

# Southwestern University

Financial Statements as of and for the  
Years Ended June 30, 2009 and 2008,  
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, 2009 and 2008, 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, 2009 and 2008, 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 5 to the financial statements, the University adopted the provisions of the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*. As discussed in Note 6 to the financial statements, the University retroactively adopted the provisions of FASB Staff Position No. 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*.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 23, 2009, 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 23, 2009

# SOUTHWESTERN UNIVERSITY

## STATEMENTS OF FINANCIAL POSITION AS OF JUNE 30, 2009 AND 2008

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|                                                       | 2009                  | 2008                  |
|-------------------------------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                                         |                       |                       |
| CURRENT ASSETS:                                       |                       |                       |
| Cash and cash equivalents                             | \$ 41,001,004         | \$ 3,050,531          |
| Receivables:                                          |                       |                       |
| Student accounts receivable — net                     | 63,272                | 47,032                |
| Unconditional promises receivable — current portion   | 4,052,230             | 5,566,940             |
| Investment transactions                               | 95,580                | 1,434,193             |
| Other                                                 | 686,965               | 406,249               |
| Prepayments and other current assets                  | <u>1,123,634</u>      | <u>953,635</u>        |
| Total current assets                                  | 47,022,685            | 11,458,580            |
| UNCONDITIONAL PROMISES RECEIVABLE — Long-term portion | 4,716,941             | 8,666,850             |
| INVESTMENTS                                           | 196,478,966           | 289,137,485           |
| BENEFICIAL INTERESTS IN FUNDS HELD BY OTHERS          | 3,569,227             | 4,289,203             |
| INVESTMENT IN PLANT — Net                             | 92,358,068            | 87,497,208            |
| STUDENT LOANS RECEIVABLE — Net                        | 4,252,595             | 3,637,305             |
| OTHER ASSETS                                          | <u>251,489</u>        | <u>295,408</u>        |
| TOTAL                                                 | <u>\$ 348,649,971</u> | <u>\$ 404,982,039</u> |
| <b>LIABILITIES AND NET ASSETS</b>                     |                       |                       |
| CURRENT LIABILITIES:                                  |                       |                       |
| Accounts payable — accrued and other liabilities      | \$ 5,630,736          | \$ 5,706,410          |
| Notes payable — current portion                       | 1,150,000             | 1,110,000             |
| Accrued post retirement benefits — current portion    | 792,439               | 700,675               |
| Student deposits and advance payments                 | 1,316,994             | 1,339,840             |
| Total current liabilities                             | 8,890,169             | 8,856,925             |
| NOTES PAYABLE — Long-term portion                     | 28,423,973            | 29,602,730            |
| ACCRUED POSTRETIREMENT BENEFITS                       | 21,579,238            | 18,803,789            |
| REFUNDABLE ADVANCES                                   | 3,277,220             | 3,089,276             |
| DEFERRED COMPENSATION AND OTHER LONG-TERM LIABILITIES | 88,900                | 73,400                |
| Total liabilities                                     | <u>62,259,500</u>     | <u>60,426,120</u>     |
| NET ASSETS:                                           |                       |                       |
| Unrestricted                                          | 78,992,140            | 88,767,114            |
| Temporarily restricted                                | 140,275,176           | 187,291,503           |
| Permanently restricted                                | <u>67,123,155</u>     | <u>68,497,302</u>     |
| Total net assets                                      | <u>286,390,471</u>    | <u>344,555,919</u>    |
| TOTAL                                                 | <u>\$ 348,649,971</u> | <u>\$ 404,982,039</u> |

See notes to financial statements.

