

Southwestern University

Financial Statements as of and for the
Years Ended June 30, 2008 and 2007, and
Independent Auditors' Report

SOUTHWESTERN UNIVERSITY

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007:	
Statements of Financial Position	2
Statements of Activities	3-4
Statements of Cash Flows	5
Notes to Financial Statements	6-16

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Southwestern University
Georgetown, Tennessee

We have audited the accompanying statements of financial position of Southwestern University (the "University") as of June 30, 2008 and 2007, 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, 2008 and 2007, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2008, 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's Touche LLP

October 28, 2008

SOUTHWESTERN UNIVERSITY

STATEMENTS OF FINANCIAL POSITION AS OF JUNE 30, 2008 AND 2007

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,050,531	\$ 2,626,707
Receivables:		
Student accounts receivable — net	47,032	30,560
Unconditional promises receivable — current portion	5,566,940	6,325,077
Investment transactions	1,434,193	1,449,208
Other	406,249	699,532
Prepayments and other current assets	<u>953,635</u>	<u>736,777</u>
Total current assets	11,458,580	11,867,861
UNCONDITIONAL PROMISES RECEIVABLE — Long-term portion	8,666,850	12,997,265
INVESTMENTS	289,137,485	322,281,597
BENEFICIAL INTERESTS IN FUNDS HELD BY OTHERS	4,289,203	4,540,521
INVESTMENT IN PLANT — Net	87,497,208	84,893,897
STUDENT LOANS RECEIVABLE — Net	3,637,305	3,387,819
OTHER ASSETS	<u>295,408</u>	<u>339,327</u>
TOTAL	<u>\$ 404,982,039</u>	<u>\$ 440,308,287</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable — accrued and other liabilities	\$ 5,706,410	\$ 6,201,786
Notes payable — current portion	1,110,000	1,070,000
Accrued post retirement benefits — current portion	700,675	721,278
Student deposits and advance payments	<u>1,339,840</u>	<u>1,427,133</u>
Total current liabilities	8,856,925	9,420,197
NOTES PAYABLE — Long-term portion	29,602,730	30,741,487
ACCRUED POSTRETIREMENT BENEFITS	18,803,789	20,272,618
REFUNDABLE ADVANCES	3,089,276	3,095,502
DEFERRED COMPENSATION AND OTHER LONG-TERM LIABILITIES	<u>73,400</u>	<u>79,400</u>
Total liabilities	<u>60,426,120</u>	<u>63,609,204</u>
NET ASSETS:		
Unrestricted	255,729,422	285,535,441
Temporarily restricted	20,329,195	23,491,133
Permanently restricted	<u>68,497,302</u>	<u>67,672,509</u>
Total net assets	<u>344,555,919</u>	<u>376,699,083</u>
TOTAL	<u>\$ 404,982,039</u>	<u>\$ 440,308,287</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2008

