

WILLAMETTE UNIVERSITY

OMB Circular A-133
Supplementary Financial Report

May 31, 2006

(With Independent Auditors' Report Thereon)

WILLAMETTE UNIVERSITY

OMB Circular A-133
Supplementary Financial Report

May 31, 2006

Table of Contents

	Page
Independent Auditors' Reports:	
Independent Auditors' Report	I-1
Independent Auditors' Report on Internal Control over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	I-3
Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133	I-5
Financial Statements:	
Statements of Financial Position	II-1
Statements of Activities	II-2
Statements of Cash Flows	II-4
Notes to Financial Statements	II-5
Other Schedules:	
Schedule of Expenditures of Federal Awards	III-1
Notes to Schedule of Expenditures of Federal Awards	III-2
Schedule of Findings and Questioned Costs	III-3



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

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, 2006 and 2005, 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Willamette University as of May 31, 2006 and 2005, 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.

As discussed in Note 2(m) to the financial statements, the University changed its method of accounting for conditional asset retirement obligations in 2006.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 29, 2006 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 audit 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

September 29, 2006



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, 2006, and have issued our report thereon dated September 29, 2006. As discussed in Note 2(m) to the financial statements, the University changed its method of accounting for conditional asset retirement obligations in 2006. 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 audit, 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 audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no 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 September 29, 2006.

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

September 29, 2006



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, 2006. 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, 2006, other than those requirements discussed in the following paragraph. 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 06-01.

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 06-01.

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 the reportable condition described above is not 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

January 8, 2007

WILLAMETTE UNIVERSITY

Statements of Financial Position

May 31, 2006 and 2005

(Dollars in thousands)

Assets	2006	2005
Cash and cash equivalents	\$ 19,419	20,010
Accounts receivable, net of allowances of \$295 and \$299 in 2006 and 2005, respectively	1,680	1,474
Pledges receivable, net of allowances of \$164 and \$164 in 2006 and 2005, respectively	4,982	7,117
Inventories and prepaid expenses	1,119	1,482
Student loans receivable, net of allowances of \$75 and \$79 in 2006 and 2005, respectively	7,782	7,795
Notes receivable and other assets	1,652	1,271
Investments	254,968	228,767
Present value of assets held in remainder trusts by others	1,579	1,349
Plant facilities, net	<u>103,523</u>	<u>89,699</u>
Total assets	\$ <u>396,704</u>	<u>358,964</u>
Liabilities and Net Assets		
Liabilities:		
Note payable to bank – line of credit	\$ 4,534	3,200
Accounts payable and accrued liabilities	14,045	10,692
Deferred revenue	1,295	960
U.S. Government loan advances refundable	6,557	6,476
Annuities and trusts payable	7,697	7,427
Note payable	268	295
Bonds payable	<u>28,075</u>	<u>15,230</u>
Total liabilities	<u>62,471</u>	<u>44,280</u>
Net assets:		
Unrestricted:		
Available for operations	2,425	—
Designated for endowment	137,647	55,320
Invested in plant facilities	33,629	34,507
Designated for plant facilities and other purposes	<u>453</u>	<u>2,792</u>
Total unrestricted net assets	<u>174,154</u>	<u>92,619</u>
Temporarily restricted:		
Accumulated endowment gains	—	68,519
Trusts and annuities	1,947	3,041
Invested in plant facilities	47,926	49,064
Unexpended funds received for specific purposes	<u>8,334</u>	<u>6,715</u>
Total temporarily restricted net assets	<u>58,207</u>	<u>127,339</u>
Permanently restricted:		
Endowment	93,954	88,171
Endowment – assets held in perpetual trust by others	2,366	2,366
Trusts and annuities	4,512	3,172
Student loans	<u>1,040</u>	<u>1,017</u>
Total permanently restricted net assets	<u>101,872</u>	<u>94,726</u>
Total net assets	<u>334,233</u>	<u>314,684</u>
Total liabilities and net assets	\$ <u>396,704</u>	<u>358,964</u>

