Consolidated Financial Statements and Report of Independent Certified Public Accountants

**Southwestern University** 

June 30, 2013 and 2012

# FINANCIAL STATEMENTS

# Year ended June 30, 2013

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## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Grant Thornton LLP
1717 Main Street, Suite 1500
Dallas, TX 75201-4667
T 214.561.2300
F 214.561.2370
GrantThornton.com
linkd.in/GrantThorntonUS
twitter.com/GrantThorntonUS

Board of Trustees Southwestern University

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

# Management's responsibility for the financial statements

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

### Auditor's responsibility

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

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



GRANT THORNTON LLP

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

# Opinion

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

Dallas, Texas

October 17, 2013

# CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30,

	2013	2012
ASSETS		
Current assets: Cash and cash equivalents Receivables:	\$ 41,748,390	\$ 41,174,533
Student accounts receivable, net Unconditional promises receivable, net, current portion Investment income Other	138,010 4,548,544 154,957 1,791,681	116,338 3,790,603 269,347 595,968
Prepaids and other current assets	1,107,369	1,235,827
Total current assets	49,488,951	47,182,616
Unconditional promises receivable, net, long-term portion Investments Beneficial interests in funds held by others Investment in plant, net Student loans receivable, net Other assets	4,847,051 224,521,305 4,694,096 94,567,314 5,077,457 	10,763,770 217,366,036 3,982,986 91,209,859 4,957,449 119,729
Total	\$ <u>383,271,984</u>	\$ <u>375,582,445</u>
LIABILITIES AND NET ASSETS		
Current liabilities: Accounts payable, accrued and other liabilities Notes payable, current portion Accrued post-retirement benefits, current portion Student deposits and advance payments	\$ 6,551,078 1,380,000 861,551 	\$ 5,420,236 1,325,000 1,216,845 
Total current liabilities	10,250,154	9,165,404
Notes payable, long-term portion Accrued post-retirement benefits, long-term portion Refundable advances Deferred compensation and other long-term liabilities	23,133,947 8,969,472 3,322,554 104,150	24,542,703 44,280,146 3,298,919 92,900
Total liabilities	45,780,277	81,380,072
Net assets     Unrestricted     Temporarily restricted     Permanently restricted	96,167,694 161,792,187 79,531,826	58,253,628 157,681,583 <u>78,267,162</u>
Total net assets	337,491,707	<u>294,202,373</u>
Total	\$ <u>383,271,984</u>	\$ <u>375,582,445</u>

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

# CONSOLIDATED STATEMENT OF ACTIVITIES

For the year ended June 30, 2013

	Unrestricted Temporarily Restricted		Permanently Restricted	Total	
Operating Revenues:					
Tuition and fees	\$46,922,629	\$ -	\$ -	\$ 46,922,629	
Less: Scholarships and grants	<u>23,734,814</u>			23,734,814	
Net tuition and fees	23,187,815	-	-	23,187,815	
Private gifts and grants	6,036,197	6,908,742	546,157	13,491,096	
Government grants	228,731	472,204	-	700,935	
Investment income, net	1,874,515	17,663,951	39,760	19,578,226	
Other income (loss)	1,666,464	(28,699)	-	1,637,765	
Auxiliary enterprises	10,368,907	-	-	10,368,907	
Net assets released from restrictions	<u>15,881,239</u>	(15,881,239)			
Total operating revenues	<u>59,243,868</u>	9,134,959	<u>585,917</u>	<u>68,964,744</u>	
Operating Expenses:					
Instructional services	25,034,604	-	_	25,034,604	
Student services	9,087,253	-	-	9,087,253	
Auxiliary services	7,661,279	-	_	7,661,279	
Institutional support	<u>17,995,899</u>			17,995,899	
Total operating expenses	<u>59,779,035</u>			59,779,035	
Change in net assets from operating activities	(535,167)	9,134,959	585,917	9,185,709	
Non-Operating Activities:					
Loss on disposal of fixed assets	(575,432)	-	-	(575,432)	
Change in value of split-interest agreements Allowance for uncollectible promises	S -	(24,355)	678,747	654,392	
receivable	-	(5,000,000)	-	(5,000,000)	
Post-retirement prior service cost credit Post-retirement related changes	36,913,698	-	-	36,913,698	
other than net periodic pension costs	<u>2,110,967</u>			<u>2,110,967</u>	
Total non-operating activities	38,449,233	(5,024,355)	678,747	34,103,625	
Change in net assets	37,914,066	4,110,604	1,264,664	43,289,334	
Net assets – Beginning of year	<u>58,253,628</u>	157,681,583	<u>78,267,162</u>	<u>294,202,373</u>	
Net assets – End of year	\$ <u>96,167,694</u>	\$ <u>161,792,187</u>	\$ <u>79,531,826</u>	\$ <u>337,491,707</u>	

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

# CONSOLIDATED STATEMENT OF ACTIVITIES

For the year ended June 30, 2012

	Temporarily <u>Unrestricted</u> Restricted		Permanently Restricted	<u>Total</u>	
Operating Revenues:					
Tuition and fees	\$ 44,572,691	\$ -	\$ -	\$ 44,572,691	
Less: Scholarships and grants	<u>20,799,640</u>			20,799,640	
Net tuition and fees	23,773,051	-	-	23,773,051	
Private gifts and grants	2,804,822	14,038,452	518,293	17,361,567	
Government grants	222,704	604,429	-	827,133	
Investment loss, net	(698,178)	(5,561,003)	(14,495)	(6,273,676)	
Other income	1,412,870	27,093	-	1,439,963	
Auxiliary enterprises	9,292,620	-	-	9,292,620	
Net assets released from restrictions	18,367,549	(18,367,549)			
Total operating revenues	55,175,438	(9,258,578)	503,798	46,420,658	
Operating Expenses:					
Instructional services	24,445,112	-	-	24,445,112	
Student services	8,478,489	-	-	8,478,489	
Auxiliary services	7,644,284	-	-	7,644,284	
Institutional support	17,206,992			17,206,992	
Total operating expenses	57,774,877			57,774,877	
Change in net assets from					
operating activities	(2,599,439)	(9,258,578)	503,798	(11,354,219)	
Non-Operating Activities:					
Loss on disposal of fixed assets	(24,962)	-	-	(24,962)	
Change in value of split-interest agreemen	its -	(82,857)	(212,296)	(295,153)	
Post-retirement related changes		,	,	,	
other than net periodic pension costs	(13,487,602)			<u>(13,487,602)</u>	
Total non-operating activities	es <u>(13,512,564)</u>	(82,857)	(212,296)	(13,807,717)	
Change in net assets	(16,112,003)	(9,341,435)	291,502	(25,161,936)	
Net assets – Beginning of year	74,365,631	167,023,018	<u>77,975,660</u>	319,364,309	
Net assets – End of year	\$ <u>58,253,628</u>	\$ <u>157,681,583</u>	\$ <u>78,267,162</u>	\$ <u>294,202,373</u>	

