

Southwestern University

*Financial Statements as of and for the
Years Ended June 30, 2007 and 2006,
Supplemental Schedules for the
Years Ended June 30, 2007 and 2006, and
Independent Auditors' Report*

SOUTHWESTERN UNIVERSITY

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Southwestern University
Georgetown, TX

We have audited the accompanying statements of financial position of Southwestern University (the "University") as of June 30, 2007 and 2006, 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, 2007 and 2006, 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.

As discussed in Note 8 to the financial statements, the University changed its method of accounting for postretirement benefit plan upon adoption of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, effective June 30, 2007.

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 18 through 22 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 October 3, 2007, 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

October 3, 2007

SOUTHWESTERN UNIVERSITY

STATEMENTS OF FINANCIAL POSITION AS OF JUNE 30, 2007 AND 2006

	2007	2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,626,707	\$ 3,047,837
Receivables:		
Student accounts receivable — net	30,560	30,462
Unconditional promises receivable — current portion	6,325,077	3,772,313
Investment transactions	1,449,208	1,280,506
Other	699,532	399,509
Prepayments and other current assets	736,777	704,013
Assets held for sale — investments in land		<u>646,356</u>
Total current assets	11,867,861	9,880,996
UNCONDITIONAL PROMISES RECEIVABLE — Long-term portion	12,997,265	13,077,792
INVESTMENTS	322,281,597	285,302,471
BENEFICIAL INTERESTS IN FUNDS HELD BY OTHERS	4,540,521	4,072,807
INVESTMENT IN PLANT — Net	84,893,897	78,587,812
STUDENT LOANS RECEIVABLE — Net	3,387,819	3,533,745
OTHER ASSETS	<u>339,327</u>	<u>330,097</u>
TOTAL	<u>\$ 440,308,287</u>	<u>\$ 394,785,720</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable — accrued and other liabilities	\$ 6,201,786	\$ 4,571,979
Notes payable — current portion	1,070,000	925,000
Accrued post retirement benefits — current portion	721,278	
Student deposits and advance payments	<u>1,427,133</u>	<u>1,134,452</u>
Total current liabilities	9,420,197	6,631,431
NOTES PAYABLE — Long-term portion	30,741,487	26,840,243
ACCRUED POSTRETIREMENT BENEFITS	20,272,618	10,381,279
REFUNDABLE ADVANCES	3,095,502	3,021,126
DEFERRED COMPENSATION AND OTHER LONG-TERM LIABILITIES	<u>79,400</u>	<u>79,400</u>
Total liabilities	<u>63,609,204</u>	<u>46,953,479</u>
NET ASSETS:		
Unrestricted	285,535,441	260,715,983
Temporarily restricted	23,491,133	20,690,810
Permanently restricted	<u>67,672,509</u>	<u>66,425,448</u>
Total net assets	<u>376,699,083</u>	<u>347,832,241</u>
TOTAL	<u>\$ 440,308,287</u>	<u>\$ 394,785,720</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2007

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:				
Tuition and fees	\$ 30,005,092	\$ -	\$ -	\$ 30,005,092
Less scholarships and grants	<u>9,999,440</u>	<u>-</u>	<u>-</u>	<u>9,999,440</u>
Net tuition and fees	20,005,652	-	-	20,005,652
Private gifts and grants	7,487,502	3,423,756	1,247,061	12,158,319
Government grants	439,229	172,535		611,764
Investment income	3,026,339	6,190,549		9,216,888
Change in value of split-interest agreements		369,613		369,613
Net realized gains on investments	6,843,150			6,843,150
Net unrealized gains on investments	33,195,709			33,195,709
Other income	627,528	26,190		653,718
Auxiliary enterprises	<u>7,311,568</u>	<u>-</u>	<u>-</u>	<u>7,311,568</u>
Total revenues	78,936,677	10,182,643	1,247,061	90,366,381
NET ASSETS RELEASED FROM RESTRICTIONS	<u>7,382,320</u>	<u>(7,382,320)</u>	<u>-</u>	<u>-</u>
	<u>86,318,997</u>	<u>2,800,323</u>	<u>1,247,061</u>	<u>90,366,381</u>
EXPENSES:				
Instructional services	22,617,124			22,617,124
Student services	8,225,588			8,225,588
Auxiliary services	8,189,560			8,189,560
Institutional support	<u>13,663,887</u>	<u>-</u>	<u>-</u>	<u>13,663,887</u>
Total expenses	<u>52,696,159</u>	<u>-</u>	<u>-</u>	<u>52,696,159</u>
Change in net assets before effect of change in accounting principle	33,622,838	2,800,323	1,247,061	37,670,222
Cumulative effect of change in accounting principle — refer to Note 8	<u>(8,803,380)</u>	<u>-</u>	<u>-</u>	<u>(8,803,380)</u>
CHANGE IN NET ASSETS	24,819,458	2,800,323	1,247,061	28,866,842
NET ASSETS — Beginning of year	<u>260,715,983</u>	<u>20,690,810</u>	<u>66,425,448</u>	<u>347,832,241</u>
NET ASSETS — End of year	<u>\$ 285,535,441</u>	<u>\$ 23,491,133</u>	<u>\$ 67,672,509</u>	<u>\$ 376,699,083</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

