



**BROWN UNIVERSITY**

Financial Statements

June 30, 2013 and 2012

(With Independent Auditors' Report Thereon)



KPMG LLP  
6th Floor, Suite A  
100 Westminster Street  
Providence, RI 02903-2321

## Independent Auditors' Report

The President and Corporation  
Brown University:

We have audited the accompanying financial statements of Brown University, which comprise the balance sheets as of June 30, 2013 and 2012, the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditors' Responsibility*

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### *Opinion*

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

**KPMG LLP**

October 29, 2013

**BROWN UNIVERSITY**

## Balance Sheets

June 30, 2013 and 2012

(Dollars in thousands)

<b>Assets</b>	<b>2013</b>	<b>2012</b>
Cash and cash equivalents	\$ 14,009	52,890
Receivables for investments sold	21,287	79,720
Accounts receivable and other assets	38,535	72,168
Contributions receivable, net	146,051	158,784
Notes receivable, net	32,960	32,202
Funds held in trust by others	66,463	17,333
Investments	3,076,163	2,786,235
Land, buildings and equipment, net	1,019,875	953,334
Total assets	<u>\$ 4,415,343</u>	<u>4,152,666</u>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable and accrued liabilities	\$ 46,182	64,384
Liabilities associated with investments	7,276	78,423
Student deposits and grant advances	52,913	50,806
Federal student loan advances	24,590	24,671
Split-interest obligations	26,640	23,143
Other long-term obligations	54,242	88,544
Bonds, loans and notes payable	751,335	660,096
Total liabilities	<u>963,178</u>	<u>990,067</u>
Net assets:		
Unrestricted	934,271	717,741
Temporarily restricted	1,262,860	1,262,796
Permanently restricted	1,255,034	1,182,062
Total net assets	<u>3,452,165</u>	<u>3,162,599</u>
Total liabilities and net assets	<u>\$ 4,415,343</u>	<u>4,152,666</u>

See accompanying notes to financial statements.

**BROWN UNIVERSITY**

Statement of Activities

Year ended June 30, 2013

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating revenues:				
Tuition and fees	\$ 400,020	—	—	400,020
Less university scholarships	(141,914)	—	—	(141,914)
Net tuition and fees	258,106	—	—	258,106
Grants and contracts – direct	121,931	—	—	121,931
Grants and contracts – indirect	40,355	—	—	40,355
Contributions	55,527	14,978	—	70,505
Endowment return appropriated	119,966	5,892	—	125,858
Sales and services of auxiliary enterprises	84,947	—	—	84,947
Other income	30,436	—	—	30,436
Net assets released from restrictions	3,137	(3,137)	—	—
Total operating revenues	<u>714,405</u>	<u>17,733</u>	<u>—</u>	<u>732,138</u>
Operating expenses:				
Salaries and wages	294,674	—	—	294,674
Employee benefits	94,185	—	—	94,185
Graduate student support	58,869	—	—	58,869
Purchased services	59,420	—	—	59,420
Supplies and general	85,086	—	—	85,086
Utilities	17,567	—	—	17,567
Other	30,889	—	—	30,889
Interest	22,495	—	—	22,495
Operating expenses before depreciation	<u>663,185</u>	<u>—</u>	<u>—</u>	<u>663,185</u>
Net change from operating activities before depreciation	51,220	17,733	—	68,953
Depreciation	<u>66,597</u>	<u>—</u>	<u>—</u>	<u>66,597</u>
Change in net assets from operating activities	<u>(15,377)</u>	<u>17,733</u>	<u>—</u>	<u>2,356</u>
Nonoperating activities:				
Contributions	50,966	9,065	64,185	124,216
Net investment return	72,772	212,013	4,592	289,377
Endowment return appropriated	(21,867)	(103,991)	—	(125,858)
Other changes, net	127,425	(132,145)	4,195	(525)
Net assets released from restrictions	2,611	(2,611)	—	—
Change in net assets from nonoperating activities	<u>231,907</u>	<u>(17,669)</u>	<u>72,972</u>	<u>287,210</u>
Change in net assets	216,530	64	72,972	289,566
Net assets, beginning of year	<u>717,741</u>	<u>1,262,796</u>	<u>1,182,062</u>	<u>3,162,599</u>
Net assets, end of year	<u>\$ 934,271</u>	<u>1,262,860</u>	<u>1,255,034</u>	<u>3,452,165</u>

See accompanying notes to financial statements.

**BROWN UNIVERSITY**

Statement of Activities  
 Year ended June 30, 2012  
 (Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating revenues:				
Tuition and fees	\$ 360,794	—	—	360,794
Less university scholarships	(122,940)	—	—	(122,940)
Net tuition and fees	237,854	—	—	237,854
Grants and contracts – direct	130,002	—	—	130,002
Grants and contracts – indirect	43,031	—	—	43,031
Contributions	58,539	9,980	—	68,519
Endowment return appropriated	111,937	4,488	—	116,425
Sales and services of auxiliary enterprises	81,583	—	—	81,583
Other income	26,979	459	—	27,438
Net assets released from restrictions	10,323	(10,323)	—	—
Total operating revenues	<u>700,248</u>	<u>4,604</u>	<u>—</u>	<u>704,852</u>
Operating expenses:				
Salaries and wages	281,635	—	—	281,635
Employee benefits	87,954	—	—	87,954
Graduate student support	46,997	—	—	46,997
Purchased services	58,697	—	—	58,697
Supplies and general	86,907	—	—	86,907
Utilities	19,170	—	—	19,170
Other	38,067	—	—	38,067
Interest	25,792	—	—	25,792
Operating expenses before depreciation	<u>645,219</u>	<u>—</u>	<u>—</u>	<u>645,219</u>
Net change from operating activities before depreciation	55,029	4,604	—	59,633
Depreciation	<u>59,601</u>	<u>—</u>	<u>—</u>	<u>59,601</u>
Change in net assets from operating activities	<u>(4,572)</u>	<u>4,604</u>	<u>—</u>	<u>32</u>
Nonoperating activities:				
Contributions	6,618	19,864	68,483	94,965
Net investment return	(1,513)	13,262	(401)	11,348
Endowment return appropriated	(32,248)	(84,177)	—	(116,425)
Other changes, net	(52,207)	(13,777)	6,973	(59,011)
Net assets released from restrictions	49,992	(49,992)	—	—
Change in net assets from nonoperating activities	<u>(29,358)</u>	<u>(114,820)</u>	<u>75,055</u>	<u>(69,123)</u>
Change in net assets	(33,930)	(110,216)	75,055	(69,091)
Net assets, beginning of year	<u>751,671</u>	<u>1,373,012</u>	<u>1,107,007</u>	<u>3,231,690</u>
Net assets, end of year	<u>\$ 717,741</u>	<u>1,262,796</u>	<u>1,182,062</u>	<u>3,162,599</u>

