

Southwestern University

*Financial Statements as of and for the
Years Ended June 30, 2006 and 2005,
Supplemental Schedules for the
Years Ended June 30, 2006 and 2005, and
Independent Auditors' Report*

SOUTHWESTERN UNIVERSITY

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Southwestern University
Georgetown, Texas

We have audited the accompanying statements of financial position of Southwestern University (the "University") as of June 30, 2006 and 2005, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the management of the University. 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 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, such financial statements present fairly, in all material respects, the financial position of the University, at June 30, 2006 and 2005, and the changes in its net assets and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were performed for the purpose of forming an opinion on the basic financial statements of the University, taken as a whole. The financial information in the accompanying supplemental schedules on pages 17 through 21 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. These schedules are the responsibility of the management of the University. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2006, on our consideration of the University's internal control over financial reporting and 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.

Deloitte & Touche LLP

September 15, 2006

SOUTHWESTERN UNIVERSITY

STATEMENTS OF FINANCIAL POSITION AS OF JUNE 30, 2006 AND 2005

	2006	2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,047,837	\$ 2,741,955
Receivables:		
Student accounts receivable—net	30,462	28,195
Unconditional promises—current portion	3,772,313	5,270,409
Investment transactions	1,280,506	1,158,632
Other	399,509	354,882
Prepayments and other current assets	704,013	645,605
Assets held for sale—investments in land	<u>646,356</u>	
Total current assets	9,880,996	10,199,678
UNCONDITIONAL PROMISES RECEIVABLE—Long-term portion	13,077,792	13,325,205
INVESTMENTS	285,302,471	289,623,927
BENEFICIAL INTERESTS IN FUNDS HELD BY OTHERS	4,072,807	3,906,534
INVESTMENT IN PLANT—Net	78,587,812	78,269,326
STUDENT LOANS—Net	3,533,745	3,966,576
OTHER ASSETS	<u>330,097</u>	<u>371,359</u>
TOTAL	<u>\$ 394,785,720</u>	<u>\$ 399,662,605</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable—accrued and other liabilities	\$ 4,571,979	\$ 4,082,257
Notes payable—current portion	925,000	895,000
Student deposits and advance payments	<u>1,134,452</u>	<u>1,328,770</u>
Total current liabilities	6,631,431	6,306,027
NOTES PAYABLE—Long-term portion	26,840,243	29,359,000
ACCRUED POSTRETIREMENT BENEFITS	10,381,279	8,372,198
REFUNDABLE ADVANCES	3,021,126	3,607,342
DEFERRED COMPENSATION AND OTHER LONG-TERM LIABILITIES	<u>79,400</u>	<u>72,400</u>
Total liabilities	<u>46,953,479</u>	<u>47,716,967</u>
NET ASSETS:		
Unrestricted	260,715,983	265,888,928
Temporarily restricted	20,690,810	20,960,326
Permanently restricted	<u>66,425,448</u>	<u>65,096,384</u>
Total net assets	<u>347,832,241</u>	<u>351,945,638</u>
TOTAL	<u>\$ 394,785,720</u>	<u>\$ 399,662,605</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2006