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:				
Tuition and fees	\$ 32,596,218	\$ -	\$ -	\$ 32,596,218
Less scholarships and grants	<u>12,348,764</u>	<u>-</u>	<u>-</u>	<u>12,348,764</u>
Net tuition and fees	20,247,454	-	-	20,247,454
Private gifts and grants	3,258,338		824,793	4,083,131
Government grants	247,377	274,436		521,813
Investment income	5,427,326	3,982,818		9,410,144
Change in value of split-interest agreements		(338,776)		(338,776)
Net realized gains on investments	18,105,359			18,105,359
Net unrealized loss on investments	(41,614,472)			(41,614,472)
Other income	689,664	24,721		714,385
Auxiliary enterprises	<u>7,694,817</u>	<u>-</u>	<u>-</u>	<u>7,694,817</u>
Total revenues	14,055,863	3,943,199	824,793	18,823,855
NET ASSETS RELEASED FROM RESTRICTIONS				
	<u>7,105,137</u>	<u>(7,105,137)</u>	<u>-</u>	<u>-</u>
	<u>21,161,000</u>	<u>(3,161,938)</u>	<u>824,793</u>	<u>18,823,855</u>
EXPENSES:				
Instructional services	23,280,413			23,280,413
Student services	8,430,672			8,430,672
Auxiliary services	8,474,540			8,474,540
Institutional support	<u>13,459,120</u>	<u>-</u>	<u>-</u>	<u>13,459,120</u>
Total expenses	<u>53,644,745</u>	<u>-</u>	<u>-</u>	<u>53,644,745</u>
CHANGE IN NET ASSETS FROM OPERATING ACTIVITIES	(32,483,745)	(3,161,938)	824,793	(34,820,890)
POST-RETIREMENT-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST				
	<u>2,677,726</u>	<u>-</u>	<u>-</u>	<u>2,677,726</u>
CHANGE IN NET ASSETS	(29,806,019)	(3,161,938)	824,793	(32,143,164)
NET ASSETS — Beginning of year	<u>285,535,441</u>	<u>23,491,133</u>	<u>67,672,509</u>	<u>376,699,083</u>
NET ASSETS — End of year	<u>\$255,729,422</u>	<u>\$20,329,195</u>	<u>\$68,497,302</u>	<u>\$344,555,919</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 7	<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

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$(32,143,164)	\$ 28,866,842
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	4,441,920	4,204,273
Amortization of premiums and issuance costs on bonds	(28,757)	(28,756)
Loss on disposal of assets	22,220	28,536
Net unrealized (gain) loss on investments	41,614,472	(33,195,709)
Net realized gain on investments	(18,105,359)	(6,843,150)
Gifts and grants restricted for endowment	(1,611,339)	(765,220)
(Increase) decrease in operating assets:		
Student accounts and loans receivable	(265,958)	145,828
Unconditional promises receivable	5,088,552	(2,472,237)
Investment transactions receivable	15,015	(168,702)
Other receivables	293,283	(300,023)
Prepayments and other assets	(172,939)	(41,994)
Beneficial interest in funds held in trust by others	251,318	(467,714)
Increase (decrease) in operating liabilities:		
Accounts payable, accrued and other liabilities	(495,376)	946,132
Accrued postretirement benefits	(1,489,432)	10,612,617
Student deposits and advance payments	(87,293)	292,681
Refundable advances	(6,226)	74,376
Deferred compensation and other long-term liabilities	(6,000)	
Net cash (used in) provided by operating activities	<u>(2,685,063)</u>	<u>887,780</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(62,131,303)	(44,548,300)
Sales of investments	71,766,302	48,254,389
Purchases of fixed assets	<u>(7,067,451)</u>	<u>(9,855,219)</u>
Net cash provided by (used in) investing activities	<u>2,567,548</u>	<u>(6,149,130)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment on notes payable	(1,070,000)	(925,000)
Proceeds from note payable		5,000,000
Gifts and grants restricted for endowment	<u>1,611,339</u>	<u>765,220</u>
Net cash provided by financing activities	<u>541,339</u>	<u>4,840,220</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	423,824	(421,130)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>2,626,707</u>	<u>3,047,837</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 3,050,531</u>	<u>\$ 2,626,707</u>
SUPPLEMENTAL CASH FLOW INFORMATION — Interest paid	<u>\$ 1,200,300</u>	<u>\$ 1,172,371</u>
SUPPLEMENTAL CASH FLOW INFORMATION — Additions to fixed assets in accrued expenses	<u>\$ 8,369</u>	<u>\$ 683,675</u>

See notes to financial statements.

SOUTHWESTERN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

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 Rutgersville 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 1,241 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.

