

University of San Francisco

Financial Statements as of and for the
Years Ended May 31, 2012 and 2011, and
Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the
University of San Francisco
San Francisco, California

We have audited the accompanying statements of financial position of the University of San Francisco (the "University") as of May 31, 2012 and 2011, and the related statements of activities and changes in net assets and of 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. 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, such financial statements present fairly, in all material respects, the financial position of the University as of May 31, 2012 and 2011, 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.

Deloitte + Touche LLP

September 27, 2012

UNIVERSITY OF SAN FRANCISCO

STATEMENTS OF FINANCIAL POSITION

AS OF MAY 31, 2012 AND 2011

(In thousands)

	2012	2011
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 104,405	\$ 112,364
RECEIVABLES:		
Student accounts, net	6,701	7,195
Contributions, net	28,475	25,204
Student loans, net	11,303	11,676
Other	7,826	5,826
INVESTMENTS	221,717	235,296
RESTRICTED INVESTMENTS		5,000
BENEFICIAL INTEREST IN TRUSTS	14,767	14,601
PREPAID EXPENSES AND OTHER ASSETS	8,804	7,635
PROPERTY, PLANT, AND EQUIPMENT — Net	<u>393,812</u>	<u>325,376</u>
TOTAL	<u>\$ 797,810</u>	<u>\$ 750,173</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued liabilities	\$ 41,365	\$ 39,775
Asset retirement obligations	1,639	2,106
Liability under split-interest agreements	1,988	2,040
Liability under interest rate swap agreements	20,769	11,350
Deferred revenue	29,513	28,726
Federal student loan funds refundable	10,206	10,007
Bonds payable	159,005	162,595
Notes payable	<u>27,500</u>	
Total liabilities	<u>291,985</u>	<u>256,599</u>
NET ASSETS:		
Unrestricted	303,897	290,073
Temporarily restricted	78,458	89,296
Permanently restricted	<u>123,470</u>	<u>114,205</u>
Total net assets	<u>505,825</u>	<u>493,574</u>
TOTAL	<u>\$ 797,810</u>	<u>\$ 750,173</u>

See notes to financial statements.

UNIVERSITY OF SAN FRANCISCO

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED MAY 31, 2012 (In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES AND OTHER SUPPORT:				
Tuition and fees	\$ 310,913	\$ -	\$ -	\$ 310,913
Grants and contracts	13,618			13,618
Investment income	967	2,524		3,491
Contributions	5,560	5,675	9,954	21,189
Net realized and unrealized gain/(loss) on investments	(2,176)	(8,554)	(42)	(10,772)
Change in value of split-interest agreements		(6)	(647)	(653)
Change in value of interest rate swap agreements	(9,418)			(9,418)
Auxiliary revenue	33,242			33,242
Other	4,927			4,927
Total revenues	357,633	(361)	9,265	366,537
Net assets released from restrictions	10,477	(10,477)		
Total revenues and other support	368,110	(10,838)	9,265	366,537
EXPENSES — Program expenses:				
Instruction	136,580			136,580
Research	3,224			3,224
Public service	2,157			2,157
Academic support	27,385			27,385
Student services	39,359			39,359
Institutional support	42,288			42,288
Scholarships and fellowships	73,945			73,945
Auxiliary enterprises	29,348			29,348
Total expenses	354,286	-	-	354,286
INCREASE / (DECREASE) IN NET ASSETS	13,824	(10,838)	9,265	12,251
NET ASSETS — Beginning of year	290,073	89,296	114,205	493,574
NET ASSETS — End of year	\$ 303,897	\$ 78,458	\$ 123,470	\$ 505,825

See notes to financial statements.

UNIVERSITY OF SAN FRANCISCO

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED MAY 31, 2011 (In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES AND OTHER SUPPORT:				
Tuition and fees	\$ 291,768	\$ -	\$ -	\$ 291,768
Grants and contracts	12,996			12,996
Investment income	1,282	2,856		4,138
Contributions	12,428	15,808	1,632	29,868
Net realized and unrealized gain/(loss) on investments	7,231	24,205		31,436
Change in value of split-interest agreements		1,064	487	1,551
Change in value of interest rate swap agreements	269			269
Gain on extinguishment of debt	1,984			1,984
Auxiliary revenue	30,810			30,810
Other	3,547			3,547
Total revenues	362,315	43,933	2,119	408,367
Net assets released from restrictions	13,924	(13,924)	-	-
Total revenues and other support	376,239	30,009	2,119	408,367
EXPENSES — Program expenses:				
Instruction	126,535			126,535
Research	2,883			2,883
Public service	1,997			1,997
Academic support	25,895			25,895
Student services	30,631			30,631
Institutional support	39,185			39,185
Scholarships and fellowships	71,389			71,389
Auxiliary enterprises	27,389			27,389
Total expenses	325,904	-	-	325,904
INCREASE IN NET ASSETS	50,335	30,009	2,119	82,463
NET ASSETS — Beginning of year	239,738	59,287	112,086	411,111
NET ASSETS — End of year	\$ 290,073	\$ 89,296	\$ 114,205	\$ 493,574

See notes to financial statements.

UNIVERSITY OF SAN FRANCISCO

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED MAY 31, 2012 AND 2011 (In thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	\$ 12,251	\$ 82,463
Adjustment to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation	16,423	15,001
Accretion of asset retirement obligation liability	(467)	(151)
Amortization of bond issuance costs	(20)	206
Amortization of lease intangibles	382	
Provision for bad debt	649	935
Discount on contribution receivable	(139)	(37)
Forgiveness of employee notes	161	262
Net realized and unrealized (gain)/loss on investments	10,772	(31,436)
Change in value of split-interest agreements	743	(1,482)
Change in value of interest rate swap agreements	9,418	(3,340)
Gain on extinguishment of debt		(1,984)
Gain on disposal of assets	(227)	(39)
Contributions restricted for investment in endowment and plant	(5,244)	(16,202)
Distributions of interest in trusts	211	
Gifts of investments	(1,287)	(2,767)
Changes in:		
Student accounts receivable	(183)	521
Contributions receivable	(3,104)	(6,816)
Other receivables	(2,244)	2,277
Prepaid expenses and other assets	244	(181)
Accounts payable and accrued liabilities	(1,442)	7,136
Liability under split-interest agreements	(52)	(115)
Deferred revenue	787	6,240
Net cash provided by operating activities	<u>37,632</u>	<u>50,491</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property, plant, and equipment	(83,558)	(29,055)
Proceeds from disposal of assets	227	39
Proceeds from sale of investments	61,471	46,804
Purchases of investments	(53,497)	(54,456)
Issuance of student loans	(1,262)	(740)
Student loan repayments	1,635	1,448
Issuance of employee notes	(152)	(191)
Employee notes repayments	235	1,230
Net cash used in investing activities	<u>(74,901)</u>	<u>(34,921)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of bonds payable		79,770
Proceeds from issuance of notes payable	27,500	
Payments on bonds payable	(3,570)	(81,039)
Premium on bonds payable		330
Debt issuance costs	(63)	(950)
Contributions restricted for investment in endowment and plant	5,244	16,202
Net change in federal student loan funds refundable	199	182
Net cash provided by financing activities	<u>29,310</u>	<u>14,495</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(7,959)	30,065
CASH AND CASH EQUIVALENTS — Beginning of year	<u>112,364</u>	<u>82,299</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 104,405</u>	<u>\$ 112,364</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION — Interest paid	<u>\$ 8,977</u>	<u>\$ 6,042</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES — Additions to property, plant, and equipment included in accounts payable and accrued liabilities	<u>\$ 3,899</u>	<u>\$ 2,767</u>

See notes to financial statements.

