not recognized by the University.

(4) Accounts Receivable

Student accounts receivable consists of amounts due from students for tuition, room, board, and other enrollment-related charges. In addition, the University has other miscellaneous receivables that are paid to the University shortly after the end of the fiscal year. At May 31, 2012 and 2011, these receivable balances were as follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Student accounts receivable	\$ 948	1,026
Accounts in collections	486	480
Other receivables	<u>897</u>	<u>757</u>
	2,331	2,263
Less allowance for doubtful accounts	<u>(407)</u>	<u>(400)</u>
	<u>\$ 1,924</u>	<u>1,863</u>

The University determines the adequacy of the allowance based on various factors including length of time past due, historical experience, and consideration of economic conditions. Balances are written off only after all means of collection have been exhausted and collection is considered remote.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(5) Student Loans Receivable

The University's student loans receivable consists of a revolving loan fund for Federal Perkins Loans 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. These loans are recorded based on the outstanding principal balance, less an allowance for estimated losses.

The availability of funds for loans under the Federal Perkins Loan program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds held in the Federal Perkins Loan programs of \$6,927,000 are ultimately refundable to the government and are classified as a liability in the statement of financial position.

Balances of student loans receivable as of May 31, 2012 consist of the following (amounts in thousands):

	<u>Perkins loans</u>	<u>Institutional loans</u>	<u>Total</u>
Receivable	\$ 8,360	64	8,424
Less allowance	—	(29)	(29)
Balance at May 31, 2012	<u>\$ 8,360</u>	<u>35</u>	<u>8,395</u>

Since student loans under the Federal Perkins Loan program can be assigned to the U.S. government when they are no longer collectible, a Perkins loan write-off will reduce the amount refundable to the government. Due to this program provision, the University does not maintain an allowance for doubtful accounts with regard to Perkins loans.

For each class of student loans receivable, the following table presents the nonperforming portion of the receivable as of May 31, 2012 (amounts in thousands).

	<u>Perkins</u>	<u>Institutional</u>	<u>Total</u>
Performing	\$ 7,187	35	7,222
Nonperforming (defaulted)	1,173	29	1,202
Balance at May 31, 2012	<u>\$ 8,360</u>	<u>64</u>	<u>8,424</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(6) Investments

Investments at May 31, 2012 and 2011 are as follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Fixed income funds	\$ 30,523	32,817
Equity strategy funds	109,065	126,043
Real assets	30,198	32,835
Hedge funds	47,378	51,067
Other investments	10,221	10,621
	<u>\$ 227,385</u>	<u>253,383</u>

Net realized and unrealized gains and losses, net of investment fees, were \$374,000 and \$427,000 for years ended May 31, 2012 and 2011, respectively.

(a) Overall Investment Objective

The overall investment objective of the University is to invest its assets in a manner that will produce the maximum total return consistent with prudent management and preservation of principal and will provide a consistent inflation-adjusted level of support over the long term. The University diversifies its investments among various asset classes incorporating multiple strategies and managers. The University has contracted with the Commonfund Strategic Solutions (Commonfund), to serve as its investment advisor. Major investment decisions are authorized by the University's Endowment Committee, which oversees the University's investment program in accordance with established guidelines approved by the Board of Trustees.

(b) Investment Strategies

The University's investment portfolio has been divided into five investment categories: fixed income funds, equity strategy funds, real assets, hedge funds, and other investments. Asset allocations are determined by the Endowment Committee and are reviewed at least annually. Fixed income funds are used to provide a hedge against deflation, provide a stable component of return, and to reduce the overall volatility of the investment portfolio. Equity strategy funds are selected to provide principal appreciation that exceeds inflation. Equity investments carry greater market price variability and risk than other asset classes. Some equity strategy investments may be illiquid, like private equity, venture capital, and distressed debt. The expected return on illiquid investments is greater than marketable securities. The purpose of the real assets segment is to provide a hedge against inflation. Real assets may include liquid investments like Treasury Inflation Protected Securities (TIPS) and commodities. Other illiquid investment strategies, like private real estate and natural resources, may also be included in real assets. Hedged strategies involve funds used to reduce volatility of the overall portfolio and to provide an alternative source of return from that of the equity capital markets. Hedge funds may include a variety of investment strategies using marketable securities that seek to generate absolute positive returns regardless of the direction of the capital markets. Other investments include charitable remainder trusts, and perpetual trusts that are held by other institutions but pay an annual income to the University.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(c) Basis of Reporting

Investments are reported at estimated fair value using the provisions of ASC 820, as discussed in footnote 2(1). If an investment is held directly by the University and an active market with quoted prices exists, the market price of an identical security is used as reported fair value. Reported fair values for shares in mutual funds are based on share prices reported by the funds as of the last business day of the fiscal year.