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended June 30,

1 of the years effect fune 50;	2013	2012
Cash flows from operating activities:		
Change in net assets	\$ 43,289,334	\$ (25,161,936)
Adjustments to reconcile change in net assets to net cash used in	ıı <b>,</b> ,	" (,,
operating activities:		
Depreciation	4,296,704	4,272,948
Amortization of premiums and issuance costs on bonds	(28,757)	(28,757)
Loss on disposal of assets	602,054	32,484
Donated Stock	(1,612,910)	-
Net (gain) loss on investments	(15,245,347)	9,808,609
Change in value of split-interest agreements	(711,110)	215,443
Allowance for promises receivable	5,000,000	-
Gifts and grants restricted for endowment	(552,531)	(810,433)
(Increase) decrease in operating assets:	(4.44.600)	(0.40.40=)
Student accounts and loans receivable	(141,680)	(268,187)
Unconditional promises receivable	158,778	(6,273,727)
Investment income receivable	114,390	(169,434)
Other receivables	(1,195,713)	(57,326)
Prepaids and other assets	172,377	(53,506)
Beneficial interest in funds held by others	-	402,120
Increase (decrease) in operating liabilities:	416,318	(258,092)
Accounts payable, accrued and other liabilities Accrued post-retirement benefits	(35,665,968)	15,954,296
Student deposits and advance payments	254,202	42,315
Refundable advances	23,636	(70,095)
Deferred compensation and other long-term liabilities	11,250	16,500
	•	
Net cash used in operating activities	(814,973)	(2,406,778)
Cash flows from investing activities:		
Purchases of investments	(154,780,723)	(135,904,687)
Sales of investments	164,483,711	144,717,102
Purchases of fixed assets	<u>(7,541,689</u> )	(4,332,347)
Net cash provided by investing activities	2,161,299	4,480,068
Cash flows from financing activities:	(4.225.000)	(4.260.000)
Payment on notes payable	(1,325,000)	(1,260,000)
Gifts and grants restricted for endowment	<u>552,531</u>	<u>810,433</u>
Net cash used in financing activities	<u>(772,469</u> )	(449,567)
Net increase in cash and cash equivalents	573,857	1,623,723
Cash and cash equivalents - Beginning of year	41,174,533	39,550,810
Cash and cash equivalents - End of year	\$ <u>41,748,390</u>	\$ <u>41,174,533</u>
Supplemental cash flow information:		
	\$ 363,441	\$ <u>420,353</u>
Interest paid Noncash information:	Ψ <u>JUJ,<del>11</del>1</u>	Ψ <u>+40,333</u>
Donated Stock	1,612,910	_
Additions to fixed assets in accounts payable	714,524	668,958
to intel account payable		
Total noncash information	\$ <u>2,327,434</u>	\$ <u>668,958</u>

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

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013 and 2012

#### **NOTE 1 - NATURE OF OPERATIONS**

Southwestern University (the "University"), located in Georgetown, Texas, is the oldest chartered institution of higher learning in the state. It traces its roots to the 1840 founding of Rutersville College in the Republic of Texas near La Grange. A nationally recognized, independent, undergraduate liberal arts college affiliated with the United Methodist Church, the University has an enrollment of 1,346 students and a current student-to-faculty ratio of 10.4:1. Students choose from 38 major programs in the University's two academic areas, The Brown College of Arts and Sciences and the Sarofim School of Fine Arts.

The revenues generated by the University consist primarily of tuition and fees paid by students. Many students rely on funds received from federal financial aid programs under Title IV of the Federal Higher Education Act of 1965 (HEA), as amended, to pay for a substantial portion of their tuition. As an educational institution, the University is subject to licensure from various accrediting and state authorities and other regulatory requirements of the United States Department of Education (USDE).

Southwestern Foundation (the "Foundation"), a Texas non-profit corporation, was founded in 1993. The Foundation is organized and operated to maintain real or personal property and to use and apply the income therefrom and the principal thereof exclusively for charitable, scientific, literary and educational purposes. The Foundation is administered solely for the benefit and support of Southwestern University. For reporting purposes, the Foundation is consolidated in Southwestern University's consolidated financial statements. Inter-entity transactions have been eliminated in the consolidated financial statements. Hereinafter the "University" will refer to the consolidated entity including both Southwestern University and Southwestern Foundation.

Tax-Exempt Status - The University claims exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The University files unrelated business income tax and other information returns as required by government authorities. There were no unrelated business income taxes for the years ended June 30, 2013 and 2012. The University has concluded that it does not have any unrecognized tax benefits resulting from current or prior period tax positions. Accordingly, no additional disclosures have been made on the consolidated financial statements regarding uncertain tax provisions.

Student Financial Assistance Programs - The University participates in various student financial aid programs. These programs are subject to periodic review by the USDE pursuant to the HEA, as amended. In order to continue to participate in Title IV Programs, the University must comply with the standards set forth in the HEA and the regulations promulgated thereunder (the "Regulations"). Among other things, these Regulations require the University to exercise due diligence in approving and disbursing funds and servicing loans, and to exercise financial responsibility related to maintaining certain financial ratios and requirements, all of which have been met at June 30, 2013 and 2012.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Financial Statement Presentation** - The consolidated financial statements of the University have been prepared on the accrual basis of accounting.

The three net asset categories as reflected in the accompanying consolidated financial statements are as follows:

*Umrestricted* - Unrestricted net assets are assets that are free of donor-imposed restrictions, including all revenues, expenses, gains, and losses that are not changes in permanently or temporarily restricted net assets. Since this category includes realized and unrealized gains on endowment and other long-term investments, the University's policy is to reinvest a portion of such earnings for future growth.

Temporarily Restricted - Temporarily restricted net assets are assets for which use by the University is limited by donor-imposed stipulations that either expire by passage of time or that can be fulfilled or removed by actions of the University pursuant to those stipulations. Such uses for temporarily restricted net assets as of June 30, 2013 and 2012 are as follows:

	2013	2012
Scholarships	\$ 34,605,553	\$ 31,011,865
Professorships and faculty development	36,301,129	34,969,140
Plant	13,492,473	17,973,125
Other	15,276,572	14,510,040
Restricted for use in future periods	<u>62,116,460</u>	59,217,413
Total	\$ <u>161,792,187</u>	\$157,681,583

Permanently Restricted - Permanently restricted net assets are assets for which use by the University is limited by donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the University.

The corpus of permanently restricted net assets is required to be invested in perpetuity, with the income from such net assets as of June 30, 2013 and 2012, being expendable to support the following:

	2013	2012
Unrestricted	\$28,367,128	\$28,366,028
Scholarships	30,671,456	30,146,458
Professorships and faculty development	9,751,859	9,747,359
Plant	1,488,758	1,488,758
Other	<u>9,252,625</u>	<u>8,518,559</u>
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Total	\$ <u>79,531,826</u>	\$ <u>78,267,162</u>

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Cash and Cash Equivalents - The University considers all highly liquid assets with a maturity of three months or less when purchased as cash and cash equivalents. Cash and cash equivalents held in transition for investment are included in investments. The University places its cash and cash equivalents with high quality financial institutions, which at times may exceed federally insured limits. The University has not experienced any losses on such accounts.

**Loans Receivable** - The Federal Perkins Loan Program consists primarily of funds advanced to students by the U.S. government. Under the terms of the program, these loans are subject to forgiveness or assignment back to the federal government under certain circumstances. The amount to be forgiven or assigned is based on the occurrence of certain future events that cannot be anticipated.

**Investments** - Investments with readily determinable fair values are stated at fair value. Fair value is 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. Investments in securities traded on a national securities exchange are valued at the last reported sales price on the last business day of the fiscal year. Investments in government obligations are valued at the bid price or the average of the bid and asked price on the last business day of the year from published sources where available and, if not available, from other sources considered reliable. Purchases and sales of securities are recorded as of the trade date. Realized gains and losses on sales of securities are determined on the basis of average cost. Interest income is recognized on the accrual basis. Dividend income is recognized on the ex-dividend date. Investments in real estate and other investments are reported at either cost or the fair value at the date the gift was received.

Investments held in privately managed institutional funds are valued at redemption values that represent the net asset values of units held at year-end in accordance with ASU 2010-12, *Investments in Certain Entities that Calculate Net Asset Value Per Share (or Its Equivalent)*, as discussed in Note 6.