# SOUTHWESTERN UNIVERSITY

## STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2009

|                                                                      | Unrestricted         | Temporarily Restricted | Permanently Restricted | Total                 |
|----------------------------------------------------------------------|----------------------|------------------------|------------------------|-----------------------|
| REVENUES:                                                            |                      |                        |                        |                       |
| Tuition and fees                                                     | \$ 35,150,452        | \$ -                   | \$ -                   | \$ 35,150,452         |
| Less scholarships and grants                                         | <u>13,255,410</u>    | <u>-</u>               | <u>-</u>               | <u>13,255,410</u>     |
| Net tuition and fees                                                 | 21,895,042           | -                      | -                      | 21,895,042            |
| Private gifts and grants                                             | 6,901,266            | 2,675,987              | 829,606                | 10,406,859            |
| Government grants                                                    | 240,733              | 360,583                | -                      | 601,316               |
| Investment income (loss)                                             | 250,768              | (41,234,464)           | -                      | (40,983,696)          |
| Change in value of split-interest agreements                         | -                    | (708,968)              | -                      | (708,968)             |
| Other income                                                         | 973,730              | 26,526                 | -                      | 1,000,256             |
| Auxiliary enterprises                                                | <u>8,483,881</u>     | <u>-</u>               | <u>-</u>               | <u>8,483,881</u>      |
| Total revenues                                                       | 38,745,420           | (38,880,336)           | 829,606                | 694,690               |
| NET ASSETS RELEASED FROM RESTRICTIONS                                | <u>8,135,991</u>     | <u>(8,135,991)</u>     | <u>-</u>               | <u>-</u>              |
|                                                                      | <u>46,881,411</u>    | <u>(47,016,327)</u>    | <u>829,606</u>         | <u>694,690</u>        |
| EXPENSES:                                                            |                      |                        |                        |                       |
| Instructional services                                               | 23,963,984           | -                      | -                      | 23,963,984            |
| Student services                                                     | 8,974,059            | -                      | -                      | 8,974,059             |
| Auxiliary services                                                   | 8,353,833            | -                      | -                      | 8,353,833             |
| Institutional support                                                | <u>13,838,226</u>    | <u>-</u>               | <u>-</u>               | <u>13,838,226</u>     |
| Total expenses                                                       | <u>55,130,102</u>    | <u>-</u>               | <u>-</u>               | <u>55,130,102</u>     |
| CHANGE IN NET ASSETS FROM OPERATING ACTIVITIES                       | (8,248,691)          | (47,016,327)           | 829,606                | (54,435,412)          |
| LOSS DUE TO CHANGE IN NATURE OF PROMISES RECEIVABLE                  | -                    | -                      | (2,203,753)            | (2,203,753)           |
| POST-RETIREMENT-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST | <u>(1,526,283)</u>   | <u>-</u>               | <u>-</u>               | <u>(1,526,283)</u>    |
| CHANGE IN NET ASSETS                                                 | (9,774,974)          | (47,016,327)           | (1,374,147)            | (58,165,448)          |
| NET ASSETS — Beginning of year                                       | <u>88,767,114</u>    | <u>187,291,503</u>     | <u>68,497,302</u>      | <u>344,555,919</u>    |
| NET ASSETS — End of year                                             | <u>\$ 78,992,140</u> | <u>\$ 140,275,176</u>  | <u>\$ 67,123,155</u>   | <u>\$ 286,390,471</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 (loss)                                             | (981,974)            | (13,116,995)           | -                      | (14,098,969)          |
| Change in value of split-interest agreements                         | -                    | (338,776)              | -                      | (338,776)             |
| Other income                                                         | 632,432              | 81,953                 | -                      | 714,385               |
| Auxiliary enterprises                                                | <u>7,694,817</u>     | <u>-</u>               | <u>-</u>               | <u>7,694,817</u>      |
| Total revenues                                                       | 31,098,444           | (13,099,382)           | 824,793                | 18,823,855            |
| NET ASSETS RELEASED FROM RESTRICTIONS                                | <u>17,457,570</u>    | <u>(17,457,570)</u>    | <u>-</u>               | <u>-</u>              |
|                                                                      | <u>48,556,014</u>    | <u>(30,556,952)</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                       | (5,088,731)          | (30,556,952)           | 824,793                | (34,820,890)          |
| POST-RETIREMENT-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST | 2,677,726            | -                      | -                      | 2,677,726             |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE                  | <u>(194,357,322)</u> | <u>194,357,322</u>     | <u>-</u>               | <u>-</u>              |
| CHANGE IN NET ASSETS                                                 | (196,768,327)        | 163,800,370            | 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>\$ 88,767,114</u> | <u>\$ 187,291,503</u>  | <u>\$ 68,497,302</u>   | <u>\$ 344,555,919</u> |

See notes to financial statements.

# SOUTHWESTERN UNIVERSITY

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

|                                                                                                       | 2009                 | 2008                |
|-------------------------------------------------------------------------------------------------------|----------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES:                                                                 |                      |                     |
| Change in net assets                                                                                  | \$ (58,165,448)      | \$ (32,143,164)     |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities: |                      |                     |
| Depreciation                                                                                          | 4,524,254            | 4,441,920           |
| Amortization of premiums and issuance costs on bonds                                                  | (28,757)             | (28,757)            |
| Loss on disposal of assets                                                                            | 4,138                | 22,220              |
| Net loss on investments                                                                               | 47,352,065           | 23,509,113          |
| Gifts and grants restricted for endowment                                                             | (749,845)            | (1,611,339)         |
| (Increase) decrease in operating assets:                                                              |                      |                     |
| Student accounts and loans receivable                                                                 | (631,530)            | (265,958)           |
| Unconditional promises receivable                                                                     | 5,464,619            | 5,088,552           |
| Investment transactions receivable                                                                    | 1,338,613            | 15,015              |
| Other receivables                                                                                     | (280,716)            | 293,283             |
| Prepayments and other assets                                                                          | (126,080)            | (172,939)           |
| Beneficial interest in funds held in trust by others                                                  | 719,976              | 251,318             |
| Increase (decrease) in operating liabilities:                                                         |                      |                     |
| Accounts payable, accrued and other liabilities                                                       | (75,674)             | (495,376)           |
| Accrued postretirement benefits                                                                       | 2,867,213            | (1,489,432)         |
| Student deposits and advance payments                                                                 | (22,846)             | (87,293)            |
| Refundable advances                                                                                   | 187,944              | (6,226)             |
| Deferred compensation and other long-term liabilities                                                 | 15,500               | (6,000)             |
| Net cash provided by (used in) operating activities                                                   | <u>2,393,426</u>     | <u>(2,685,063)</u>  |
| CASH FLOWS FROM INVESTING ACTIVITIES:                                                                 |                      |                     |
| Purchases of investments                                                                              | (249,755,938)        | (62,131,303)        |
| Sales of investments                                                                                  | 295,062,392          | 71,766,302          |
| Purchases of fixed assets                                                                             | <u>(9,389,252)</u>   | <u>(7,067,451)</u>  |
| Net cash provided by investing activities                                                             | <u>35,917,202</u>    | <u>2,567,548</u>    |
| CASH FLOWS FROM FINANCING ACTIVITIES:                                                                 |                      |                     |
| Payment on notes payable                                                                              | (1,110,000)          | (1,070,000)         |
| Gifts and grants restricted for endowment                                                             | <u>749,845</u>       | <u>1,611,339</u>    |
| Net cash provided by (used in) financing activities                                                   | <u>(360,155)</u>     | <u>541,339</u>      |
| NET INCREASE IN CASH AND CASH EQUIVALENTS                                                             | 37,950,473           | 423,824             |
| CASH AND CASH EQUIVALENTS — Beginning of year                                                         | <u>3,050,531</u>     | <u>2,626,707</u>    |
| CASH AND CASH EQUIVALENTS — End of year                                                               | <u>\$ 41,001,004</u> | <u>\$ 3,050,531</u> |
| SUPPLEMENTAL CASH FLOW INFORMATION — Interest paid                                                    | <u>\$ 813,553</u>    | <u>\$ 1,200,300</u> |
| SUPPLEMENTAL CASH FLOW INFORMATION — Additions to fixed assets in accrued expenses                    | <u>\$ 339,354</u>    | <u>\$ 8,369</u>     |

