



WILLAMETTE UNIVERSITY

OMB Circular A-133
Supplementary Financial Report

May 31, 2005

(With Independent Auditors' Report Thereon)

WILLAMETTE UNIVERSITY

OMB Circular A-133
Supplementary Financial Report

May 31, 2005

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KPMG LLP
Suite 3800
1300 South West Fifth Avenue
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Independent Auditors' Report

The Board of Trustees
Willamette University:

We have audited the accompanying statements of financial position of Willamette University (an Oregon nonprofit corporation) as of May 31, 2005 and 2004, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the University's management. 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 audit 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the financial statements referred to above present fairly, in all material respects, the financial position of Willamette University as of May 31, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 12, 2005 on our consideration of Willamette University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants 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 audit.



Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

August 12, 2005



KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

**Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards***

The Board of Trustees
Willamette University:

We have audited the financial statements of Willamette University as of and for the year ended May 31, 2005, and have issued our report thereon dated August 12, 2005. We conducted our audit 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.

Internal Control over Financial Reporting

In planning and performing our audits, we considered Willamette University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Willamette University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Willamette University in a separate letter dated August 12, 2005.

This report is intended solely for the information and use of the board of trustees, University management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

August 12, 2005



KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

**Report on Compliance with Requirements Applicable
to Each Major Program and on Internal Control
over Compliance in Accordance with OMB Circular A-133**

The Board of Trustees
Willamette University:

Compliance

We have audited the compliance of Willamette University with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended May 31, 2005. Willamette University's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Willamette University's management. Our responsibility is to express an opinion on Willamette University's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Willamette University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Willamette University's compliance with those requirements.

In our opinion, Willamette University complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended May 31, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 05-01.

Internal Control over Compliance

The management of Willamette University is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Willamette University's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Willamette University's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 05-01.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the board of trustees, University management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

August 12, 2005

WILLAMETTE UNIVERSITY

Statements of Financial Position

May 31, 2005 and 2004

(Dollars in thousands)

Assets	2005	2004
Cash and cash equivalents	\$ 20,010	12,309
Accounts receivable, net of allowances of \$299 and \$374 in 2005 and 2004, respectively	1,474	1,134
Pledges receivable, net of allowance of \$164 in 2005 and 2004	7,117	9,927
Inventories and prepaid expenses	1,482	958
Student loans receivable, net of allowances of \$79 and \$92 in 2005 and 2004, respectively	7,795	7,521
Notes receivable and other assets	1,271	1,587
Investments	228,767	211,718
Present value of assets held in remainder trusts by others	1,349	1,136
Plant facilities, net	89,699	89,977
Total assets	\$ 358,964	336,267
Liabilities and Net Assets		
Liabilities:		
Note payable to bank – line of credit	\$ 3,200	4,900
Accounts payable and accrued liabilities	10,692	9,232
Deferred revenue	960	808
U.S. Government loan advances refundable	6,476	6,368
Annuities and trusts payable	7,427	7,091
Note payable	295	109
Bonds payable	15,230	7,735
Total liabilities	44,280	36,243
Net assets:		
Unrestricted:		
Designated for endowment	55,320	60,482
Invested in plant facilities	34,507	34,145
Designated for plant facilities and other purposes	2,792	3,335
Total unrestricted net assets	92,619	97,962
Temporarily restricted:		
Accumulated endowment gains	68,519	54,875
Trusts and annuities	3,041	2,732
Invested in plant facilities	49,064	49,993
Unexpended funds received for specific purposes	6,715	6,359
Total temporarily restricted net assets	127,339	113,959
Permanently restricted:		
Endowment	88,171	82,222
Endowment – assets held in perpetual trust by others	2,366	2,050
Trusts and annuities	3,172	2,838
Student loans	1,017	993
Total permanently restricted net assets	94,726	88,103
Total net assets	314,684	300,024
Total liabilities and net assets	\$ 358,964	336,267

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statement of Activities

Year ended May 31, 2005

(Dollars in thousands)