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statement of Activities

Year ended May 31, 2006

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, and other support:				
Student charges:				
Tuition and fees	\$ 66,402	—	—	66,402
Less student scholarships	(28,279)	—	—	(28,279)
Net tuition and fees	38,123	—	—	38,123
Room and board fees	8,274	—	—	8,274
Contributions	2,146	2,056	6,534	10,736
Endowment income distributed	7,541	5,534	24	13,099
Auxiliary enterprises	2,705	—	—	2,705
U.S. Government grants	610	772	—	1,382
Other income	2,287	—	—	2,287
Net assets released from restrictions	7,313	(7,313)	—	—
Total revenues, gains, and other support	68,999	1,049	6,558	76,606
Expenses:				
Instruction	30,683	—	—	30,683
Research	931	—	—	931
Academic support	13,089	—	—	13,089
Student services	7,806	—	—	7,806
General institutional support	9,319	—	—	9,319
Room and board program	6,336	—	—	6,336
Auxiliary enterprises	2,593	—	—	2,593
Total expenses	70,757	—	—	70,757
Change in net assets before other changes	(1,758)	1,049	6,558	5,849
Other changes:				
Endowment income, net of distributions	13,792	—	212	14,004
Adjustment related to annuities and trusts	—	754	(101)	653
Student loan interest and cancellations	12	—	—	12
Other	—	(341)	(460)	(801)
Reclassification of net assets	69,657	(70,594)	937	—
Changes in net assets	81,703	(69,132)	7,146	19,717
Cumulative effect of change in accounting principle	(168)	—	—	(168)
Total changes in net assets	81,535	(69,132)	7,146	19,549
Net assets, beginning of year	92,619	127,339	94,726	314,684
Net assets, end of year	\$ 174,154	58,207	101,872	334,233

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Statement of Activities

Year ended May 31, 2005

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
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

Statements of Cash Flows

Years ended May 31, 2006 and 2005

(Dollars in thousands)

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Change in net assets	\$ 19,549	14,660
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	3,994	3,729
Net realized and unrealized gains on investments	(24,151)	(17,820)
Contributions restricted for long-term investment	(6,722)	(5,736)
Proceeds subject to annuity and unitrust agreements	(702)	(238)
Increase in accounts receivable	(206)	(340)
(Increase) decrease in interest and dividends receivable	(48)	31
Decrease in pledges receivable	2,135	2,810
Decrease (increase) in inventories and prepaid expenses	363	(524)
Decrease (increase) in student loans receivable	13	(274)
(Increase) decrease in notes receivable and other assets	(381)	316
Increase in assets held in remainder trusts by others, net	(230)	(213)
Increase in accounts payable and accrued liabilities	79	1,460
Increase in deferred revenue	335	152
Increase in annuities and trusts payable	270	336
Net cash used in operating activities	<u>(5,702)</u>	<u>(1,651)</u>
Cash flows from investing activities:		
Purchases of investments	(139,299)	(104,955)
Proceeds from maturities/sales of investments	137,297	105,695
Purchase of plant facilities	(14,544)	(3,451)
Net cash used in investing activities	<u>(16,546)</u>	<u>(2,711)</u>
Cash flows from financing activities:		
Proceeds (repayments) from borrowing under line of credit, net	1,334	(1,700)
Cash contributions restricted for:		
Investment in endowment	6,035	5,367
Investment in plant facilities	687	369
Investment subject to annuity and unitrust agreements	702	238
(Payments on) proceeds from note payable	(27)	186
Increase in U.S. Government loan advances refundable	81	108
Principal payments on bonds payable	(690)	—
Proceeds from bonds payable	13,535	7,495
Net cash provided by financing activities	<u>21,657</u>	<u>12,063</u>
Net (decrease) increase in cash and cash equivalents	(591)	7,701
Cash and cash equivalents, beginning of year	<u>20,010</u>	<u>12,309</u>
Cash and cash equivalents, end of year	\$ <u>19,419</u>	\$ <u>20,010</u>
Supplemental cash flow information:		
Cash paid for interest	\$ 1,103	581

See accompanying notes to financial statements.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

(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, 2006 include \$69,657,000 that was transferred from temporarily restricted net assets to correctly reflect accumulated gains on endowed investments.