The University's interests in certain investments that do not have readily determinable fair values, including private equity investments and investments in hedge funds, energy fund partnerships, real estate and other funds, are generally reported at the NAV reported by the fund managers, which is used as a practical expedient to estimate the fair value of the University's interest therein, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of May 31, 2012 and 2011, the University had no plans or intentions to sell investments at amounts different from NAV. These investments are reported as Level 3 items in the table below.

The following tables summarize the University's investments and other assets by major category in the fair value hierarchy as of May 31, 2012 and 2011 (amounts in thousands):

	May 31, 2012				Redemption or liquidation	Days' notice
	Total	Level 1	Level 2	Level 3		
Assets held in remainder trusts by others	\$ 906	—	—	906	Illiquid (a)	N/A
Investments:						
Fixed income funds:						
Money market funds	7,252	—	7,252	—	Daily	One
High quality bond funds	19,395	1,301	18,094	—	Daily – weekly	One – five
Global fixed income funds	3,685	433	3,252	—	Daily – monthly	One – five
Short- and intermediate-term bond funds	55	55	—	—	Daily	Two
High yield bond funds	136	136	—	—	Daily	One
Total	<u>30,523</u>	<u>1,925</u>	<u>28,598</u>	<u>—</u>		
Equity strategy funds:						
Blended equity funds	48	48	—	—	Daily	Four
Small to mid-cap equity funds	196	196	—	—	Daily	One – four
Large cap equity funds	18,986	1,252	17,734	—	Daily – weekly	One – five
All cap equity funds	13,961	—	13,961	—	Monthly	Five
International equity funds	10,563	599	9,964	—	Daily – monthly	One – five
Emerging markets equity funds	20,013	168	19,845	—	Daily – monthly	One – thirty
Equity index funds	1,010	—	1,010	—	Daily	One
Private equity partnerships	44,288	—	—	44,288	Illiquid (b)	N/A
Total	<u>109,065</u>	<u>2,263</u>	<u>62,514</u>	<u>44,288</u>		
Real assets:						
Treasury inflation protected securities funds	6,688	—	6,688	—	Monthly	Five
Commodities	4,810	—	4,810	—	Monthly	Five

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

May 31, 2012						
	Total	Level 1	Level 2	Level 3	Redemption or liquidation	Days' notice
Energy fund partnerships	\$ 13,798	—	—	13,798	Illiquid (c)	N/A
Real estate	4,902	685	—	4,217	See note (d)	See note (d)
Total	<u>30,198</u>	<u>685</u>	<u>11,498</u>	<u>18,015</u>		
Hedge funds:						
Directional funds	29,360	—	—	29,360	See note (e)	See note (e)
Relative value	18,018	—	—	18,018	Annually	95
Total	<u>47,378</u>	<u>—</u>	<u>—</u>	<u>47,378</u>		
Other investments:						
Charitable remainder trusts	8,041	—	—	8,041	Illiquid (f)	N/A
Perpetual trusts	1,745	—	—	1,745	Illiquid (a)	N/A
Bonds and notes	416	375	41	—	Daily	One – three
Royalties	19	—	—	19	Annually	One
Total	<u>10,221</u>	<u>375</u>	<u>41</u>	<u>9,805</u>		
Total investments	<u>227,385</u>	<u>5,248</u>	<u>102,651</u>	<u>119,486</u>		
Total assets	<u>\$ 228,291</u>	<u>5,248</u>	<u>102,651</u>	<u>120,392</u>		