	2005			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Student charges:				
Tuition and fees	\$ 64,232	—	—	64,232
Less student scholarships	(28,149)	—	—	(28,149)
Net tuition and fees	36,083	—	—	36,083
Room and board fees	8,399	—	—	8,399
Contributions	2,325	1,630	5,747	9,702
Endowment income distributed	7,459	4,104	23	11,586
Auxiliary enterprises	2,787	—	—	2,787
U.S. Government grants	692	802	—	1,494
Other income	1,276	111	—	1,387
Net assets released from restrictions	6,985	(6,985)	—	—
Total revenues, gains, and other support	66,006	(338)	5,770	71,438
Expenses:				
Instruction	28,616	—	—	28,616
Research	873	—	—	873
Academic support	11,450	—	—	11,450
Student services	7,306	—	—	7,306
General institutional support	9,084	—	—	9,084
Room and board program	6,076	—	—	6,076
Auxiliary enterprises	2,720	—	—	2,720
Total expenses	66,125	—	—	66,125
Change in net assets before other changes	(119)	(338)	5,770	5,313
Other changes:				
Endowment income, net of distributions	2,383	6,063	390	8,836
Adjustment related to annuities and trusts	—	110	370	480
Student loan interest and cancellations	31	—	—	31
Other	(58)	(35)	93	—
Reclassification of net assets	(7,580)	7,580	—	—
Total changes in net assets	(5,343)	13,380	6,623	14,660
Net assets, beginning of year	97,962	113,959	88,103	300,024
Net assets, end of year	\$ 92,619	127,339	94,726	314,684

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statement of Activities

Year ended May 31, 2004

(Dollars in thousands)

	2004			
	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, and other support:				
Student charges:				
Tuition and fees	\$ 59,220	—	—	59,220
Less student scholarships	(26,568)	—	—	(26,568)
Net tuition and fees	32,652	—	—	32,652
Room and board fees	7,724	—	—	7,724
Contributions	4,472	7,619	5,855	17,946
Endowment income distributed	8,462	4,540	27	13,029
Auxiliary enterprises	2,743	—	—	2,743
U.S. Government grants	650	1,146	—	1,796
Other income	1,536	23	—	1,559
Net assets released from restrictions	7,467	(7,467)	—	—
Total revenues, gains, and other support	65,706	5,861	5,882	77,449
Expenses:				
Instruction	27,171	—	—	27,171
Research	1,361	—	—	1,361
Academic support	10,159	—	—	10,159
Student services	7,244	—	—	7,244
General institutional support	8,473	—	—	8,473
Room and board program	6,070	—	—	6,070
Auxiliary enterprises	2,667	—	—	2,667
Total expenses	63,145	—	—	63,145
Change in net assets before other changes	2,561	5,861	5,882	14,304
Other changes:				
Endowment income (loss), net of distributions	5,600	6,816	(14)	12,402
Adjustment related to annuities and trusts	—	176	248	424
Student loan interest and cancellations	6	—	—	6
Other	125	(645)	520	—
Total changes in net assets	8,292	12,208	6,636	27,136
Net assets, beginning of year	89,670	101,751	81,467	272,888
Net assets, end of year	\$ 97,962	113,959	88,103	300,024