UNIVERSITY OF SAN FRANCISCO

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED MAY 31, 2012 AND 2011

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization — The University of San Francisco (the “University”) was founded by the Society of Jesus in 1855. The University is committed to the highest standards of learning and scholarship in the American, Catholic, and Jesuit traditions. The University balances its primary commitment to the liberal arts and sciences with its dedication to educating for the professions.

Basis of Accounting — The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”), which include the principles of not-for-profit accounting as defined by the Financial Accounting Standards Board (FASB). The accounting principles require that unconditional promises to give be recorded as receivables and revenues within the appropriate net asset category and that classification of net assets and its associated revenues, gains, and losses be divided into three categories, based on the existence or absence of externally imposed restrictions. Accordingly, net assets of the University are classified and defined as follows:

Unrestricted Net Assets — Unrestricted net assets are not subject to donor-imposed stipulations and are available to support the University’s operating activities. Unrestricted net assets include temporarily restricted resources that become available for use by the University in accordance with the intentions of the donors. Unrestricted net assets may be designated for specific purposes by action of the board of trustees (the “Board”) or by management.

Temporarily Restricted Net Assets — Temporarily restricted net assets are contributions whose use is limited by donor-imposed stipulations that will either expire with the passage of time or be fulfilled and removed by actions of the University pursuant to those stipulations.

Permanently Restricted Net Assets — Permanently restricted net assets result from contributions whose use is limited by donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the University. The earnings from these investments are primarily available to support activities of the University as designated by the donor.

Cash and Cash Equivalents — Cash and cash equivalents include cash on deposit, money market funds, fixed-income securities with a maturity of three months or less, and variable rate demand notes which have a put feature that allow the University to put the notes back to the issuer on the daily interest reset date.

Student Accounts Receivable — Student accounts receivable are amounts due from students primarily for tuition and fees and are stated at the amount billed to students less applied scholarships and loan proceeds. The University also offers several payment plans that allow students to defer payment for a nominal fee. Late fees are charged on delinquent accounts. The University records an allowance for doubtful student accounts receivable that is based on various factors, such as historical collection information and existing economic conditions. Delinquent accounts are written off based on evaluation of the student’s specific circumstances. Student accounts receivable totaled \$8,918,000 and \$9,682,000 as of May 31, 2012 and 2011, respectively. Student accounts receivable allowance for bad debt is calculated as \$2,217,000 and \$2,487,000 as of May 31, 2012 and 2011, respectively.

Student Loans Receivable — Student loans receivable are primarily amounts loaned to students under the Federal Perkins Loan Program, Nursing Student Loans and Nursing Faculty Loan Program and are stated at their outstanding principal amount. Principal and interest payments on loans generally do not commence until after the borrower graduates or otherwise ceases enrollment. The University records an allowance for doubtful student loans receivable based on historical collection information and existing economic conditions.

Investments — Investments represent a diversified portfolio of equity and fixed-income investments, private capital, real asset funds, hedge funds, life income, annuity, and trust funds, and real estate. Investments received through gifts are recorded at fair value on the date of donation.

Assets Held in Charitable Remainder Trusts and Liability to Beneficiaries of Trust Agreements — Assets held in charitable remainder trusts are recognized at fair value when irrevocable trusts naming the University as a beneficiary are executed. Additionally, charitable remainder trusts that name the University as trustee are executed with a corresponding liability to beneficiaries of trust agreements. Such liability is calculated as the present value of the estimated future cash flows to be distributed to the income beneficiaries over their expected lives. The University has determined such liability using investment returns consistent with the composition of investment portfolios, single or joint life expectancies from the 2000CM Internal Revenue Service (IRS) mortality table, and an average discount rate of 5.2%.

As of May 31, 2012 and 2011, investments in marketable securities include \$1,770,000 and \$1,941,000, respectively, in assets held by the University, as trustee, on which investment income is paid to designated beneficiaries until death, at which time the assets may be used by the University as designated by the donor. Liabilities to such beneficiaries of \$739,000 and \$818,000 are included in liability under split interest agreements as of May 31, 2012 and 2011, respectively. The University holds a beneficial interest in such trusts where the University is not the trustee which includes \$12,300,000 and \$12,684,000 as of May 31, 2012 and 2011, respectively.

Life Income, Annuity, and Trust Funds — Life income, annuity, and trust funds represent unconditional promises to give assets to the University upon the death of the designated beneficiaries, some of whom receive income on the assets until death. Such funds are recorded by the University at the actuarially determined present value, and the University has determined such liability using investment returns consistent with the composition of investment portfolios, single or joint life expectancies from the 2000CM IRS mortality table, and an average discount rate of 4.18%.

As of May 31, 2012 and 2011, investments in marketable securities include \$2,324,000 and \$2,429,000, respectively, in assets held by the University, as trustee, on which investment income is paid to designated beneficiaries until death, at which time the assets may be used by the University as designated by the donor. Liabilities to such beneficiaries of \$1,248,000 and \$1,222,000 are included in liability under split-interest agreements as of May 31, 2012 and 2011, respectively. The University holds a beneficial interest in such trusts where the University is not the trustee which includes \$2,467,000 and \$1,917,000 as of May 31, 2012 and 2011, respectively.

As of May 31, 2012 and 2011, investments include \$284,000 and \$303,000, respectively, in pooled income funds where the University is the trustee.

Prepaid Expenses and Other Assets — Prepaid expenses and other assets include bond issuance costs, which are amortized using the effective interest method. The unamortized bond issuance costs were \$2,327,000 and \$2,367,000 as of May 31, 2012 and 2011, respectively.

Property, Plant, and Equipment — Purchased assets are recorded at cost. Donated assets are recorded at fair value or appraised value on the date of donation. The carrying value of all long-lived assets is evaluated periodically to determine whether adjustment to the useful life or to the undepreciated balance is warranted.

Upon acquisition of a property, the University estimates the fair value of acquired tangible assets (consisting of land, buildings and improvements) and intangible assets and liabilities (consisting of above and below market leases and origination value of all in-place leases). The University determines fair values using replacement cost, estimated cash flow projections and other valuation techniques and applying appropriate discount and capitalization rates based on available market information.