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:				
Tuition and fees	\$ 28,239,327	\$ -	\$ -	\$ 28,239,327
Less scholarships and grants	<u>9,319,921</u>	<u> </u>	<u> </u>	<u>9,319,921</u>
Net tuition and fees	18,919,406	-	-	18,919,406
Private gifts and grants	6,812,717		1,163,152	7,975,869
Government grants	543,491	10,200		553,691
Investment income	1,930,166	6,512,841		8,443,007
Change in value of split-interest agreements	(71,304)	361	165,912	94,969
Net realized gains on investments	8,761,651			8,761,651
Net unrealized losses on investments	(5,236,278)			(5,236,278)
Other income	483,201	26,105		509,306
Auxiliary enterprises	<u>7,211,517</u>	<u> </u>	<u> </u>	<u>7,211,517</u>
Total revenues	39,354,567	6,549,507	1,329,064	47,233,138
NET ASSETS RELEASED FROM RESTRICTIONS	<u>6,819,023</u>	<u>(6,819,023)</u>	<u> </u>	<u> </u>
	<u>46,173,590</u>	<u>(269,516)</u>	<u>1,329,064</u>	<u>47,233,138</u>
EXPENSES:				
Instructional services	21,284,469			21,284,469
Student services	7,963,239			7,963,239
Auxiliary services	8,503,709			8,503,709
Institutional support	<u>13,595,118</u>	<u> </u>	<u> </u>	<u>13,595,118</u>
Total expenses	<u>51,346,535</u>	<u> </u>	<u> </u>	<u>51,346,535</u>
CHANGE IN NET ASSETS	(5,172,945)	(269,516)	1,329,064	(4,113,397)
NET ASSETS—Beginning of year	<u>265,888,928</u>	<u>20,960,326</u>	<u>65,096,384</u>	<u>351,945,638</u>
NET ASSETS—End of year	<u>\$ 260,715,983</u>	<u>\$ 20,690,810</u>	<u>\$ 66,425,448</u>	<u>\$ 347,832,241</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2005

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:				
Tuition and fees	\$ 25,662,341	\$ -	\$ -	\$ 25,662,341
Less scholarships and grants	<u>8,298,062</u>	<u>-</u>	<u>-</u>	<u>8,298,062</u>
Net tuition and fees	17,364,279	-	-	17,364,279
Private gifts and grants	4,863,968	2,408,787	905,548	8,178,303
Government grants	638,966			638,966
Investment income	2,871,435	4,815,317		7,686,752
Change in value of split-interest agreements	(91,488)	16,676	176,742	101,930
Net realized gains on investments	4,443,381			4,443,381
Net unrealized gains on investments	1,366,051			1,366,051
Other income	435,859	8,116		443,975
Auxiliary enterprises	<u>7,110,441</u>	<u>-</u>	<u>-</u>	<u>7,110,441</u>
Total revenues	39,002,892	7,248,896	1,082,290	47,334,078
NET ASSETS RELEASED FROM RESTRICTIONS	<u>4,490,790</u>	<u>(4,490,790)</u>	<u>-</u>	<u>-</u>
	<u>43,493,682</u>	<u>2,758,106</u>	<u>1,082,290</u>	<u>47,334,078</u>
EXPENSES:				
Instructional services	20,259,862			20,259,862
Student services	7,379,323			7,379,323
Auxiliary services	7,893,378			7,893,378
Institutional support	<u>12,473,970</u>	<u>-</u>	<u>-</u>	<u>12,473,970</u>
Total expenses	48,006,533	-	-	48,006,533
CHANGE IN NET ASSETS	(4,512,851)	2,758,106	1,082,290	(672,455)
NET ASSETS—Beginning of year	<u>270,401,779</u>	<u>18,202,220</u>	<u>64,014,094</u>	<u>352,618,093</u>
NET ASSETS—End of year	<u>\$ 265,888,928</u>	<u>\$ 20,960,326</u>	<u>\$ 65,096,384</u>	<u>\$ 351,945,638</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ (4,113,397)	\$ (672,455)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	4,863,483	4,482,355
Amortization of premiums and issuance costs on bonds	12,505	(28,757)
Loss on disposal of assets	25,814	106,632
Net unrealized loss (gain) on investments	5,236,278	(1,366,051)
Net realized gain on investments	(8,761,651)	(4,443,381)
Gifts and grants restricted for endowment	(1,356,104)	(2,101,647)
(Increase) decrease in operating assets:		
Student accounts and loans receivable	430,564	323,007
Unconditional promises receivable	1,745,509	387,275
Investment transactions receivable	(121,874)	(156,467)
Other receivables	(44,627)	69,418
Prepayments and other assets	(58,408)	(507,634)
Beneficial interest in funds held in trust by others	(166,273)	(193,418)
Increase (decrease) in operating liabilities:		
Accounts payable, accrued and other liabilities	418,151	404,814
Accrued postretirement benefits	2,009,081	1,656,483
Student deposits and advance payments	(194,318)	(3,711)
Refundable advances	(586,216)	(479,636)
Deferred compensation and other long-term liabilities	7,000	(2,000)
Net cash used in operating activities	<u>(654,483)</u>	<u>(2,525,173)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(72,898,759)	(48,853,805)
Sales of investments	80,099,232	51,086,500
Purchases of fixed assets	<u>(5,136,212)</u>	<u>(3,207,073)</u>
Net cash provided by (used in) investing activities	<u>2,064,261</u>	<u>(974,378)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment on notes payable	(2,460,000)	(1,020,000)
Refinanced Bond Principal		(28,305,000)
New Bond Principal		31,302,757
Gifts and grants restricted for endowment	<u>1,356,104</u>	<u>2,101,647</u>
Net cash (used in) provided by financing activities	<u>(1,103,896)</u>	<u>4,079,404</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	305,882	579,853
CASH AND CASH EQUIVALENTS—Beginning of year	<u>2,741,955</u>	<u>2,162,102</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 3,047,837</u>	<u>\$ 2,741,955</u>
SUPPLEMENTAL CASH FLOW INFORMATION—Interest paid	<u>\$ 1,006,093</u>	<u>\$ 958,074</u>
SUPPLEMENTAL CASH FLOW INFORMATION—Accrued fixed asset purchases	<u>\$ 71,571</u>	<u>\$ -</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The University—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 approximately 1,260 students and a current student-to-faculty ratio of 10.5:1. 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.