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statements of Cash Flows

Years ended May 31, 2005 and 2004

(Dollars in thousands)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Change in net assets	\$ 14,660	27,136
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	3,729	3,570
Net realized and unrealized gains on investments	(17,820)	(22,463)
Contributions restricted for long-term investment	(5,736)	(11,712)
Contributions subject to annuity and unitrust agreements	(238)	(341)
Contribution of land	—	(820)
Increase in accounts receivable	(340)	(288)
Decrease in interest and dividends receivable	31	3
Decrease (increase) in pledges receivable	2,810	(1,211)
Increase in inventories and prepaid expenses	(524)	(16)
Increase in student loans receivable	(274)	(231)
Decrease (increase) in notes receivable and other assets	316	(241)
(Increase) decrease in assets held in remainder trusts by others, net	(213)	396
Increase in accounts payable and accrued liabilities	1,460	880
Increase in deferred revenue	152	126
Increase in annuities and trusts payable	336	169
Net cash used in operating activities	<u>(1,651)</u>	<u>(5,043)</u>
Cash flows from investing activities:		
Purchases of investments	(104,955)	(101,279)
Proceeds from maturities/sales of investments	105,695	104,536
Additions to plant facilities	(3,451)	(6,986)
Net cash used in investing activities	<u>(2,711)</u>	<u>(3,729)</u>
Cash flows from financing activities:		
Proceeds (repayments) from borrowing under line of credit	(1,700)	4,900
Proceeds restricted for:		
Investment in endowment	5,367	5,761
Investment in plant facilities	369	5,951
Investment subject to annuity and unitrust agreements	238	341
Proceeds from (payments on) note payable	186	(11)
Increase in U.S. Government loan advances refundable	108	171
Proceeds from (payments on) bonds payable	7,495	(560)
Net cash provided by financing activities	<u>12,063</u>	<u>16,553</u>
Net increase in cash and cash equivalents	7,701	7,781
Cash and cash equivalents, beginning of year	<u>12,309</u>	<u>4,528</u>
Cash and cash equivalents, end of year	\$ <u>20,010</u>	<u>12,309</u>
Supplemental cash flow information:		
Cash paid for interest	\$ 581	562

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(1) Organization

Willamette University (the University) is a private institution of higher education accredited by the Northwest Association of Schools and Colleges. The University offers students a number of graduate and undergraduate degrees in programs covering a wide variety of scholastic disciplines. The University is an Oregon not-for-profit organization funded by student tuition revenue, endowment income, and outside contributions.

(2) Summary of Significant Accounting Policies

(a) General

These financial statements, which are presented on the accrual basis of accounting, have been prepared to focus on the University as a whole and to present transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of net assets and transactions into three classes as follows:

Unrestricted Net Assets – Net assets not subject to donor-imposed restrictions. Unrestricted net assets at May 31, 2005 include \$7,580,000 that was transferred from temporarily restricted net assets to correctly reflect gains on endowed investments. The University determined that the transaction did not have a significant impact on beginning net assets.

Temporarily Restricted Net Assets – Net assets subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time.

Permanently Restricted Net Assets – Net assets subject to donor-imposed restrictions that they be permanently maintained by the University. Generally the donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless their use is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets with the exception of activity related to life income agreements. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor restrictions or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Income and net gains on investments of endowment and similar funds are reported as follows:

- Increases in permanently restricted net assets if the terms of the gift or Willamette University's interpretation of relevant state law require they be added to the principal of a permanently restricted net asset.
- Increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income.
- Increases in unrestricted net assets in all other cases.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

Contributions, including unconditional promises to give, are recognized as revenues in the period in which the unconditional promise is received. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. Amortization of the discount is recorded as additional contribution revenue. An allowance for uncollectible contributions receivable is provided based upon management's judgment, including such factors as prior collection history, type of contribution, and nature of fund-raising activity. Contributions of assets other than cash are recorded at their estimated fair value. Contributions for capitalized long-lived assets are released from restriction over the estimated useful lives of the assets using the University's depreciation policies.

(b) *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Assets held in trust by others represent resources neither in the possession nor under the control of the University, but held and administered by outside trustees, from which the University derives income or has a residual interest in the related assets. Assets held in trust by others are recognized at the estimated fair value of the assets or the present value of the future cash flows when the trust is established or the University is notified of its existence.

(c) *Assets Held in Charitable Trusts*

The University serves as the trustee for various charitable trusts. Under the terms of these trust agreements, the University makes distributions to income beneficiaries for a given term or for the life of the income beneficiaries. Assets remaining in the trusts will be transferred to the University at the end of the term or upon death of the income beneficiaries. The University classifies assets held in charitable trusts as investments which are recorded at their fair market value. The related liability is recorded at the estimated discounted value of the amounts due to the income beneficiaries.