Alternative investments consist of the University's investments in hedge funds, private equity, venture capital, real estate, and other alternative investments that are not publicly traded. Participation in these funds is achieved via ownership of shares in limited partnerships and limited liability companies. Some of these alternative investments may entail liquidity risks to the extent that they are difficult to sell or cannot be converted readily to cash at favorable prices. The University's alternative investments are not traded in an active market; however, the net asset value (NAV) of the shares is reported by the fund manager on a monthly or quarterly basis.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Contributions - All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. The University reclassifies to unrestricted net assets contributions recognized as temporarily restricted due to donor-imposed restrictions upon fulfilling the donor's restrictions. However, if a restriction is fulfilled in the same time period in which the contribution is received, the University reports the support as unrestricted. Unconditional promises receivable are recorded at the present value of their estimated future cash flows, net of allowances. An allowance for uncollectible promises receivable is determined by a specific review based upon management's judgment, including such factors as prior collection history and currently available information relating to the donor's intent and ability to satisfy the pledge. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are expected to be received. Amortization of the discounts is included in contribution revenue. Conditional promises to give are not included as support until the likelihood of not fulfilling the condition is remote.

Bequests in Probate and Conditional Promises Receivable - The University considers unconditional bequests, as declared valid by probate court, to be unconditional promises receivable. Unconditional bequests that are not in probate are considered to be intentions to give and are not recognized in the consolidated financial statements.

**Investment in Plant** - Additions are generally recorded at cost at the date of acquisition or at fair value at the date of donation. Normal replacements of movable plant assets are charged to expense as maintenance. The University's asset capitalization threshold is \$2,500 for individual asset acquisitions.

Depreciation of physical plant and equipment was \$4,296,704 and \$4,272,948 for 2013 and 2012, respectively. Depreciation is computed using the straight-line method for all depreciable assets over their estimated useful lives as follows:

Computers and software	5 years
Automobiles	5 years
Furniture and equipment	7 years
Grounds improvements	15 years
Library books	25 years
Buildings	40 years

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Starting in July 2012, depreciation for new physical plant building renovations and construction is computed using the straight-line method for all depreciable assets over the following useful lives:

Building Shell	40 years
Elevator System	20 years
Fire Protection System	20 years
Fixed Equipment Assets	20 years
Plumbing System	20 years
Electrical and Lighting System	20 years
Floor Coverings	15-30 years
HVAC	15 years
Interior Finish	15 years
Miscellaneous	15 years
Roof Covering	10-30 years

**Bond Issuance Costs** - In conjunction with the issuance of the Series 2004A, Series 2004B and Series 2006 bonds, the University capitalized \$209,330, \$203,291, and \$53,150, respectively, of deferred financing costs. The University amortizes such costs on a straight-line basis, which approximates effective interest, over the respective lives of the bonds. Such deferred issuance costs are included in other assets, net of accumulated amortization.

**Split-Interest Agreements** - The University is the income or remainder beneficiary for various perpetual and charitable remainder trusts held by third-party trustees where the trustee has no discretion regarding the beneficiaries' participation in the trust. The University's beneficial interest in these agreements and related contribution revenue is recognized at the fair value at the date of donation. Changes from year to year in the fair value of the University's beneficial interest are reported as a change in value of split-interest agreements in the appropriate net asset class according to the trust restrictions.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Scholarships and Grants - The consolidated statements of activities present financial assistance provided to students in the form of institutional scholarships and grants as a reduction to tuition and fees revenues. Scholarships and grants include programs supported by donor-restricted endowments, donor-restricted gifts and grants and programs supported by general operations of the University. The following table presents the amount of scholarships and grants revenue reduction, and the related percentage of tuition and fee revenues supported by donor-restricted and general operation support scholarships and grants revenue reductions:

	2013		2012	
	Amount	Discount Rate to Tuition	Amount	Discount Rate to Tuition
Scholarships and grants supported by endowments and gifts Scholarships and grants supported	\$ 2,757,791	5.9%	\$ 2,888,513	6.5%
by general operations	<u>20,977,023</u>	<u>44.7%</u>	<u>17,911,127</u>	<u>40.2</u> %
Total scholarships and grants	\$ <u>23,734,814</u>	<u>50.6%</u>	\$ <u>20,799,640</u>	<u>46.7</u> %

Allocation of Certain Expenses - The consolidated statements of activities present expenses by functional classification. The University's primary program services are instruction and student services. Expenses reported as institutional support and auxiliary services are incurred in support of these primary program services. Depreciation, interest expense and the cost of operation and maintenance of plant facilities are allocated to functional categories based on building square footage dedicated to that specific function.

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

Change in Accounting Estimate – During the fiscal year 2013, management changed the policy for the estimated useful life of property, plant, and equipment due to new tax regulation changes. This change in the useful life of property, plant, and equipment was accounted as a change in the accounting estimate for new physical plant building renovations and construction beginning from July 1, 2012 as discussed in the Investment in Plant section of Note 2.

**Reclassification to Prior Year Financial Statements** – As of June 30, 2013, the University changed the reporting of the statements of activities to provide a measure of operations by separating operating and non-operating activities. Certain prior year amounts have been reclassified for comparative purposes to conform to the current year's presentation.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

## NOTE 3 - STUDENT ACCOUNTS AND LOANS RECEIVABLE

#### Student Accounts

Student accounts receivable are reported net of allowances for doubtful accounts of \$471,094 and \$398,342 for the years ended June 30, 2013 and 2012, respectively. Allowance for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence collectability of the balance outstanding. The allowance percentage ranges from 10% for accounts past due 30 days to 100% for accounts past due 181 or more days but still undergoing collection procedures. Balances are written off only when they are deemed permanently uncollectible. Amounts due under the Perkins loan program are guaranteed by the government and, therefore, no reserves are placed on any past due balances under the program.

#### Loans Receivable

The University makes uncollateralized loans to students based on financial need. Student loans are funded through Federal government loan programs or institutional resources. At June 30, 2013 and 2012, student loans represent 1.3% of total assets.

At June 30, student loans consisted of the following:

	2013	2012
Federal government programs	\$4,102,371	\$4,202,633
Institutional programs	1,348,869	<u>1,126,570</u>
Less allowance for doubtful accounts:	<u>5,451,240</u>	<u>5,329,203</u>
Beginning of year	(371,754)	(333,830)
Increases	(2,029)	(37,924)
End of year	(373,783)	(371,754)
Student loans receivable, net	\$ <u>5,077,457</u>	\$ <u>4,957,449</u>

The University participates in the Perkins federal revolving loan program. The availability of funds for loans under the program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the Federal government and net accumulations in the revolving loan fund were \$3,233,420 and \$3,179,812 at June 30, 2013 and 2012, respectively, and are ultimately refundable to the government and are classified as refundable advances in the consolidated statements of financial position. Outstanding loans cancelled under the program result in a reduction of the funds available for loan and a decrease in the liability to the government.

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

<u>June 30,</u>	Currently due	31-90 days past due	90+ days past due	Total past due
2013	\$1,861,638	\$348,862	\$1,394,998	\$3,605,498
2012	\$1,817,156	\$196,732	\$1,375,382	\$3,389,270

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 4 - UNCONDITIONAL PROMISES RECEIVABLE

Unconditional promises receivable at June 30, 2013 and 2012, consist of the following:

	2013	2012
Restricted for scholarships	\$ 373,885	\$ 379,636
Restricted for plant	10,277,246	11,312,787
Restricted for other uses	3,037,001	2,770,719
Restricted for use in future periods	<u>744,225</u>	<u>199,859</u>
•	14,432,357	14,663,001
Present Value Discount	(36,762)	(108,628)
Allowance for uncollectable promises receivable	(5,000,000)	
Unconditional promises receivable, net	\$ <u>9,395,595</u>	\$ <u>14,554,373</u>

As of June 30, 2013 and 2012, the expected gross amounts to be received from unconditional promises receivable are as follows:

	2013	2012
Less than one year	\$ 4,548,544	\$ 3,790,603
One to five years  More than five years	9,880,313 	10,866,898 5,500
Total unconditional promises receivable	\$ <u>14,432,357</u>	\$ <u>14,663,001</u>

The University uses discount rates commensurate with the risks involved to discount anticipated cash flows for unconditional promises receivable. The rates used to discount the anticipated cash flows ranged from 0.3% to 5.3% for 2013 and 2012.