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, 2008 and 2007, are as follows:

	2008	2007
Scholarships	\$ 3,561,421	\$ 2,012,897
Professorships and faculty development	1,063,527	1,511,691
Plant	10,017,141	14,252,841
Other	5,422,799	5,381,409
Restricted for use in future periods	<u>264,307</u>	<u>332,295</u>
Total	<u>\$20,329,195</u>	<u>\$23,491,133</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, 2008 and 2007, being expendable to support the following:

	2008	2007
Unrestricted	\$28,363,929	\$28,362,929
Scholarships	21,923,657	21,261,214
Professorships and faculty development	8,628,919	8,625,569
Plant	1,438,523	1,438,523
Other	<u>8,142,274</u>	<u>7,984,274</u>
Total	<u>\$68,497,302</u>	<u>\$67,672,509</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, 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, 2008, net of accumulated amortization totaling \$83,732, \$81,316, and \$5,315, 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 \$17,568 and \$22,879 for 2008 and 2007, respectively. Management of the University expects future lease expenses to decline from the current year total.

Allocation of Certain Expenses — The statement of activities presents expenses by functional classification. The University's primary program services are instruction and departmental research. Expenses reported as student services, institutional support and auxiliary services are incurred in support of these primary program services. 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.

Recent Accounting Pronouncements — In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement No. 157, *Fair Value Measurements*. The statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The University has not determined the effect, if any, of the financial impact of adoption of Statement No. 157.

In February 2007, FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, including an amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The statement permits entities to choose to measure financial instruments and other items at fair value that are not currently required to be measured at fair value. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The University is in the process of determining the financial impact, if any, of the adoption of Statement No. 159.

In March 2008, FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. The statement requires qualitative disclosures about the objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk related contingent features in derivative instruments. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2008. The University is in the process of determining the financial impact, if any, of adoption of Statement No. 161.

In August 2008, FASB issued FASB Staff Position (FSP) FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act and Enhanced Disclosures for All Endowment Funds*. The FSP responds to accounting questions raised by the model Uniform Prudent Management of Institutional Funds Act (UPMIFA) that was approved by the Uniform Law Commission in July 2006 to modernize the Uniform Management of Institutional Funds Act of 1972 (UMIFA) for governing the investment and management of donor-restricted endowment funds by not-for-profit organizations. Effective September 2007, the State of Texas enacted UPMIFA. Among UPMIFA's most significant changes is the elimination of UMIFA's concept of historic dollar value threshold, the amount below which an organization could not spend from the fund, in favor of a more robust set of guidelines about what constitutes prudent spending. The provisions of the FSP expand disclosures about an organization's endowment funds (both donor-restricted and board-designated). In addition, the FSP requires that the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets be classified as temporarily restricted net assets until appropriated for expenditure. The University has determined that retaining its existing policies regarding net asset classification of its donor-restricted endowment funds is appropriate as of June 30, 2008, based on accounting standards in effect. The provisions of the FSP are effective for fiscal years ending after December 15, 2008. Accordingly, the University will adopt the FSP for the year ending June 30, 2009.

2. INVESTMENTS

A summary of investments at June 30, 2008 and 2007, is as follows:

	2008	2007
At fair value:		
Short-term investments	\$ 6,683,057	\$ 3,981,934
Bonds	66,129,966	71,179,678
Publicly traded stocks	207,302,919	238,071,357
At cost or market at date of acquisition:		
Real estate	8,794,264	8,794,264
Other	<u>227,279</u>	<u>254,364</u>
 Total investments	 <u>\$289,137,485</u>	 <u>\$322,281,597</u>

Investment income is reported net of investment advisory fees of \$758,678 and \$767,058 in fiscal year 2008 and 2007, 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 5.90% for fiscal year 2008 and 5.55% for fiscal year 2007. 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 2008 and 2007. Student loans receivable are reported net of allowance for doubtful accounts of \$148,065 and \$107,823 for 2008 and 2007, respectively.