(d) *Cash and Cash Equivalents*

Cash and cash equivalents consist primarily of demand deposits and investments in money market mutual funds with original maturity dates of 90 days or less.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(e) Investments

Investments in marketable equity securities and all debt securities are stated at fair value. Investments in land are stated at cost on the date of acquisition or fair market value at date of receipt in the case of gifts. Investments in private equity and real estate investment trusts are stated at fair value as determined by underlying security value on open market as estimated by management of the University. Other investments such as hedge funds and venture capital are accounted for at estimated fair market value. Realized and unrealized gains and losses on investments are reflected in the statements of activities as endowment income designated for operations or reinvested endowment income.

(f) Plant Facilities

Plant facilities are stated at cost at the date of acquisition, or fair market value at the date of receipt, if contributed. Routine repair and maintenance expenses, and replacement costs are expensed as incurred.

The University computes depreciation using the straight-line method over the estimated useful lives of plant facilities, except land, as follows:

Land improvements	25 years
Buildings	50 years
Furniture, fixtures, and equipment	5-15 years
Library holdings	25 years

(g) Income Taxes

The Internal Revenue Service has recognized the University as exempt from tax under the provisions of Section 501(c)(3) of the Internal Revenue Code except to the extent of unrelated business income under sections 511 through 515. Unrelated business income tax, if any, is immaterial and therefore, no tax provision has been made.

(h) Postretirement Benefits

In December 2003, FASB Statement No. 132 (revised), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, was issued. SFAS No. 132 (revised) prescribes employers' disclosures about pension plans and other postretirement benefit plans; it does not change the measurement or recognition of those plans. The Statement retains and revises the disclosure requirements contained in the original SFAS No. 132. It also requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans (see note 13).

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(3) Pledges Receivable

The University records pledges receivable at the present value of estimated future cash flows using a discount rate of 6%. Annual payments are scheduled to be received as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Less than one year	\$ 3,349	5,968
One to five years	4,276	4,496
More than five years	168	286
	<u>7,793</u>	<u>10,750</u>
Less discount	(512)	(659)
Less reserve for uncollectible accounts	(164)	(164)
Total pledges receivable	<u>\$ 7,117</u>	<u>9,927</u>

During 2005, conditional promises in the gross amount of \$600,000 were received, but not recognized as a receivable.

(4) Accounts and Student Loans Receivable

Accounts and student loans receivable consist of the following at May 31, 2005 (in thousands):

	<u>2005</u>	<u>2004</u>
Student accounts receivable	\$ 692	604
Related parties	440	440
Collections	179	186
Other receivables	462	278
	<u>1,773</u>	<u>1,508</u>
Less allowance for doubtful accounts	(299)	(374)
	<u>\$ 1,474</u>	<u>1,134</u>

The Perkins program provides for cancellation of loans if the student is employed in certain occupations following graduation (employment cancellations). Such employment cancellations are absorbed in full by the U.S. Government. Perkins loan funds are generally payable (including interest at 3%, 4%, and 5%) over approximately eleven years following college attendance. Principal payments, interest, and losses due to cancellation are shared by the University and the U.S. Government in proportion to their share of funds provided.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(5) Investments

Investments at May 31, 2005 and 2004 are as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Short-term investments	\$ 4,175	1,212
Interest and dividends receivable	54	85
Bonds and notes	33,665	33,689
Corporate stocks	122,389	101,811
Private equity, venture capital, and real estate investment trust	19,785	47,435
Hedge funds	43,171	21,925
Land held for investment	3,162	3,511
Perpetual trusts	2,366	2,050
	<u>\$ 228,767</u>	<u>211,718</u>

The University has committed \$46,041,000 to private equity funds in the form of limited partnership/trust investments. As of May 31, 2005, Willamette University has funded approximately \$12,048,000 of these commitments. These commitments are due on demand from the general partners/advisors. These partnerships/trusts invest in emerging growth technologies companies, venture capital funds, and other alternative investments. The termination of these partnerships/trusts are based upon specific provisions in the agreements.