See accompanying notes to financial statements.

**BROWN UNIVERSITY**

Statements of Cash Flows

Years ended June 30, 2013 and 2012

(Dollars in thousands)

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Change in net assets	\$ 289,566	(69,091)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net realized and unrealized gains on investments	(294,498)	(19,010)
Realized loss on partial swap termination	2,600	2,767
Depreciation	66,597	59,601
Amortization of bond premium	(3,658)	—
Loss from disposals of land, building and equipment	591	4,056
Change in funded status of pension obligation	(11,109)	11,805
Change in fair value of interest rate swap liabilities	(23,577)	29,989
Change in asset retirement obligation	384	43
Change in estimate of split-interest obligations	5,765	4,817
Contributions restricted for plant and endowment	(72,745)	(77,129)
Change in accounts receivable and other assets	33,633	(16,702)
Change in accounts payable and accrued liabilities	(8,753)	(541)
Change in other operating assets, net	672	15,458
Change in other operating liabilities, net	2,026	(6,349)
Net cash used in operating activities	<u>(12,506)</u>	<u>(60,286)</u>
Cash flows from investing activities:		
Additions to land, buildings and equipment	(143,178)	(119,113)
Purchases of investments	(933,127)	(1,521,797)
Sales and redemptions of investments	979,988	1,590,401
Notes (advanced to) repaid by students and others	(758)	988
Change in funds held in trust by others	(49,130)	10,610
Net cash used in investing activities	<u>(146,205)</u>	<u>(38,911)</u>
Cash flows from financing activities:		
Contributions restricted for plant and endowment	72,745	77,129
Payments under split-interest obligations	(2,268)	(2,252)
Payment for partial swap termination	(2,600)	(2,767)
Payments on long-term debt	(5,910)	(84,525)
Proceeds from issuance of debt, including premium	149,807	80,630
Proceeds from commercial paper programs	9,220	35,000
Payments on commercial paper programs	(58,220)	—
Proceeds from secured borrowings for investment purposes	—	55,005
Payments on secured borrowings for investment purposes	(55,005)	(79,998)
Cash collateral posted under swap agreements	(2,000)	(35,300)
Cash collateral returned under swap agreements	14,500	22,800
Advance from line of credit	—	566
Payment of advance from line of credit	—	(566)
Bond issuance costs	(439)	(606)
Net cash provided by financing activities	<u>119,830</u>	<u>65,116</u>
Change in cash and cash equivalents	(38,881)	(34,081)
Cash and cash equivalents, beginning of year	52,890	86,971
Cash and cash equivalents, end of year	\$ <u>14,009</u>	\$ <u>52,890</u>

See accompanying notes to financial statements.

## **BROWN UNIVERSITY**

### Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

#### **(1) Summary of Significant Accounting Policies**

##### **(a) Organization**

Brown University is a private, not-for-profit, nonsectarian, co-educational institution of higher education with approximately 6,400 undergraduate students and 2,400 graduate and medical students. Established in 1764, Brown University offers educational programs for undergraduates in liberal arts and engineering, professional training for students pursuing a career in medicine, and graduate education and training in the arts and sciences, engineering and medicine.

##### **(b) Basis of Presentation and Tax Status**

The accompanying financial statements are presented on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP) and present balances and transactions according to the existence or absence of donor-imposed restrictions.

The John Nicholas Brown Center for the Study of American Civilization; Fairview Incorporated, a real estate holding company; and KARING, a Rhode Island not-for-profit corporation that holds certain property of the Warren Alpert Medical School, are all separate legal entities that are consolidated in the financial statements. Brown University and these consolidated entities are collectively referred to herein as the University. All significant inter-entity transactions and balances have been eliminated.

The University is a not-for-profit organization as described in Section 501(c)(3) of the Internal Revenue Code, as amended, and is generally exempt from income taxes. The University assesses uncertain tax positions and determined that there are no such positions that have a material effect on the financial statements.

##### **(c) Classification of Net Assets**

The University is incorporated in and subject to the laws of Rhode Island, which contain the provisions outlined in the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Under UPMIFA, the net assets of a donor-restricted endowment fund may be appropriated for expenditure by the Corporation of the University in accordance with the standard of prudence prescribed by UPMIFA. The University has classified its net assets as follows:

- *Permanently restricted net assets* contain donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the University and primarily consist of the historic dollar value of contributions to establish or add to donor-restricted endowment funds.
- *Temporarily restricted net assets* contain donor-imposed stipulations as to the timing of their availability or use for a particular purpose. These net assets are released from restrictions when the specified time elapses or actions have been taken to meet the restrictions. Net assets of donor-restricted endowment funds in excess of their historic dollar value are classified as temporarily restricted net assets until appropriated by the Corporation and spent in accordance with the standard of prudence imposed by UPMIFA.

## BROWN UNIVERSITY

### Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

- *Unrestricted net assets* contain no donor-imposed restrictions and are available for the general operations of the University. Such net assets may be designated by the Corporation for specific purposes, including to function as endowment funds.