See notes to financial statements.

# SOUTHWESTERN UNIVERSITY

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

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### 1. NATURE OF OPERATIONS

Southwestern University (the "University"), located in Georgetown, Texas, is the oldest chartered institution of higher learning in the state. It traces its roots to the 1840 founding of 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 1,235 students and a current student-to-faculty ratio of 10.3:1. 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. As an educational institution, the University is subject to licensure from various accrediting and state authorities and other regulatory requirements of the United States Department of Education.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**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, 2009 and 2008, are as follows:

|                                        | 2009                  | 2008                  |
|----------------------------------------|-----------------------|-----------------------|
| Scholarships                           | \$ 27,692,956         | \$ 14,643,967         |
| Professorships and faculty development | 33,213,748            | 36,875,453            |
| Plant                                  | 8,038,104             | 10,596,668            |
| Other                                  | 15,601,612            | 8,360,281             |
| Restricted for use in future periods   | <u>55,728,756</u>     | <u>116,815,134</u>    |
| Total                                  | <u>\$ 140,275,176</u> | <u>\$ 187,291,503</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, 2009 and 2008, being expendable to support the following:

|                                        | <b>2009</b>              | <b>2008</b>              |
|----------------------------------------|--------------------------|--------------------------|
| Unrestricted                           | \$ 28,364,929            | \$ 28,363,929            |
| Scholarships                           | 20,311,887               | 21,923,657               |
| Professorships and faculty development | 8,843,001                | 8,628,919                |
| Plant                                  | 1,438,523                | 1,438,523                |
| Other                                  | <u>8,164,815</u>         | <u>8,142,274</u>         |
| <br>Total                              | <br><u>\$ 67,123,155</u> | <br><u>\$ 68,497,302</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 issuance costs are included in other assets at June 30, 2009, net of accumulated amortization totaling \$104,665, \$101,645, and \$7,972, 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.

**Scholarships and Grants** — The statement of activities presents financial assistance provided to students in the form of institutional scholarships and grants as a reduction to tuition and fees revenues. Scholarship and grants include programs supported by donor-restricted endowments, donor-restricted gifts and grants and programs supported by general operations of the University. The following table presents the amount of scholarship and grant expenses, and the related percentage of tuition and fee revenues supported by donor-restricted and general operation support scholarship and grant expenditures:

|                                                              | 2009                |                                | 2008                |                                |
|--------------------------------------------------------------|---------------------|--------------------------------|---------------------|--------------------------------|
|                                                              | Amount              | Discount<br>Rate to<br>Tuition | Amount              | Discount<br>Rate to<br>Tuition |
| Scholarships and grants supported<br>by endowments and gifts | \$ 3,116,027        | 8.9 %                          | \$ 3,477,196        | 10.7 %                         |
| Scholarships and grants supported<br>by general operations   | <u>10,139,383</u>   | <u>28.8</u>                    | <u>8,871,568</u>    | <u>27.2</u>                    |
| Total scholarships and grants                                | <u>\$13,255,410</u> | <u>37.7 %</u>                  | <u>\$12,348,764</u> | <u>37.9 %</u>                  |

**Lease Expense** — Total lease expense for all operating leases was \$11,390 and \$17,568 for 2009 and 2008, 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.

**New Accounting Pronouncements** — In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Specifically, this

Statement sets forth a definition of fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants at the measurement date; establishes a hierarchy prioritizing the inputs to valuation techniques, giving the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs; and, expands disclosure requirements. The provisions of SFAS No. 157 are generally required to be applied on a prospective basis for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FSP No. 157-2, which delayed the effective date of SFAS No. 157 one year for all non-financial assets and non-financial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. The University adopted the provisions of SFAS No. 157 effective July 1, 2008.

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 has currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with accounting principles generally accepted in the United States.