(6) Endowment and Quasi-Endowment Funds – Net Asset Allocation

Endowment and quasi-endowment net asset balances, including life income net assets, at May 31, 2005 and 2004 are as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Original historic gift value	\$ 109,885	102,895
Net increase in market price of investments:		
Realized	80,127	77,826
Unrealized	30,577	24,478
Total market value	<u>\$ 220,589</u>	<u>205,199</u>
	<u>2005</u>	<u>2004</u>
Unrestricted net assets	\$ 55,320	52,902
Temporarily restricted net assets	71,560	65,187
Permanently restricted net assets	93,709	87,110
Totals	<u>\$ 220,589</u>	<u>205,199</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(7) Endowment and Quasi-Endowment Funds

Substantially all investments of the University held for endowment are pooled for investment purposes. Income earned on endowment fund investments is allocated on the basis of each fund's proportionate interest in the pooled investment portfolio.

The University determines the amount of endowment gains and income to spend in a particular fiscal year based on a formula recommended by the Board of Trustees Committee on Financial Affairs and adopted by the Executive Committee. The University's long-range financial plan is to fix the unrestricted endowment spending at the current spending amount of \$6,830,000 until the spending amount is 5% of the endowment value. The rate applied to restricted use funds has continued to remain at 6%.

The components of total endowment investments return are reflected below (in thousands):

	<u>2005</u>	<u>2004</u>
Dividends and interest	\$ 2,831	3,283
Net realized gains	11,720	10,003
Net change in cumulative unrealized gains and losses	6,100	12,460
Investment fees	<u>(229)</u>	<u>(315)</u>
Total	<u>\$ 20,422</u>	<u>25,431</u>

Investment return, as reflected in the statements of activities, is as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Revenues:		
Unrestricted	\$ 7,459	8,462
Temporarily restricted	4,104	4,540
Permanently restricted	23	27
	<u>11,586</u>	<u>13,029</u>
Other changes in net assets:		
Unrestricted	2,383	5,600
Temporarily restricted	6,063	6,816
Permanently restricted	390	(14)
	<u>8,836</u>	<u>12,402</u>
Total	<u>\$ 20,422</u>	<u>25,431</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

	Fair value	
	2005	2004
General and quasi-endowment funds	\$ 214,376	199,629
Annuity and trust funds	13,641	12,661
Total fair value	\$ 228,017	212,290

(8) Plant Facilities

Plant facilities consist of the following at May 31, 2005 and 2004 (in thousands):

	2005	2004
Land and land improvements	\$ 10,435	10,004
Buildings	94,249	92,795
Furniture, fixtures, and equipment	5,230	4,972
Library holdings	27,472	25,997
Art collection	1,956	1,835
Construction in progress	444	1,048
Accumulated depreciation	(50,087)	(46,674)
Net plant facilities	\$ 89,699	89,977

The University has received gifts of art and other collectibles (the Collection), which are housed or displayed in the Hallie Ford Museum of Art. The University has a recorded value for the Collection of \$1,956,000 in the plant facilities balance in the statement of financial position, and depreciation will not be recorded on these assets.

(9) Bonds Payable

In June 2004 the University issued Oregon Facilities Authority Revenue Bonds in the aggregate principal amount of \$15,075,000. The bonds have annual payment obligations ranging from \$1,332,000 to \$458,000 through 2034, and bear interest at rates ranging from 3% to 5%. The bond proceeds were used for the purpose of refunding the \$7,735,000 outstanding principal of the City of Salem Educational Facilities Revenue and Refunding Bonds, Series 1994, as well as to repay drawings under a bank line of credit which was used to finance property acquisitions and improvements, and finally to finance additional facilities for the University.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

Principal payments on bonds payable are as follows:

2006	\$	690,000
2007		710,000
2008		870,000
2009		890,000
2010		920,000
Thereafter		<u>10,995,000</u>
		<u>15,075,000</u>
Add unamortized bond premium, interest at 3% to 5%		<u>155,000</u>
	\$	<u><u>15,230,000</u></u>

The University has a revolving line of credit at a variable interest rate that is calculated at the LIBOR rate plus 50 basis points (2.31% at May 31, 2005). As of May 31, 2005, there were draws of \$3,200,000 outstanding against this line.