The fair value of the tangible assets is determined by valuing the property as if it were vacant. Land values are derived from current comparative sales values. Building values are calculated as replacement cost less depreciation, or management's estimates of the fair value of these assets using discounted cash flows analyses or similar methods. The fair value of the above and below market leases is based on the present value of the difference between the contractual amounts to be received pursuant to the acquired leases (using a discount rate that reflects the risks associated with the acquired leases) and the University's estimate of the current market lease rates measured over a period equal to the remaining term of the leases when there is not a bargain renewal option. The capitalized values of the above market leases and below market leases are amortized to other income beginning in the year acquired over the remaining term of the respective leases. The origination value of in-place leases is based on costs to execute similar leases including commissions and other related costs. The origination value of in-place leases also includes real estate taxes, insurance and an estimate of lost rent revenue at market rates during the estimated time required to lease up the property from vacant to the occupancy level at the date of acquisition.

Depreciation begins in the year following the year in which the asset is placed in service and is recorded on the straight-line basis using the following useful lives:

Buildings and improvements	10–50 years
Furniture and equipment	3–10 years
Tenant improvements	Shorter of lease term or useful life
In-place leases	Lease term
Below market leases	Lease term
Library books and collections	20–50 years

Medical Benefits — The University is self-insured for one of its employee medical plans up to a stop-loss limit of \$75,000 per individual and a 125% aggregate excess. As of May 31, 2012 and 2011, an estimated liability for payment of incurred and unpaid claims of \$730,000 and \$724,000, respectively, is included in accrued liabilities.

Worker's Compensation — The University insures its workers' compensation benefits through a third-party insurer with a high deductible policy that contains a \$250,000 per claim deductible. As of May 31, 2012 and 2011, an estimate of uninsured losses of \$816,000 and \$1,162,000, respectively, has been included in accrued liabilities.

Asset Retirement Obligation — Certain assets of the University contain asbestos. Although the asbestos is properly contained, in accordance with current environmental regulations, the University's practice is to remediate asbestos whenever substantial renovations to University assets occur. The University determined that certain assets recorded within property, plant, and equipment meet the criteria for recording a liability under the accounting guidance.

As of May 31, 2012 and 2011, the University incurred accretion expense of \$(468,000) and \$(151,000), respectively. During the years ended May 31, 2012 and 2011, the University incurred abatement costs of \$854,000 and \$137,000, respectively.

Derivative Financial Instruments — Derivative financial instruments are used by the University on a limited basis to manage interest rate risk associated with its tax-exempt bonds. Derivative financial instruments are recorded at their fair market value in the liabilities section in the accompanying statements of financial position (disclosed in Note 7). Changes in the underlying value of derivative financial instruments are recorded in change in value of interest rate swap agreements in the accompanying statements of activities and changes in net assets. The University does not enter into derivative contracts for the purpose of speculation.

Deferred Revenue — Deferred revenue is recorded for tuition and fees assessed and billed in the current fiscal year that is applicable to subsequent years.

Federal Student Loan Funds Refundable — Funds provided by the U.S. Government under the Federal Perkins Loan Program, Nursing Student Loans and Nursing Faculty Loan Program are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the government and are, therefore, recorded as a liability in the accompanying financial statements.

Contributions — Contributions are recognized as revenue when they are received or unconditionally pledged. When a donor restriction on a contribution expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities and changes in net assets as net assets released from restrictions. Contributions for which restrictions are met in the same period in which the unconditional pledge is received are recorded as unrestricted revenue. Contributions of cash and other assets restricted to acquiring long-lived assets are recorded as unrestricted revenue or as released from restrictions when the capital expenditure is incurred.

Contributions receivable are recorded at the present value of expected future cash flows, discounted using a risk-free interest rate. In-kind gifts, such as donated materials, supplies, or other nonfinancial assets, are recorded as assets and at fair value on the date of the gift. Conditional promises to give are not included as revenue until the conditions are substantially met. The University records an allowance for doubtful contributions receivable based on historical collection information and existing economic conditions.

Contribution receivable also includes amounts due to the University through bequests. The University recognizes contribution revenue from bequests when the University has the legal right to the assets and has a basis for estimating the fair market value of the assets.

Functional Expense Allocations — Expenses are classified into function classifications as follows:

- Instruction, which includes the costs directly related to teaching and instruction
- Research, which includes the costs to produce research, whether external or institutional funded
- Public Service, which includes non-instructional services beneficial to individuals and groups external to the institution such as institutes and community service.
- Academic support, which includes libraries, media service, and academic administration.

- Student Services, which includes financial aid administration, registrar, admissions, and student health promotions.
- Institutional Support, which includes general administration, fiscal operations, information technology services, human resources and development.
- Scholarships and fellowships, which includes internally and externally funded financial aid provided to students.
- Auxiliary enterprises, which includes the operations of the University's residence halls, bookstore, and food service.

Depreciation, interest, and operation and maintenance of plant expenses are allocated among program and supporting services based on allocation methods (including square footage) and estimates made by the University's management.

Fair Value of Financial Instruments — The fair value of an investment is the amount that would be received to sell the investment in an orderly transaction between market participants at the measurement date (i.e., the exit price). For cash and cash equivalents, student accounts and other receivables, accounts payable and accrued liabilities, the carrying amounts approximate fair value because of the short maturity of these financial instruments.

Investments are reflected in the accompanying statements of financial position at their fair value as required under generally accepted accounting principles. Investment fair value is discussed further in Note 5.

Contributions receivable and beneficial interest in trusts approximate fair value because such assets are recorded at estimated net present value based on anticipated future cash flows. The fair value of bonds and notes payable and interest rate swap agreements (disclosed in Note 7 and Note 8) is determined based on the University's discounted cash flow analysis and comparison with similar financial instruments in the marketplace having similar interest rate and maturity structures. Given the significant restrictions, varying interest rates, and repayment terms on student loans receivable and federal student loan funds, it is not practicable to estimate the fair value of such amounts.

Use of Estimates — The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications — Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 financial statement presentation. In 2012, the University changed classification of bequests receivable. Accordingly, \$1,869,000 has been reclassified from other receivables to contribution receivables in 2011 to conform to the 2012 financial statement presentation.

Tax-Exempt Status — The University is a nonprofit corporation that qualifies under the provisions of Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes on related activities. The University is, however, subject to federal and state income tax on unrelated business income and appropriate provision for any such taxes is included in the accompanying financial statements. In accordance with the accounting standards, the University evaluates its income tax position each fiscal year to determine whether the University's tax position is more likely than not to be sustained

if examined by the applicable taxing authority. The review had no material impact on the University's consolidated financial statements. The open tax years that remain subject to federal and state examination include tax years 2009-2012.

New Accounting Pronouncements — In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in Generally Accepted Accounting Principles and International Financial Reporting Standards*, which provides clarifications of prior Accounting Standards Codification (ASC) 820 guidance and requires enhanced disclosures. The amended guidance is to be applied prospectively and is effective for nonpublic entities for annual periods beginning after December 15, 2011. The University will adopt this guidance beginning with the fiscal year ending May 31, 2013. Management is considering the impact the guidance will have on the financial statements and its related disclosures.