- (a) Assets held in remainder trusts by others and perpetual trusts are not under the control of the University.
- (b) Approximately \$15 million of these funds are expected to liquidate within five years; an additional \$29 million is expected to liquidate within six to ten years, and the remainder is expected to liquidate within eleven to fourteen years. Each investment fund's liquidation date is established by the partnership and defined in the partnership agreement. One partnership added a year to its liquidation date and three partnerships added two years to their respective liquidation dates during the year ended May 31, 2012, in accordance with allowable terms within the partnership.
- (c) These funds are expected to liquidate within 3 – 5 years. The liquidation date is established by the partnership and defined in the partnership agreement. There were no changes in liquidation dates during the fiscal year ended May 31, 2012.
- (d) Real estate funds in the Level 1 category can be redeemed on a daily basis and require one day's notice. There are five funds in Level 3 and each fund has a different redemption schedule. They are as follows: (i) One fund can be liquidated on a quarterly basis with 120 days' notice; (ii) One fund is in dissolution, which will continue until the last investment is disposed of, and liquidation occurs; (iii) One fund has no set expiration date and has indefinitely deferred redemptions by its partners; (iv) One fund is scheduled to terminate in 2021; and (v) One investment is an annuity funded by real estate. The real estate is currently for sale. Upon sale, the proceeds will be used to purchase the investment in the University's annuity pool.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

- (e) One directional hedge fund is mostly liquidated. The residual balance will be distributed during the third quarter of calendar year 2012. The remaining two funds in this category can be redeemed on a quarterly basis and require 95 days' notice.
- (f) The University is the beneficiary of charitable remainder trusts; however, the investments are normally under the control of the donor or an outside trustee (amounts in thousands).

		May 31, 2011					
		Total	Level 1	Level 2	Level 3	Redemption or liquidation	Days' notice
Assets held in remainder trusts by others	\$	767	—	—	767	Illiquid (a)	N/A
Investments:							
Fixed income funds:							
Money market funds		11,238	131	11,107	—	See note (b)	See note (b)
High quality bond funds		17,691	1,042	16,649	—	Daily – weekly	One – five
Global fixed income funds		3,718	361	3,357	—	Daily – monthly	One – five
Short- and intermediate-term bond funds		52	52	—	—	Daily	Two
High yield bond funds		118	118	—	—	Daily	One
Total		32,817	1,704	31,113	—		
Equity strategy funds:							
Blended equity funds		49	49	—	—	Daily	Four
Small to mid-cap equity funds		264	264	—	—	Daily	One – four
Large cap equity funds		14,745	1,273	13,472	—	Daily – weekly	One – five
All cap equity funds		25,171	—	25,171	—	Monthly	Five
International equity funds		16,105	562	15,543	—	Daily – monthly	One – five
Emerging markets equity funds		23,381	98	23,283	—	Daily – monthly	One – thirty
Equity index funds		2,295	—	2,295	—	Daily	One
Private equity partnerships		44,033	—	—	44,033	Illiquid (c)	N/A
Total		126,043	2,246	79,764	44,033		
Real assets:							
Treasury inflation protected securities funds		7,570	—	7,570	—	Monthly	Five
Commodities		6,131	—	6,131	—	Monthly	Thirty
Energy fund partnerships		17,744	—	—	17,744	Illiquid (d)	N/A
Real estate		1,390	655	—	735	See note (e)	See note (e)
Total		32,835	655	13,701	18,479		

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

	May 31, 2011				Redemption or liquidation	Days' notice
	Total	Level 1	Level 2	Level 3		
Hedge funds:						
Directional funds	\$ 31,502	—	—	31,502	See note (f)	See note (f)
Relative value	19,565	—	—	19,565	Annually	95
Total	51,067	—	—	51,067		
Other investments:						
Charitable remainder trusts	8,305	—	—	8,305	Illiquid (g)	N/A
Perpetual trusts	1,847	—	—	1,847	Illiquid (a)	N/A
Bonds and notes	450	391	59	—	Daily	One – three
Royalties	19	—	—	19	Annually	One
Total	10,621	391	59	10,171		
Total investments	253,383	4,996	124,637	123,750		
Total assets	\$ 254,150	4,996	124,637	124,517		