4. UNCONDITIONAL PROMISES RECEIVABLE

Unconditional promises receivable at June 30, 2008 and 2007, consist of the following:

	2008	2007
Restricted for scholarships	\$ 2,488,831	\$ 3,361,624
Restricted for plant	10,368,496	15,340,867
Restricted for other uses	1,674,561	1,637,801
Restricted for use in future periods	<u>270,712</u>	<u>345,352</u>
	14,802,600	20,685,644
Discount	<u>(568,810)</u>	<u>(1,363,302)</u>
Net unconditional promises receivable	<u>\$ 14,233,790</u>	<u>\$ 19,322,342</u>

As of June 30, 2008 and 2007, amounts due from unconditional promises receivable are as follows:

	2008	2007
Due in less than one year	\$ 5,566,940	\$ 6,325,077
Due in one to five years	<u>9,235,660</u>	<u>14,360,567</u>
Total	<u>\$ 14,802,600</u>	<u>\$ 20,685,644</u>

The University uses risk-free rates of 2.0% to 5.3% 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, 2008 and 2007, investment in plant consists of the following:

	2008	2007
Land	\$ 111,509	\$ 111,509
Buildings	113,586,631	97,146,885
Furniture and equipment	31,197,225	30,378,107
Ground improvements	<u>13,601,267</u>	<u>13,601,267</u>
Total property	158,496,632	141,237,768
Less accumulated depreciation	<u>(74,423,240)</u>	<u>(70,515,638)</u>
	84,073,392	70,722,130
Construction in progress	<u>3,423,816</u>	<u>14,171,767</u>
Investment in plant — net	<u>\$ 87,497,208</u>	<u>\$ 84,893,897</u>

6. NOTES PAYABLE

The University's notes and bonds payable as of June 30, 2008 and 2007, including related premiums of \$172,730 and \$201,487, respectively, consisted of the following:

	2008	2007
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	\$ 6,787,730	\$ 7,771,487
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>4,885,000</u>	<u>5,000,000</u>
Total	<u>\$30,712,730</u>	<u>\$31,811,487</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 both fiscal years 2008 and 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 2009, 2010, 2011, 2012, and 2013 principal payments of \$990,000, \$1,025,000, \$1,075,000, \$1,120,000, and \$1,180,000, 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 2009, 2010, 2011, 2012, and 2013, principal payments of \$120,000, \$125,000, \$135,000, \$140,000, and \$145,000, respectively, will become due.

7. 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 \$2,165,671 and \$2,094,464 for fiscal year 2008 and fiscal year 2007, respectively, were expensed. In addition, supplemental payments totaling \$6,137 in fiscal year 2008 and 2007 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 \$4,439,403 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 \$3,286,800 in fiscal year 2008 and \$3,121,187 in fiscal year 2007.

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.

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 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	\$11,860,058	\$(778,157)	\$(1,429,921)	\$ 9,651,980
Prior service costs	<u>(3,056,678)</u>	<u>429,717</u>	<u>(899,365)</u>	<u>(3,526,326)</u>
	<u>\$ 8,803,380</u>	<u>\$(348,440)</u>	<u>\$(2,329,286)</u>	<u>\$ 6,125,654</u>

In fiscal year 2009, the University expects to recognize as net periodic benefit approximately \$702,000 and \$430,000 of previously unamortized net gain and net prior service cost, respectively.

The status of the University's accrued postretirement benefit cost at June 30, 2008 and 2007, is as follows:

	2008	2007
Retirees	\$ 8,321,104	\$ 7,170,504
Fully eligible active plan participants	3,002,167	3,062,366
Other active plan participants	<u>8,181,193</u>	<u>10,761,026</u>
Accumulated postretirement benefit obligation (APBO)	19,504,464	20,993,896
Plan assets	_____	_____
Funded status	<u>\$(19,504,464)</u>	<u>\$(20,993,896)</u>
Employer contributions	\$ 759,991	\$ 644,103
Plan participants' contributions	759,991	644,103
Benefits paid	759,991	644,103

Net periodic postretirement benefit cost recognized during fiscal year 2008 and 2007 is as follows:

	2008	2007
Service cost	\$ 455,503	\$ 613,131
Interest cost	1,144,342	1,217,813
Amortization of prior actuarial loss	778,157	970,181
Amortization of prior service gain from plan amendment	<u>(429,717)</u>	<u>(347,785)</u>
Total	<u>\$1,948,285</u>	<u>\$2,453,340</u>

The University used a weighted average discount rate of 6.84% and 6.25% to determine the post retirement benefit obligation at June 30, 2008 and June 30, 2007, respectively. An average discount rate of 6.25% was used to determine the net periodic benefit cost for fiscal years 2008 and 2007.

In determining the net periodic benefit cost the assumed pre-Medicare health care cost trend rate was 8.0% for fiscal year 2008, declining gradually to 5% by 2014. The assumed post-Medicare health care cost trend rate was 10.0% for fiscal year 2008, declining gradually to 5% by 2018. In determining the post retirement benefit obligation at June 30, 2008, the assumed health care cost trend rate was 10.0% for 2008 declining gradually to 5.0% 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, 2008, by \$3,138,180 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$285,203.

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, 2008, by \$2,562,300 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$229,440.

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	\$ 539,411	\$ (83,908)	\$ 455,503
Interest cost	1,372,681	(228,339)	1,144,342
Amortization of prior service cost	(429,717)		(429,717)
Amortization of net (gain) loss	<u>1,005,427</u>	<u>(227,270)</u>	<u>778,157</u>
	<u>\$2,487,802</u>	<u>\$ (539,517)</u>	<u>\$1,948,285</u>

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

	2008	2007
Net loss (gain)	\$(1,429,921)	N/A
Transition obligation (asset)		
Prior service cost (credit)	(899,365)	
Amortization of net loss (gain)	(778,157)	
Amortization of transition obligation (asset)		
Amortization of prior service cost	429,717	
Total recognized in unrestricted net assets	(2,677,726)	
Total recognized in net periodic benefit cost and unrestricted net assets	(729,441)	

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 June 30	Medical Benefits	Prescription Drug Subsidy	Net
2009	\$ 842,669	\$ (118,427)	\$ 724,242
2010	949,087	(132,298)	816,789
2011	1,047,662	(148,829)	898,833
2012	1,158,032	(169,213)	988,819
2013	1,231,812	(185,033)	1,046,779
2014–2018	7,729,393	(1,197,164)	6,532,229

The University expects to contribute \$724,000 to the plan during fiscal year 2009.

8. 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 expired on June 30, 2008. The University has obtained approval to renew this line of credit for the period of June 30, 2008 through June 30, 2009. The University did not draw on this line of credit in either fiscal year 2008 or 2007.

9. TAX-EXEMPT STATUS

The University claims exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The University has been classified as an organization that is not a private foundation, and contributions to it qualify for deduction as charitable contributions. The University files unrelated business income tax and other information returns as required by government authorities. A provision totaling \$0 for unrelated business income taxes is included in the accompanying financial statements for the years ended June 30, 2008 and 2007.

The University adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”) effective June 1, 2007. FIN 48 requires that the University recognize in its financial statements the financial effects of a tax position, if that position is more likely than not of being sustained upon examination, including resolution of any appeals or litigation processes, based upon the technical merits of the position. Tax positions taken related to the University’s tax exempt status, unrelated business activities taxable income and the deductibility of expenses and other miscellaneous tax positions have been reviewed, and management is of the opinion that material positions taken by the University would more likely than not be sustained by examination. Accordingly, the University has not recorded an income tax liability for uncertain tax benefits.

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, 2008 and 2007, 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 6). 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 \$30,712,730 and \$31,811,487 and have an estimated fair value of approximately \$26,851,475 and \$27,661,861 at June 30, 2008 and 2007, 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, 2008, the remaining commitments under these contracts approximated \$4,760,000.

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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