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, 2006 and 2005

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.

(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.

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.

(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.

(e) *Investments*

Investments in marketable equity securities and all debt securities are stated at fair value. The fair value of all debt and equity securities with a readily determinable fair value are based on quotations obtained from national securities exchanges. The alternative investments, which are not readily marketable, are carried at estimated fair values provided by the investment managers. Willamette University reviews and evaluates the values provided by the investment managers and agrees the valuation methods and assumptions used in determining the fair value of the alternative investments. Those estimated fair values may differ significantly from the values that would have been used had a

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

ready market for those securities existed. 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. Realized and unrealized gains and losses on investments are reflected in the statements of activities as endowment investment income.

(f) Split Interest Agreements

The University uses the actuarial method of recording certain split interest arrangements. Under this method, the present value of the payments to beneficiaries is determined based upon life expectancy tables when the gift is received. The present value of those payments is recorded as a liability and the remainder as temporarily or permanently restricted net assets depending on donor-imposed restrictions. Periodic adjustments are made between the liability and the net assets to record actuarial gains or losses. The discount rate used by the University in calculating the present value of all split interest agreements ranges from 4% - 8% at May 31, 2006.

(g) 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

(h) Inventory

Inventory consists primarily of books and supplies and is recorded at the lower of cost (first-in first out) or market.

(i) Bond Issuance Costs

Bond issuance costs include amounts paid by the University in connection with the issuance of 2004 and 2005 Oregon Facilities Authority Revenue Bonds. Bond issuance costs are reported as a component of notes receivable and other assets in the accompanying statements of financial position. Amortization is calculated using a method that approximates effective yield over the life of the bonds.

(j) 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.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

(k) 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).

(l) Deferred Revenue

Deferred revenue consists primarily of prepayments of tuition and fees related to future academic terms.

(m) New Accounting Pronouncements

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47). Under FIN 47, costs related to legal obligations to perform certain activities in connection with the retirement, disposal, or abandonment of assets are required to be accrued.

The University has identified asbestos abatement as a conditional asset retirement obligation. Asbestos abatement costs were estimated using a per square foot estimate. The University recorded site improvements of \$64,000 related accumulated depreciation of \$13,000, an asset retirement obligation (included in accounts payable and accrued liabilities) of \$225,000, and a cumulative effect of change in accounting principle of \$168,000 at May 31, 2006.

(n) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to current year presentation.

(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>2006</u>	<u>2005</u>
Less than one year	\$ 2,440	3,349
One to five years	3,025	4,276
More than five years	—	168
	<u>5,465</u>	<u>7,793</u>
Less discount	(319)	(512)
Less reserve for uncollectible accounts	<u>(164)</u>	<u>(164)</u>
Total pledges receivable	<u>\$ 4,982</u>	<u>7,117</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

During 2006, conditional promises in the amount of \$3,825,000 were received, but not recognized as a receivable.

(4) Accounts and Student Loans Receivable

Accounts receivable consist of the following at May 31, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Student accounts receivable	\$ 895	692
Related parties	350	440
Collections	250	179
Other receivables	480	462
	<u>1,975</u>	<u>1,773</u>
Less allowance for doubtful accounts	<u>(295)</u>	<u>(299)</u>
	<u>\$ 1,680</u>	<u>1,474</u>

Student loans receivable consist of the following at May 31, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Notes receivable	\$ 93	101
Perkins loans	7,764	7,773
	<u>7,857</u>	<u>7,874</u>
Less allowance for doubtful accounts	<u>(75)</u>	<u>(79)</u>
	<u>\$ 7,782</u>	<u>7,795</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% - 5%, over approximately 10 years following university 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, 2006 and 2005