At June 30, 2013, the University held a conditional promise receivable of \$5,892,000 which is not recognized in the consolidated financial statements because, in the judgment of management, the likelihood of meeting the condition is remote. The conditional promise receivable is scheduled to be received in annual installments through fiscal 2019, but is terminated upon the death of the promisor.

At June 30, 2013, the University held a second conditional promise receivable of \$1,500,000, which is not recognized in the consolidated financial statements because, in the judgment of management, the likelihood of meeting the condition is uncertain. This conditional promise receivable is scheduled for receipt of \$500,000 per year in 2016, 2017 and 2018, but is subject to the financial condition of the donor in 2016 and is subject to approval by the then-serving donor's Trustees.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

## **NOTE 5 - INVESTMENTS**

Investments consist of long-term assets controlled by the University. Investment securities are exposed to various risks such as interest rate, liquidity, market, currency and credit. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the consolidated statements of financial position.

A summary of investments at June 30, 2013 and 2012 is as follows:

	2013	2012
At fair value:		
Cash equivalents	\$ 11,127,378	\$ 14,436,625
Fixed income and co-mingled fixed income funds	35,840,827	30,525,735
Equities, equity mutual funds and co-mingled equity funds	113,615,477	96,791,490
Alternative investments	55,416,068	67,045,826
Total at fair value	215,999,750	208,799,676
At cost or market at date of acquisition:		
Real estate	8,356,044	8,372,043
Other	<u>165,511</u>	<u>194,317</u>
Total at cost or market at date of acquisition	8,521,555	8,566,360
Total investments	\$ <u>224,521,305</u>	\$ <u>217,366,036</u>
Investment income earned by the University is as follows:		
	2013	2012
Investment income	\$ 5,379,580	\$ 5,897,461
Net gains (losses) on investments reported at fair value	15,245,347	(9,808,609)
Other income	1,558,654	494,783
Investment fees and expenses	(2,605,355)	(2,857,311)
Total investment income (loss), net	\$ <u>19,578,226</u>	\$ <u>(6,273,676</u> )
Investment fees and expenses netted against investment income are components:	comprised of	the following
I amount	2013	2012
Management, direct fund and custodial fees	\$1,514,102	\$1,579,216
Commingled fund and partnership expenses	883,941	1,240,506
Incentive fees*	207,312	<u>37,589</u>
Total investment fees and expenses	\$ <u>2,605,355</u>	\$ <u>2,857,311</u>

<sup>\*</sup>Incentive fees depicted above are only fees charged as of the report date. Management is aware future amounts could differ based on unknown fee amounts for funds in which the University is invested.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### **NOTE 6 - FAIR VALUE MEASUREMENT**

The University measures the fair value of investments using a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1 - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the University has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

Level 2 - Valuations based on quoted prices in markets that are not active and for which all significant inputs are observable, either directly or indirectly. The University holds Level 2 inputs investments, which included certain co-mingled equity funds, co-mingled debt funds and most government agency securities, investment-grade corporate bonds, certain mortgage products, less-liquid equities, and state and municipal obligations.

Level 3 - Valuations based on inputs that are unobservable. The University holds Level 3 inputs investments, which included certain hedge funds, private equity, venture capital, real estate investments, less liquid corporate debt securities (including distressed debt instruments), collateralized debt obligations, and less liquid mortgage securities (backed by either commercial or residential real estate), and some privately held currently non-marketable common stock. When observable prices are not available for these securities, the University uses one or more valuation techniques for which sufficient and reliable data is available. The degree of judgment exercised in determining fair value is greatest for securities categorized in Level 3, due to the inherent uncertainty of these valuations. Level 3 estimated values may differ significantly from the values that would have been used had a ready market for the investment existed, and the differences could be material.

The inputs used by the University in estimating the value of Level 3 investments include the original transaction price, recent transactions in the same or similar instruments, completed or pending third-party transactions in the investment or comparable issuers, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows. Level 3 investments may also be adjusted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the University in the absence of market information. The fair value measurement of Level 3 investments does not include transaction costs that may have been capitalized as part of the security's cost basis.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

# NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table presents the financial instruments carried on the consolidated statements of financial position by caption and by level within the valuation hierarchy as of June 30, 2013.

	Assets at Fair Value as of June 30, 2013			
	Level 1	Level 2	Level 3	Total
Investments carried at fair value:				
Cash equivalents	\$11,127,378	\$ -	\$ -	\$ 11,127,378
Equities:				
Large Cap equity, mutual				
funds and co-mingled funds	39,229,150	126,171	-	39,355,321
All cap co-mingled funds	-	14,978,255	-	14,978,255
International co-mingled funds	-	49,281,901	-	49,281,901
Emerging markets co-mingled funds	-	10,000,000	-	10,000,000
Fixed income:				
Mutual Funds	-	392,738	-	392,738
Core bonds co-mingled funds	-	21,314,094	-	21,314,094
Global bonds co-mingled funds	-	6,811,976	-	6,811,976
Inflation-protected U.S. Treasury				
co-mingled funds	-	5,815,538	-	5,815,538
U.S. Treasury and agency				
co-mingled funds	-	1,506,481	-	1,506,481
Alternative investments:				
Natural resources stock index co-mingled				
funds and limited partnerships	-	10,389,890	3,435,891	13,825,781
Commodities co-mingled funds	-	5,032,615	-	5,032,615
Distressed debt limited partnerships	-	-	8,414,008	8,414,008
Directional strategies co-mingled funds	-	4,178,682	-	4,178,682
Relative value and event-driven				
co-mingled funds	-	-	16,530,787	16,530,787
Private capital limited partnerships	-	-	6,063,221	6,063,221
Private equity		<del></del>	1,370,974	1,370,974
Total investments valued at fair value	50,356,528	129,828,341	35,814,881	215,999,750
Beneficial interest in funds held by others			<u>4,694,096</u>	4,694,096
Total	\$ <u>50,356,528</u>	\$ <u>129,828,341</u>	\$ <u>40,508,977</u>	\$ <u>220,693,846</u>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

# NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table includes additional disclosures required by Accounting Standards Codification (ASC) 820 for the fair value measurements of investments valued at net asset value at June 30, 2013.