In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, to enhance the disclosure requirements in FASB ASC 310, *Receivables*. The amended disclosures are designed to provide more information to financial statement users about the credit quality of a creditor's financing receivables and the adequacy of its allowance for credit losses. The University has adopted ASU 2010-20 and it is presented herein.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements*, which, among other things, amends ASC 820 to require entities to separately present purchases, sales, issuances, and settlements in their reconciliation of Level III fair value measurements (i.e., to present such items on a gross basis rather than on a net basis), and which clarifies existing disclosure requirements provided by ASC 820 regarding the level of disaggregation and the inputs and valuation techniques used to measure fair value for measurements that fall within either Level II or Level III of the fair value hierarchy. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level III fair value measurements (which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years). The University has adopted ASU 2010-06 in its entirety and it is presented herein.

2. CONTRIBUTIONS RECEIVABLE

Contributions receivable as of May 31, 2012 and 2011, consist of amounts expected to be collected in:

	2012	2011
Less than one year	\$ 13,430,000	\$ 9,268,000
One to five years	13,176,000	14,010,000
More than five years	<u>3,400,000</u>	<u>3,625,000</u>
Total	<u>30,006,000</u>	<u>26,903,000</u>
Less allowance for uncollectible contributions	(921,000)	(950,000)
Less unamortized discount	<u>(610,000)</u>	<u>(749,000)</u>
	<u>(1,531,000)</u>	<u>(1,699,000)</u>
Contributions receivable — net	<u>\$28,475,000</u>	<u>\$25,204,000</u>

3. CREDIT QUALITY OF FINANCING RECEIVABLES

Student Loans — The University makes uncollateralized loans to students based on financial need. Student loans are funded through Federal government loan programs or institutional resources. At May 31, 2012 and 2011, student loans, net represented 1.42% and 1.56% of total assets, respectively.

At May 31, 2012, student loans consisted of the following:

	2012	2011
Federal government programs	\$ 11,092,000	\$ 11,260,000
Institutional programs	<u>1,220,000</u>	<u>1,312,000</u>
Student loans receivable	12,312,000	12,572,000
Less allowance for doubtful accounts:		
Beginning of Year — May 31,	(896,000)	(869,000)
Increases	(112,000)	(24,000)
Write-offs	<u>(1,000)</u>	<u>(3,000)</u>
End of year — May 31,	<u>(1,009,000)</u>	<u>(896,000)</u>
Student loans receivable, net	<u>\$ 11,303,000</u>	<u>\$ 11,676,000</u>

The University has approximately \$1,914,000 in aged student loan receivables that are greater than 240 days. Allowances for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. Institutional loan balances are written off when they are deemed by management to be permanently uncollectible.

Faculty and Staff Loans — The University provides home mortgage financing assistance to certain faculty and senior staff. Notes receivable amounting to \$1,900,000 and \$2,145,000 were outstanding at May 31, 2012 and 2011, respectively, and are collateralized by deeds of trust on properties concentrated in the region surrounding the University. No allowance for doubtful accounts has been recorded against these loans based on their collateralization and prior collection history.

The faculty and staff loan amounts represent 0.24% and 0.29% of total assets, respectively. At May 31, 2012 and 2011, there were no amounts past due under the faculty and staff loan program.

4. INVESTMENTS

Investments as of May 31, 2012 and 2011, consist of the following:

	2012	2011
Equity securities and high-yield bond funds	\$ 53,172,000	\$ 68,155,000
Fixed-income investments	34,283,000	36,017,000
Short-term investments	33,000	32,000
Other investment fund	12,214,000	11,996,000
Real estate	14,203,000	14,082,000
Auction rate securities	1,863,000	2,354,000
Alternative investments:		
Private capital	44,507,000	50,004,000
Real asset funds	11,425,000	10,860,000
Hedge funds	<u>50,017,000</u>	<u>41,796,000</u>
Total	<u>\$ 221,717,000</u>	<u>\$ 235,296,000</u>

Restricted investments of \$5,000,000 as of May 31, 2011, include bond proceeds restricted to finance the acquisition, construction, renovation, remodeling, and equipping of certain educational facilities and were invested in fixed income mutual funds. Such restricted investments were expended during the year ended May 31, 2012.

5. FAIR VALUE MEASUREMENTS

Fair Value Measurements — The University is subject to accounting principles which define fair value, establish a framework for measuring fair value, and expand disclosures about fair value measurements. The accounting principles also establish a hierarchical disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value. Market price observability is impacted by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Investments measured and reported at fair value are classified and disclosed in one of the following categories. The categorization of an investment within the hierarchy is based on the pricing transparency of the investment and does not necessarily correspond to the University's perceived risk of that investment.

Level I — Quoted prices are available in active markets for identical investments as of the reporting date. This category includes active exchange-traded money market funds, fixed income investments, equity securities, and short-term investments.

Level II — Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date. At May 31, 2012 and 2011, The University's Level II investment holdings were valued at \$23,821,000 (3% of total assets) and \$27,079,000 (4% of total assets), respectively, whose values have been determined by the management of the University utilizing observable data that is readily available, regularly updated, reliable and verifiable, not proprietary and provided by sources that are actively involved in the relevant market. This category includes hedge funds, fixed income investments and a private investment fund, which is a privately held institutional equity fund whose underlying securities are publicly traded. Fair values for these investments are

estimated by the University using valuation methodologies that consider a range of factors, including, but not limited to, trading values on public exchanges for comparable securities, interest rates, and net asset value per share.

Level III — Pricing inputs are unobservable and include situations where there is little, if any, market activity for the investment. At May 31, 2012 and 2011, the University's Level III investment holdings were valued at \$111,708,000 (14% of total assets) and \$105,421,000 (14% of total assets), respectively, whose values have been estimated by the management of the University in the absence of readily ascertainable market values. Fair values for these investments are estimated by the University using valuation methodologies that consider a range of factors, including, but not limited to, the price at which the investment was acquired, the nature of the investment, local market conditions, trading values on public exchanges for comparable securities, current and projected operating performance, financial condition, and financing transactions subsequent to the acquisition of the investment. The inputs into the determination of fair value require significant judgment by the University. Due to the inherent uncertainty of these estimates, these values may differ materially from the values that would have been used had a ready market for these investments existed.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The University's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the investment.

The University uses the net asset value as a practical expedient to determine the fair value of all investments, which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company.