Interest expense for the years ended May 31, 2005 and 2004 was approximately \$581,000 and \$562,000, respectively.

(10) Net Assets Released from Restriction

Net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes, occurrence of events specified by the donors, the change in restrictions specified by the donors, or the passage of time. Net assets released from restriction during the years ended May 31, 2005 and 2004 are as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Purpose of restricted contributions:		
Instruction	\$ 316	396
Sponsored research	305	694
Academic support	166	17
Student services	8	9
Scholarships	4,791	5,050
Plant	<u>17</u>	<u>—</u>
	5,603	6,166
Time restricted contributions:		
Amortization of restricted gifts to acquire long-lived assets	<u>1,382</u>	<u>1,301</u>
Total net assets released from restrictions	\$ <u><u>6,985</u></u>	<u><u>7,467</u></u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(11) Institutional Support Fund Raising Expense

Fund raising expenses of \$2,058,000 and \$1,977,000 are included in general institutional support expenses in the statement of activities for the years ended May 31, 2005 and 2004, respectively.

(12) Pension Plan

The University has a defined contribution retirement plan covering eligible employees under arrangements with Teachers Insurance and Annuity Association (TIAA) and the College Retirement Equities Fund (CREF), and three alternative asset management vehicles. The University's contributions are based on a percentage of participating employees' salaries, and, along with employee contributions, are paid to TIAA/CREF monthly. Under the arrangements, TIAA/CREF is responsible for payment of all benefits. Retirement plan expense for the years ended May 31, 2005 and 2004 was approximately \$2,653,000 and \$2,560,000, respectively.

(13) Other Postretirement Benefits and Related Liability Estimates

All employees retiring from the University who were hired before January 1, 1983 are eligible for reimbursement of the actual cost of premiums for Medicare supplement insurance up to \$125 per quarter. Persons who retired from the University prior to January 1, 1977 are eligible for full Medicare supplement insurance with premiums paid by the University. In addition, full-time continuing faculty members, administrators, and classified employees with twenty years or more of service, upon reaching age fifty-nine are eligible for a voluntary severance arrangement that provides cash payments and University paid health insurance until the individual is eligible for Medicare.

The University provides health care and life insurance benefits for certain of its retired employees, which includes prescription drug benefits. In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 was passed, whereby a prescription drug benefit under Medicare was enacted as well as a federal subsidy to sponsors of retiree health care plans. In January and May 2004, the FASB issued FASB Staff Position No. 106-1 and 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003" ("FSP 106-1" and "FSP 106-2"). Any measures of the APBO or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act on the Post Retirement Plan as the University is unable to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

The schedule below details the estimated liabilities included in the accounts payable and accrued liabilities balance in the statement of financial position as of May 31, 2005, associated with the above-described benefits. The liability estimates are discounted from estimated future costs using a 5% interest rate and the voluntary severance payment estimate calculation assumes a 3% annual growth in the compensation upon which the benefit is based. No assets have been specifically set aside to fund these estimated benefit obligations. Benefits paid by the University relating to postretirement benefit plan were approximately \$187,000 for the year ended May 31, 2005.

	Accumulated post- retirement obligation
Medicare Supplement – Up to \$125 per quarter:	
For 77 current retirees	\$ 381,000
For 53 current employees	217,000
Full Medicare Supplement:	
For 3 pre-1977 retirees	42,000
Health Insurance Until Medicare Eligibility:	
For 11 early retirees	152,000
For an estimated 440 future early retirees	1,578,000
Voluntary Severance Payments:	
For 11 early retirees	531,000
For an estimated 440 future early retirees	<u>1,953,000</u>
Accrued post retirement benefit cost	<u>\$ 4,854,000</u>

The following lists postretirement benefit payments, which reflect expected future service. Payments expected to be paid are as follows:

2006	\$ 290,000
2007	320,000
2008	335,000
2009	350,000
2010	370,000
Thereafter	<u>3,189,000</u>
	<u>\$ 4,854,000</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(14) Annuities and Life Income Funds