<u>Category</u>	Level 2 Fair Value	Level 3 <u>Fair Value</u>	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Equity mutual funds	\$ 126,171	\$ -	\$ -	Daily	N/A
Fixed income mutual funds	392,738	¥ <u>-</u>	Ψ -	Daily	N/A
All cap equity co-mingled funds	,	_	_	Monthly	5 days
International equity co-mingled	11,570,200			1.10111111	o day o
funds	13,694,403	_	_	Semi-monthly	2 days
International equity co-mingled				,	, -
funds	35,587,498	-	-	Monthly	5 days
Emerging markets equity				,	,
co-mingled funds	10,000,000	-	-	Weekly	5 days
Core bonds co-mingled funds	10,442,327	-	-	Weekly	5 days
Core bonds co-mingled funds	10,871,767	-	-	Monthly	15 days
Global bonds co-mingled funds	6,811,976	-	-	Monthly	5 days
Inflation-protected U.S.				·	•
Treasury co-mingled funds	5,815,538	-	-	Monthly	5 days
U.S. Treasury and agency					
co-mingled funds	1,506,481	-	-	Daily	N/A
Natural resources stock index					
co-mingled funds	10,389,890	-	-	Daily	2 days
	-	-	-	No redemption	
	-	-	-	capability until	
	-	-	-	partnership	
	-	-	-	liquidation in	
Natural resources limited	-	-	-	August 2023 &	
partnership	-	3,435,891	6,400,000	December 2026	-
Commodities co-mingled funds Distressed debt limited	5,032,615	-	-	Monthly	5 days
partnerships	-	8,414,008	1,563,200	Annually	95 days
Directional strategies				•	•
co-mingled funds	4,178,682	-	-	Quarterly	95 days
Relative value and event-					·
driven co-mingled funds	-	16,530,787	-	Annually	95 days
Private capital LP's – Strategic					
Core Real Estate Fund	-	2,359,797	-	Quarterly No redemption	120 days
Private capital LP's – Realty	-	-	-	except as	-
Opportunity Fund	-	1,064,109	1,957,415	approved by GP	
Private equity	-	1,370,974	-	No redemption	-
Private capital LP's				No redemption capability until partnership liquidation in December 2023, January 2024, January 2026 &	
partnerships		2,639,315	11,863,000	February 2027	-
Total	\$ <u>129,828,341</u>	\$ <u>35,814,881</u>	\$ <u>21,783,615</u>		

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 6 - FAIR VALUE MEASUREMENT - Continued

Certain investments valued at net asset value were classified as Level 2 because substantially all of the holdings of each fund are in securities traded in an active market; however, the University's ownership in the co-mingled fund itself is valued at the net asset value of the fund as of June 30. The University believes these investments can be readily liquidated at values approximating fair value as of the balance sheet date.

Certain investments valued at net asset value were classified as Level 3 in the preceding table, including multi-manager funds using long-short and directional equity, distressed debt and private equity strategies.

The following provides additional disclosures required by ASC 820 for alternative investment strategies included in Level 3 and valued at net asset value:

Natural resources. This limited partnership invests primarily in limited partnerships, which in turn make oil, gas and other natural resources-related investments with the objective of obtaining long-term growth of capital. A commitment of \$5 million was made by the University in 2012 to this fund. Along with the remaining portion of the initial \$5 million commitment that was made in 2008, there is \$6,400,000 in remaining commitments to this fund at June 30, 2013. Of this total, \$950,000 is expected to be funded by the University during fiscal year 2014. The initial partnership investment is expected to terminate in August 2023, unless terminated earlier by the general partner in accordance with the provisions of the partnership agreement. The second partnership investment is expected to terminate in December 2026, unless terminated earlier by the general partner. Fair value of this investment was determined using net asset values.

**Global distressed debt.** This fund invests in restructured debt, stressed debt, distressed debt, "special situation" debt and mezzanine debt instruments and seeks to provide a net internal rate of return in the mid-teens. The University's remaining commitment to this fund was \$1,563,200 as of June 30, 2013, of which \$480,000 is expected to be funded by the University during fiscal 2014. Fair value of this investment was determined using net asset values.

Core real estate fund. This limited liability company invests in a diversified portfolio of open-end funds that focus on core real estate investing. A \$2 million commitment was made by the University to this fund in 2012, with funding completed during fiscal 2013. Fair value of this investment was determined using net asset values.

**Realty opportunity fund.** This limited partnership invests in value-add, distressed and opportunistic private real estate funds. The University made a \$3,000,000 commitment to this fund in fiscal 2012. The remaining commitment as of June 30, 2013 is \$1,957,415, of which \$1,080,000 is expected to be funded by the University during fiscal 2014. Fair value of this investment was determined using net asset values.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 6 - FAIR VALUE MEASUREMENT - Continued

International private equity and venture capital. These limited partnerships invest in a diversified portfolio of international private capital funds with the objective of generating higher returns than those generally available on the foreign listed securities exchanges over a long-term horizon. The partnerships are scheduled to terminate in December 2023, January 2024, January 2026 and February 2027. With no new commitments in fiscal 2013, the University has remaining commitments to these funds of \$11,863,000, as of June 30, 2013, of which \$1,520,000 is expected to be funded by the University during fiscal 2014. Fair value of these investments are determined using net asset values.

**Private equity**. Shares of common stock in a bank holding company were donated to the University during fiscal year 2013. A third party report of per share valuation was reviewed along with public financial reports for the bank. The University has discounted this value until the shares become marketable.

The following table includes a roll forward for the year ended June 30, 2013 of amounts for financial instruments classified within Level 3. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement. The unobservable inputs and valuation techniques are not disclosed due to all information being provided by third parties.

	Alternative Investments
Balance - June 30, 2012	\$39,374,700
Purchases	3,501,485
Sales	(8,120,707)
Transfers	1,612,910
Net investment income	207,832
Net realized gains	3,221,647
Change in value of split-interest agreements	<u>711,110</u>
Balance - June 30, 2013	\$ <u>40,508,977</u>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

# NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table presents the financial instruments carried on the consolidated statement of financial position by caption and by level within the valuation hierarchy as of June 30, 2012.

	Assets at Fair Value as of June 30, 2012			
	Level 1	Level 2	Level 3	Total
Investments carried at fair value:				
Cash equivalents	\$14,436,625	\$ -	\$ -	\$ 14,436,625
Equities:				
Large Cap equity, mutual				
funds and co-mingled funds	41,746,441	106,343	-	41,852,784
All cap co-mingled funds	-	22,608,113	-	22,608,113
International co-mingled funds	-	12,704,041	-	12,704,041
Emerging markets co-mingled funds	-	19,626,552	-	19,626,552
Fixed income:				
Mutual Funds	-	413,050	-	413,050
Core bonds co-mingled funds	-	16,490,992	-	16,490,992
Global bonds co-mingled funds	-	9,353,917	-	9,353,917
Inflation-protected U.S. Treasury				
co-mingled funds	-	3,374,923	-	3,374,923
U.S. Treasury and agency				
co-mingled funds	-	892,853	-	892,853
Alternative investments:				
Natural resources stock index co-mingled				
funds and limited partnerships	-	4,411,703	2,199,684	6,611,387
Commodities co-mingled funds	-	10,001,192	-	10,001,192
Distressed debt limited partnerships	-	-	7,279,252	7,279,252
Directional strategies co-mingled funds	-	17,241,217	1,925,354	19,166,571
Relative value and event-driven				
co-mingled funds	-	-	20,175,805	20,175,805
Private capital limited partnerships		<del></del>	3,811,619	3,811,619
Total investments valued at fair value	56,183,066	117,224,896	35,391,714	208,799,676
Beneficial interest in funds held by others			3,982,986	3,982,986
Total	\$ <u>56,183,066</u>	\$ <u>117,224,896</u>	\$ <u>39,374,700</u>	\$ <u>212,782,662</u>

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table includes a roll forward for the year ended June 30, 2012 of amounts for financial instruments classified within Level 3. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement.