#### (d) *Fair Value Measurements*

Investments, funds held in trust by others, and interest rate swaps are reported at fair value in the University's financial statements. Fair value represents the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants as of the measurement date. The University uses a three-tiered hierarchy to categorize those assets and liabilities based on the valuation methodologies employed. In addition, classification of certain alternative investments within the fair value hierarchy is based on the University's ability to timely redeem its interest rather than the valuation inputs. The hierarchy is defined as follows:

- Level 1 – Valuation based on quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities;
- Level 2 – Valuations based on inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, and also includes alternative investments redeemable on or near the measurement date; and
- Level 3 – Valuation based on unobservable inputs used in situations in which little or no market data is available, and also includes alternative investments not redeemable near the measurement date.

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. The University utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. Transfers between categories occur when there is an event that changes the inputs used to measure the fair value of an asset or liability, or when alternative investments become more or less redeemable because of term or other changes. Transfers between fair value categories are recognized at the end of the reporting period.

#### (e) *Statements of Activities*

The statements of activities separately report changes in net assets from operating and nonoperating activities. Operating activities consist principally of revenues and expenses related to ongoing educational and research programs, including endowment return appropriated by the Corporation of the University (the Corporation) to support those programs. Nonoperating activities consist of net investment return, an offset for endowment return appropriated for operating activities, noncapitalized plant expenditures, changes in fair values of interest rate swaps and early termination thereof, change in pension plan and other long-term obligations, contributions for long-term purposes and other programs, net assets released from donor restrictions for property placed in service, and other activities not in direct support of annual operations.



## **BROWN UNIVERSITY**

### Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

Revenues are derived from various sources, as follows:

- Tuition and fees are recognized at established rates, net of financial aid and scholarships provided directly to students, in the period in which the sessions are primarily provided. Deposits and other advance payments are reported as a liability. Sales and services of auxiliary enterprises are recognized at the time the services are provided.
- Contributions, including unconditional promises from donors reported as contributions receivable, are recognized at fair value in the period received and are classified based upon the existence or absence of donor-imposed restrictions. Expirations of donor-imposed restrictions are reported as net assets released from restrictions. Contributions subject to donor-imposed stipulations that are met in the same reporting period are reported as unrestricted revenue. Bequest intentions and conditional promises are not recorded in the University's financial statements.
- Government grants and contracts normally provide for the recovery of direct and indirect costs, subject to audit. The University recognizes revenue associated with direct and indirect costs as direct costs are incurred. The recovery of indirect costs is pursuant to an agreement which provides for a predetermined fixed indirect cost rate. Payments received in advance of grant and contract expenditures are reported as a liability.
- Dividends, interest and realized and unrealized gains (losses) on investments are reported as increases (decreases) in (1) permanently restricted net assets if the terms of the contributions require them to be added to principal; (2) temporarily restricted net assets if the terms of the related contributions impose restrictions on their availability or use; or (3) unrestricted net assets in all other cases. Investment return attributable to donor-restricted endowment funds is reported as temporarily restricted to the extent not appropriated and spent.

Expenses are reported as decreases in unrestricted net assets.

**(f) Cash Equivalents**

For purposes of the statements of cash flows, cash equivalents, except for those held by investment managers, consist of money market funds and investments with original maturities of three months or less and are carried at cost, which approximates fair value.

**(g) Accounts Receivable and Other Assets and Notes Receivable**

Accounts receivable and other assets include amounts due from students, reimbursements due from sponsors of externally funded research, accrued income on investments, inventory and prepaid expenses, and cash held as interest rate swap collateral, and are carried at net realizable value, which approximates fair value. Notes receivable are presented net of an allowance for uncollectible amounts and consist primarily of loans to students that may have significant restrictions and long maturities, and it is not practicable to estimate their fair value.

## **BROWN UNIVERSITY**

### Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

**(h) Land, Buildings and Equipment**

Land, buildings and equipment are stated at cost of acquisition or construction (including capitalized interest) or, to the extent received as a gift, at estimated fair value at the time of receipt, and are presented net of accumulated depreciation. All other expenditures for maintenance and repairs are charged to operating activities as incurred.

Depreciation is calculated using the straight-line method with estimated useful lives of 30-to-40 years for buildings, 20-to-30 years for building improvements, and 10 years for equipment. Equipment is depreciated over a range of 3-to-15 years, depending upon asset class.

**(i) Fund Held in Trust by Others**

Funds held in trust by others represent funds that are held and administered by outside trustees, including perpetual trusts established by donors of \$12,848 and \$12,127 at June 30, 2013 and 2012, respectively. The University receives all or a specified portion of the return on the underlying assets of such trusts, which is primarily restricted for scholarships. The University will never receive the assets held in trust. These are classified in Level 3 in the fair value hierarchy because they are held by the trustees in perpetuity. Other trustee funds of \$53,615 and \$5,206 at June 30, 2013 and 2012, respectively, represent debt proceeds to be utilized for construction projects or otherwise required to be held in reserve in accordance with debt or similar agreements. These are classified in Level 1 in the fair value hierarchy.

**(j) Federal Student Loan Advances**

The University holds certain amounts advanced by the U.S. government under the Federal Perkins Loan Program and the Health Professions Student Loan Program (the Programs). Such amounts may be re-loaned by the University after collection; however, in the event that the University no longer participates in the Programs, the amounts are generally refundable to the U.S. government.

**(k) Collections**

The University's collections include works of art, historical treasures, and artifacts that are maintained in the University's libraries and museums. These collections are protected and preserved for education and research purposes. The collections are not recognized as assets in the financial statements of the University.

**(l) Liabilities Associated with Investments**

The University participated in a repurchase agreement under which the University periodically borrowed funds collateralized with certain of its securities for other investment purposes. These amounts are reflected both as investments and liabilities associated with investments as of June 30, 2012, and amounted to \$55,005. The University discontinued this program in fiscal 2013. Liabilities associated with investments also may include payables for securities purchased.