Annuities and life income funds consist of the following at May 31, 2005 (in thousands):

	<u>Charitable gift annuities</u>	<u>Annuity trusts and unitrusts</u>	<u>Total</u>
Assets:			
Accounts Receivable	\$ 9	—	9
Investments	4,504	6,142	10,646
Land	1,325	592	1,917
Total assets	<u>\$ 5,838</u>	<u>6,734</u>	<u>12,572</u>
Liabilities and net assets:			
Annuities payable	\$ 3,321	4,106	7,427
Net assets	2,517	2,628	5,145
Total liabilities and net assets	<u>\$ 5,838</u>	<u>6,734</u>	<u>12,572</u>

Pursuant to ORS 731.716 (1995), the University maintains a reserve adequate to meet the actuarially determined future payments of the Charitable Gift Annuities.

(15) Legal Contingencies

The University is subject to legal proceedings generally incidental to its business. Although the final outcome of any legal proceeding is subject to a great many variables and cannot be predicted with any degree of certainty, the University presently believes that the ultimate outcome resulting from these proceedings would not have a material effect on the University's financial position or results of operations.

(16) Self Insurance

The University has placed certain of its medical and dental insurance coverage with the Oregon Independent Colleges Employee Benefit Trust (OICEBT), formulated by seven similar western colleges and universities for the purpose of providing medical and dental insurance to higher education institutions. Under the agreement, member institutions are required to make contributions to the fund at such times and in an amount as determined by the Trustees for the various benefit programs sufficient to provide the benefits, pay the administrative expenses of the Plan which are not otherwise paid by the University directly, and to establish and maintain a minimum reserve as determined by the Trustee. In the event losses of OICEBT exceed its capital and secondary coverages, the maximum contingent liability exposure to the University is approximately \$738,000. This exposure will fluctuate based on factors including changes in actuarial assumptions, medical trend rates and reinsurance amounts.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2005 and 2004

(17) Fair Value of Financial Instruments

The University has estimated fair values of financial instruments using available market information and appropriate valuation methodologies. At May 31, 2005 and 2004, the carrying values of cash and cash equivalents, accounts and notes receivable, accounts payable, and accrued liabilities approximate fair value due to the short-term nature of these instruments. Taking into account current borrowing rates as of May 31, 2005, the fair value of the University's bonds approximates \$15,634,396 as compared to its carrying value of \$15,075,000.

(18) Subsequent Event

In August 2005, the University issued Oregon Facilities Authority Revenue Bonds in the amount of \$13,000,000. The bonds will have annual payment obligations ranging from \$671,000 to \$835,000 through 2036, and bear interest at rates ranging from 3% to 4%. The bond proceeds will be used primarily for construction of a new residence hall and to assist with other facility upgrades and improvements. The bonds have minimum payout schedules that call for principal payments of \$65,000 in 2007, \$230,000 in 2008, \$235,000 in 2009, \$245,000 in 2010, \$250,000 in 2011 and \$11,975,000 thereafter.

WILLAMETTE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2005

	Federal CFDA number	Expenditures
		<u> </u>
Student Financial Aid Cluster:		
Department of Education:		
Federal Pell Grant Program	84.063	\$ 1,027,190
Federal Pell Administrative Allowance	84.063	1,965
Federal Work Study	84.063	444,446
Federal Work Study Administrative Allowance	84.063	100,000
Supplemental Education Opportunity Grant	84.007	342,991
Supplemental Education Opportunity Grant transfer from CWS	84.007	181,482
Federal Perkins Loans	84.038	1,660,099
		<u>3,758,173</u>
Total Student Financial Aid Cluster		
National Science Foundation:		
NSF Grant – Willemson	47.049	41,747
NSF Grant – Williamson	47.049	7,528
NSF Grant – Hawke	47.049	2,079
		<u>51,354</u>
Total National Science Foundation		
Department of Education:		
DOE-PT3 grant	84.342	142,963
OACTE (Biffle)	84.336	1,758
Fulbright-Hayes DOE	84.021	26,255
NCLB-CLIM (Brown)	84.367	272
National Writing Project	84.928	24,840
		<u>196,088</u>
Total Department of Education		
Department of Agriculture:		
USDA – Leete	10.200	5,099
Department of Agriculture	10.200	10,254
		<u>15,353</u>
Total Department of Agriculture		
Total expenditures of federal awards		\$ <u><u>4,020,968</u></u>

See accompanying notes to schedule of expenditures of federal awards.