	Alternative <u>Investments</u>
Balance - June 30, 2011	\$ 42,641,079
Purchases	31,839,190
Sales	(35,052,083)
Transfers	1,925,354
Net investment income	61,056
Net realized losses	(1,824,453)
Change in value of split-interest agreements	(215,443)
Balance - June 30, 2012	\$ <u>39,374,700</u>

## **NOTE 7 - ENDOWMENTS**

The University's endowment consists of approximately 450 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Adoption and Interpretation of Relevant Law - The University interprets the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) enacted in the State of Texas as allowing the University, absent explicit donor stipulations to the contrary as stated in the gift instrument, to appropriate as much of a donor-restricted endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment is established. However, during the years ended June 30, 2013 and 2012, the University continued to preserve the fair value of the original gift as of the gift date of the donor-restricted endowment funds. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified 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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

# NOTE 7 - ENDOWMENTS - Continued

In accordance with UPMIFA, the University considers the following seven 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 or deflation
- 5. The expected total return from income and the appreciation of investments
- 6. Other resources of the University
- 7. The University's investment policies

Endowment Net Asset Composition By Type of Fund As of June 30, 2013	<u>Unrestricted</u>	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds Board-designated endowment funds	\$ (180,923) 34,492,656	\$139,631,334	\$79,006,570 	\$218,456,981 _34,492,656
Total endowment net assets	\$ <u>34,311,733</u>	\$ <u>139,631,334</u>	\$ <u>79,006,570</u>	\$ <u>252,949,637</u>
Endowment Net Asset Composition By Type of Fund As of June 30, 2012	<u>Unrestricted</u>	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds Board-designated endowment funds	\$ (421,299) 39,808,092	\$133,487,929	\$77,748,224 ———————————————————————————————————	\$210,814,854 _39,808,092
Total endowment net assets	\$ <u>39,386,793</u>	\$ <u>133,487,929</u>	\$ <u>77,748,224</u>	\$ <u>250,622,946</u>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

# NOTE 7 - ENDOWMENTS - Continued

The University endowment net assets and changes in endowment nets assets for the years ended June 30, 2013 and 2012 are reported in the following table. The University's beneficial interest in funds held in trust by others of \$4,694,096, \$3,982,986, and \$4,600,549 for June 30, 2013, 2012, and 2011, respectively, is included in endowment net asset balances within the table. Changes in the fair value of the University's beneficial interest in funds held in trust by others is reported as change in value of split-interest agreements within the table.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at June 30, 2011	\$ 42,024,665	\$149,875,725	\$77,082,509	\$268,982,899
Investment return:				
Investment income (loss)	(715,829)	(5,680,020)	-	(6,395,849)
Change in value of split-interest agreements		(32,054)	(183,389)	(215,443)
Total net investment return	(715,829)	(5,712,074)	(183,389)	(6,611,292)
Contributions	(25,315)	5,315	765,477	745,477
Funds with deficiencies reclassification	(312,034)	312,034	-	-
Appropriated for expenditure	(12,176,057)	- (4.0.002.074)	-	(12,176,057)
Net assets released from restrictions Transfers to/from other funds	10,993,071 (401,708)	(10,993,071)	83,627	(318,081)
Endowment net assets at June 30, 2012	39,386,793	133,487,929	77,748,224	250,622,946
Investment return:				
Investment income	1,807,006	16,436,120	-	18,243,126
Change in value of split-interest agreements		5,295	705,815	711,110
Total net investment return	1,807,006	16,441,415	705,815	18,954,236
Contributions	1,612,910	-	552,531	2,165,441
Appropriated for expenditure	(11,494,038)	-	-	(11,494,038)
Net assets released from restrictions	10,059,548	(10,059,548)	-	-
Funds with deficiencies reclassification	297,188	(297,188)	-	-
Transfers to/from other funds	<u>(7,357,674</u> )	<u>58,726</u>	<del></del>	<u>(7,298,948</u> )
Endowment net assets at June 30, 2013	\$ <u>34,311,733</u>	\$ <u>139,631,334</u>	\$ <u>79,006,570</u>	\$ <u>252,949,637</u>

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 7 - ENDOWMENTS - Continued

Endowment Funds With Deficiencies - From time-to-time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level required by the donor-restriction to retain as a fund of perpetual duration. These deficiencies typically result from unfavorable market fluctuations that occur shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. Deficiencies of this nature are reported as a reduction of unrestricted net assets and totaled \$180,923 and \$421,299, as of June 30, 2013 and 2012, respectively.

**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 over time. 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.

The University seeks an average total annual return that exceeds the spending/payout rate plus inflation, as measured over 5- and 10-year periods in order to preserve, over time, the principal value of the assets as measured in real, inflation-adjusted terms. The endowment is a long-term pool of funds with an indefinite time horizon that runs concurrent with the endurance of the institution, in perpetuity. As such, the endowment assets are invested with a time horizon that extends well beyond a normal market cycle, and can assume an above-average level of risk as measured by the standard deviation of annual returns. The University seeks to minimize portfolio risk through use of professional asset management and sufficient portfolio diversification to smooth volatility and help ensure reasonable consistency of return over time.

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 diversified asset allocation among both equity and fixed income strategies. As a long-term policy guideline, endowment assets are allocated between equity classes, 70% (with ranges of 60-80%), and fixed income asset class investments, 30% (with ranges of 20-40%). The University's policy statement restricts investment in non-traditional (alternative) asset classes to no more than 50% of the portfolio, and restricts the total amount of illiquid investments to 25% or less of the portfolio. An illiquid investment is defined by the policy statement to mean "investments that could not be converted to cash in an orderly market over a period of twelve months or in a shorter period of time by accepting a discount of more than 10%."

**Spending Policy** - The University has adopted a spending formula for determining that part of the total return on endowment funds which can be expended annually. The spending formula determines spendable endowment return as a percentage of the 20-quarter average endowment market value, excluding investments in real estate, as of June 30 of the preceding fiscal year. The spending rate was 5.0% for fiscal year 2013 and 5.15% for fiscal year 2012. The University plans to maintain the 5.0% spending rate going forward. Spending on endowments with a market value less than \$25,000 is retained in the endowment unless distribution is specifically required by the donor.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 7 - ENDOWMENTS - Continued

The University employs a reduced spending rate for endowments with deficiencies of market value to permanently restricted net asset value as of the date of the spending calculation. For endowments with deficiencies less than 10%, the spending rate is reduced to 4%. For endowments with deficiencies greater than 10% but less than 20%, the spending rate is reduced to 3%. Endowments with deficiencies greater than 20% have no spending appropriation for the year.

In establishing this policy, the University considered the long-term expected return on its endowment. Accordingly, over the long term, the University expects the current spending policy, and planned changes to that policy, to allow its endowment to grow at an average rate that equals or exceeds inflation.

In October 2011, upon approval by the Board of Trustees, the University announced it was re-initiating a football program and beginning a women's lacrosse program as part of the University's student life programs under the direction of the President and the Director of Intercollegiate Athletics. Initial start-up costs were incurred in fiscal year 2013 and include costs for facilities (playing fields and field house) and start-up costs for coaches, equipment, and related costs. These costs totaled \$7.4 million in fiscal year 2013 and were funded with endowment withdrawals from unrestricted funds functioning as endowment. An additional \$3.0 million in start-up costs is estimated for fiscal year 2014 with funding provided by endowment withdrawals from unrestricted funds functioning as endowment. The Board of Trustees has plans to substantially replenish these funds from gifts pledged to date, new gifts to be secured, and from football program revenues including net tuition revenue.