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2007 AND 2006

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 28,866,842	\$ (4,113,397)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	4,204,273	4,863,483
Amortization of premiums and issuance costs on bonds	(28,756)	12,505
Loss on disposal of assets	28,536	25,814
Net unrealized (gain) loss on investments	(33,195,709)	5,236,278
Net realized gain on investments	(6,843,150)	(8,761,651)
Gifts and grants restricted for endowment	(765,220)	(1,356,104)
(Increase) decrease in operating assets:		
Student accounts and loans receivable	145,828	430,564
Unconditional promises receivable	(2,472,237)	1,745,509
Investment transactions receivable	(168,702)	(121,874)
Other receivables	(300,023)	(44,627)
Prepayments and other assets	(41,994)	(58,408)
Beneficial interest in funds held in trust by others	(467,714)	(166,273)
Increase (decrease) in operating liabilities:		
Accounts payable, accrued and other liabilities	946,132	418,151
Accrued postretirement benefits	10,612,617	2,009,081
Student deposits and advance payments	292,681	(194,318)
Refundable advances	74,376	(586,216)
Deferred compensation and other long-term liabilities	—	7,000
Net cash provided by (used in) operating activities	<u>887,780</u>	<u>(654,483)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(44,548,300)	(72,898,759)
Sales of investments	48,254,389	80,099,232
Purchases of fixed assets	<u>(9,855,219)</u>	<u>(5,136,212)</u>
Net cash (used in) provided by investing activities	<u>(6,149,130)</u>	<u>2,064,261</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment on notes payable	(925,000)	(2,460,000)
Proceeds from note payable	5,000,000	—
Gifts and grants restricted for endowment	<u>765,220</u>	<u>1,356,104</u>
Net cash provided by (used in) by financing activities	<u>4,840,220</u>	<u>(1,103,896)</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(421,130)	305,882
CASH AND CASH EQUIVALENTS — Beginning of year	<u>3,047,837</u>	<u>2,741,955</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 2,626,707</u>	<u>\$ 3,047,837</u>
SUPPLEMENTAL CASH FLOW INFORMATION — Interest paid	<u>\$ 1,172,371</u>	<u>\$ 1,006,093</u>
SUPPLEMENTAL CASH FLOW INFORMATION — Additions to fixed assets in accrued expenses	<u>\$ 683,675</u>	<u>\$ 71,571</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2007 AND 2006

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 1,235 students and a current student-to-faculty ratio of 10:1. 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.

Accounting Changes – In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans*. FASB Statement No. 158 is effective for fiscal years ending after December 15, 2006, and requires entities with defined benefit pension plans and other postretirement benefit plans to recognize the funded or underfunded status of those plans as an asset or liability in the statement of financial position and to recognize the changes in that funded status in the year in which the changes occur as changes in unrestricted net assets in the statement of activities. Additionally, FASB Statement No. 158 requires employers to measure the funded or underfunded status of a plan as of the date of the year-end statement of financial position. The incremental effect of adopting FASB Statement No. 158 is to be reflected in the financial statements in the year of adoption. Retroactive application is not allowed.