Accrual Basis—The financial statements of the University have been prepared on an accrual basis of accounting.

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

Unrestricted—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, 2006 and 2005, are as follows:

	2006	2005
Scholarships	\$ 1,547,430	\$ 1,514,539
Professorships and faculty development	1,428,760	3,010,345
Plant	11,585,932	12,193,084
Other	5,712,902	3,146,445
Restricted for use in future periods	<u>415,786</u>	<u>1,095,913</u>
Total	<u>\$20,690,810</u>	<u>\$20,960,326</u>

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, 2006 and 2005, being expendable to support, as follows:

	2006	2005
Unrestricted	\$28,311,929	\$28,303,522
Scholarships	18,540,178	17,432,484
Professorships and faculty development	8,606,286	8,594,523
Plant	1,438,523	1,438,523
Other	<u>9,528,532</u>	<u>9,327,332</u>
Total	<u>\$66,425,448</u>	<u>\$65,096,384</u>

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.

Investments—Investments in marketable debt and equity securities are stated at fair value. Investments in real estate and other forms of investments are reported at either cost or the fair value at the date the gift was received.

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. 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 to give are recorded at the present value of their estimated future cash flows, net of allowances. 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.

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.

Depreciation of physical plant and equipment is computed using the straight-line method for all depreciable assets over their estimated useful lives as follows:

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

Bond Issuance Costs—In conjunction with the issuance of the Series 2004A and Series 2004B bonds, the University capitalized \$209,330 and \$203,291, respectively, of deferred financing costs. The University amortizes such costs over the respective lives of the bonds. Such deferred financial costs are included in other assets at June 30, 2006, net of accumulated amortization totaling \$41,866 and \$40,658, for the Series 2004A and Series 2004B bonds, respectively.

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 has been valued at the discounted present value of expected future cash flows. The expected future cash flows have been discounted at rates of 5% to 7% based upon the current market value of the trust's assets and other factors stipulated in the agreements. The present value of the expected future cash flows has been reflected as a beneficial interest in funds held in trust by others in the statement of financial position. A contribution is recognized in the year the University becomes aware of the existence of the agreement. Changes from year to year in the net present value of the estimated future cash flows to be received are reported as a change in value of split-interest agreements in the appropriate net asset class according to the trust restrictions.

Lease Expense—Total lease expense for all operating leases was \$114,564 and \$100,765 for 2006 and 2005, respectively. Management of the University expects future lease expenses to remain consistent with the current year expense incurred.