- (a) Assets held in remainder trusts by others and perpetual trusts are not under the control of the University.
- (b) The majority of money market funds can be redeemed on a daily basis with a day's notice. There was one fund in transition as of May 31, 2011. The funds from this transition were intended for a private equity fund and the transaction was completed in early June.
- (c) Most of these funds are expected to liquidate within 1 – 10 years. One fund is in the process of dissolution per the fund agreement. Disbursements from the fund's underlying investment are made as cash becomes available. Each investment fund's liquidation date is established by the partnership and defined in the partnership agreement. One partnership added a year to its liquidation date, in accordance with allowable terms within the partnership.
- (d) These funds are expected to liquidate within 5 – 7 years. The liquidation date is established by the partnership and defined in the partnership agreement. There were no changes in liquidation dates during the fiscal year ended May 31, 2011.
- (e) Real estate funds in the Level 1 category can be redeemed on a daily basis and require one day's notice. There are three investments in Level 3 and each investment has a different redemption schedule that ranges from 1 to 5 years. They are as follows: (i) One investment is in dissolution, which will continue until the last investment is disposed of, and liquidation occurs; (ii) Investment was in the process of being liquidated at May 31, 2011. The fund is having difficulties meeting its debt obligations; and (iii) Investment is an annuity funded by real estate. The real estate is currently for sale. Upon sale, the proceeds will be used to purchase the investment in the University's annuity pool.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

- (f) One directional hedge fund was in the process of being liquidated at May 31, 2011. The fund is expected to be fully liquidated within the next year. The remaining two funds in this category can be redeemed on a quarterly basis and require 95 days' notice.
- (g) The University is the beneficiary of charitable remainder trusts; however, the investments are normally under the control of the donor or an outside trustee.

Investment liquidity as of May 31, 2012 is aggregated below based on redemption or sale period (amounts in thousands):

	Investments' fair values
Daily	\$ 13,548
Weekly	35,828
Monthly	58,522
Quarterly	31,371
Annually	18,037
Currently being liquidated	719
Illiquid	<u>69,360</u>
Total	<u>\$ 227,385</u>

The following methods and assumptions were used to estimate the fair values of the financial instruments measured at fair value:

The University's beneficial interest in irrevocable split-interest agreements held or controlled by a third party is classified as Level 3 as the fair values are based on a combination of Level 1 inputs (observable market values of the trusts' investment portfolios) and significant unobservable inputs (real estate and entity-specific estimates of cash flows). The fair values are measured at the present value of the future distributions the University expects to receive over the term of the agreements.

U.S. Treasuries and registered mutual funds are classified in Level 1 of the fair value hierarchy as defined in note 2 because their fair values are based on quoted prices for identical securities. Most investments classified in Levels 2 and 3 consist of shares or units in nonregistered investment funds as opposed to direct interests in the funds' underlying securities, some of which are marketable or not difficult to value. Because each fund's reported NAV is used as a practical expedient to estimate the fair value of the University's interest therein, the level in which a fund's fair value measurement is classified is based on the University's ability to redeem its interest at or near the date of the statements of financial position. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risks associated with those investments or a reflection of the liquidity of or degree of difficulty in estimating the fair value of each fund's underlying assets and liabilities.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

The following table presents the University's activities for the fiscal year ended May 31, 2012 for investments classified in Level 3 (amounts in thousands):

	<u>Balances, May 31, 2011</u>	<u>Net realized and unrealized gains (losses) included in change in net assets</u>	<u>Purchases</u>	<u>Sales</u>	<u>Settlements</u>	<u>Transfers out of Level 3</u>	<u>Balances, May 31, 2012</u>
Assets:							
Assets held in trust by others	\$ 767	139	—	—	—	—	906
Investments:							
Equity strategy funds:							
Private equity partnerships	44,033	1,712	5,726	(7,183)	—	—	44,288
Real assets:							
Energy fund partnerships	17,744	(3,557)	321	(710)	—	—	13,798
Real estate	735	526	3,010	(54)	—	—	4,217
Hedge funds:							
Directional funds	31,502	(2,058)	—	(84)	—	—	29,360
Relative value	19,565	(1,547)	—	—	—	—	18,018
Other investments	10,171	(1,049)	729	(46)	—	—	9,805
Totals	\$ <u>124,517</u>	<u>(5,834)</u>	<u>9,786</u>	<u>(8,077)</u>	<u>—</u>	<u>—</u>	<u>120,392</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

The following table presents the University's activities for the fiscal year ended May 31, 2011 for investments classified in Level 3 (amounts in thousands):