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, 2007 and 2006, are as follows:

	2007	2006
Scholarships	\$ 2,012,897	\$ 1,547,430
Professorships and faculty development	1,511,691	1,428,760
Plant	14,252,841	11,585,932
Other	5,381,409	5,712,902
Restricted for use in future periods	<u>332,295</u>	<u>415,786</u>
Total	<u>\$23,491,133</u>	<u>\$20,690,810</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, 2007 and 2006, being expendable to support the following:

	2007	2006
Unrestricted	\$28,362,929	\$28,311,929
Scholarships	18,038,329	18,540,178
Professorships and faculty development	8,625,569	8,606,286
Plant	4,661,408	1,438,523
Other	<u>7,984,274</u>	<u>9,528,532</u>
Total	<u>\$67,672,509</u>	<u>\$66,425,448</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 2004SA, 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 over the respective lives of the bonds. Such deferred financial costs are included in other assets at June 30, 2007, net of accumulated amortization totaling \$62,799, \$60,987 and \$2,658, for the Series 2004A, Series 2004B, and Series 2006 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%, determined at date of donation, 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 \$22,879 and \$114,564 for 2007 and 2006, 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, 2007 and 2006, is as follows:

	2007	2006
At fair value:		
Short-term investments	\$ 3,981,934	\$ 4,613,802
Bonds	71,179,678	67,834,995
Publicly traded stocks	238,071,357	204,385,240
At cost or market at date of acquisition:		
Real estate	8,794,264	8,294,550
Other	254,364	173,884
	<u>\$322,281,597</u>	<u>\$285,302,471</u>
Total investments		

Investment income is reported net of investment advisory fees of \$767,058 and \$753,196 in fiscal year 2007 and 2006, 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 20-quarter average endowment market value, excluding investments in real estate, as of December 31 preceding the fiscal year. The spending rate was 5.55% for fiscal year 2007 and 5.60% for fiscal year 2006. 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 2007 and 2006. Student loans receivable are reported net of allowance for doubtful accounts of \$107,823 and \$80,889 for 2007 and 2006, respectively.

4. UNCONDITIONAL PROMISES RECEIVABLE

Unconditional promises receivable at June 30, 2007 and 2006, consist of the following:

	2007	2006
Restricted for scholarships	\$ 3,361,624	\$ 2,930,811
Restricted for plant	15,340,867	12,429,246
Restricted for other uses	1,637,801	2,255,975
Restricted for use in future periods	<u>345,352</u>	<u>430,990</u>
	20,685,644	18,047,022
Discount	<u>(1,363,302)</u>	<u>(1,196,917)</u>
Net unconditional promises receivable	<u>\$ 19,322,342</u>	<u>\$ 16,850,105</u>

As of June 30, 2007 and 2006, amounts due from unconditional promises receivable are as follows:

	2007	2006
Due in less than one year	\$ 6,325,077	\$ 3,772,312
Due in one to five years	<u>14,360,567</u>	<u>14,274,710</u>
Total	<u>\$ 20,685,644</u>	<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 receivable. No allowance for uncollectible promises receivable has been recorded as historically the University has not experienced material uncollectible amounts.

5. INVESTMENT IN PLANT - NET

At June 30, 2007 and 2006, investment in plant consists of the following:

	2007	2006
Land	\$ 111,509	\$ 111,509
Buildings	97,146,885	97,019,437
Furniture and equipment	30,378,107	28,662,092
Ground improvements	<u>13,601,267</u>	<u>13,568,441</u>
Total property	141,237,768	139,361,479
Less accumulated depreciation	<u>(70,515,638)</u>	<u>(66,452,324)</u>
	70,722,130	72,909,155
Construction in progress	<u>14,171,767</u>	<u>5,678,657</u>
Investment in plant — net	<u>\$ 84,893,897</u>	<u>\$ 78,587,812</u>

6. ASSETS HELD FOR SALE

At June 30, 2006, the University has classified \$646,356 of real estate investments as held for sale. During fiscal year 2007 the University reclassified these real estate investment assets to regular investments and ceased to market the investments. The University decided to remove these assets from the market due to the continuation in real estate appreciation in the central Texas area. All of these assets have an estimated fair market value in excess of the related asset's carrying value.