Allocation of Certain Expenses—The statement of activities presents expenses by functional classification. Depreciation 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. Interest expense is allocated based on the use of the related borrowings.

Use of Estimates—The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America 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 those estimates.

2. INVESTMENTS

A summary of investments at June 30, 2006 and 2005, is as follows:

	2006	2005
At fair value:		
Short-term investments	\$ 4,613,802	\$ 5,401,832
Bonds	67,834,995	72,274,779
Publicly traded stocks	204,385,240	202,831,024
At cost or market at date of acquisition:		
Real estate	8,294,550	8,914,874
Other	<u>173,884</u>	<u>201,418</u>
Total investments	<u>\$285,302,471</u>	<u>\$289,623,927</u>

Investment income is reported net of investment advisory fees of \$753,196 and \$844,607 in fiscal 2006 and 2005, respectively. Gains and losses on investments in the endowment are considered unrestricted unless specifically restricted by the donor.

The University utilizes the total return concept of managing its endowment investment portfolio as provided by the Texas Uniform Management of Institutional Funds Act. Accordingly, 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 16-quarter average endowment market value, excluding investments in real estate, as of December 31 preceding the fiscal year. The spending rate was 5.60% for fiscal year 2006 and 5.75% for fiscal year 2005. Spending on endowments with a market value less than \$25,000 or with a market value less than the historic gift corpus amount is retained in the endowment unless distribution is specifically required by the donor.

3. STUDENT ACCOUNTS AND LOANS RECEIVABLE

Student accounts receivable are reported net of allowances for doubtful accounts of \$113,694 for 2006 and 2005. Student loans receivable are reported net of allowance for doubtful accounts of \$80,889 and \$11,788 for 2006 and 2005 respectively.

4. UNCONDITIONAL PROMISES RECEIVABLE

Unconditional promises receivable at June 30, 2006 and 2005, consist of the following:

	2006	2005
Restricted for scholarships	\$ 2,930,811	\$ 3,760,250
Restricted for plant	12,429,246	13,170,193
Restricted for professorships		1,895,485
Restricted for other uses	2,255,975	
Restricted for use in future periods	<u>430,990</u>	<u>1,120,527</u>
	18,047,022	19,946,455
Discount	<u>(1,196,917)</u>	<u>(1,350,841)</u>
Net unconditional promises receivable	<u>\$ 16,850,105</u>	<u>\$ 18,595,614</u>

As of June 30, 2006, amounts due from unconditional promises to give are as follows:

Due in less than one year	\$ 3,772,312
Due in one to five years	<u>14,274,710</u>
Total	<u>\$ 18,047,022</u>

The University uses risk-free rates of 2% to 5.25% to discount the anticipated cash flows for unconditional promises to give. No allowance for uncollectible promises receivable has been recorded as historically the University has not experienced material uncollectible amounts.

5. INVESTMENT IN PLANT

At June 30, 2006 and 2005, investment in plant consists of the following:

	2006	2005
Land	\$ 111,509	\$ 111,509
Buildings	97,019,437	96,535,208
Furniture and equipment	28,662,092	27,316,918
Ground improvements	<u>13,568,441</u>	<u>13,557,365</u>
Total property	139,361,479	137,521,000
Less accumulated depreciation	<u>(66,452,324)</u>	<u>(61,606,160)</u>
	72,909,155	75,914,840
Construction in progress	<u>5,678,657</u>	<u>2,354,486</u>
Investment in plant—net	<u>\$ 78,587,812</u>	<u>\$ 78,269,326</u>

6. ASSETS HELD FOR SALE

At June 30, 2006, the University has classified \$646,356 of real estate investments as held for sale. This classification was made because the University has committed to a plan to sell these assets in their current condition. All related properties are being actively marketed by a realtor or a buyer has already been identified. The University expects to sell these assets for an amount greater than or equal to the related asset's carrying value. The University expects to sell these properties within the next year.