	<u>Balances, May 31, 2010</u>	<u>Net realized and unrealized gains included in change in net assets</u>	<u>Purchases</u>	<u>Sales</u>	<u>Settlements</u>	<u>Transfers out of Level 3</u>	<u>Balances, May 31, 2011</u>
Assets:							
Assets held in trust by others	\$ 2,159	235	—	—	(1,559)	(68)	767
Investments:							
Fixed income funds:							
Global fixed income funds	1	—	—	(1)	—	—	—
Equity strategy funds:							
Private equity partnerships	38,995	3,301	8,951	(7,214)	—	—	44,033
Real assets:							
Energy fund partnerships	13,726	4,996	403	(1,381)	—	—	17,744
Real estate	7,216	406	400	(7,287)	—	—	735
Hedge funds:							
Directional funds	30,313	2,337	3,800	(4,948)	—	—	31,502
Relative value	15,723	1,331	6,500	(3,989)	—	—	19,565
Other investments	7,356	847	1,968	—	—	—	10,171
Totals	\$ <u>115,489</u>	<u>13,453</u>	<u>22,022</u>	<u>(24,820)</u>	<u>(1,559)</u>	<u>(68)</u>	<u>124,517</u>

At May 31, 2012, the University has approximately \$120 million in investments with underlying investments that are not readily marketable compared to approximately \$125 million at 2011. These investments represent approximately 53% and 49% of total investments and approximately 38% and 37% of net assets at both May 31, 2012 and 2011, respectively. These investment instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments, and nondisclosure of full portfolio composition. Because these investments are not readily marketable, their estimated values are subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such difference could be material.

As of May 31, 2012, the University has committed a total of approximately \$124 million to alternative investments in the form of limited partnership/trust investments compared to approximately \$117 million at May 31, 2011. As of May 31, 2012, the University has funded approximately \$94 million of these commitments compared to \$85 million at May 31, 2011. At May 31, 2012, the remaining unfunded balance of approximately \$30 million is due at the request of the general partners/advisors. These partnerships/trusts invest in emerging growth technology companies, venture capital funds, and other alternative investments. The termination of these partnerships/trusts is based upon specific provisions in the agreements.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(7) Endowment and Quasi-Endowment Funds

The University's endowment consists of approximately 500 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the governing board to function as endowments. As required by U.S. generally accepted accounting principles (GAAP), net assets associated with endowment funds, including funds designated by the governing board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The University's management has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) enacted in the State of Oregon to allow board definition of prudent spending from donor-restricted endowment funds absent explicit donor instruction. For accounting purposes, the University classifies as permanently restricted net assets (a) the original value of the 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 as 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 UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the University and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the University
- The investment policies of the University

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

Endowment net asset composition by type of fund consists of the following as of May 31, 2012 (amounts in thousands):

		2012			
		Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	\$	(9,436)	75,539	124,662	190,765
Board-designated endowment funds		21,255	—	—	21,255
Total endowment net assets	\$	<u>11,819</u>	<u>75,539</u>	<u>124,662</u>	<u>212,020</u>

Endowment net asset composition by type of fund consists of the following as of May 31, 2011 (amounts in thousands):

		2011			
		Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	\$	(3,165)	93,711	121,618	212,164
Board-designated endowment funds		24,628	—	—	24,628
Total endowment net assets	\$	<u>21,463</u>	<u>93,711</u>	<u>121,618</u>	<u>236,792</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

Changes in endowment net assets, including quasi-endowments, for the year ended May 31, 2012 are as follows (amounts in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2011	\$ 21,463	93,711	121,618	236,792
Investment return:				
Investment income	—	2,297	—	2,297
Net appreciation (depreciation) realized and unrealized	<u>(2,396)</u>	<u>(14,224)</u>	<u>222</u>	<u>(16,398)</u>
Total investment return	(2,396)	(11,927)	222	(14,101)
Contributions	—	—	1,799	1,799
Appropriation of endowment assets for expenditures	(7,248)	(6,245)	—	(13,493)
Other changes:				
Repurposed funds	—	—	790	790
Annuity maturities	—	—	132	132
Transfers – other	<u>—</u>	<u>—</u>	<u>101</u>	<u>101</u>
Endowment net assets, May 31, 2012	\$ <u>11,819</u>	<u>75,539</u>	<u>124,662</u>	<u>212,020</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