**BROWN UNIVERSITY**  
Notes to Financial Statements  
June 30, 2013 and 2012  
(Dollars in thousands)

**(m) Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

**(n) Reclassifications**

Certain 2012 financial information has been reclassified to conform to the 2013 presentation.

**(2) Contributions Receivable**

The University's contributions receivable are recognized net of discounts at rates commensurate with the risks involved and after allowance for uncollectibles are reported at net realizable value, which approximates fair value. Contributions receivable were as follows at June 30:

	<u>2013</u>	<u>2012</u>
Contributions expected to be received in:		
Less than one year	\$ 57,596	50,727
Between one and five years	101,819	120,913
More than five years	<u>9,818</u>	<u>11,006</u>
Gross contributions receivable	169,233	182,646
Unamortized discount (at rates ranging from 0.2% to 2.5%) and allowance for uncollectibles	<u>(23,182)</u>	<u>(23,862)</u>
Contributions receivable, net	<u>\$ 146,051</u>	<u>158,784</u>

**(3) Investments**

***Investment Strategy***

In addition to traditional stocks and fixed-income securities, the University may also hold shares or units in institutional funds as well as in alternative investment funds involving hedged, private equity and real asset strategies. Hedged strategies involve funds whose managers have the authority to invest in various asset classes at their discretion, including the ability to invest long and short. Funds with hedged strategies generally hold securities or other financial instruments for which a ready market exists and may include stocks, bonds, put or call options, swaps, currency hedges and other instruments, and are valued accordingly. Private equity funds employ buyout and venture capital strategies and may focus on investments in turn-around situations. Real asset funds generally hold interests in public real estate investment trusts (REITs), commercial properties or commodities, or oil and gas, generally through commingled funds. Private equity and real asset strategies therefore often require the estimation of fair values by fund managers in the absence of readily determinable market values.

## **BROWN UNIVERSITY**

### Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

Investments also include assets related to donor annuities, pooled income funds, and charitable remainder trusts. Certain of these funds are held in trust by the University for one or more beneficiaries who are generally paid lifetime income, after which the principal is made available to the University in accordance with donor restrictions, if any. The assets are reported at fair value and related liabilities, which are reported as split-interest obligations, represent the present value of estimated future payments to beneficiaries.

#### ***Basis of Reporting***

Investments are reported at estimated fair value. If an investment is held directly by the University and an active market with quoted prices exists, the market price of an identical security is used to report fair value. Fair values for shares in registered mutual funds are based on published share prices. The University's interests in alternative investment funds are generally reported at the net asset value (NAV) reported by the fund managers and assessed as reasonable by the University, which is used as a practical expedient to estimate the fair value of the University's interest therein, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of June 30, 2013 and 2012, the University had no plans or intentions to sell investments at amounts different from NAV.

Because of the inherent uncertainties of valuation, these estimated fair values may differ significantly from values that would have been used had a ready market existed, and the differences could be material. Such valuations are determined by fund managers and generally consider variables such as operating results, comparable earnings multiples, projected cash flows, recent sales prices, and other pertinent information, and may reflect discounts for the illiquid nature of certain investments held.

**BROWN UNIVERSITY**

## Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

The following tables summarize the University's investments within the fair value hierarchy by strategy type as of June 30, 2013 and 2012:

	<b>June 30, 2013</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Investments:				
Equities:				
U.S. equities	\$ 25,753	110,693	57,103	193,549
Non-U.S. equity funds	167,101	273,744	67,555	508,400
Fixed income:				
Domestic	4,704	136,264	148,010	288,978
U.S. Treasury inflation-protected	72,654	7,577	15,155	95,386
Hedged strategies:				
General arbitrage funds	—	116,620	46,115	162,735
Distressed funds	—	—	47,698	47,698
Global/Non-U.S. funds	—	77,583	502,850	580,433
Private equity:				
Buy-out funds	—	—	408,798	408,798
Venture funds	—	—	188,306	188,306
Real assets:				
Real estate and timber	1,735	1,121	198,726	201,582
Commodities, oil and gas	—	—	59,682	59,682
Cash and cash equivalents	340,616	—	—	340,616
Total	\$ 612,563	723,602	1,739,998	3,076,163

**BROWN UNIVERSITY**

Notes to Financial Statements

June 30, 2013 and 2012

(Dollars in thousands)

	<b>June 30, 2012</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Investments:				
Equities:				
U.S. equities	\$ 16,330	99,700	47,813	163,843
Non-U.S. equity index funds	83,696	—	—	83,696
Non-U.S. equity funds	162,812	201,794	60,989	425,595
Fixed income:				
Domestic	4,907	153,492	82,868	241,267
U.S. Treasury inflation-protected	76,467	8,124	16,248	100,839
Hedged strategies:				
General arbitrage funds	—	117,221	14,449	131,670
Distressed funds	—	—	55,762	55,762
Global/Non-U.S. funds	—	142,324	411,867	554,191
Private equity:				
Buy-out funds	—	—	430,559	430,559
Venture funds	—	—	188,350	188,350
Real assets:				
Real estate and timber	976	1,790	210,741	213,507
Commodities, oil and gas	52	—	48,819	48,871
Cash and cash equivalents	148,085	—	—	148,085
<b>Total</b>	<b>\$ 493,325</b>	<b>724,445</b>	<b>1,568,465</b>	<b>2,786,235</b>

Registered mutual funds and directly held equity securities are classified in Level 1 of the fair value hierarchy. The University's fixed income strategy includes directly held U.S. corporate bonds, which although readily marketable are valued using matrix pricing and are classified in Level 2. Most investments classified in Levels 2 and 3 consist of shares or units in nonregistered investment funds as opposed to direct interests in the funds' underlying securities, which may be readily marketable or not difficult to value. Because the NAV reported by each fund is used as a practical expedient to estimate the fair value of the University's interest therein, its classification in Level 2 or 3 is based on the University's ability to redeem its interest at or near the date of the balance sheet date. If the interest can be redeemed in the near term, the investment is classified in Level 2. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risks associated with those investments or a reflection of the liquidity of or degree of difficulty in estimating the fair value of each fund's underlying assets and liabilities.