7. NOTES PAYABLE

The University's notes and bonds payable as of June 30, 2007 and 2006, including related premiums of \$201,487 and \$230,243, respectively, consisted of the following:

	2007	2006
City of Crawford Education Facilities Corporation Higher Education Revenue Refunding Bonds Series 2004A, interest rates ranging from 3% to 5%, semiannual interest payments due, maturing at various dates through 2014	\$ 7,771,487	\$ 8,725,243
City of Crawford Education Facilities Corporation Higher Education Revenue Refunding Bonds Series 2004B, interest rates ranging from 3% to 5%, monthly interest payments due, maturing in October 2014	19,040,000	19,040,000
City of Riesel Education Facilities Corporation 2006 Note, fixed interest rate of 4.76%, semiannual interest payments due beginning February 2008, maturing in February 2026	<u>5,000,000</u>	<u> </u>
Total	<u>\$31,811,487</u>	<u>\$27,765,243</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 year 2007. 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 years 2008, 2009, 2010, 2011 and 2012, principal payments of \$955,000, \$990,000, \$1,025,000, \$1,075,000 and \$1,120,000, 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 \$17,800,000 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.

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 (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 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 2008, 2009, 2010, 2011, and 2012, principal payments of \$115,000, \$120,000, \$125,000, \$135,000, and \$140,000, 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 \$2,094,464 and \$2,035,702 for fiscal year 2007 and fiscal year 2006, respectively, were expensed. In addition, supplemental payments totaling \$6,137 in fiscal year 2007 and 2006 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 \$4,053,069 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 \$3,121,187 in fiscal year 2007 and \$2,754,912 in fiscal year 2006.

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.

In fiscal year 2007, the University adopted the recognition and disclosure provisions of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. This Statement requires the recognition of the net underfunded status of the University's defined post retirement benefit plan as of June 30, 2007, with a corresponding reduction to unrestricted net assets. The following table displays the incremental effect of applying FASB Statement No. 158 on individual line items in the statement of financial position for fiscal year 2007:

	Before Application of SFAS No. 158	Adjustments	After Application of SFAS No. 158
Accrued post retirement benefits — current portion	\$ -	\$ 721,278	\$ 721,278
Accrued post retirement benefits — non-current portion	<u>12,190,515</u>	<u>8,082,102</u>	<u>20,272,618</u>
Accrued post retirement benefits — total	12,190,515	8,803,380	20,993,896
Unrestricted net assets	<u>\$ 294,338,821</u>	<u>\$ (8,803,380)</u>	<u>\$ 285,535,441</u>

Pursuant to the provisions of FASB Statement No. 158 unamortized costs are reflected in the statement of activities as a net change in unrestricted net assets apart from expenses. The University amortizes a portion of these costs each year and reclassifies these amounts into as 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	\$ 12,828,360	\$ (970,181)	\$ 1,879	\$ 11,860,058
Prior service costs	<u>(3,404,463)</u>	<u>347,785</u>	<u> </u>	<u>(3,056,678)</u>
	<u>\$ 9,423,897</u>	<u>\$ (622,396)</u>	<u>\$ 1,879</u>	<u>\$ 8,803,380</u>

In fiscal year 2008, the University expects to recognize as net periodic benefit approximately \$970,000 and \$348,000 and of previously unamortized net gain and net prior service cost, respectively.

The status of the University's accrued postretirement benefit cost at June 30, 2007 and 2006, is as follows:

	2007	2006
Retirees	\$ 7,170,504	\$ 7,248,877
Fully eligible active plan participants	3,062,366	3,005,340
Other active plan participants	<u>10,761,026</u>	<u>9,550,959</u>
Accumulated postretirement benefit obligation ("APBO")	20,993,896	19,805,176
Plan assets	<u> </u>	<u> </u>
Unfunded status	20,993,896	19,805,176
Unrecognized net actuarial (loss)		(12,828,360)
Unrecognized prior service gain from plan amendment	<u> </u>	<u>3,404,463</u>
Accrued postretirement benefit cost	<u>\$20,993,896</u>	<u>\$ 10,381,279</u>

Net periodic postretirement benefit cost recognized during fiscal year 2007 and 2006 is as follows:

	2007	2006
Service cost	\$ 613,131	\$ 645,469
Interest cost	1,217,813	1,036,966
Amortization of prior actuarial loss	970,181	1,197,532
Amortization of prior service gain from plan amendment	<u>(347,785)</u>	<u>(347,785)</u>
Total	<u>\$2,453,340</u>	<u>\$2,532,182</u>

The University used a weighted average discount rate of 6.25% to determine the post retirement benefit obligation and net periodic benefit cost for fiscal years 2007 and 2006.