## **NOTE 8 - INVESTMENT IN PLANT - NET**

At June 30, 2013 and 2012, investment in plant - net consists of the following:

	2013	2012
Land	\$ 111 <b>,</b> 509	\$ 111,509
Buildings	132,151,088	129,120,954
Furniture and equipment and computers and software	20,228,581	21,741,831
Library books	10,535,920	10,416,915
Automobiles	855,688	770,766
Ground improvements	13,725,474	<u>14,706,246</u>
Total property	177,608,260	176,868,221
Less accumulated depreciation	(91,248,485)	(91,532,483)
•	86,359,775	85,335,738
Construction in progress	8,207,539	5,874,121
Investment in plant - net	\$ <u>94,567,314</u>	\$ <u>91,209,859</u>

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### **NOTE 9 - NOTES PAYABLE**

The University's notes and bonds payable as of June 30, 2013 and 2012, including related premiums of \$28,947 and \$57,703, respectively, consisted of the following:

	2013	2012
Revenue Refunding Bonds Series 2004A	\$ 1,253,947	\$ 2,462,703
Revenue Refunding Bonds Series 2004B	19,040,000	19,040,000
City of Riesel Education Facilities Corporation 2006 Note	4,220,000	4,365,000
Total	\$ <u>24,513,947</u>	\$ <u>25,867,703</u>

On July 13, 2004, the University entered into a loan agreement with the issuer under which the City of Crawford Education Facilities Corporation Higher Education Revenue Refunding Bonds (Southwestern University Project), Series 2004A, dated July 1, 2004, were issued at an aggregate par value of \$10,410,000. The issuer loaned the proceeds from the sale of the 2004A Bonds to the University, evidenced by a promissory note between the University and the issuer. The bonds were issued for the purpose of refunding the City of Georgetown Higher Education Finance Corporation Higher Education Revenue Bonds, Series 1994, and to pay costs of issuance of the Series 2004A Bonds. The bonds were issued at a premium of \$287,757, of which \$28,757 was amortized against interest expense during fiscal years 2012 and 2013. The University contributed \$326,260 at closing which, together with the net proceeds of the Series 2004A Bonds, was transferred to The Bank of New York Trust Company, N.A., as trustee under the trust indenture providing for the issuance of the Series 1994 bonds to redeem on August 16, 2004, all of the \$10,505,000 outstanding principal amount of the Series 1994 Bonds and related accrued interest. The University will pay interest in arrears on the Series 2004A Bonds on February 15 and August 15 each year. The bonds mature at various dates through February 15, 2014, and bear interest at rates ranging from 4.0% to 5.0% for the various maturities. In fiscal year 2014 the final principal payment of \$1,225,000 will become due.

On July 13, 2004, the University entered into a loan agreement with the issuer under which the City of Crawford Education Facilities Corporation Higher Education Revenue Refunding Bonds (Southwestern University Project), Series 2004B, dated July 1, 2004, were issued at an aggregate par value of \$20,605,000. The issuer loaned the proceeds from the sale of the 2004B Bonds to the University, evidenced by a promissory note between the University and the issuer. The University contributed \$9,612 to the bond issue funds at the time of closing. The bonds were issued for the purpose of financing a portion of the renovation cost of the Alma Thomas Fine Arts Center at The Sarofim School of Fine Arts (\$2,393,817), refunding the City of Georgetown Higher Education Finance Corporation Higher Education Revenue Bonds, Series 1984 (\$17,800,000), and to pay costs of issuance of the Series 2004B Bonds (\$194,648). At closing, \$18,022,500 was transferred to The Bank of New York Trust Company, N.A., as trustee under the trust indenture providing for the issuance of the Series 1984 bonds, to redeem on August 1, 2004, all of the \$17,800,000 outstanding principal amount, plus accrued interest, of the Series 1984 Bonds. Interest is paid in arrears on the first day of each month beginning August 1, 2004. Principal is due and payable on October 1, 2014.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 9 - NOTES PAYABLE - Continued

On August 1, 2006, the University entered into a loan agreement whereby Wachovia Bank, National Association (Bank) loaned \$5,000,000 to the University through the City of Riesel Education Facilities Corporation, a nonprofit education facilities corporation, for the purpose of financing a portion of the construction cost of a new residential apartment complex for students consisting of 32 two-bedroom suites in three residential buildings, as well as an apartment for a residential assistant and related recreational facilities, community facilities, parking and to pay costs of issuance (\$53,150). The loan is secured by the unrestricted net assets of the University. The cost of issuance was capitalized and will be amortized over the life of the loan agreement. Principal repayment is due annually beginning February 15, 2008, payable over a 20 year period based on a 25 year amortization schedule, with a balloon payment of \$1,815,000 due on February 15, 2026. The loan has a fixed rate of 4.76% with interest to be paid in arrears on February 15 and August 15 each year. In fiscal years 2014, 2015, 2016, 2017, and 2018 and thereafter principal payments of \$155,000, \$160,000, \$170,000, \$175,000, 185,000 and \$3,375,000, respectively, will become due. Subsequent to issuance of the loan, the University, the Bank and the issuer amended the net assets-to-debt ratio of the debt covenant provisions to conform the calculation and related debt covenant requirement to the net asset classifications of ASC 958-205 Not-For-Profit Entities Presentation of Financial Statements. The University is in compliance with the amended ratio and covenant provisions at June 30, 2013.

#### **NOTE 10 - BENEFIT PLANS**

The University has defined contribution retirement plans for eligible faculty members and non-faculty employees. Contributions equal to various percentages of each eligible participant's regular salary are contributed to the plan and allocated among the plan fiduciary selected list of investment options based on the fund allocation directed by the participant. Teachers Insurance and Annuity Association and/or College Retirement Equities Fund maintains custody of all plan assets. Such contributions totaling \$1,751,611 and \$1,714,358 for fiscal years 2013 and 2012, respectively, were expensed.

The University has a contributory health and welfare plan (the "Health Plan") that became self-funded beginning January 1, 1999. The University and employee contributions are used to provide various medical benefits to eligible active employees and their dependents. The Health Plan has excess loss insurance that, in general, limits the amount of total claims paid by the University during the current plan year to approximately \$5,998,041 and claims paid per employee by the University during a plan year to \$150,000. The University recognized expenses related to the Health Plan of \$4,431,254 and \$4,481,276 in fiscal years 2013 and 2012, respectively.

The University also provides post-retirement health care benefits for eligible retirees and their spouses. Currently, the plan is structured as an unfunded defined benefit plan. However, the Board of Trustees adopted a certified resolution on March 18, 2013 amending the plan design to a defined contribution plan. Beginning on January 1, 2014, eligible retirees (age 65 and over) will have access to Medicare supplemental plans and will receive a subsidy from the University which may be used to pay for supplemental health insurance premiums or eligible medical expenses. The University will subsidize 100% of the cost of the "benchmark" plan premiums through 2018. Beginning on January 1, 2019, the subsidy is capped at the 2018 rate. The "benchmark" plan is defined as Medicare Supplemental (Medigap) Plan L and the average premiums of the Medicare Part D prescription drug programs available in Travis and Williamson counties.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 10 - BENEFIT PLANS - Continued

The University will make contributions annually to the retirees' health reimbursement arrangement account.

All active employees who were hired on or before July 1, 1996, who meet the eligibility criteria to officially retire from the University will be eligible for the above schedule of benefits at the time of their retirement. An employee who retires before age 65 and is an Early Retiree or a Faculty Phased Retiree continues coverage (and their spouse, if applicable) under the University's group medical plan or equivalent coverage and the University will subsidize 100% of the premium cost for the retiree and spouse (if age 65). If the spouse is not yet age 65, the retiree continues to pay premiums for the spouse until the spouse attains age 65. If a retiree is not an Early Retiree or a Faculty Phased Retiree, then the retiree pays 100% of the premiums for the University's group medical plan (and their spouse's premium, if applicable). All employees hired after July 1, 1996, are not eligible for retiree medical benefits.

Upon attaining age 65, all eligible retirees are required to enroll into the Extend Health program and discontinue participation in the University's group medical plan. If the retiree's spouse is not yet age 65, then the retiree pays 100% of the spouse's premium for the University's group medical plan. When the spouse attains age 65, the spouse enrolls in Extend Health program as the retiree's spouse and discontinues participation in the University's group medical plan.