In August 2008, FASB issued FASB Staff Position (FSP) FAS 117-1, *Endowments for 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. The State of Texas enacted UPMIFA effective September 2007. Among UPMIFA's more significant changes is the elimination of UMIFA's concept of historic dollar 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 adopted the provisions of the FSP as of July 1, 2007. The change was reported as a cumulative effect of a change in accounting principle in the Statement of Activities for the year ended June 30, 2008. Certain amounts previously reported for fiscal 2008 have been reclassified in order to conform to the provisions of FAS 117-1.

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.

**Reclassifications** — Certain reclassification of the fiscal year 2008 financial information has been made to conform to the 2009 financial statement presentation.

### 3. STUDENT ACCOUNTS AND LOANS RECEIVABLE

Student accounts receivable are reported net of allowances for doubtful accounts of \$113,694 for 2009 and 2008. Student loans receivable are reported net of allowance for doubtful accounts of \$148,065 for 2009 and 2008.

### 4. UNCONDITIONAL PROMISES RECEIVABLE

Unconditional promises receivable at June 30, 2009 and 2008, consist of the following:

|                                                 | <b>2009</b>         | <b>2008</b>          |
|-------------------------------------------------|---------------------|----------------------|
| Restricted for scholarships                     | \$ 2,520,526        | \$ 2,488,831         |
| Restricted for plant                            | 6,617,572           | 10,368,496           |
| Restricted for other uses                       | 1,761,514           | 1,674,561            |
| Restricted for use in future periods            | <u>336,961</u>      | <u>270,712</u>       |
|                                                 | 11,236,573          | 14,802,600           |
| Allowance for uncollectible promises receivable | (2,203,753)         | -                    |
| Discount                                        | (263,649)           | (568,810)            |
| Net unconditional promises receivable           | <u>\$ 8,769,171</u> | <u>\$ 14,233,790</u> |

As of June 30, 2009 and 2008, gross amounts due from unconditional promises receivable are as follows:

|                           | <b>2009</b>          | <b>2008</b>          |
|---------------------------|----------------------|----------------------|
| Due in less than one year | \$ 4,052,230         | \$ 5,566,940         |
| Due in one to five years  | <u>7,184,343</u>     | <u>9,235,660</u>     |
| Total                     | <u>\$ 11,236,573</u> | <u>\$ 14,802,600</u> |

The University uses risk-free rates of 1.5% to 5.2% to discount the anticipated cash flows for unconditional promises receivable. In fiscal 2009 the University established an allowance of \$2,203,753, which represents the estimated change in the quantity or nature of promises receivable. This allowance is reported as a reduction of permanently restricted net assets in the Statement of Activities.

## 5. INVESTMENTS

A summary of investments at June 30, 2009 and 2008, is as follows:

|                                                         | <b>2009</b>           | <b>2008</b>           |
|---------------------------------------------------------|-----------------------|-----------------------|
| At fair value:                                          |                       |                       |
| Fixed income and co-mingled fixed income funds          | \$ 42,957,085         | \$ 66,129,966         |
| Equity, equity mutual funds and co-mingled equity funds | 103,240,202           | 214,040,925           |
| Alternative investments                                 | <u>41,814,728</u>     | <u>-</u>              |
| Total at fair value                                     | 188,012,015           | 280,170,891           |
| At cost or market at date of acquisition:               |                       |                       |
| Real estate                                             | 8,293,965             | 8,794,264             |
| Other                                                   | <u>172,986</u>        | <u>172,330</u>        |
| Total at cost or market at date of acquisition          | <u>8,466,951</u>      | <u>8,966,594</u>      |
| Total investments                                       | <u>\$ 196,478,966</u> | <u>\$ 289,137,485</u> |

Investment income earned by the University and its allocation among net asset classifications are as follows:

|                                                              | <b>2009</b>            | <b>2008</b>            |
|--------------------------------------------------------------|------------------------|------------------------|
| Investment income                                            | \$ 5,780,127           | \$ 9,627,687           |
| Net gains (losses) on investments reported at fair value     | (47,544,666)           | (23,509,114)           |
| Net realized gains on investments not reported at fair value | 217,939                | -                      |
| Other income                                                 | 933,916                | 541,136                |
| Investment expenses netted against income                    | (371,012)              | (758,678)              |
| Total investment income                                      | <u>\$ (40,983,696)</u> | <u>\$ (14,098,969)</u> |
| Net asset classification of investment income:               |                        |                        |
| Unrestricted                                                 | \$ 250,768             | \$ (981,974)           |
| Temporarily restricted                                       | (41,234,464)           | (13,116,995)           |
| Permanently restricted                                       | <u>-</u>               | <u>-</u>               |
|                                                              | <u>\$ (40,983,696)</u> | <u>\$ (14,098,969)</u> |

**Fair Value Measurement** — The University adopted the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“FAS 157”), effective July 1, 2008, which establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument’s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

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

*Level 1* — Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the University has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment. As of June 30, 2009, the University valued, using Level 1 inputs, \$27,809,471 of investments, which included equity securities traded on active exchanges.

*Level 2* — Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. As of June 30, 2009, the University valued, using Level 2 inputs \$136,363,817 of investments, which included certain co-mingled equity funds, co-mingled debt funds and most government agency securities, investment-grade corporate bonds, certain mortgage products, less-liquid equities, and state and municipal obligations.