7. NOTES PAYABLE

On October 1, 1984, the University entered into a Letter of Credit and Bond Purchase Agreement (the "Agreement") with Chemical Bank of New York (subsequently J.P. Morgan Chase & Co.) under which \$17.8 million of the City of Georgetown Higher Education Finance Corporation (the "Issuer") Variable Rate Demand Higher Education Revenue Bonds, Series 1984, dated October 31, 1984, were sold, and Nations Bank was named trustee. The Issuer loaned the proceeds from the sale of the Series 1984 bonds to the University, evidenced by a loan agreement. The Issuer assigned its rights and obligations under the loan agreement to the trustee. The University executed a promissory note for the proceeds plus interest, payable on demand, with J.P. Morgan Chase & Co. As security for repayment of the proceeds, J.P. Morgan Chase & Co. issued an irrevocable letter of credit to the trustee. Subsequent to issuance of the bonds, the Bank of New York became trustee. The promissory note and related bonds, had an original maturity in 2014. These bonds were refunded in fiscal 2005 by the issuance of the City of Crawford Education Facilities Corporation Higher Education Revenue Refunding Bonds (Southwestern University Project), Series 2004B. The University recognized as a loss on refunding of notes payable the remaining unamortized bond issuance costs of \$271,013 on the Series 1984 bonds in fiscal 2004.

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 2005. The University contributed \$326,260 at closing which, together with the net proceeds of the Series 2004A Bonds, was transferred to the 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 3.0% to 5.0% for the various maturities. In fiscal 2007, 2008, 2009, 2010, and 2011, principal payments of \$925,000, \$955,000, \$990,000, \$1,025,000, and \$1,075,000, respectively, 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 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 \$17.8 million 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.

Subsequent to year end (on August 1, 2006) the University entered into a loan agreement whereby Wachovia Bank, National Association (Bank) loaned \$5.0 million to the University through the City of Riesel Education Facilities Corporation (Issuer), 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 will be capitalized and 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 2007, 2008, 2009, 2010, and 2011, principal payments of \$0, \$115,000, \$120,000, \$125,000, and \$135,000, respectively, will become due.

8. BENEFIT PLANS

The University has defined contribution retirement plans for eligible faculty members and nonfaculty employees. Contributions equal to various percentages of each eligible participant's regular salary are used to purchase individual annuities issued to the participant by Teachers Insurance and Annuity Association and/or College Retirement Equities Fund. Such contributions totaling \$2,035,702 and \$1,910,950 for fiscal 2006 and fiscal 2005, respectively, were expensed. In addition, supplemental payments totaling \$6,137 in fiscal 2006 and 2005 were made to certain retired employees.

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 \$3,787,000 and claims paid per employee by the University during a plan year to \$125,000. The University recognized expenses related to the Health Plan of \$2,754,912 in fiscal 2006 and \$2,361,162 in fiscal 2005.

The University also provides health care benefits for eligible retired employees through an unfunded defined benefit plan. All active employees as of June 30, 1996, are eligible for benefits under the plan. All employees hired on or after July 1, 1996, are not eligible for retiree medical benefits. All retirees participating in the postretirement medical plan will remain covered. Employees with at least ten years of service can retire with full benefits at age 65. In addition, employees who attain age 55, 56, or 57 with at least ten years of service may choose to enter the early retirement program, which allows retirement with full benefits at age 60, 61, or 62, respectively, assuming continued employment at the University until retirement.