The financial assets and liabilities carried on the statements of financial position by level within the valuation hierarchy as of May 31, 2012 and 2011, are as follows:

	Fair Value Measurements 2012			
	Level I	Level II	Level III	Total
Assets — cash equivalents	<u>\$ 22,296,000</u>	<u>\$ 28,126,000</u>	<u>\$ -</u>	<u>\$ 50,422,000</u>
Equity securities and high-yield bond funds	\$ 53,172,000	\$ -	\$ -	\$ 53,172,000
Fixed income investments	32,983,000	1,300,000		34,283,000
Short-term investments	33,000			33,000
Other investment fund		12,214,000		12,214,000
Real estate			14,203,000	14,203,000
Auction rate securities			1,863,000	1,863,000
Alternative investments:				
Private capital			44,507,000	44,507,000
Real asset funds			11,425,000	11,425,000
Hedge funds		<u>10,307,000</u>	<u>39,710,000</u>	<u>50,017,000</u>
Total investments	<u>\$ 86,188,000</u>	<u>\$ 23,821,000</u>	<u>\$ 111,708,000</u>	<u>\$ 221,717,000</u>
Liabilities — interest rate swap agreements	<u>\$ -</u>	<u>\$ 20,769,000</u>	<u>\$ -</u>	<u>\$ 20,769,000</u>
	Fair Value Measurements 2011			
	Level I	Level II	Level III	Total
Assets — cash equivalents	<u>\$ 74,211,000</u>	<u>\$ 18,790,000</u>	<u>\$ -</u>	<u>\$ 93,001,000</u>
Equity securities and high-yield bond funds	\$ 68,155,000	\$ -	\$ -	\$ 68,155,000
Fixed income investments	34,609,000	1,408,000		36,017,000
Short-term investments	32,000			32,000
Other investment fund		11,996,000		11,996,000
Real estate			14,082,000	14,082,000
Auction rate securities			2,354,000	2,354,000
Alternative investments:				
Private capital			50,004,000	50,004,000
Real asset funds			10,860,000	10,860,000
Hedge funds		<u>13,675,000</u>	<u>28,121,000</u>	<u>41,796,000</u>
Total investments	<u>\$ 102,796,000</u>	<u>\$ 27,079,000</u>	<u>\$ 105,421,000</u>	<u>\$ 235,296,000</u>
Total restricted investments	<u>\$ 5,000,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,000,000</u>
Liabilities — interest rate swap agreements	<u>\$ -</u>	<u>\$ 11,350,000</u>	<u>\$ -</u>	<u>\$ 11,350,000</u>

The changes in investments classified as Level III are as follows for the years ended May 31, 2012 and 2011:

	2012					
	Real Estate	Auction Rate Securities	Private Capital	Real Asset Funds	Hedge Funds	Total
Balance — May 31, 2011	\$14,082,000	\$ 2,354,000	\$50,004,000	\$10,860,000	\$28,121,000	\$ 105,421,000
Total realized and unrealized gain/(loss)	117,000	(491,000)	(5,768,000)	(477,000)	(1,398,000)	(8,017,000)
Purchases	2,604,000		4,994,000	2,298,000	13,000,000	22,896,000
Sales	(2,600,000)		(4,723,000)	(1,256,000)	(13,000)	(8,592,000)
Balance — May 31, 2012	<u>\$14,203,000</u>	<u>\$ 1,863,000</u>	<u>\$44,507,000</u>	<u>\$11,425,000</u>	<u>\$39,710,000</u>	<u>\$ 111,708,000</u>
Change in unrealized gain/(loss) included in the changes in net assets relating to Level III investments still held at May 31, 2012	<u>\$ 67,000</u>	<u>\$ (491,000)</u>	<u>\$ (5,768,000)</u>	<u>\$ (477,000)</u>	<u>\$ (889,000)</u>	<u>\$ (7,558,000)</u>
	2011					
	Real Estate	Auction Rate Securities	Private Capital	Real Asset Funds	Hedge Funds	Total
Balance — May 31, 2011	\$12,474,000	\$ 4,805,000	\$44,203,000	\$ 7,211,000	\$19,555,000	\$ 88,248,000
Total realized and unrealized gain/(loss)	(1,104,000)	549,000	5,131,000	904,000	1,727,000	7,207,000
Purchases (sales) — net	<u>2,712,000</u>	<u>(3,000,000)</u>	<u>670,000</u>	<u>2,745,000</u>	<u>6,839,000</u>	<u>9,966,000</u>
Balance — May 31, 2011	<u>\$14,082,000</u>	<u>\$ 2,354,000</u>	<u>\$50,004,000</u>	<u>\$10,860,000</u>	<u>\$28,121,000</u>	<u>\$ 105,421,000</u>
Change in unrealized gain/(loss) included in the changes in net assets relating to Level III investments still held at May 31, 2011	<u>\$ (1,104,000)</u>	<u>\$ 376,000</u>	<u>\$ 5,132,000</u>	<u>\$ 904,000</u>	<u>\$ 3,841,000</u>	<u>\$ 9,149,000</u>

Total realized and unrealized gains and losses recorded for Level III investments are reported in “Net realized and unrealized gain/(loss) on investments” in the statements of activities and changes in net assets.

The University evaluates its financial assets and liabilities carried on the statement of financial position by level and transfers between levels based upon its ability to liquidate its investments at May 31 each fiscal year. No transfers were made during the year ended May 31, 2012.

Investment Strategy and Redemption Information — The following table summarizes the investment strategy types and various features of the University’s alternative investments as of May 31, 2012 and 2011. The University has commitments under some of the associated investment agreements to make additional capital contributions as noted.

		2012			
		Fair Value	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Level II	Hedge funds	\$ 10,307,000	\$ -	Semimonthly, quarterly	1–60 days
Level III	Private capital	44,507,000	16,691,000	Quarterly, annually, over 3 years	45–120 days
	Real asset funds	11,425,000	5,154,000		
	Hedge funds	39,710,000			
		2011			
		Fair Value	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Level II	Hedge funds	\$ 13,675,000	\$ -	Semimonthly, quarterly	1–90 days
Level III	Private capital	50,004,000	15,873,000	Quarterly, annually, over 3 years	60–120 days
	Real asset funds	10,860,000	5,690,000		
	Hedge funds	28,121,000			

The hedge fund category includes both long/short and absolute return strategies. The long/short hedge funds invest both long and short in global equity securities. The funds have the ability to shift investment strategies. The absolute return hedge funds pursue multiple strategies to diversify risk and reduce volatility. The goal of these vehicles is to achieve a positive return regardless of the directions of the broad credit and equity markets. These types of funds also have the ability to shift investment strategies. Investments in the hedge fund category can generally be redeemed on a quarterly basis, with 1 to 120 days’ notice. However, the managers may impose gates or disallow redemptions at their discretion. The fair values of the investments in this category have been determined using the net asset value per share of the investment funds.

The private capital category includes funds that invest in a broad range of public and privately owned domestic and foreign companies. These funds are structured as partnerships in which the University is a limited partner, and each involves a commitment to invest a maximum dollar amount over the term of the partnership. The investment managers request, or “call” the funds from the general and limited partners over the term of the partnership as individual investment opportunities are identified. Therefore, there is a period of time for each of these funds during which the committed amount is not yet invested, or “called.” These investments cannot be redeemed. Distributions are received when the underlying assets of the funds are liquidated. The investment periods for these funds typically range from five to six years, with the goal of liquidating the entire fund within 10 years. If necessary, funds can typically extend their time to liquidate by two additional years in accordance with the terms of the partnership agreement. The University expects the underlying assets within this category will be liquidated over the next 12 years, which includes likely extension agreements. The fair values of the investments in this

category have been determined using the University's ownership interest in partners' capital to which a proportionate share of net assets is attributed as of the most recent quarter-end, adjusted for cash transactions and estimated valuation changes of similar publicly traded asset portfolios through the University's fiscal year-end.