In determining the post retirement benefit obligation the assumed pre-Medicare health care cost trend rate was 8.5% for fiscal year 2007, declining gradually to 5% by 2014. The assumed post-Medicare health care cost trend rate was 10.5% for fiscal year 2007, 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 amount of the obligation at June 30, 2007 by \$3,670,545 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$351,096. 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, 2007 by \$2,971,273 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$280,314.

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 post retirement benefit obligation and service costs. Components of net periodic benefit costs, including the effect the estimated Medicare prescription drug subsidy, is as follows:

	Before Subsidy	Effect of Subsidy	After Subsidy
Service cost	\$ 718,249	\$ (105,118)	\$ 613,131
Interest cost	1,441,369	(223,556)	1,217,813
Amortization of prior service cost	(347,785)		(347,785)
Amortization of net (gain)/loss	<u>1,214,971</u>	<u>(244,790)</u>	<u>970,181</u>
	<u>\$3,026,804</u>	<u>\$ (573,464)</u>	<u>\$2,453,340</u>

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
2008	\$ 848,766	\$ (105,290)	\$ 743,476
2009	932,998	(122,918)	810,080
2010	1,033,348	(136,315)	897,033
2011	1,134,035	(151,626)	982,409
2012–2016	7,629,212	(1,102,995)	6,526,217

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 has obtained approval to renew this line of credit for the period of June 30, 2007 through June 30, 2008. The University did not draw on this line of credit in either fiscal year 2007 or 2006.

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, 2007 and 2006, 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 \$31,811,487 and \$27,765,243 and have an estimated fair value of approximately \$27,661,861 and \$27,666,984 at June 30, 2007 and 2006, 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, 2007, the remaining commitments under these contracts approximated \$5,789,598.

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, 2007 (UNAUDITED)

	Budget	Actual
REVENUES:		
Educational and general:		
Tuition and fees:		
Arts and sciences	\$25,588,691	\$25,579,733
Fine arts	3,963,557	3,972,975
Summer school	400,000	452,384
Student services	115,490	98,286
General library	16,000	13,485
Investment income	197,000	197,452
Endowment funds	11,611,866	11,598,728
Private gifts and grants	1,885,288	1,952,746
Special schools and enterprises	194,500	171,725
Student aid:		
Endowment	2,727,325	2,784,891
Gifts and grants	513,420	436,463
Government funds	706,049	832,433
Research and sponsored projects	<u>450,000</u>	<u>701,154</u>
Total educational and general	<u>48,369,186</u>	<u>48,792,455</u>
Sales and services of auxiliary enterprises:		
University food services	2,711,777	2,703,020
Residence halls	2,647,155	2,698,331
Golf course	130,000	101,772
University store and snack bar	<u>45,000</u>	<u>21,404</u>
Total sales and services of auxiliary enterprises	<u>5,533,932</u>	<u>5,524,527</u>
Other noneducational	<u>100,000</u>	<u>132,261</u>
Total revenues	<u>\$54,003,118</u>	<u>\$54,449,243</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, 2007 (UNAUDITED)