Changes in endowment net assets, including quasi-endowments, for the year ended May 31, 2011 are as follows (amounts in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2010	\$ 15,247	80,153	118,122	213,522
Investment return:				
Investment income	—	2,696	—	2,696
Net appreciation realized and unrealized	13,745	17,383	263	31,391
Total investment return	13,745	20,079	263	34,087
Contributions	—	—	3,232	3,232
Appropriation of endowment assets for expenditures	(7,527)	(6,521)	(25)	(14,073)
Other changes:				
Transfers – other	(2)	—	26	24
Endowment net assets, May 31, 2011	\$ <u>21,463</u>	<u>93,711</u>	<u>121,618</u>	<u>236,792</u>

Funds with Deficiencies – From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the University to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$9,436,000 and \$3,165,000 as of May 31, 2012 and 2011, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the governing board. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

Return Objectives and Risk Parameters – The University has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the University must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the Higher Education Price Index (HEPI) plus 5%, while assuming a moderate level of investment risk. The University expects its endowment funds to provide operating fund support for current activities, and at the same time provide growth through investment returns that will assist future generations.

Strategies Employed for Achieving Objectives – To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The University targets a

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

diversified asset allocation that places a greater emphasis on equity-based and alternative investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy – The University has a policy of appropriating for distribution each year 5% to 6% of its endowment fund’s average fair value over the prior five years through the fiscal year-end preceding the fiscal year in which the distribution is planned. The University has a long-range plan to lower the distribution to 5% of the funds’ average fair value over the prior five years. This policy is consistent with the University’s objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional growth through new gifts and investment return. Based on the University’s spending policy, the effective spending rate for the fiscal years ended May 31, 2012 and 2011 was 5.85% and 6.12%, respectively.

Substantially all of the University’s endowment funds are pooled for investment purposes. Income earned on endowment fund investments is allocated on the basis of each fund’s proportionate interest in the pooled investment portfolio.

The components of total endowment investments return are reflected below (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Dividends and interest	\$ 2,298	2,696
Net realized gains (losses)	3,222	(628)
Net change in cumulative unrealized gains (losses)	(19,247)	32,446
Investment fees and other	<u>(374)</u>	<u>(427)</u>
Total	\$ <u>(14,101)</u>	<u>34,087</u>

Investment return, as reflected in the statements of activities, is as follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Revenues:		
Unrestricted	\$ 7,248	7,527
Temporarily restricted	6,245	6,521
Permanently restricted	<u>—</u>	<u>25</u>
	<u>13,493</u>	<u>14,073</u>
Other changes in net assets:		
Unrestricted	(9,644)	6,218
Temporarily restricted	(18,172)	13,558
Permanently restricted	<u>222</u>	<u>238</u>
	<u>(27,594)</u>	<u>20,014</u>
Total	\$ <u>(14,101)</u>	<u>34,087</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(8) Plant Facilities, Net

Plant facilities consist of the following at May 31, 2012 and 2011 (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Land and land improvements	\$ 21,163	21,086
Buildings	156,178	154,241
Furniture, fixtures, and equipment	5,695	5,409
Library holdings	35,617	34,646
Art collection	3,330	3,162
Construction in progress	458	565
Accumulated depreciation	<u>(81,332)</u>	<u>(76,985)</u>
Net plant facilities	<u>\$ 141,109</u>	<u>142,124</u>

The University recorded depreciation expense of \$5,171,000 and \$5,202,000, respectively, during the years ended May 31, 2012 and 2011.

The University has received gifts and purchased art and other collectibles (the Collection), which are housed or displayed in the Hallie Ford Museum of Art. The University has a recorded value for the Collection of \$3,330,000 at May 31, 2012 and \$3,162,000 at May 31, 2011 in the plant facilities balance in the statements of financial position, and depreciation will not be recorded on these assets.

(9) Bonds Payable

In June 2007, the University issued Oregon Facilities Authority Revenue Bonds in the amount of \$31,820,000. The proceeds of the bonds were used to repay the outstanding line of credit, to finance the construction of five major projects, and to advance refund \$8,400,000 of the Series 2004 bonds. The bonds have annual principal and interest obligations ranging from \$1,525,000 to \$3,266,000 and bear interest at rates ranging from 4% to 5%. At May 31, 2012 and 2011, there were outstanding balances of \$31,761,000 and \$31,906,000, respectively.