The status of the University’s accrued postretirement benefit cost at June 30, 2006 and 2005, is as follows:

	2006	2005
Retirees	\$ 7,248,877	\$ 5,813,964
Fully eligible active plan participants	3,005,340	2,614,498
Other active plan participants	<u>9,550,959</u>	<u>11,433,890</u>
Accumulated postretirement benefit obligation (“APBO”)	19,805,176	19,862,352
Plan assets		
Funded status	<u>19,805,176</u>	<u>19,862,352</u>
Unrecognized net actuarial (loss)	(12,828,360)	(15,242,402)
Unrecognized prior service gain from plan amendment	<u>3,404,463</u>	<u>3,752,248</u>
Accrued postretirement benefit cost	<u>\$ 10,381,279</u>	<u>\$ 8,372,198</u>

A reconciliation of the beginning and ending balances of the APBO for the years ended June 30, 2006 and 2005, is as follows:

	2006	2005
Beginning of year	\$ 19,862,352	\$ 16,053,555
Service cost	645,469	602,781
Interest cost	1,036,966	986,127
Benefit payments	(523,101)	(547,359)
Actuarial (gain)/loss	<u>(1,216,510)</u>	<u>2,767,248</u>
End of year	<u>\$ 19,805,176</u>	<u>\$ 19,862,352</u>

Net periodic postretirement benefit cost recognized during fiscal 2006 and 2005 is as follows:

	2006	2005
Service cost	\$ 645,469	\$ 602,781
Interest cost	1,036,966	986,127
Amortization of unrecognized actuarial loss	1,197,532	962,719
Amortization of prior service gain from plan amendment	<u>(347,785)</u>	<u>(347,785)</u>
 Total	 <u>\$2,532,182</u>	 <u>\$2,203,842</u>

Weighted average assumptions used to determine the accrued post retirement benefit obligation and net periodic benefit cost are as follows:

	2006	2005
Discount rate:		
Net periodic postretirement benefit cost	5.25%	6.25%
Benefit obligation for disclosure purposes	6.25%	5.25%

In determining the APBO, the assumed pre-Medicare health care cost trend rate was 9% for fiscal 2006, declining gradually to 5% by 2014. The assumed post-Medicare health care cost trend rate was 11% for fiscal 2006, declining gradually to 5% by 2018. 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 APBO at June 30, 2006 by \$3,319,000 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$364,000. Alternatively, a decrease in the assumed health care cost trend rate by one percentage point in each year would decrease the APBO at June 30, 2006 by \$2,821,000 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$228,000.

The University has determined its prescription drug coverage plan is at least actuarially equivalent to the Medicare prescription drug coverage. Accordingly, the estimated value of the prescription drug subsidy is reflected as an actuarial gain and serves to reduce the APBO, Service Costs, and thus, the Net Periodic Benefit Cost (“NPBC”) for fiscal year 2005.

The following postretirement 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	Medical Benefits	Prescription Drug Subsidy	Net
2007	\$ 644,103	\$ (88,708)	\$ 555,395
2008	743,476	(105,290)	638,186
2009	810,080	(122,918)	687,162
2010	897,033	(136,315)	760,718
2011	982,409	(151,626)	830,783
2012–2016	6,205,396	(1,030,945)	5,174,451

The effect of the Medicare Part D prescription drug subsidy expected to be received is as follows:

APBO at June 30, 2005	\$(3,551,864)
APBO at June 30, 2006	(3,620,981)
Net periodic postretirement benefit cost:	
Service cost	(111,875)
Interest cost	(190,014)
Amortization of unrecognized net gain	<u>(294,279)</u>
Total	<u>\$ (596,168)</u>

9. LINE OF CREDIT

The University has an unsecured line of credit for \$1,500,000 with First Texas Bank, Georgetown, at the bank's prime rate, which expires on June 30, 2007. The University did not draw on this line of credit in either fiscal 2006 or 2005.

10. 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, 2006 and 2005, 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 7). 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 practicable. The University's notes payable total \$27,765,243 and \$30,254,000 and have an estimated fair value of approximately \$27,666,984 and \$30,355,414 at June 30, 2006 and 2005, respectively. These amounts were determined using rates currently available to the University for debt with similar terms and maturities.

11. COMMITMENTS

The University has contracts for the construction of infrastructure projects and for other building and classroom improvements. At June 30, 2006, the remaining commitments under these contracts approximated \$8,198,000.

12. 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.