Certain hedge funds of funds contain "rolling" lock-up provisions. Under such provisions, tranches of the investment are available for redemption once every two or three years, if the University makes a redemption request prior to the next available withdrawal date in accordance with the notification terms of the agreement. Private equity and real assets are held in funds that have initial terms of seven to eight years with extensions of one to three years, and have an average remaining life of approximately six to seven years.

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The following tables present the activities for the years ended June 30, 2013 and 2012 for the University's investments classified in Level 3:

Level 3 roll forward	2013					
	Equities	Fixed income	Hedged strategies	Private equity	Real assets	Total
Fair value as of June 30, 2012	\$ 108,802	99,116	482,078	618,909	259,560	1,568,465
Acquisitions	2,000	36,874	104,000	56,298	36,355	235,527
Dispositions	(2,521)	(52)	(92,329)	(167,020)	(43,234)	(305,156)
Net realized and unrealized gains	16,377	27,227	102,914	88,917	5,727	241,162
Fair value at June 30, 2013	\$ 124,658	163,165	596,663	597,104	258,408	1,739,998

  

Level 3 roll forward	2012					
	Equities	Fixed income	Hedged strategies	Private equity	Real assets	Total
Fair value as of June 30, 2011	\$ 150,881	47,154	532,863	583,079	250,141	1,564,118
Acquisitions	4,000	49,600	31,089	69,152	27,236	181,077
Dispositions	(11,475)	(32)	(81,703)	(77,992)	(22,903)	(194,105)
Transfers	(25,169)	(8,124)	—	—	—	(33,293)
Net realized and unrealized (losses) gains	(9,435)	10,518	(171)	44,670	5,086	50,668
Fair value at June 30, 2012	\$ 108,802	99,116	482,078	618,909	259,560	1,568,465

Fiscal 2012 transfers of \$33,293 represent the expiration of lock-ups.

Total investment return is included in the statements of activities as follows for the years ended June 30:

	2013	2012
Operating:		
Endowment return appropriated	\$ 125,858	116,425
Included in other income	13,883	13,019
Nonoperating activities:		
Net investment return	289,377	11,348
Endowment return appropriated	(125,858)	(116,425)
Total return	\$ 303,260	24,367

Total investment management and advisory expenses, including internal costs, were \$16,817 and \$22,158 for the years ended June 30, 2013 and 2012, respectively, and have been netted against the total return.

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**(a) Liquidity**

Investment liquidity as of June 30, 2013 is aggregated below based on redemption or sale period:

	<u>Daily</u>	<u>Monthly</u>	<u>Quarterly</u>	<u>Semi- annually</u>	<u>Subject to rolling lock-ups</u>	<u>Illiquid</u>	<u>Total</u>
Equities	\$ 186,729	118,252	307,835	20,873	61,551	6,709	701,949
Fixed income	218,708	85,939	—	—	79,717	—	384,364
Hedged strategies	—	154,456	39,747	43,725	445,540	107,398	790,866
Private equity	—	—	—	—	—	597,104	597,104
Real assets	2,856	—	—	—	—	258,408	261,264
Cash and cash equivalents	340,616	—	—	—	—	—	340,616
Total	<u>\$ 748,909</u>	<u>358,647</u>	<u>347,582</u>	<u>64,598</u>	<u>586,808</u>	<u>969,619</u>	<u>3,076,163</u>

Investments with daily liquidity generally do not require advance notice prior to withdrawal. Investments with monthly, quarterly, and semi-annual redemption frequency typically require notice periods ranging from 15 to 90 days.

**(b) Commitments**

Private equity and real asset investments are generally made through limited partnerships. Under the terms of these agreements, the University is obligated to remit additional funding periodically as capital or liquidity calls are exercised by the manager. These partnerships have a limited existence, generally ten years, and such agreements may provide for annual extensions for the purpose of disposing portfolio positions and returning capital to investors. However, depending on market conditions, the inability to execute the fund's strategy, and other factors, a manager may extend the terms of a fund beyond its originally anticipated existence or may wind the fund down prematurely. As a result, the timing and amount of future capital or liquidity calls expected to be exercised in any particular future year is uncertain. The aggregate amount of unfunded commitments associated with private equity and real asset investments as of June 30, 2013 was \$173,776 and \$86,504, respectively. Additionally, some marketable investments require capital to be phased in over time. The aggregate amount of unfunded commitments associated with other alternative investments as of June 30, 2013 was \$43,350.

**(c) Investment Derivatives**

The University's endowment investment portfolio includes derivative financial instruments that have been acquired to reduce overall portfolio risk by hedging exposure to certain assets held in the portfolio. The endowment also employs certain derivative financial instruments to replicate long or short asset positions more cost effectively than through purchases or sales of the underlying assets. The University has established policies, procedures, and internal controls governing the use of derivatives.



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#### (4) Endowment

The University's endowment consists of approximately 2,600 individual funds established for a variety of purposes, including both donor-restricted endowment funds and funds designated by the Corporation to function as endowments. Net assets associated with the endowment are classified and reported based upon the existence or absence of donor-imposed restrictions. The 2012 endowment information has been reclassified to reflect the removal of \$62,553, consisting of previously appropriated but unspent return on donor-restricted endowments and split-interest agreements outside of the University's long-term pool. In addition, in 2013, upon further analysis of the endowment, \$97,143 associated primarily with accumulated returns on Corporation-designated funds was reclassified from temporarily restricted to unrestricted net assets and is included in other changes, net on the 2013 statement of activities. This change had no impact on total expendable net assets or the total endowment.