In May 2010, the University issued Oregon Facilities Authority Revenue Bonds in the amount of \$32,500,000. The proceeds of the bonds were used to repay the outstanding line of credit, to advance refund the remaining balances of the Series 2004 and Series 2005 bonds, to provide funding for several capital projects, and to assist with other facility upgrades and improvements. The bonds have annual principal and interest obligations ranging from \$1,223,000 to \$13,185,000, through 2040, and bear interest at rates ranging from 1.15% to 5.00%. At May 31, 2012 and 2011, there were outstanding balances of \$31,719,000 and \$32,604,000, respectively.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

Principal payments on bonds payable are as follows (amounts in thousands):

2013	\$	1,050
2014		1,125
2015		12,505
2016		1,245
2017		1,345
Thereafter		<u>45,010</u>
		62,280
Add unamortized bond premium		<u>1,200</u>
	\$	<u><u>63,480</u></u>

Interest expense on bonds payable for the years ended May 31, 2012 and 2011, was approximately \$2,748,000 and \$2,764,000, respectively, and is included in various functional expenses in the statements of activities.

The University is in compliance with all bond covenants as of May 31, 2012.

(10) Net Assets Released from Restriction

Net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes, occurrence of events specified by the donors, the change in restrictions specified by the donors, or the passage of time. Net assets released from restriction during the years ended May 31, 2012 and 2011 are as follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Purpose of restricted contributions:		
Instruction	\$ 1,400	1,367
Sponsored research	1,979	1,153
Academic support	963	835
Student services and other	52	115
Institutional support	15	146
Plant facilities	10	51
Room and board	62	—
Scholarships	<u>5,466</u>	<u>5,978</u>
	9,947	9,645
Time-restricted contributions:		
Amortization of restricted gifts to acquire long-lived assets	<u>1,690</u>	<u>1,712</u>
Total net assets released from restrictions	\$ <u><u>11,637</u></u>	<u><u>11,357</u></u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(11) Institutional Support Fund-Raising Expense

Fund-raising expenses of \$2,171,000 and \$2,360,000 are included in general institutional support expenses in the statements of activities for the years ended May 31, 2012 and 2011, respectively.

(12) Pension Plan

During the fiscal year, the University changed retirement plan administrators to Diversified. Individuals were allowed to keep their account balances in their current funds with Teachers Insurance and Annuity Association (TIAA) and the College Retirement Equities Fund (CREF), or the plan with VALIC; or they could elect to transfer any or all of the account balances to Diversified. All contributions after January 1, 2012 were deposited into Diversified accounts. The University's contributions are based on a percentage of participating employees' salaries and, along with employee contributions, are paid into the plan monthly. Retirement plan expense for the years ended May 31, 2012 and 2011 was approximately \$3,916,000 and \$3,856,000, respectively.

(13) Other Postretirement Benefits and Related Liability Estimates

All employees retiring from the University who were hired before January 1, 1983 are eligible for reimbursement of the actual cost of premiums for Medicare supplemental insurance up to \$125 per quarter. In addition, full-time continuing faculty members, administrators, and classified employees with 20 years or more of service, upon reaching age 59 are eligible for a voluntary severance arrangement that provides cash payments and University paid health and life insurance until the individual is eligible for Medicare coverage.

The schedule below details the estimated liabilities included in accounts payable and accrued liabilities in the statements of financial position as of May 31, 2012 and 2011. At May 31, 2012, liability estimates are discounted from estimated future costs using a rate of 4.5%, down from the May 31, 2011, rate of 5.85%. The voluntary severance payment estimate calculation assumes a 3.50% annual growth in the compensation upon which the benefit is based. Benefits paid by the University relating to the postretirement benefit plan were approximately \$450,000 and \$323,000 for the fiscal years ended May 31, 2012 and 2011, respectively.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