The private capital category includes venture capital, private debt, buyout, and multistrategy funds and fund-of-funds. Venture capital funds represent approximately 47% of the private capital category. These venture capital funds invest in small domestic and foreign companies in the technology or life sciences sector. Private debt funds, which consist mainly of distressed debt and mezzanine debt funds that invest in both domestic and foreign companies, represent approximately 19% of the private capital category. Buyout funds, which represent approximately 17% of the category, invest in small-, mid-, or large-cap companies across a range of industries. The remaining balance of the category consists of multistrategy funds and fund-of-funds that invest in a mix of domestic and foreign venture capital and private equity funds across a range of industries.

The real asset category consists of investments in real estate funds and natural resource funds. The University's portfolio of real estate funds is diversified between commercial and residential properties and is diversified geographically. The natural resource funds are invested mainly in the energy sector. All of the real asset funds are structured as partnerships in which the University is a limited partner. Similar to the University's private capital investments, these investments cannot be redeemed. Distributions are received when the underlying assets of the funds are liquidated. The University expects the underlying assets within this category will be liquidated over the next 10 years, which includes likely extension agreements. The fair values of the real estate funds and natural resource funds have been determined using the University's ownership interest in the partners' capital to which a proportionate share of net assets is attributed as of the most recent quarter-end, adjusted for cash transactions and estimated valuation changes of similar publicly traded asset portfolios through the University's fiscal year-end.

6. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment as of May 31, 2012 and 2011, consist of the following:

	2012	2011
Land and land improvements	\$ 31,606,000	\$ 16,271,000
Buildings and improvements	345,225,000	312,715,000
Furniture and equipment	54,706,000	53,232,000
Library books and collections	70,534,000	66,706,000
Construction in progress	<u>46,198,000</u>	<u>17,099,000</u>
Property, plant, and equipment — total	548,269,000	466,023,000
Less accumulated depreciation	<u>(154,457,000)</u>	<u>(140,647,000)</u>
Property, plant, and equipment — net	<u>\$ 393,812,000</u>	<u>\$ 325,376,000</u>

Property Acquisitions — On August 23, 2011 the University purchased the Folger Building located at 101 Howard Street in San Francisco, California. In connection with the property acquisition, the University acquired leases with rental rates below market rental rates. Such differences are recorded as an intangible lease liability (below market leases), pursuant to ASC 805, *Business Combinations*, and amortized to other income over the remaining life of the related leases. The total net impact to other income due to the amortization of below market leases was an increase of approximately \$382,000 for the year ended May 31, 2012.

As of May 31, 2012, the University has recorded gross intangible assets and liabilities in the amounts of \$1,349,000 and \$1,519,000 for the value attributable to in-place leases and below market leases, respectively. These amounts are included in prepaid expenses and other assets and accounts payable and accrued liabilities in the accompanying statement of financial position.

As of May 31, 2012, the University has recorded net accumulated amortization of approximately \$0 and \$382,000, related to the in-place leases and below market leases, respectively. As of May 31, 2012, the remaining weighted average lease term related to these intangible assets and liabilities is approximately 2.58 years.

Projected net amortization of the intangible assets and liabilities for the next five year as of May 31, 2012 is as follows:

Years Ending May 31	
2013	\$ (55,000)
2014	(84,000)
2015	(64,000)
2016	(39,000)
2017	(6,000)
Thereafter	<u>-</u>
Total	<u>\$ (248,000)</u>

7. BONDS PAYABLE

Bonds payable consist of tax-exempt borrowings issued through the California Educational Facilities Authority (CEFA) in the form of either fixed rate or variable rate revenue bonds. The University has issued CEFA revenue bonds to finance the construction, renovation, and equipping of certain educational facilities; to pay certain costs of issuance; and to refund or defease prior bond issues. Bonds payable as of May 31, 2012 and 2011, consist of the following:

	2012	2011
California Educational Facilities Authority (CEFA)		
Revenue bonds:		
CEFA Series 2011; fixed interest rates from 3.0% to 6.125%, principal due annually beginning October 1, 2011, and applicable interest due semiannually in varying amounts through 2036; secured by the University's assets	\$ 77,270,000	\$ 79,770,000
CEFA Series 2005B; variable interest rate, principal due annually beginning October 1, 2007, and applicable interest due monthly in varying amounts through 2035; secured by a letter of credit issued by JPMorgan Chase	27,000,000	27,100,000
CEFA Series 2003; variable interest rate, principal due annually beginning May 31, 2004, and applicable interest due monthly in varying amounts through 2033; secured by a letter of credit issued by JPMorgan Chase	34,330,000	34,500,000
CEFA Series 2000; variable interest rate, first principal payment due on June 1, 2004, then due annually beginning May 1, 2005 through 2030, and applicable interest due monthly in varying amounts through 2030; secured by a letter of credit issued by JPMorgan Chase	<u>20,100,000</u>	<u>20,900,000</u>
	158,700,000	162,270,000
Net unamortized premium on bonds payable	<u>305,000</u>	<u>325,000</u>
Total	<u>\$ 159,005,000</u>	<u>\$ 162,595,000</u>

Aggregate annual maturities of bonds payable for the fiscal year ended May 31, 2012, are as follows:

Years Ending May 31	
2013	\$ 3,875,000
2014	3,885,000
2015	4,255,000
2016	4,465,000
2017	4,565,000
Thereafter	<u>137,655,000</u>
Total	<u>\$ 158,700,000</u>

In conjunction with the issuance of the Series 2011 Bonds in February 2011, the University restructured the security for all of its debt, creating a parity debt structure comprised of a pledge of gross unrestricted revenues and a negative pledge on certain buildings and improvements located on the University's main campus.

Effective December 21, 2010, the University legally defeased its Series 1996 Bonds by depositing \$2,315,000 in an escrow fund, which was held in trust for the benefit of the 1996 bondholders until the Series 1996 Bonds matured on October 1, 2011.

The fair value of the CEFA bonds at May 31, 2012 and 2011, were approximately \$171,842,000 and \$164,866,000, respectively.

The University utilizes interest rate swap agreements to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness. Under the terms of the agreements, the University pays fixed rates ranging from 3.34% to 3.95% to the swap counterparty in exchange for a variable rate ranging from 64% to 67% of 1-month LIBOR on the notional amount. These swap agreements do not qualify as cash flow hedges, and as a result, changes in the fair value of the interest rate swap agreements during a period are recognized immediately in change in unrestricted net assets. The fair value of the interest rate swap agreements are based on quotes from the market makers and, therefore, are classified as Level II in the fair value hierarchy as shown in Note 5.

As of May 31, 2012 and 2011, the fair values of derivatives consisted of the following:

	Statements of Financial Position Location	Fair Value	
		2012	2011
Interest rate swap agreements	Liability under interest rate swap agreements	<u>\$20,769,000</u>	<u>\$ 11,350,000</u>
Total		<u>\$20,769,000</u>	<u>\$ 11,350,000</u>

Amounts reflected in the change in value of interest rate swap agreements for the years ended May 31, 2012 and 2011, were as follows:

	Statements of Activities and Changes in Net Assets Location	Realized and Unrealized Gains (Losses)	
		2012	2011
Interest rate swap agreements	Change in value of interest rate swap agreements	<u>\$ (9,418,000)</u>	<u>\$ 269,000</u>
Total		<u>\$ (9,418,000)</u>	<u>\$ 269,000</u>

The effective interest rate on the University's bonds payable was 3.01% and 4.47% as of May 31, 2012 and 2011, respectively.