*Level 3* — Valuations based on inputs that are unobservable and significant to the overall fair value measurement. As of June 30, 2009, the University valued, using Level 3 inputs \$23,838,727 of investments, which included certain fixed income funds, private equity and real estate investments, less liquid corporate debt securities (including distressed debt instruments), collateralized debt obligations, and less liquid mortgage securities (backed by either commercial or residential real estate). When observable prices are not available for these securities, the University uses one or more valuation techniques for which sufficient and reliable data is available. The degree of judgment exercised in determining fair value is greatest for securities categorized in Level 3, due to the inherent uncertainty of these valuations. Level 3 estimated values may differ significantly from the values that would have been used had a ready market for the investment existed, and the differences could be material.

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

The following table presents the financial instruments carried on the Statement of Financial Position by caption and by level within the valuation hierarchy as of June 30, 2009.

| <b>Assets at Fair Value as of June 30, 2009</b>         |                      |                       |                      |                       |
|---------------------------------------------------------|----------------------|-----------------------|----------------------|-----------------------|
|                                                         | <b>Level 1</b>       | <b>Level 2</b>        | <b>Level 3</b>       | <b>Total</b>          |
| Fixed income and co-mingled fixed income funds          | \$ -                 | \$ 42,927,518         | \$ -                 | \$ 42,927,518         |
| Equity, equity mutual funds and co-mingled equity funds | 27,809,471           | 70,286,587            | -                    | 98,096,058            |
| Alternative investments                                 | <u>-</u>             | <u>23,149,712</u>     | <u>23,838,727</u>    | <u>46,988,439</u>     |
| <b>Total</b>                                            | <u>\$ 27,809,471</u> | <u>\$ 136,363,817</u> | <u>\$ 23,838,727</u> | <u>\$ 188,012,015</u> |

The following table includes a roll forward for the year ended June 30, 2009 of amounts for financial instruments classified within Level 3. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement.

|                         | <b>Alternative<br/>Investments</b> |
|-------------------------|------------------------------------|
| Balance — June 30, 2008 | \$ -                               |
| Purchases               | 23,925,900                         |
| Sales                   | -                                  |
| Net investment income   | 386,837                            |
| Net realized losses     | (67,874)                           |
| Net unrealized losses   | <u>(406,136)</u>                   |
| Balance — June 30, 2009 | <u>\$ 23,838,727</u>               |

## 6. ENDOWMENTS

The University endowment consists of approximately 450 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by generally accepted accounting principles (GAAP), net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

**Adoption and Interpretation of Relevant Law** — Effective September 1, 2007, Texas adopted its version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which sets out the rules governing endowment funds held by charitable institutions. The University adopted the provisions of UPMIFA through various resolutions of the Board of Trustees actions in fiscal 2009. Portions of UPMIFA, including the investment management provisions of the Act, were made immediately effective by the University. The University will apply the provisions of the Act's prudence standards for appropriation of endowment income for programmatic support effective for fiscal years beginning after June 30, 2009.

The University's Board of Trustees has interpreted the UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following seven factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the University and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation or deflation

5. The expected total return from income and the appreciation of investments
6. Other resources of the University
7. The University's investment policies

**Endowment Net Asset Composition  
by Type of Fund  
As of June 30, 2009**

|                                                          | <b>Unrestricted</b>  | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>          |
|----------------------------------------------------------|----------------------|-----------------------------------|-----------------------------------|-----------------------|
| Donor-restricted endowment funds                         | \$ (1,390,532)       | \$ 125,106,412                    | \$ 66,616,012                     | \$ 190,331,892        |
| Board-designated funds functioning as<br>endowment funds | <u>36,525,519</u>    | <u>-</u>                          | <u>-</u>                          | <u>36,525,519</u>     |
| Total funds                                              | <u>\$ 35,134,987</u> | <u>\$ 125,106,412</u>             | <u>\$ 66,616,012</u>              | <u>\$ 226,857,411</u> |

**Changes in Endowment Net Assets  
For the Fiscal Year Ended June 30, 2009**

|                                              | <b>Unrestricted</b>  | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>          |
|----------------------------------------------|----------------------|-----------------------------------|-----------------------------------|-----------------------|
| Endowment net assets — beginning of year     | <u>\$ 43,170,118</u> | <u>\$ 171,601,927</u>             | <u>\$ 65,866,167</u>              | <u>\$ 280,638,212</u> |
| Investment return:                           |                      |                                   |                                   |                       |
| Investment income                            | 363,011              | 5,667,433                         | -                                 | 6,030,444             |
| Net gains (losses)                           | (663,687)            | (46,603,038)                      | -                                 | (47,266,725)          |
| Change in value of split interest agreements | <u>-</u>             | <u>(719,977)</u>                  | <u>-</u>                          | <u>(719,977)</u>      |
| Total net investment return                  | (300,676)            | (41,655,582)                      | -                                 | (41,956,258)          |
| Contributions                                | 10,000               | -                                 | 749,845                           | 759,845               |
| Appropriated for expenditure                 | (7,744,455)          | (6,323,377)                       | -                                 | (14,067,832)          |
| Transfers from other funds                   | <u>-</u>             | <u>1,483,444</u>                  | <u>-</u>                          | <u>1,483,444</u>      |
| Endowment net assets — end of year           | <u>\$ 35,134,987</u> | <u>\$ 125,106,412</u>             | <u>\$ 66,616,012</u>              | <u>\$ 226,857,411</u> |