Postretirement benefit obligation at May 31, 2012 and 2011 is as follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Medicare supplement – up to \$125 per quarter	\$ 498	527
Full Medicare supplement	—	11
Health and life insurance until Medicare eligibility	2,603	1,905
Voluntary severance payments	<u>3,013</u>	<u>2,381</u>
Postretirement benefit obligation	<u>\$ 6,114</u>	<u>4,824</u>
Postretirement benefit liability:		
Current liability	\$ 345	367
Noncurrent liability	<u>5,769</u>	<u>4,457</u>
Net amount recognized in statements of financial position	<u>\$ 6,114</u>	<u>4,824</u>

The following table presents expected postretirement benefit payments, which reflect expected future service (amounts in thousands):

2013	\$ 345
2014	402
2015	462
2016	470
2017	479
Thereafter	<u>3,956</u>
	<u>\$ 6,114</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(14) Annuities and Life Income Funds

Annuities and life income funds consist of the following at May 31, 2012 (amounts in thousands):

	<u>Charitable gift annuities</u>	<u>Annuity trust and unit trusts</u>	<u>Total</u>
Assets:			
Investments:			
Fixed income funds	\$ 1,720	—	1,720
Equity strategy funds	2,195	—	2,195
Real assets	1,084	—	1,084
Bonds and notes	416	—	416
Charitable remainder trusts	—	8,040	8,040
Assets held in remainder trusts by others	—	906	906
Total assets	<u>\$ 5,415</u>	<u>8,946</u>	<u>14,361</u>
Liabilities and net assets:			
Annuities payable	\$ 3,584	4,940	8,524
Net assets	1,831	4,006	5,837
Total liabilities and net assets	<u>\$ 5,415</u>	<u>8,946</u>	<u>14,361</u>

Annuities and life income funds consist of the following at May 31, 2011 (amounts in thousands):

	<u>Charitable gift annuities</u>	<u>Annuity trust and unit trusts</u>	<u>Total</u>
Assets:			
Investments:			
Fixed income funds	\$ 1,497	—	1,497
Equity strategy funds	2,176	—	2,176
Real assets	1,056	—	1,056
Bonds and notes	450	—	450
Charitable remainder trusts	—	8,305	8,305
Assets held in remainder trusts by others	—	767	767
Total assets	<u>\$ 5,179</u>	<u>9,072</u>	<u>14,251</u>
Liabilities and net assets:			
Annuities payable	\$ 3,335	5,234	8,569
Net assets	1,844	3,838	5,682
Total liabilities and net assets	<u>\$ 5,179</u>	<u>9,072</u>	<u>14,251</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2012 and 2011

(15) Fair Value of Financial Instruments

The University has estimated fair values of financial instruments using available market information and appropriate valuation methodologies. At May 31, 2012 and 2011, the carrying values of cash and cash equivalents, accounts and notes receivable, accounts payable, and accrued liabilities approximate fair value due to the short-term nature of these instruments. A reasonable estimate of the fair value of the receivables from students under government loan programs and grants refundable to the government for student loans could not be made because the notes receivable are not saleable and can only be assigned to the U.S. government or its designee. The fair value of receivables under institutional loan programs approximates carrying value. The carrying amounts of the actuarial liability for trusts and annuities payable are based on life expectancies, quoted market prices, and the applicable discount rates in effect at the time the agreements were received by the University.

Taking into account current borrowing rates as of May 31, 2012 and 2011, the fair value of the University's bonds approximates \$66,160,237 and \$62,895,000, respectively, as compared to their carrying value of \$63,480,000 and \$64,510,000, respectively. Fair value of the bonds as of May 31, 2012 reflects the difference between the current borrowing rate and the University's actual average interest rate being paid on all debt obligations.

(16) Commitments and Contingencies

The University is subject to legal proceedings generally incidental to its business. Although the final outcome of any legal proceeding is subject to many variables and cannot be predicted with any degree of certainty, the University presently believes that the ultimate outcome resulting from these proceedings would not have a material effect on the University's financial position or results of operations.

(17) Self-Insurance

The University has placed certain of its medical and dental insurance coverage with the 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 Trustee. In the event losses of PEHT exceed its capital and secondary coverages, the maximum contingent liability exposure to the University is approximately \$706,000. 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.

(18) Subsequent Events

The University evaluated subsequent events after the statement of financial position date of May 31, 2012 through October 9, 2012, which was the date the financial statements were issued, and found no reportable events.