	Budget	Actual
EXPENDITURES AND TRANSFERS:		
Educational and general:		
General administration	\$ 2,403,650	\$ 2,302,117
General expense	6,123,998	6,125,650
Student services	6,933,681	6,929,592
Instruction:		
Arts and sciences	10,048,812	10,382,621
Fine arts	2,159,351	2,326,064
General library	2,356,575	2,294,932
Research	465,700	718,559
Operation and maintenance of plant	4,993,841	4,733,146
Special schools and enterprises	187,399	163,337
Student aid	10,486,715	10,420,913
Academic support and other	<u>3,438,726</u>	<u>3,143,954</u>
Educational and general expenditures	<u>49,598,448</u>	<u>49,540,885</u>
Nonmandatory transfers for:		
Principal and interest	450,000	687,464
Renewals and replacements	<u>5,494</u>	<u>255,891</u>
Total educational and general	<u>50,053,942</u>	<u>50,484,240</u>
Auxiliary enterprises:		
University food services	1,679,924	1,661,380
Residence halls	2,106,218	2,153,145
Golf course	130,000	117,906
University store and snack bar	<u>33,034</u>	<u>9,276</u>
Total auxiliary enterprises	<u>3,949,176</u>	<u>3,941,707</u>
Total expenditures and non-mandatory transfers	<u>54,003,118</u>	<u>54,425,947</u>
NET INCREASE	<u>\$ -</u>	<u>\$ 23,296</u>

(Concluded)

SOUTHWESTERN UNIVERSITY

SUPPLEMENTAL SCHEDULE OF DISAGGREGATED ASSETS, LIABILITIES, AND NET ASSETS AS OF JUNE 30, 2007 (UNAUDITED)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	\$ 2,626,707	\$ -	\$ -	\$ 2,626,707
Receivables:				
Student accounts receivable — net	30,560			30,560
Unconditional promises — current portion		5,699,732	625,345	6,325,077
Investment transactions	1,108,100	87,897	253,211	1,449,208
Other	699,532			699,532
Prepayments and other current assets	<u>736,777</u>			<u>736,777</u>
Total current assets	5,201,676	5,787,629	878,556	11,867,861
UNCONDITIONAL PROMISES				
RECEIVABLE — Long-term portion		10,399,725	2,597,540	12,997,265
INVESTMENTS	255,321,926	6,485,095	60,474,576	322,281,597
BENEFICIAL INTERESTS IN FUNDS HELD BY OTHERS		818,684	3,721,837	4,540,521
INVESTMENT IN PLANT — Net	84,893,897			84,893,897
STUDENT LOANS — Net	3,387,819			3,387,819
OTHER ASSETS	<u>339,327</u>			<u>339,327</u>
TOTAL	<u>\$ 349,144,645</u>	<u>\$ 23,491,133</u>	<u>\$ 67,672,509</u>	<u>\$ 440,308,287</u>
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES:				
Accounts payable, accrued, and other liabilities	\$ 6,201,786	\$ -	\$ -	\$ 6,201,786
Notes payable — current portion	1,070,000			1,070,000
Accrued post retirement benefits--current portion	721,278			721,278
Student deposits and advance payments	<u>1,427,133</u>			<u>1,427,133</u>
Total current liabilities	9,420,197			9,420,197
NOTES PAYABLE — Long-term portion	30,741,487			30,741,487
ACCRUED POSTRETIREMENT BENEFITS — Long-term portion	20,272,618			20,272,618
REFUNDABLE ADVANCES	3,095,502			3,095,502
DEFERRED COMPENSATION AND OTHER LONG-TERM LIABILITIES	<u>79,400</u>			<u>79,400</u>
Total liabilities	<u>63,609,204</u>	<u>-</u>	<u>-</u>	<u>63,609,204</u>
NET ASSETS:				
Unrestricted	285,535,441			285,535,441
Temporarily restricted		23,491,133		23,491,133
Permanently restricted			67,672,509	67,672,509
Total net assets	<u>285,535,441</u>	<u>23,491,133</u>	<u>67,672,509</u>	<u>376,699,083</u>
TOTAL	<u>\$ 349,144,645</u>	<u>\$ 23,491,133</u>	<u>\$ 67,672,509</u>	<u>\$ 440,308,287</u>

SOUTHWESTERN UNIVERSITY

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

	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	<u>\$ 307,669,462</u>	<u>\$ 20,690,810</u>	<u>\$ 66,425,448</u>	<u>\$ 394,785,720</u>
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	<u>\$ 307,669,462</u>	<u>\$ 20,690,810</u>	<u>\$ 66,425,448</u>	<u>\$ 394,785,720</u>