**Endowment Net Asset Composition  
by Type of Fund  
As of June 30, 2008**

|                                                          | <b>Unrestricted</b>  | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>          |
|----------------------------------------------------------|----------------------|-----------------------------------|-----------------------------------|-----------------------|
| Donor-restricted endowment funds                         | \$ (229,577)         | \$ 171,601,927                    | \$ 65,866,167                     | \$ 237,238,517        |
| Board-designated funds functioning as<br>endowment funds | <u>43,399,695</u>    | <u>-</u>                          | <u>-</u>                          | <u>43,399,695</u>     |
| Total funds                                              | <u>\$ 43,170,118</u> | <u>\$ 171,601,927</u>             | <u>\$ 65,866,167</u>              | <u>\$ 280,638,212</u> |

| <b>Changes in Endowment Net Assets<br/>For the Fiscal Year Ended June 30, 2008</b> | <b>Unrestricted</b>  | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>          |
|------------------------------------------------------------------------------------|----------------------|-----------------------------------|-----------------------------------|-----------------------|
| Endowment net assets — beginning of year                                           | \$ 243,365,051       | \$ 3,277,611                      | \$ 64,345,628                     | \$ 310,988,290        |
| Net asset reclassification based on<br>change in law                               | <u>(194,266,931)</u> | <u>194,266,931</u>                | <u>-</u>                          | <u>-</u>              |
| Endowment net assets<br>after reclassification                                     | <u>49,098,120</u>    | <u>197,544,542</u>                | <u>64,345,628</u>                 | <u>310,988,290</u>    |
| Investment return:                                                                 |                      |                                   |                                   |                       |
| Investment income                                                                  | 1,807,163            | 7,242,931                         | -                                 | 9,050,094             |
| Net gains (losses)                                                                 | (4,493,419)          | (20,305,666)                      | -                                 | (24,799,085)          |
| Change in value of split interest agreements                                       | <u>-</u>             | <u>(251,317)</u>                  | <u>-</u>                          | <u>(251,317)</u>      |
| Total net investment return                                                        | (2,686,256)          | (13,314,052)                      | -                                 | (16,000,308)          |
| Contributions                                                                      | 195                  | -                                 | 1,520,539                         | 1,520,734             |
| Appropriated for expenditure                                                       | <u>(3,241,941)</u>   | <u>(12,628,563)</u>               | <u>-</u>                          | <u>(15,870,504)</u>   |
| Endowment net assets — end of year                                                 | <u>\$ 43,170,118</u> | <u>\$ 171,601,927</u>             | <u>\$ 65,866,167</u>              | <u>\$ 280,638,212</u> |

**Endowment Funds With Deficiencies** — From time-to-time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level required by the donor-restriction to retain as a fund of perpetual duration. These deficiencies typically result from unfavorable market fluctuations that occur shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. In accordance with GAAP, deficiencies of this nature are reported as a reduction of unrestricted net assets and totaled \$1,522,318 and \$254,349, as of June 30, 2009 and June 30, 2008, respectively.

**Return Objectives and Risk Parameters** — The University has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets over time. Endowment assets include those assets of donor-restricted funds that the University must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds.

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

**Strategies Employed for Achieving Objectives** — To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The University targets a diversified asset allocation among both equity and fixed income strategies. As a long-term policy guideline, endowment assets are allocated between equity classes, 70% (with ranges of 60-80%), and fixed income asset class investments, 30% (with ranges of 20-40%). The University's policy statement restricts investment in non-traditional (alternative) asset classes to no more than 50% of the portfolio, and restricts the total amount of illiquid investments to 25% or less of the portfolio. Illiquid is

defined by the policy statement to mean “investments that could not be converted to cash in an orderly market over a period of twelve months or in a shorter period of time by accepting a discount of more than 10%”.

**Spending Policy** — The University has adopted a spending formula for determining that part of the total return on endowment funds which can be expended annually. The spending formula determines spendable endowment return as a percentage of the 20-quarter average endowment market value, excluding investments in real estate, as of December 31 preceding the fiscal year. The spending rate was 5.75% for fiscal year 2009 and 5.9% for fiscal 2008. The University plans to reduce the spending rate to 5.5%, 5.3%, 5.15% and 5.0% in fiscal years 2010, 2011, 2012 and 2013, respectively. In establishing this policy, the University considered the long-term expected return on its endowment. Accordingly, over the long term, the University expects the current spending policy, and planned changes to that policy, to allow its endowment to grow at an average rate that equals or exceeds inflation. Spending on endowments with a market value less than \$25,000 is retained in the endowment unless distribution is specifically required by the donor.