Interest in the amount of \$527,000 and \$189,000 was capitalized in conjunction with construction projects for the years ended May 31, 2012 and 2011, respectively.

The CEFA agreements require compliance with various debt covenants and financial ratios. As of May 31, 2012, the University believes it was in compliance with the required financial covenants.

8. NOTES PAYABLE

Notes payable as of May 31, 2012 and 2011, consist of the following:

	2012	2011
Term loan:		
Fixed interest rate per annum equal to 3.09%; principal due annually beginning May 1, 2013, and applicable interest due quarterly and the maturity date through May 1, 2019, secured by a first priority parity interest of all Gross Unrestricted Revenues of the University	<u>\$ 27,500,000</u>	<u>\$ -</u>

Aggregate annual maturities of notes payable for the fiscal year ended May 31, 2012, are as follows:

Years Ending May 31	
2013	\$ 1,500,000
2014	1,500,000
2015	1,500,000
2016	1,500,000
2017	1,500,000
Thereafter	<u>20,000,000</u>
Total	<u>\$ 27,500,000</u>

On April 18, 2012, the University entered in a \$27,500,000 term loan agreement for the purpose of partially reimbursing itself for a recent building acquisition. The University shall repay the bank principal amount in equal annual installments of \$1,500,000 on May 1 of each year (beginning May 1, 2013) until the maturity date of May 1, 2019 when the final principal repayment installment shall be repaid. The term loan bears interest at a rate per annum equal to 3.09% and is secured by a first priority parity pledge of and perfected security interest in all of the gross unrestricted revenues of the University.

The effective interest rate on the University's notes payable was 3.13% as of May 31, 2012.

The term loan agreement requires compliance with various debt covenants and financial ratios. As of May 31, 2012, the University believes it was in compliance with the required financial covenants.

The fair value of the note payable at May 31, 2012 was approximately \$27,500,000.

9. ENDOWMENTS

The University's endowment fund consists of individual donor-restricted endowment funds and funds designated by the University's Board to function as endowments. The net assets associated with endowment funds, including those funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The State of California enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in 2008. The Board has interpreted the adopted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for appropriation for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate endowment funds:

- a. The duration and preservation of the fund
- b. The purposes of the University and the donor-restricted endowment fund
- c. General economic conditions
- d. The possible effect of inflation and deflation
- e. The expected total return from income and appreciation of investments
- f. Other resources of the University
- g. The investment policies of the University

Where the Board designates unrestricted funds to function as endowments, they are classified as Board-designated endowments and are included within unrestricted net assets.

The following table presents the University's endowment composition as of May 31, 2012 and 2011, by type of fund:

	2012			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment fund	\$ -	\$45,775,000	\$ 109,946,000	\$ 155,721,000
Board-designated endowment fund	<u>42,715,000</u>	_____	_____	<u>42,715,000</u>
Total funds	<u>\$42,715,000</u>	<u>\$45,775,000</u>	<u>\$ 109,946,000</u>	<u>\$ 198,436,000</u>
	2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment fund	\$ -	\$57,255,000	\$ 107,064,000	\$ 164,319,000
Board-designated endowment fund	<u>46,941,000</u>	_____	_____	<u>46,941,000</u>
Total funds	<u>\$46,941,000</u>	<u>\$57,255,000</u>	<u>\$ 107,064,000</u>	<u>\$211,260,000</u>

The changes in the University's endowments for the year ended May 31, 2012 and 2011, are as follows:

	2012			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets — May 31, 2011	\$ 46,941,000	\$ 57,255,000	\$ 107,064,000	\$ 211,260,000
Investment income	427,000	2,524,000		2,951,000
Investment expense	(1,054,000)			(1,054,000)
Net realized and unrealized gain/(loss) on investments	(1,454,000)	(8,597,000)		(10,051,000)
Additions (withdrawals) to investment pool — net	134,000		2,882,000	3,016,000
Appropriation of endowment assets for expenditure	(1,564,000)	(6,122,000)		(7,686,000)
Transfer for underwater endowments	(715,000)	715,000		
Endowment net assets — May 31, 2012	<u>\$ 42,715,000</u>	<u>\$ 45,775,000</u>	<u>\$ 109,946,000</u>	<u>\$ 198,436,000</u>
	2011			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets — May 31, 2010	\$ 37,180,000	\$ 38,958,000	\$ 104,045,000	\$ 180,183,000
Investment income	924,000	2,856,000		3,780,000
Investment expense	(1,006,000)			(1,006,000)
Net realized and unrealized gain/(loss) on investments	7,774,000	24,039,000		31,813,000
Additions (withdrawals) to investment pool — net	81,000	(232,000)	3,019,000	2,868,000
Appropriation of endowment assets for expenditure	(1,116,000)	(5,262,000)		(6,378,000)
Transfer for underwater endowments	3,104,000	(3,104,000)		
Endowment net assets — May 31, 2011	<u>\$ 46,941,000</u>	<u>\$ 57,255,000</u>	<u>\$ 107,064,000</u>	<u>\$ 211,260,000</u>

Description of amounts classified as permanently restricted net assets and temporarily restricted net assets as of May 31, 2012 and 2011, is as follows:

Permanently Restricted Net Assets	2012	2011
The portion of permanently restricted net assets not participating in the investment pool that is required to be retained permanently by explicit donor stipulation or UPMIFA	\$ 13,524,000	\$ 7,141,000
The portion of permanently restricted net assets participating in the investment pool that is required to be retained permanently by explicit donor stipulation or UPMIFA	<u>109,946,000</u>	<u>107,064,000</u>
Total permanently restricted net assets	<u>\$ 123,470,000</u>	<u>\$ 114,205,000</u>
 Temporarily Restricted Net Assets		
The portion of perpetual endowment funds subject to a time restriction under UPMIFA	\$ 45,775,000	\$ 57,255,000
The portion of perpetual endowment funds subject to a time restriction under UPMIFA not participating in the investment pool	<u>56,000</u>	<u>56,000</u>
Total accumulated appreciation of permanently restricted funds not appropriated for expenditure	<u>\$ 45,831,000</u>	<u>\$ 57,311,000</u>

Endowment Funds with Deficits — From time to time, the fair value of assets associated with individual donor endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When individual donor endowments decline, temporarily restricted net assets are reduced up to the fair value of the original gift. Further reductions in the fair value of the individual donor endowment are classified as a reduction of unrestricted net assets. Such deficits resulted from unfavorable market and authorized appropriations and expenditures that were deemed prudent. The annual appropriation for endowment funds with deficits is returned to corpus rather than released for spending. Deficits of this nature reported in unrestricted net assets totaled \$1,040,000 and \$325,000 as of May 31, 2012 and 2011, respectively. Future appreciation of the donor endowment restores the value to the original required level.