Plan design amendments described above decreased the accrued post-retirement liability by \$36,913,698. This change is separately reported as an unrecognized prior service cost credit in the non-operating section in the consolidated statement of activities as of June 30, 2013.

Pursuant to the provisions of ASC 715-60 Defined Benefits Plans - Other Post-Retirement, and 715-20 Defined Benefit Plans - General, unamortized costs are reflected in the consolidated statements of activities as a net change in unrestricted net assets apart from operating expenses. The University amortizes a portion of these costs each year and reclassifies these amounts into net periodic benefit costs. Amounts amortized and the changes in balances of unamortized costs are as follows:

	Beginning balance of unamortized amounts	Amount amortized into net periodic benefit costs	Current year gains/losses	Ending balance of unamortized amounts
Net gains/losses Prior service costs	\$27,569,973 <u>(3,310,343)</u>	\$(2,545,083) 652,103	\$ (217,987) (36,913,698)	\$ 24,806,903 (39,571,938)
	\$ <u>24,259,630</u>	\$ <u>(1,892,980</u> )	\$ <u>(37,131,685</u> )	\$ <u>(14,765,035</u> )

In fiscal year 2013, the University expects to recognize as net periodic benefit approximately \$2,550,000 and \$650,000 of previously unamortized net gain and net prior service cost, respectively.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

## NOTE 10 - BENEFIT PLANS - Continued

The status of the University's accrued post-retirement benefit cost at June 30, 2013 and 2012 is as follows:

	2013	2012
Reconciliation of benefit obligation:		
Obligation at beginning of year	\$ 45,496,991	\$ 29,542,695
Service cost including expenses	893,893	602,205
Interest cost	1,813,006	1,887,909
Plan Amendment	(36,913,698)	-
Actuarial (gain)/loss	(217,987)	14,603,526
Benefit payments and expected expenses	(1,241,182)	(1,139,344)
Obligation at end of year	9,831,023	45,496,991
Reconciliation of fair value of plan assets:		
Employer contributions	1,241,182	1,139,344
Benefit payments and actual expenses	(1,241,182)	(1,139,344)
Fair value of plan assets at end of year		
Funded status at end of year	\$ <u>(9,831,023)</u>	\$ <u>(45,496,991</u> )
Amounts recognized in the consolidated statements of financial position a	re as follows:	
	2013	2012
Current liabilities	\$ (861,551)	\$ (1,216,845)
Noncurrent liabilities	(8,969,472)	(44,280,146)
Total	\$ <u>(9,831,023</u> )	\$ <u>(45,496,991</u> )
Net periodic post-retirement benefit cost recognized during fiscal year 2013 and 2012, is as follows:		
	2013	2012

 Service cost
 \$893,893
 \$602,205

 Interest cost
 1,813,006
 1,887,909

 Amortization of prior actuarial loss
 2,545,083
 1,768,027

 Amortization of prior service gain from plan amendment
 (652,103)
 (652,103)

 Total
 \$4,599,879
 \$3,606,038

The University used a weighted average discount rate of 4.26% and 4.04% to determine the post-retirement benefit obligation at June 30, 2013 and 2012, respectively. An average discount rate of 4.04% and 5.61% was used to determine the net periodic benefit cost for fiscal years 2013 and 2012, respectively. The increase in the discount rate from 4.04% to 4.26% decreased the accrued post-retirement liability by approximately \$218,000.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 10 - BENEFIT PLANS - Continued

In determining the net periodic benefit cost the assumed pre-Medicare health care cost trend rate was 7.6% for fiscal year 2013, declining gradually to 4.6% by 2082. The assumed post-Medicare health care cost trend rate was 7.6% for fiscal year 2013, declining gradually to 4.6% by 2082. In determining the post- retirement benefit obligation at June 30, 2013, the assumed health care cost trend rate was 7.8% for 2013 declining gradually to 4.4% by 2091. These health care cost trend rate assumptions have a significant effect on the amount of the obligation and periodic cost reported. For example, an increase in the assumed health care cost trend rate by one percentage point in each year would increase the amount of the obligation at June 30, 2013, by \$1,439,881 and the aggregate of service cost and interest cost components of net periodic post-retirement benefit cost for the year then ended by \$591,971. Alternatively, a decrease in the assumed health care cost trend rate by one percentage point in each year would decrease the obligation at June 30, 2013, by \$1,212,040 and the aggregate of service cost and interest cost components of net periodic post-retirement benefit cost for the year then ended by \$463,839.

Other changes in plan assets and benefit obligations recognized in unrestricted net assets:

	2013	2012
Net loss (gain) Prior service cost (credit) Amortization of net loss (gain) Amortization of prior service cost	\$ (217,987) (36,913,698) (2,545,083) <u>652,103</u>	\$14,603,526 (1,768,027) 652,103
Total recognized in unrestricted net assets	(39,024,665)	13,487,602
Total recognized in net periodic benefit cost and unrestricted net assets	\$ <u>(34,424,786)</u>	\$ <u>17,093,640</u>

The following post-retirement benefit payments, which reflect expected future service, as appropriate, are expected to be paid, net of the estimated Medicare prescription drug subsidies expected to be received:

Years ending	
<u>June 30,</u>	
2014	\$ 879,711
2015	466,807
2016	573,012
2017	631,506
2018	644,106
2019-2023	3,382,230

## **NOTE 11 - LINE OF CREDIT**

The University had an unsecured line of credit on June 30, 2013 and 2012 for \$1,500,000 with First Texas Bank, Georgetown, at the bank's prime rate. The line of credit expires annually on June 30th. The University has obtained approval to renew this line of credit through June 30, 2014. The University did not draw on this line of credit in either fiscal year 2013 or 2012.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

#### NOTE 12 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the University using available market information and appropriate valuation methodologies. Considerable judgment is required in developing these estimates, however, and accordingly, no assurance can be given that the estimated values presented herein are indicative of the amounts that would be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a material effect on the estimated fair value amounts.

As of June 30, 2013 and 2012, the carrying amounts of the University's assets and liabilities which are considered to be financial instruments approximate their fair value except for student loans receivable (Note 3) and notes payable (Note 9). Based on the nature of the federal loan program and the privately contributed loan funds representing student loans receivable, such financial instruments may not be sold. Accordingly, determining fair value is not practical. The University's notes payable total \$24,513,947 and \$25,867,703 and have an estimated fair value of \$24,778,809 and \$26,512,662 at June 30, 2013 and 2012, respectively. As determined by our third party specialist, the notes payable amount is valued using current market yields. The University believes that these inputs used in valuing this debt would be classified as level 2.

## **NOTE 13 - COMMITMENTS**

The University has contracts for the construction of infrastructure projects and for other building and classroom improvements. At June 30, 2013, the remaining commitments under these contracts approximated \$2,576,000.

## **NOTE 14 - TRANSACTIONS WITH RELATED PARTIES**

Two members of the Board of Trustees of the University also serve as directors of a financial institution where the University has a significant banking relationship. The University has a conflict of interest policy that is regularly updated by all members of the Board of Trustees. The relationships with the financial institution have been consistently reported as a conflict of interest. In all matters related to business decisions at the meetings of the Board of Trustees, these parties refrain from participating in any votes on these matters. The abstentions are reflected in the official minutes of the meetings.

# **NOTE 15 - SUBSEQUENT EVENTS**

The University has evaluated subsequent events through October 17, 2013, the date when consolidated financial statements were available to be issued, and has determined there are no material subsequent events or transactions that would require additional disclosure in the University's consolidated financial statements.