**7. INVESTMENT IN PLANT — NET**

At June 30, 2009 and 2008, investment in plant - net consists of the following:

|                               | <b>2009</b>          | <b>2008</b>          |
|-------------------------------|----------------------|----------------------|
| Land                          | \$ 111,509           | \$ 111,509           |
| Buildings                     | 118,200,309          | 113,586,631          |
| Furniture and equipment       | 31,877,177           | 31,197,225           |
| Ground improvements           | <u>13,842,411</u>    | <u>13,601,267</u>    |
| Total property                | 164,031,406          | 158,496,632          |
| Less accumulated depreciation | <u>(78,748,531)</u>  | <u>(74,423,240)</u>  |
|                               | 85,282,875           | 84,073,392           |
| Construction in progress      | <u>7,075,193</u>     | <u>3,423,816</u>     |
| Investment in plant — net     | <u>\$ 92,358,068</u> | <u>\$ 87,497,208</u> |

## 8. NOTES PAYABLE

The University's notes and bonds payable as of June 30, 2009 and 2008, including related premiums of \$143,973 and \$172,730, respectively, consisted of the following:

|                                                                                                                                                                                                                                  | 2009                | 2008                |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| City of Crawford Education Facilities Corporation<br>Higher Education Revenue Refunding Bonds Series 2004A,<br>interest rates ranging from 3% to 5%, semiannual interest<br>payments due, maturing at various dates through 2014 | \$ 5,768,973        | \$ 6,787,730        |
| City of Crawford Education Facilities Corporation<br>Higher Education Revenue Refunding Bonds Series 2004B,<br>interest rates ranging from 3% to 5%, monthly interest<br>payments due, maturing in October 2014                  | 19,040,000          | 19,040,000          |
| City of Riesel Education Facilities Corporation 2006 Note,<br>fixed interest rate of 4.76%, semiannual interest payments<br>due beginning February 2008, maturing in February 2026                                               | 4,765,000           | 4,885,000           |
| Total                                                                                                                                                                                                                            | <u>\$29,573,973</u> | <u>\$30,712,730</u> |

On July 13, 2004, the University entered into a loan agreement with the Issuer under which the City of Crawford Education Facilities Corporation Higher Education Revenue Refunding Bonds (Southwestern University Project), Series 2004A, dated July 1, 2004, were issued at an aggregate par value of \$10,410,000. The Issuer loaned the proceeds from the sale of the 2004A Bonds to the University, evidenced by a promissory note between the University and the Issuer. The bonds were issued for the purpose of refunding the City of Georgetown Higher Education Finance Corporation Higher Education Revenue Bonds, Series 1994, and to pay costs of issuance of the Series 2004A Bonds. The bonds were issued at a premium of \$287,757, of which \$28,757 was amortized against interest expense during fiscal years 2009 and 2008. 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 2010, 2011, 2012, 2013 and 2014 principal payments of, \$1,025,000, \$1,075,000, \$1,120,000, \$1,180,000 and \$1,225,000 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 2010, 2011, 2012, 2013, 2014 and 2015 and thereafter principal payments of \$125,000, \$135,000, \$140,000, \$145,000, \$155,000, and \$4,065,000 respectively, will become due.

## **9. BENEFIT PLANS**

The University has defined contribution retirement plans for eligible faculty members and non-faculty employees. Contributions equal to various percentages of each eligible participant's regular salary are used to purchase individual annuities issued to the participant by Teachers Insurance and Annuity Association and/or College Retirement Equities Fund. Such contributions totaling \$2,209,325 and \$2,165,671 for fiscal year 2009 and fiscal year 2008, respectively, were expensed. In addition, supplemental payments totaling \$6,137 in fiscal year 2009 and 2008, 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 \$4,348,000 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 \$3,592,914 in fiscal year 2009 and \$3,286,800 in fiscal year 2008.

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 Financial Accounting Standards Board (FASB) Statement No. 158, *Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment to FASB Statements No. 87, 88, 106 and 132R, 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:

|                     | <b>Beginning Balance<br/>of Unamortized<br/>Amounts</b> | <b>Amount Amortized<br/>into Net Periodic<br/>Benefit Costs</b> | <b>Current Year<br/>Gains/Losses</b> | <b>Ending Balance<br/>of Unamortized<br/>Amounts</b> |
|---------------------|---------------------------------------------------------|-----------------------------------------------------------------|--------------------------------------|------------------------------------------------------|
| Net gains/losses    | \$ 9,651,980                                            | \$ (701,606)                                                    | \$ 1,798,172                         | \$ 10,748,546                                        |
| Prior service costs | (3,526,326)                                             | 429,717                                                         | -                                    | (3,096,609)                                          |
|                     | <u>\$ 6,125,654</u>                                     | <u>\$ (271,889)</u>                                             | <u>\$ 1,798,172</u>                  | <u>\$ 7,651,937</u>                                  |

In fiscal year 2010, the University expects to recognize as net periodic benefit approximately \$775,000 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, 2009 and 2008, is as follows:

|                                                    | <b>2009</b>            | <b>2008</b>            |
|----------------------------------------------------|------------------------|------------------------|
| <i>Reconciliation of benefit obligation</i>        |                        |                        |
| Obligation at beginning of year                    | \$ 19,504,464          | \$ 20,993,896          |
| Service cost including expenses                    | 483,947                | 455,503                |
| Interest cost                                      | 1,309,336              | 1,144,342              |
| Plan amendments                                    | -                      | (899,365)              |
| Actuarial (gain)/loss                              | 1,798,172              | (1,429,921)            |
| Benefit payments and expected expenses             | <u>(724,242)</u>       | <u>(759,991)</u>       |
| Obligation at end of year                          | <u>22,371,677</u>      | <u>19,504,464</u>      |
| <i>Reconciliation of fair value of plan assets</i> |                        |                        |
| Employer contributions                             | 724,242                | 759,991                |
| Benefit payments and actual expenses               | <u>(724,242)</u>       | <u>(759,991)</u>       |
| Fair value of plan assets at end of year           | -                      | -                      |
| <i>Funded status at end of year</i>                | <u>\$ (22,371,677)</u> | <u>\$ (19,504,464)</u> |