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SUPPLEMENTAL SCHEDULES

SOUTHWESTERN UNIVERSITY

SUPPLEMENTAL SCHEDULE OF BUDGETED CURRENT UNRESTRICTED FUND REVENUES, EXPENDITURES, AND OTHER CHANGES AND COMPARISON TO ACTUAL FOR THE YEAR ENDED JUNE 30, 2006

	Budget	Actual
REVENUES:		
Educational and general:		
Tuition and fees:		
Arts and sciences	\$24,101,423	\$24,123,668
Fine arts	3,686,830	3,627,956
Summer school	300,000	487,704
Student services	104,682	101,920
General library	15,000	18,640
Investment income	197,000	197,000
Endowment funds	11,346,853	11,706,203
Private gifts and grants	1,905,806	2,042,300
Special schools and enterprises	194,500	151,547
Student aid:		
Endowment	2,660,361	2,759,911
Gifts and grants	488,940	420,694
Government funds	780,000	723,066
Research and sponsored projects	<u>450,000</u>	<u>566,854</u>
Total educational and general	<u>46,231,395</u>	<u>46,927,463</u>
Sales and services of auxiliary enterprises:		
University food services	2,640,132	2,657,142
Residence halls	2,566,165	2,637,070
Golf course	130,000	105,046
University store and snack bar	<u>45,000</u>	<u>40,000</u>
Total sales and services of auxiliary enterprises	5,381,297	5,439,258
Other noneducational	<u>139,000</u>	<u>113,893</u>
Total revenues	<u>51,751,692</u>	<u>52,480,614</u>

(Continued)

SOUTHWESTERN UNIVERSITY

SUPPLEMENTAL SCHEDULE OF BUDGETED CURRENT UNRESTRICTED FUND REVENUES, EXPENDITURES, AND OTHER CHANGES AND COMPARISON TO ACTUAL FOR THE YEAR ENDED JUNE 30, 2006

	Budget	Actual
EXPENDITURES AND TRANSFERS:		
Educational and general:		
General administration	\$ 2,091,750	\$ 2,147,768
General expense	6,317,341	5,866,420
Student services	6,548,111	6,538,505
Instruction:		
Arts and sciences	9,758,131	9,929,766
Fine arts	1,784,400	2,127,853
General library	2,255,385	2,216,840
Research	463,000	579,904
Operation and maintenance of plant	4,757,694	4,786,572
Special schools and enterprises	179,318	122,097
Student aid	9,704,872	9,705,806
Academic support and other	<u>3,074,782</u>	<u>2,952,401</u>
Educational and general expenditures	<u>46,934,784</u>	<u>46,973,932</u>
Nonmandatory transfers for:		
Principal and interest	450,000	611,586
Renewals and replacements	<u>523,707</u>	<u>836,773</u>
Total educational and general	<u>47,908,491</u>	<u>48,422,291</u>
Auxiliary enterprises:		
University food services	1,694,264	1,663,820
Residence halls	1,980,480	2,224,838
Golf course	137,361	127,076
University store and snack bar	<u>31,096</u>	<u>21,038</u>
Total auxiliary enterprises	<u>3,843,201</u>	<u>4,036,772</u>
Total expenditures and non-mandatory transfers	<u>51,751,692</u>	<u>52,459,063</u>
NET INCREASE	<u>\$ -</u>	<u>\$ 21,551</u>

(Concluded)