Endowment net assets consist of the following at June 30, 2013:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (7,126)	1,067,832	1,126,878	2,187,584
Corporation-designated endowment funds	<u>423,905</u>	<u>58,459</u>	<u>—</u>	<u>482,364</u>
Total endowment net assets	<u>\$ 416,779</u>	<u>1,126,291</u>	<u>1,126,878</u>	<u>2,669,948</u>

Endowment net assets consist of the following at June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (22,176)	1,061,044	1,065,141	2,104,009
Corporation-designated endowment funds	<u>300,994</u>	<u>57,535</u>	<u>—</u>	<u>358,529</u>
Total endowment net assets	<u>\$ 278,818</u>	<u>1,118,579</u>	<u>1,065,141</u>	<u>2,462,538</u>

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Changes in endowment net assets for the year ended June 30, 2013 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment at June 30, 2012	\$ 278,818	1,118,579	1,065,141	2,462,538
Investment return, net	62,797	211,197	—	273,994
Endowment return appropriated	(21,867)	(103,991)	—	(125,858)
Contributions	—	1,669	59,959	61,628
Reclassifications and other changes	97,031	(101,163)	1,778	(2,354)
Endowment at June 30, 2013	\$ <u>416,779</u>	<u>1,126,291</u>	<u>1,126,878</u>	<u>2,669,948</u>

Changes in endowment net assets for the year ended June 30, 2012 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment at June 30, 2011	\$ 310,069	1,189,438	999,422	2,498,929
Investment return, net	2,260	11,042	—	13,302
Endowment return appropriated	(32,248)	(84,177)	—	(116,425)
Contributions	57	1,154	57,681	58,892
Reclassifications and other changes	(1,320)	1,122	8,038	7,840
Endowment at June 30, 2012	\$ <u>278,818</u>	<u>1,118,579</u>	<u>1,065,141</u>	<u>2,462,538</u>

**(a) Interpretation of Relevant Laws**

The portion of donor-restricted endowment funds 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 factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the University and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the University
- The investment policies of the University

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**(b) *Funds with Deficiencies***

From time to time, the fair value of assets associated with an individual donor-restricted endowment fund may fall below the fund's historic dollar value. Deficiencies of this nature, which are reported in unrestricted net assets, aggregated \$7,126 and \$22,176 as of June 30, 2013 and 2012, respectively. These deficiencies resulted principally from investment losses and continued appropriation for certain programs that was deemed prudent by the Corporation. Subsequent gains that restore the fair value of the assets of these endowment funds to their historic dollar value will be classified as increases in unrestricted net assets.

**(c) *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, including both donor-restricted and designated funds. The long-term investment return objective is formulated to maintain purchasing power after accounting for both inflation and spending. The Corporation has set a long-term return goal at 5.5% above the higher education price index. Actual returns in any given year or period of years may vary from this amount.

**(d) *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 to achieve its long-term return objectives within prudent risk constraints.

**(e) *Spending Policy and How the Investment Objectives Relate to Spending Policy***

The University invests its endowment funds and allocates the related return for expenditure in accordance with the total return concept. The endowment utilization is determined in accordance with the policy adopted by the Corporation. This policy fixes the spending range between 4.5% and 5.5% of the average fair value of applicable endowments over the prior twelve quarters, with the objective being to hold the spending rate to no more than a 5% average over time. Applicable endowments include Corporation-designated and donor-designated endowment funds.

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**(5) Land, Buildings and Equipment**

Land, buildings and equipment include the following at June 30:

	<u>2013</u>	<u>2012</u>
Land	\$ 72,241	62,649
Buildings	631,411	623,218
Improvements	808,426	752,617
Equipment	140,142	115,033
Construction in progress	<u>100,305</u>	<u>68,925</u>
	1,752,525	1,622,442
Accumulated depreciation	<u>(732,650)</u>	<u>(669,108)</u>
Land, buildings and equipment, net	<u>\$ 1,019,875</u>	<u>953,334</u>

Outstanding commitments on uncompleted construction contracts total \$43,555 at June 30, 2013.

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**(6) Bonds, Loans and Notes Payable**

The University has entered into various agreements primarily for the purpose of financing the acquisition, renovation, and improvement of its facilities. The bonds, loans and notes payable outstanding for these purposes are as follows:

Name of issue	Interest rate(s)	Type of rate	Final maturity	Balance at June 30	
				2013	2012
Rhode Island Health and Education Building Corporation (RIHEBC) Facilities Revenue Bonds:					
Series 2003A	3.70% – 4.85%	Fixed	2037	\$ 41,145	42,050
Series 2003B	0.04%	Variable	2043	42,975	43,385
Series 2004	3.75% – 4.75%	Fixed	2025	16,535	17,480
Series 2005A	0.04%	Variable	2035	85,500	85,500
Series 2007	4.25% – 5.00%	Fixed	2037	90,010	90,010
Series 2009	5.00%	Fixed	2039	70,795	70,795
Series 2011	2.50% – 5.00%	Fixed	2032	66,950	70,600
Series 2012	5.00%	Fixed	2022	118,240	—
Tax-exempt commercial paper, revolving through 2042	0.13%	Fixed	Revolving	1,000	50,000
Taxable standard commercial Paper Notes, Series A, revolving through 2036					
	0.14% – 0.18%	Fixed	Revolving	50,000	50,000
Brown University Taxable Bonds:					
Series 2005	5.09%	Fixed	2016	17,000	17,000
Series 2009	4.57%	Fixed	2019	100,000	100,000
Loans payable – community:					
Development entities	1.22%	Fixed	2041	13,748	13,748
Total bonds, loans and notes payable before premium				713,898	650,568
Unamortized premium				37,437	9,528
Total bonds, loans and notes payable				\$ 751,335	660,096

**(a) Tax Exempt Bonds**

The University's tax exempt debt, primarily Facilities Revenue Bonds, is issued through RIHEBC, a state agency serving as a conduit issuer of tax exempt debt. The University is required under certain of its financing agreements with RIHEBC to appropriate funds from operating and other net assets for payment of principal and interest and for maintenance of the related properties. The Revenue Bonds currently outstanding were issued primarily to finance new and ongoing capital projects for research, student housing, academic and administrative buildings, and infrastructure. In July 2012,

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the Series 2012 Facilities Revenue Refunding Bonds were issued in the amount of \$118,240 to refinance \$50,000 of RIHEBC tax-exempt commercial paper and \$8,220 in taxable commercial paper, with the remaining proceeds to be used for capital projects. The Series 2012 Bonds included an original issue premium of \$31,567, which will be amortized over the life of the debt.