(5) Investments

Investments at May 31, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Short-term investments, notes, commercial paper, money markets	\$ 8,003	4,175
Interest and dividends receivable	101	54
Bonds and notes	48,218	33,665
Corporate stocks	125,426	122,389
Private equity, venture capital, and real estate investment trust	32,525	19,785
Hedge funds	35,108	43,171
Land held for resale	3,222	3,162
Perpetual trusts	2,365	2,366
	<u>\$ 254,968</u>	<u>228,767</u>

At May 31, 2006, the University has approximately \$67.6 million in investments which are not readily marketable. These investments represent 26% of total investments and 20% of net assets at May 31, 2006. These investment instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and non-marketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such difference could be material. Total investment income and realized and unrealized gains on investments which are not readily marketable was \$311,000 for the year ended May 31, 2006.

The University has committed \$64,000 to private equity funds in the form of limited partnership/trust investments. As of May 31, 2006, Willamette University has funded approximately \$17,000 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.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

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

Endowment and quasi-endowment net asset balances, including life income net assets, at May 31, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Original historic gift value	\$ 116,103	109,885
Net increase in market price of investments:		
Realized	90,129	80,127
Unrealized	34,192	30,577
Total fair value	\$ <u>240,424</u>	<u>220,589</u>

	<u>2006</u>	<u>2005</u>
Unrestricted net assets	\$ 137,647	55,320
Temporarily restricted net assets	1,947	71,560
Permanently restricted net assets	100,830	93,709
Total	\$ <u>240,424</u>	<u>220,589</u>

(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>2006</u>	<u>2005</u>
Dividends and interest	\$ 3,280	2,831
Net realized gains	20,408	11,720
Net change in cumulative unrealized gains and losses	3,743	6,100
Investment fees	(328)	(229)
Total	\$ <u>27,103</u>	<u>20,422</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

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

	<u>2006</u>	<u>2005</u>
Revenues:		
Unrestricted	\$ 7,541	7,459
Temporarily restricted	5,534	4,104
Permanently restricted	24	23
	<u>13,099</u>	<u>11,586</u>
Other changes in net assets:		
Unrestricted	13,792	8,446
Permanently restricted	212	390
	<u>14,004</u>	<u>8,836</u>
Total	\$ <u>27,103</u>	<u>20,422</u>

The fair value of all endowed and life income fund investments at May 31, 2006 and 2005 is as follows (in thousands):

	<u>Fair value</u>	
	<u>2006</u>	<u>2005</u>
General and quasi-endowment funds	\$ 233,965	214,376
Annuity and trust funds	14,156	13,641
Total fair value	\$ <u>248,121</u>	<u>228,017</u>

(8) Plant Facilities

Plant facilities consist of the following at May 31, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Land and land improvements	\$ 13,592	10,435
Buildings	98,604	94,249
Furniture, fixtures, and equipment	5,284	5,230
Library holdings	28,975	27,472
Art collection	1,969	1,956
Construction in progress	9,143	444
Accumulated depreciation	<u>(54,044)</u>	<u>(50,087)</u>
Net plant facilities	\$ <u>103,523</u>	<u>89,699</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

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 \$1,969,000 at May 31, 2006 and \$1,956,000 at May 31, 2005 in the plant facilities balance in the statements 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 \$458,000 to \$1,332,000 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 to finance additional facilities for the University.

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 5%. The bond proceeds were used primarily to fund constructions of a new residential commons and to assist with other facility upgrades and improvements.

Principal payments on bonds payable are as follows:

2007	\$	775,000
2008		1,100,000
2009		1,125,000
2010		1,165,000
2011		1,200,000
Thereafter		<u>22,020,000</u>
		27,385,000
Add unamortized bond premium		<u>690,000</u>
	\$	<u><u>28,075,000</u></u>

The University has a revolving line of credit at a variable interest rate that is calculated at the LIBOR rate plus 45 basis points (5.84% at May 31, 2006). As of May 31, 2006, there were draws of \$4,534,000 outstanding against this line.