SOUTHWESTERN UNIVERSITY

SUPPLEMENTAL SCHEDULE OF DISAGGREGATED ASSETS, LIABILITIES, AND NET ASSETS AS OF JUNE 30, 2006

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	\$ 3,047,837	\$ -	\$ -	\$ 3,047,837
Receivables:				
Student accounts receivable—net	30,462			30,462
Unconditional promises—current portion		3,571,282	201,031	3,772,313
Investment transactions	959,797	76,171	244,538	1,280,506
Other	399,509			399,509
Prepayments and other current assets	704,013			704,013
Assets held for sale—investments in land	646,356			646,356
Total current assets	5,787,974	3,647,453	445,569	9,880,996
UNCONDITIONAL PROMISES RECEIVABLE—Long-term portion		10,348,013	2,729,779	13,077,792
INVESTMENTS	219,429,834	6,413,451	59,459,186	285,302,471
BENEFICIAL INTERESTS IN FUNDS HELD BY OTHERS		281,893	3,790,914	4,072,807
INVESTMENT IN PLANT—Net	78,587,812			78,587,812
STUDENT LOANS—Net	3,533,745			3,533,745
OTHER ASSETS	330,097			330,097
TOTAL	\$ 307,669,462	\$ 20,690,810	\$ 66,425,448	\$ 394,785,720
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES:				
Accounts payable, accrued, and other liabilities	\$ 4,571,979	\$ -	\$ -	\$ 4,571,979
Notes payable—current portion	925,000			925,000
Student deposits and advance payments	1,134,452			1,134,452
Total current liabilities	6,631,431	-	-	6,631,431
NOTES PAYABLE—Long-term portion	26,840,243			26,840,243
ACCRUED POSTRETIREMENT BENEFITS	10,381,279			10,381,279
REFUNDABLE ADVANCES	3,021,126			3,021,126
DEFERRED COMPENSATION AND OTHER LONG-TERM LIABILITIES	79,400			79,400
Total liabilities	46,953,479	-	-	46,953,479
NET ASSETS:				
Unrestricted	260,715,983			260,715,983
Temporarily restricted		20,690,810		20,690,810
Permanently restricted			66,425,448	66,425,448
Total net assets	260,715,983	20,690,810	66,425,448	347,832,241
TOTAL	\$ 307,669,462	\$ 20,690,810	\$ 66,425,448	\$ 394,785,720

SOUTHWESTERN UNIVERSITY

SUPPLEMENTAL SCHEDULE OF DISAGGREGATED ASSETS, LIABILITIES, AND NET ASSETS AS OF JUNE 30, 2005

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	\$ 2,741,955	\$ -	\$ -	\$ 2,741,955
Receivables:				
Student accounts receivable—net	28,195			28,195
Unconditional promises—current portion		5,020,866	249,543	5,270,409
Investment transactions	876,654	68,680	213,298	1,158,632
Other	354,882			354,882
Prepayments and other current assets	645,605			645,605
Total current assets	4,647,291	5,089,546	462,841	10,199,678
UNCONDITIONAL PROMISES RECEIVABLE—Long-term portion		10,619,772	2,705,433	13,325,205
INVESTMENTS	226,351,343	4,900,399	58,372,185	289,623,927
BENEFICIAL INTERESTS IN FUNDS HELD BY OTHERS		350,609	3,555,925	3,906,534
INVESTMENT IN PLANT—Net	78,269,326			78,269,326
STUDENT LOANS—Net	3,966,576			3,966,576
OTHER ASSETS	371,359			371,359
TOTAL	\$ 313,605,895	\$ 20,960,326	\$ 65,096,384	\$ 399,662,605
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES:				
Accounts payable, accrued, and other liabilities	\$ 4,082,257	\$ -	\$ -	\$ 4,082,257
Notes payable—current portion	895,000			895,000
Student deposits and advance payments	1,328,770			1,328,770
Total current liabilities	6,306,027	-	-	6,306,027
NOTES PAYABLE—Long-term portion	29,359,000			29,359,000
ACCRUED POSTRETIREMENT BENEFITS	8,372,198			8,372,198
REFUNDABLE ADVANCES	3,607,342			3,607,342
DEFERRED COMPENSATION AND OTHER LONG-TERM LIABILITIES	72,400			72,400
Total liabilities	47,716,967	-	-	47,716,967
NET ASSETS:				
Unrestricted	265,888,928			265,888,928
Temporarily restricted		20,960,326		20,960,326
Permanently restricted			65,096,384	65,096,384
Total net assets	265,888,928	20,960,326	65,096,384	351,945,638
TOTAL	\$ 313,605,895	\$ 20,960,326	\$ 65,096,384	\$ 399,662,605