WILLAMETTE UNIVERSITY

Notes to Schedule of Expenditures of Federal Awards

Year ended May 31, 2005

(1) Summary of Significant Accounting Policies

The accompanying schedule of expenditures of federal awards includes all federal grants received by the University which had activity during the year ended May 31, 2005. This schedule has been prepared on the accrual basis of accounting and in accordance with OMB Circular A-133.

(2) Loan Program Administration

The University administers the following loan programs:

	<u>CFDA number</u>	<u>Outstanding balance at May 31, 2005</u>
Perkins loans	84.038	\$ 7,773,443

(3) Federal Family Education Loan Program (FFELP)

During the fiscal years ended May 31, 2005, the University processed the following amount of new loans under the FFELP (which includes Stafford Loans, and Parents' Loans for Undergraduate Students):

Stafford loans	84.032	\$ 14,729,826
Parents' loans for undergraduate students	84.032	<u>4,114,978</u>
Total		<u>\$ 18,844,804</u>

WILLAMETTE UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended May 31, 2005

(1) Summary of Auditors' Results

- (a) The type of report issued on the financial statements: **Unqualified opinion**
- (b) Reportable conditions in internal control disclosed by the audit of the financial statements: **None reported**
Material weaknesses: **No**
- (c) Noncompliance which is material to the financial statements: **No**
- (d) Reportable conditions in internal control over major programs: **Yes**
Material weaknesses: **No**
- (e) The type of report issued on compliance for major programs: **Unqualified opinion**
- (f) Any audit findings which are required to reported under Section .510(a) of OMB Circular A-133: **Yes**
- (g) Major programs: **Student Financial Aid Cluster**
- (h) Dollar threshold used to distinguish between Type A and Type B programs: **\$300,000**
- (i) Auditee qualified as a low-risk auditee under Section .530 of OMB Circular A-133: **Yes**

(2) Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*: None

(3) Findings and Questioned Costs Relating to Federal Awards: Yes

WILLAMETTE UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended May 31, 2005

Finding: 05-01

Federal Program: Student Financial Aid Cluster; CFDA Numbers 84.007 (SE OG), 84.032, (Stafford/PLUS Loans), 84.038 (Perkins Loans), 84.063 (Pell/Work Study)

Federal Agency: Department of Education

Award Year: 2004-2005

Criteria: In the process of a student applying for ED Federal financial aid, an Institutional Student Information Record (ISIR) is sent electronically to the institution. The original ISIR for an award year may contain codes that relate to student eligibility requirements. If the original ISIR does not contain codes relating to those eligibility requirements, and the institution has no information indicating otherwise, the student can be considered to have met them. The institution must clear the codes provided.

Statement of Condition: After the initial review and resolution of ISIR questions is completed by University personnel, there is no secondary level of review performed over the initial clearing of these questions by University personnel to ensure that the questions were resolved properly and to ensure the student's eligibility is accurate.

Questioned Costs: None

Cause of Effect: The process of not having a secondary level of review performed is caused by the University not having a policy in place which requires review of initial work performed by University personnel to resolve ISIR questions and to ensure student is eligible to receive federal awards.

Recommendation: KPMG recommends that the University implement a policy that requires a secondary review of initial work performed by University personnel over verification of student eligibility to receive federal awards.

Willamette Response: Willamette University is implementing a quality assurance plan over eligibility verification procedures. After the initial clearing of ISIR questions and student verification is completed by a student financial aid staff member, the University will now have a second staff member review verified files to ensure that all ISIR questions have been resolved appropriately and student is eligible to receive ED Federal financial aid.