Interest expense for the years ended May 31, 2006 and 2005 was approximately \$1,201,000 and \$581,000, respectively.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

(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, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Purpose of restricted contributions:		
Instruction	\$ 679	316
Sponsored research	230	305
Academic support	453	166
Student services	16	8
Institutional Support	5	—
Scholarships	4,542	4,791
Plant	22	17
	<u>5,947</u>	<u>5,603</u>
Time restricted contributions:		
Amortization of restricted gifts to acquire long-lived assets	<u>1,366</u>	<u>1,382</u>
Total net assets released from restrictions	<u>\$ 7,313</u>	<u>6,985</u>

(11) Institutional Support Fund Raising Expense

Fund raising expenses of \$2,705,000 and \$2,058,000 are included in general institutional support expenses in the statement of activities for the years ended May 31, 2006 and 2005, 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, 2006 and 2005 was approximately \$2,912,000 and \$2,653,000, 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.

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

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.

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, 2006, associated with the above-described benefits. The liability estimates are discounted from estimated future costs using a 6% 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 \$290,000 for the year ended May 31, 2006.

Accumulated post-retirement obligation at May 31, 2006 and 2005 is as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Medicare Supplement - Up to \$125 per quarter:		
For 76 and 77 current retirees at May 31, 2006 and 2005, respectively	\$ 389,000	381,000
For 49 and 53 current employees at May 31, 2006 and 2005, respectively	206,000	217,000
Full Medicare Supplement:		
For 2 and 3 pre-1977 retirees at May 31, 2006 and 2005, respectively	31,000	42,000
Health Insurance Until Medicare Eligibility:		
For 14 and 11 early retirees at May 31, 2006 and 2005, respectively	156,000	152,000
For an estimated 474 and 440 future early retirees at May 31, 2006 and 2005, respectively	1,452,000	1,578,000
Voluntary Severance Payments:		
For 14 and 11 early retirees at May 31, 2006 and 2005, respectively	415,000	531,000
For an estimated 474 and 440 future early retirees at May 31, 2006 and 2005, respectively	<u>1,827,000</u>	<u>1,953,000</u>
Accrued post-retirement benefit cost	<u>\$ 4,476,000</u>	<u>4,854,000</u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

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

2007	\$	303,000
2008		317,000
2009		331,000
2010		346,000
2011		362,000
Thereafter		<u>2,817,000</u>
	\$	<u><u>4,476,000</u></u>

(14) Annuities and Life Income Funds

Annuities and life income funds consist of the following at May 31, 2006 (in thousands):

	<u>Charitable gift annuities</u>	<u>Annuity trusts and unitrusts</u>	<u>Total</u>
Assets:			
Investments	<u>5,657</u>	<u>7,002</u>	<u>12,659</u>
Total assets	\$ <u><u>5,657</u></u>	<u><u>7,002</u></u>	<u><u>12,659</u></u>
Liabilities and net assets:			
Annuities payable	\$ 3,497	4,200	7,697
Net assets	<u>2,160</u>	<u>2,802</u>	<u>4,962</u>
Total liabilities and net assets	\$ <u><u>5,657</u></u>	<u><u>7,002</u></u>	<u><u>12,659</u></u>

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	<u>4,504</u>	<u>6,142</u>	<u>10,646</u>
Land	<u>1,325</u>	<u>592</u>	<u>1,917</u>
Total assets	\$ <u><u>5,838</u></u>	<u><u>6,734</u></u>	<u><u>12,572</u></u>
Liabilities and net assets:			
Annuities payable	\$ 3,321	4,106	7,427
Net assets	<u>2,517</u>	<u>2,628</u>	<u>5,145</u>
Total liabilities and net assets	\$ <u><u>5,838</u></u>	<u><u>6,734</u></u>	<u><u>12,572</u></u>

WILLAMETTE UNIVERSITY

Notes to Financial Statements

May 31, 2006 and 2005

(15) 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, 2006 and 2005, 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, 2006, the fair value of the University's bonds approximates \$28,190,000 as compared to its carrying value of \$28,075,000. Fair value of the bonds as of May 31, 2006 reflects the difference between current market rate and the University's actual average interest rate being paid on all debt obligations.