**(b) Taxable Bonds and Other Debt**

The University's outstanding debt includes two taxable bond issues. Series 2005 Taxable Bonds were issued to finance a portion of the acquisition cost of an office building. Series 2009 Taxable Bonds were issued to provide liquidity and to protect against a tightening in liquidity markets. In addition, the University implemented a Taxable Commercial Paper Program in November 2005. The program provides for the issuance, up to \$50,000, of Taxable Standard Commercial Paper Notes, Series A, and Taxable Extendible Commercial Paper Notes, Series B. The Taxable Commercial Paper Program has a number of individual notes that are issued at various times, amounts and staggered maturity dates. The notes are issued at market prices which at June 30, 2013 ranged from 0.14% to 0.18%. During the life of the note, 1 day to 270 days, the rate is fixed. As an individual note matures, new notes are issued to pay for the maturing notes. The agreement allows the University to continue this revolving process until 2036.

The University also maintains a tax exempt commercial program through RIHEBC. Proceeds from the tax exempt commercial paper program must be used within 18 months, however, once debt is issued the University can continue to rollover the tax exempt commercial paper until the end of the program in 2042. The issuance of new money requires renewal by RIHEBC every three years. The program was renewed in 2012 and as of June 30, 2013, \$1,000 had been drawn and utilized.

Principal payments of bonds, notes and loans payable as of June 30, 2013 for each of the succeeding five fiscal years ending June 30 and thereafter are as follows:

Fiscal year:		
2014	\$	6,125
2015		6,415
2016		25,370
2017		8,910
2018		9,180
Thereafter		657,898
Total	\$	<u>713,898</u>

The University's bonds, loans and notes payable are stated at face value. The University's bonds trade periodically in a limited market. Utilizing available market pricing information provided by a third-party, the University determined that the aggregate estimated fair value of its debt as of June 30, 2013 and 2012 was approximately \$764,000 and \$701,000, respectively. These estimated fair values are based on significant observable inputs categorized in Level 2 of the fair value hierarchy.

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The University has a revolving line of credit available up to \$40,000. As of June 30, 2013, the full amount of \$40,000 was available at a rate of 0.94%.

The University provides the initial liquidity for each of its variable rate bond issues and commercial paper programs. Additionally, the University has backup liquidity facilities at two separate banks currently totaling \$150,000 in the event the debt is unable to be remarketed. These facilities are available exclusively for the temporary repayment of debt.

**(c) Interest Rate Swaps**

At June 30, 2013 and 2012, the University had two interest-rate swap agreements in place to effectively convert a portion of its variable-rate debt to fixed rates until maturity of the associated bonds. The swaps' notionals for the JPMorgan swap and the \$85,500 Goldman Sachs swap match and amortize at the same rate as the associated debt principal.

In fiscal 2012, the Series 2001B bonds synthetically fixed by the \$17,363 Goldman Sachs swap were refunded with fixed rate debt resulting in an unmatched swap. For economic reasons the University terminated approximately one-third of the original notional value of this swap in each of the years ended June 30, 2013 and 2012. As a result, the University recognized a realized loss on partial swap termination of \$2,600 and \$2,757, in fiscal 2013 and 2012, respectively, which is recorded in nonoperating activities in other changes, net in the statement of activities.

As of June 30, the following interest-rate swap agreements were outstanding:

Counterparty	Associated debt	Expiration date	June 30, 2013 remaining notional value	Swap fixed rate	Fair value of liability at June 30	
					2013	2012
JP Morgan	Series 2003B	9/1/2043	\$ 42,975	3.732%	\$ (10,929)	(16,943)
Goldman Sachs	Series 2005A	5/1/2035	85,500	3.979	(14,426)	(26,702)
Goldman Sachs	None	9/1/2032	17,363	3.891	(2,460)	(7,747)
					<u>\$ (27,815)</u>	<u>(51,392)</u>

The variable rate on the two Goldman Sachs swaps is based on the USD-BMA Municipal Swap Index. The variable rate on the JPMorgan swap is based on 67% of one-month LIBOR-BBA. The Goldman Sachs swaps require posting of collateral by either party at thresholds based on their respective credit ratings. Cash collateral must be posted by the University if the aggregate mark-to-market liability payable by the University exceeds \$25,000. The JPMorgan swap stipulates that if the University meets a minimum credit rating there are no collateral posting requirements. This rating was maintained by the University at June 30, 2012 and 2013.

Interest rate volatility, remaining outstanding notional value and time to maturity will affect each swap's fair value at subsequent reporting dates. To the extent the University holds a swap through its expiration date, the swap's fair value will reach zero. Because the swap fair values are based

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predominantly on observable inputs corroborated by market data, they are classified in Level 2 of the GAAP fair value hierarchy.

#### (7) Retirement Benefits

The University participates in two contributory retirement plans. The expense to the University, representing its contributions to the accounts of faculty and staff, was \$23,278 and \$22,279 for the years ended June 30, 2013 and 2012, respectively.

The Brown University Food Services and Plant Operations Employees' Pension Plan is a qualified, noncontributory defined benefit plan which provides pensions for certain full-time weekly paid employees. The policy of the University is to fund pension costs in accordance with the Employee Retirement Income Security Act of 1974, as amended.