Amounts recognized in the statements of financial position are as follows:

|                        | <b>2009</b>            | <b>2008</b>            |
|------------------------|------------------------|------------------------|
| Current liabilities    | \$ (792,439)           | \$ (700,675)           |
| Noncurrent liabilities | <u>(21,579,238)</u>    | <u>(18,803,789)</u>    |
| Total                  | <u>\$ (22,371,677)</u> | <u>\$ (19,504,464)</u> |

Net periodic postretirement benefit cost recognized during fiscal year 2009 and 2008, is as follows:

|                                                        | <b>2009</b>        | <b>2008</b>        |
|--------------------------------------------------------|--------------------|--------------------|
| Service cost                                           | \$ 483,947         | \$ 455,503         |
| Interest cost                                          | 1,309,336          | 1,144,342          |
| Amortization of prior actuarial loss                   | 701,606            | 778,157            |
| Amortization of prior service gain from plan amendment | <u>(429,717)</u>   | <u>(429,717)</u>   |
| Total                                                  | <u>\$2,065,172</u> | <u>\$1,948,285</u> |

The University used a weighted average discount rate of 6.24% and 6.84% to determine the post retirement benefit obligation at June 30, 2009 and 2008, respectively. An average discount rate of 6.84% and 6.25% was used to determine the net periodic benefit cost for fiscal years 2009 and 2008, respectively.

In determining the net periodic benefit cost the assumed pre-Medicare health care cost trend rate was 9.5% for fiscal year 2009, declining gradually to 5% by 2018. The assumed post-Medicare health care cost trend rate was 9.5% for fiscal year 2009, declining gradually to 5% by 2018. In determining the post retirement benefit obligation at June 30, 2009, the assumed health care cost trend rate was 9.5% for 2009 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, 2009, by \$3,936,000 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$329,100. 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, 2009, by \$3,179,900 and the aggregate of service cost and interest cost components of net periodic postretirement benefit cost for the year then ended by \$264,100.

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:

|                                    | <b>Before<br/>Subsidy</b> | <b>Effect of<br/>Subsidy</b> | <b>After<br/>Subsidy</b> |
|------------------------------------|---------------------------|------------------------------|--------------------------|
| Service cost                       | \$ 571,233                | \$ (87,286)                  | \$ 483,947               |
| Interest cost                      | 1,570,075                 | (260,739)                    | 1,309,336                |
| Amortization of prior service cost | (429,717)                 | -                            | (429,717)                |
| Amortization of net (gain) loss    | <u>876,805</u>            | <u>(175,199)</u>             | <u>701,606</u>           |
|                                    | <u>\$2,588,396</u>        | <u>\$ (523,224)</u>          | <u>\$2,065,172</u>       |

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

|                                                                           | <b>2009</b>         | <b>2008</b>           |
|---------------------------------------------------------------------------|---------------------|-----------------------|
| Net loss (gain)                                                           | \$ 1,798,172        | \$ (1,429,921)        |
| Transition obligation (asset)                                             | -                   | -                     |
| Prior service cost (credit)                                               | -                   | (899,365)             |
| Amortization of net loss (gain)                                           | (701,606)           | (778,157)             |
| Amortization of transition obligation (asset)                             | -                   | -                     |
| Amortization of prior service cost                                        | <u>429,717</u>      | <u>429,717</u>        |
| Total recognized in unrestricted net assets                               | <u>\$ 1,526,283</u> | <u>\$ (2,677,726)</u> |
| Total recognized in net periodic benefit cost and unrestricted net assets | <u>\$ 3,591,455</u> | <u>\$ (729,441)</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:

| <b>Years Ending<br/>June 30</b> | <b>Medical<br/>Benefits</b> | <b>Prescription<br/>Drug Subsidy</b> | <b>Net</b> |
|---------------------------------|-----------------------------|--------------------------------------|------------|
| 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                       | 9,566,535                   | (1,494,051)                          | 8,072,484  |

The University expects to contribute \$817,000 to the plan during fiscal year 2010.

## 10. 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, 2009. The University has obtained approval to renew this

line of credit for the period of June 30, 2009 through June 30, 2010. The University did not draw on this line of credit in either fiscal year 2009 or 2008.

#### **11. 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, 2009 and 2008.

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.

#### **12. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

As of June 30, 2009 and 2008, 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 8). 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 \$29,573,973 and \$30,712,730 and have an estimated fair value of approximately \$26,040,800 and \$26,851,475 at June 30, 2009 and 2008, respectively. These amounts were determined using rates currently available to the University for debt with similar terms and maturities.

#### **13. COMMITMENTS**

The University has contracts for the construction of infrastructure projects and for other building and classroom improvements. At June 30, 2009, the remaining commitments under these contracts approximated \$5,648,000.

#### **14. TRANSACTIONS WITH RELATED PARTIES**

Two members of the Board of Trustees of the University also serve as directors of a financial institution where the University has a significant banking relationship. The University has a conflict of interest policy that is regularly updated by all members of the Board of Trustees. The relationships with the

financial institution have been consistently reported as a conflict of interest. In all matters related to business decisions at the meetings of the Board of Trustees, these parties refrain from participating in any votes on these matters. The abstentions are reflected in the official minutes of the meetings.

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