(16) Commitments and 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.

(17) Self Insurance

The University has placed certain of its medical and dental insurance coverage with the Pioneer Educators Health Trust (PEHT), 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 PEHT exceed its capital and secondary coverages, the maximum contingent liability exposure to the University is approximately \$1,071,000. This exposure will fluctuate based on factors including changes in actuarial assumptions, medical trend rates and reinsurance amounts. The level of reinsurance is not expected to fluctuate significantly in the future.

WILLAMETTE UNIVERSITY

Schedule of Expenditures of Federal Awards

Year ended May 31, 2006

	Federal CFDA number	Expenditures
		<u> </u>
Student Financial Aid Cluster:		
Department of Education:		
Federal Pell Grant Program	84.063	\$ 991,014
Federal Pell Administrative Allowance	84.063	1,790
Federal Work Study	84.063	384,841
Federal Work Study Administrative Allowance	84.063	99,000
Supplemental Education Opportunity Grant	84.007	492,442
Supplemental Education Opportunity Grant transfer from CWS	84.007	161,280
Federal Perkins Loans	84.038	1,574,435
		<u>3,704,802</u>
Total Student Financial Aid Cluster		
National Science Foundation:		
NSF Grant – Willemson	47.049	38,000
NSF Grant – Williamson	47.049	18,656
NSF Grant - Stavrianeas	47.049	56,021
NSF Grant – Hawke	47.049	920
		<u>113,597</u>
Total National Science Foundation		
Department of Education:		
OACTE (Biffle)	84.336	1,042
Fulbright-Hayes DOE	84.021	4,815
National Writing Project	84.928	41,363
		<u>47,220</u>
Total Department of Education		
Department of Agriculture:		
USDA – Leete	10.200	11,995
Department of Agriculture	10.200	819
		<u>12,814</u>
Total Department of Agriculture		
Department of Defense:		
EARP	12.000	7,891
		<u>7,891</u>
Total expenditures of federal awards		<u><u>\$ 3,886,324</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, 2006

(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, 2006. 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>Amount outstanding May 31, 2006</u>
Perkins loans	84.038	\$ 7,763,054

The amount of Perkins loan disbursements shown on the Schedule of Expenditures of Federal Awards includes the fiscal years administrative cost allowance of \$78,522.

(3) Federal Family Education Loan Program (FFELP)

During the fiscal years ended May 31, 2006, 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	\$ 15,236,002
Parents' loans for undergraduate students	84.032	<u>5,922,868</u>
Total		<u>\$ 21,158,870</u>

WILLAMETTE UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended May 31, 2006

(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 - See 06-01

WILLAMETTE UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended May 31, 2006

Finding: 06-01

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

Federal Agency: Department of Education

Award Year: 2005-2006

Criteria: 34 CFR section 668.173(b) requires that return of title IV funds are required to be deposited or transferred into the student financial aid account to the ED or the appropriate FFEI lender as soon as possible, but no later than 30 days after the date the institution determines that the student withdrew.

Statement of Condition: A student withdrew from the University on September 2, 2005 and the University did not return the title IV funds to the appropriate lender until October 7, 2005. This time period between when the University determined the student withdrew and the day in which the funds were returned to the appropriate lender was 35 days which is greater than the allowed time period of 30 days per 34 CFR section 668.173(b).

Questioned Costs: None

Cause of Effect: This condition is caused by the University processing the return of title IV funds on a weekly basis which sometimes does not allow the University to account for the return of title IV funds within the 30 day period after the student withdrawal.

Recommendation: KPMG recommends the University implement a policy that requires a more timely processing of return of title IV funds.

Willamette Response: The University is implementing a quality assurance plan to change its timeframe for processing return of title IV funds from a weekly to a daily basis to ensure that the appropriate lender is notified within 30 days of the University becoming aware the change in student status.