Return Objectives and Risk Parameters — The University has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment, while seeking to maintain the purchasing power of endowment assets. Endowment assets include those assets of donor-restricted funds that the University must hold in perpetuity as well as Board-designated funds. Under this policy, endowment assets are invested in a manner that is intended to yield an annual long-term rate of return of the Consumer Price Index plus 4.5% net of management fees, while assuming a moderate level of investment risk. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Investment Objectives — To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends).

Relationship of Spending Policy to Investment Objectives — The spending policy of the fund includes both the funds available for appropriation, as well as the expenses of managing the fund. In determining the spending policy for the fund, the University took into consideration the needs of the University for current income, as well as the goal of providing a perpetual source of income to the University that will grow at least at the rate of inflation. For planning purposes, the target spending policy is 4.5% of the market value of the fund. Market value, for the purpose of calculating the spending policy, is the three-year moving average of the market value of the fund as of December 31 of each year. Funds identified for appropriation will be distributed once a year following the fiscal year-end. In addition, the Board may, in response to changing economic circumstances, raise or lower the percentage to be distributed in any given year.

Permanently Restricted Net Assets not Participating in the Investment Pool — Permanently restricted net assets not invested in the investment pool include investments in trusts and beneficial interests in trusts where the University is both the trustee and where the University is not the trustee. Permanently restricted net assets not invested in the investment pool also include donor-restricted contributions receivable.

10. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets as of May 31, 2012 and 2011, are restricted to the following:

	2012	2011
Acquisition of property, plant, and equipment	\$ 15,394,000	\$ 16,996,000
Accumulated appreciation of endowment funds not appropriated for expenditure	45,831,000	57,311,000
Passage of time	17,229,000	14,695,000
Scholarship and departmental programs	<u>4,000</u>	<u>294,000</u>
Total	<u>\$ 78,458,000</u>	<u>\$ 89,296,000</u>

Net assets released from restrictions during the years ended May 31, 2012 and 2011, were as follows:

	2012	2011
Purpose restrictions accomplished:		
Renovation of University facilities	\$ 3,694,000	\$ 4,604,000
Scholarship, departmental, and other programs	479,000	56,000
Time restrictions expired	897,000	898,000
Endowment appropriation for spending	6,122,000	5,262,000
Transfer for endowments with deficits	<u>(715,000)</u>	<u>3,104,000</u>
Total	<u>\$ 10,477,000</u>	<u>\$ 13,924,000</u>

11. RELATED-PARTY TRANSACTIONS

Members of the University's Board of Trustees and senior management may, from time to time, be associated, either directly or through interlocking board memberships, with entities doing business with the University. The University has a conflict of interest policy that requires any such associations to be disclosed in writing on an annual basis and updated as appropriate during the year. When such

associations exist, measures are taken to mitigate any actual or perceived conflict, including recusal of the board member from any decisions involving the entity doing business with the University.

In 1970, The Jesuit Community of the University of San Francisco (the Community), a corporation, became an entity separate from the University. However, certain relationships are of continuing significance. Members of the Community serve on the University faculty and administration under individual contracts. Salaries are paid in total to the Community and were approximately \$1,804,000 and \$1,460,000 for the years ended May 31, 2012 and 2011, respectively. In the opinion of the University's management, such salaries are comparable to those of other University employees. Additionally, at May 31, 2012 and 2011, the University had accounts receivable balances of \$78,000 and \$73,000, respectively, included in other receivables, from the Community for miscellaneous charges. Members of the Community occupied housing facilities recorded at historical cost of \$10,512,000 at May 31, 2012 and 2011, respectively (\$7,983,000 net book value at May 31, 2012, and \$8,193,000 net book value at May 31, 2011).

The University holds secured and unsecured notes receivable from employees for housing assistance. These notes bear interest at a range of 0%–10% and mature at various dates (see Note 3).

During the year ended May 31, 2011, the University exercised a repurchase option and acquired property from an employee for a third-party appraised value of approximately \$1,450,000.

The University has an investment in seven limited partnership agreements in which a trustee or trustee emeritus is a partner. These transactions were approved by the Board. As of May 31, 2012 and 2011, the University had contributed approximately \$8,388,000 and \$12,273,000, respectively, to such partnerships, which are included in private capital as of May 31, 2012 and 2011, the University had committed to make additional capital contributions of approximately \$1,712,000 and \$3,327,000, respectively.

12. RETIREMENT BENEFITS

Substantially all nontemporary full-time employees of the University are covered under a 401(a) defined contribution retirement plan (the "Plan") administered by the Teachers' Insurance and Annuity Association — College Retirement Equities Fund. The Plan requires the University to contribute to the Plan 10% of employees' base salary below the Social Security wage base and 12% on the base salary amount above the Social Security wage base, up to a maximum salary of \$250,000. Total retirement expense under the Plan was \$11,122,000 and \$9,809,000 for the years ended May 31, 2012 and 2011, respectively, which is net of total forfeitures under the Plan of \$231,000 and \$299,000 for the years ended May 31, 2012 and 2011, respectively. There are no employee-matching requirements under the Plan. In addition to the Plan, substantially all employees are eligible to participate in a voluntary 403(b) defined contribution plan. There are no University contribution requirements under this plan.

The University also maintains a 457(f) supplemental deferred compensation plan funded by employee pre-tax dollar contributions administered by The Hartford. The plan was established in 1985 and frozen to new participants in 1989. As of May 31, 2012 the University holds \$401,000 in investments for the plan and a corresponding liability of \$401,000 due to the participants in the plan.

13. COMMITMENTS AND CONTINGENCIES

The University has entered into 47 limited partnership arrangements for investment purposes, whereby the University has committed to make capital contributions to the partnerships of \$98,603,000. This commitment includes the related-party commitment of \$10,100,000 as discussed in Note 11. As of May 31, 2012 and 2011, the University had contributed approximately \$76,758,000 and \$69,912,000, respectively, to the partnerships.

The University has various purchase commitments totaling \$27,571,000 at May 31, 2012, related primarily to construction contracts.

The University is also contingently liable in connection with claims, matters subject to arbitration, and contracts arising in the normal course of its activities. In addition, the University receives funds from various federal and state government-funded programs, including loan funds, which are subject to audit by cognizant governmental agencies. The University is also subject to audit by other government agencies. Management is of the opinion that the ultimate outcome of such matters will not have a significant effect on the financial position of the University.

The University leases certain educational facilities under noncancelable operating leases. Future minimum lease payments for all non-cancelable operating leases in excess of one year as of May 31, 2012, for the next five years are as follows:

Years Ending May 31	
2013	\$ 1,551,000
2014	1,858,000
2015	1,886,000
2016	1,674,000
2017	1,389,000
Thereafter	<u>5,697,000</u>
Total	<u>\$ 14,055,000</u>

Rent expense was \$3,192,000 and \$2,714,000 for the years ended May 31, 2012 and 2011, respectively.

14. SUBSEQUENT EVENT

The University's management determined that there are no material events that occurred subsequent to the balance sheet date and through September 27, 2012, the date the financial statements were available to be issued, which would require adjustments to or disclosures in the financial statements.

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