Information regarding the defined benefit pension plan for the years ended June 30 is as follows:

	<u>2013</u>	<u>2012</u>
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 71,621	54,097
Service cost	3,286	2,314
Interest cost	2,857	2,954
Benefits paid	(1,889)	(1,837)
Actuarial (gain) loss	(6,668)	14,093
Projected benefit obligation at end of year	<u>\$ 69,207</u>	<u>71,621</u>

The projected benefit obligation was determined using the following assumptions as of June 30:

	<u>2013</u>	<u>2012</u>
Discount rate	4.67%	4.01%
Rate of compensation increase	3.00	3.00



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The following is a summary of activity under the plan for the years ended June 30:

	<u>2013</u>	<u>2012</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 46,542	40,823
Actual return on plan assets	4,714	1,056
Contributions	5,870	6,500
Benefits paid	<u>(1,889)</u>	<u>(1,837)</u>
Fair value of plan assets at end of year	55,237	46,542
Projected benefit obligation at end of year	<u>(69,207)</u>	<u>(71,621)</u>
Funded status included in other long-term obligations	<u>\$ (13,970)</u>	<u>(25,079)</u>
	<u>2013</u>	<u>2012</u>
Net periodic pension cost:		
Service cost	\$ 3,286	2,314
Interest cost	2,857	2,954
Expected return on assets	(3,540)	(3,312)
Amortization of unrecognized loss and prior service cost	<u>1,637</u>	<u>378</u>
Net periodic pension cost	<u>\$ 4,240</u>	<u>2,334</u>

Net periodic pension cost was determined using the following assumptions for the years ended June 30:

	<u>2013</u>	<u>2012</u>
Discount rate	4.01%	5.57%
Rate of compensation increase	3.00	3.50
Expected long-term rate of return	7.50	7.50

The expected rate of return on plan assets was derived based upon assumptions of inflation, real returns, anticipated value added by the investment manager and expected asset class allocations.

Net periodic pension cost is reflected in operating activities on the statements of activities. As of June 30, 2013 and 2012, items not yet recognized as components of net periodic pension cost are unrecognized prior service cost of \$709 and \$471, respectively, and a net unrecognized actuarial gain of \$15,147 and an actuarial loss of \$24,863, respectively. These changes affecting the funded status of the plan are included in other changes, net in nonoperating activities in the statements of activities.

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The plan assets at June 30, 2013 and 2012 consist of variable annuity investments with various equity and fixed income focuses measured at NAV and are classified in Level 2 in the GAAP fair value hierarchy because of the plan’s ability to redeem its interests at or near the balance sheet date.

The investment strategy for the Plan takes into account several factors consistent with the characteristics of an employee pension plan. As such, the strategy recognizes a long-term time horizon where a substantial allocation to equities is appropriate and will help to maximize returns; broad diversification in order to increase return and reduce risk; and investment in institutional retirement annuities that serves to reduce administrative costs.

The actual asset allocation for the pension plan as of June 30, 2013 and 2012, and the weighted average asset targeted allocation are as follows:

	<b>Target</b>	<b>Actual</b>	
		<b>2013</b>	<b>2012</b>
Equity funds	65%	65%	65%
Fixed funds	35	35	35
Total	100%	100%	100%

The University’s estimated contribution for 2014 is \$3,000.

Estimated future benefit payments as of June 30, 2013 are as follows:

Fiscal year:		
2014	\$	2,271
2015		2,399
2016		2,568
2017		2,758
2018		3,026
2019 – 2023		18,956

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**(8) Restricted Net Assets**

The University's restricted net assets as of June 30 are as follows:

	<u>2013</u>		<u>2012</u>	
	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>
Endowment	\$ 1,126,291	1,126,878	1,118,579	1,065,141
Contributions receivable	57,401	88,650	77,200	81,584
Donor-restricted purposes	79,168	28,632	67,017	25,009
Student loans	—	10,874	—	10,328
Total	<u>\$ 1,262,860</u>	<u>1,255,034</u>	<u>1,262,796</u>	<u>1,182,062</u>

**(9) Functional Classification of Expenses**

Functional categories are reported after allocating, on a square footage basis, expenses for operation and maintenance of plant, interest on indebtedness, and depreciation. Operating expenses incurred in the fiscal years ended June 30 were as follows:

	<u>2013</u>	<u>2012</u>
Instruction and departmental research	\$ 285,170	265,010
Sponsored programs	116,112	124,211
Academic and student support	137,943	134,218
Auxiliary services	85,170	85,831
Institutional support	105,387	95,550
	<u>\$ 729,782</u>	<u>704,820</u>

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#### (10) Commitments and Contingencies

All funds expended in conjunction with government grants and contracts are subject to audit by governmental agencies. In the opinion of management, any potential liability resulting from these audits will not have a material effect on the University's financial position.

The University is a defendant in various legal actions arising in the normal course of its operations. Although the final outcome of such actions cannot currently be determined, the University believes that the ultimate unrecognized liability, if any, will not have a material effect on the University's financial position.

#### (11) Related-Party Transactions

Members of the Corporation and senior management may, from time to time, be associated either directly or indirectly with companies doing business with the University. The University has a written conflict of interest policy that requires annual reporting by each Corporation member and University senior management. When such relationships exist, measures are taken to mitigate any actual or perceived conflict, including requiring that such transactions be conducted at arms' length, based on terms in the best interest of the University.

#### (12) Supplemental Disclosure of Cash Flow Information

Following is information intended to supplement the statements of cash flows for the years ended June 30:

	<u>2013</u>	<u>2012</u>
Cash paid for interest, including recurring swap settlements	\$ 30,460	27,962
Noncash investing activities:		
(Decrease) increase in accounts payable for land, buildings and equipment	(9,449)	802
Decrease in payables for purchases of investments	(16,142)	(32,100)
(Decrease) increase in receivables for investments sold	(58,433)	34,715

#### (13) Subsequent Events

The University considers events or transactions that occur after the balance sheet date, but before the financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. These financial statements were issued on October 29, 2013, and subsequent events have been evaluated through that date.