KPMG

THE WASHINGTON AND LEE UNIVERSITY

Financial Statements

June 30, 2008

(With Independent Auditors' Report Thereon)

KPMG

KPMG LLP
Suite 1710
10 S. Jefferson Street
Roanoke, VA 24011-1331

Independent Auditors' Report

The Board of Trustees
The Washington and Lee University:

We have audited the accompanying statement of financial position of The Washington and Lee University (the University) as of June 30, 2008, and the related statements of activities, and cash flows for the year 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 audit. The financial statements of the University as of and for the year ended June 30, 2007 were audited by other auditors whose report thereon dated October 12, 2007, expressed an unqualified opinion on those statements and included an explanatory paragraph that described the University's adoption of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2007. The prior year summarized comparative information has been derived from the University's 2007 financial statements, which were audited by other auditors as discussed above.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2008 financial statements referred to above present fairly, in all material respects, the financial position of The Washington and Lee University as of June 30, 2008, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 27, 2008

THE WASHINGTON AND LEE UNIVERSITY

Statement of Financial Position

June 30, 2008 (with comparative information as of June 30, 2007)

(In thousands)

Assets		**2008**	**2007**
Cash and cash equivalents *(note 22)*	$	9,924	10,897
Accounts and other receivables		1,823	1,062
Notes receivable, net *(note 3)*		4,058	3,597
Contributions receivable, net *(note 4)*		118,628	133,327
Inventories		901	730
Investments *(notes 8, 14 and 22)*		840,822	821,913
Funds held in trust by others *(notes 10 and 18)*		303,214	307,881
Assets restricted to investment in land, buildings, and equipment *(note 5)*		2,354	6,246
Land, buildings, and equipment, net *(note 5)*		198,736	185,099
Debt issuance costs, net		913	956
Total assets	$	1,481,373	1,471,708
Liabilities and Net Assets			
Liabilities:			
Accounts and other payables *(note 11)*	$	7,496	6,770
Accrued compensation		1,368	1,754
Student and other deposits		1,050	1,303
Deferred revenue		1,533	1,607
U.S. Government grants refundable		1,966	1,969
Split interest agreement obligations *(note 14)*		76,450	73,256
Asset retirement obligations		2,770	2,707
Postretirement benefit obligation *(note 16)*		9,653	9,978
Long-term debt *(note 11)*		126,117	129,819
Total liabilities		228,403	229,163
Net assets *(note 20)*:			
Unrestricted		558,765	559,924
Temporarily restricted *(note 6)*		73,881	72,572
Permanently restricted *(note 7)*		620,324	610,049
Total net assets		1,252,970	1,242,545
Commitments and contingencies *(notes 8, 17 and 19)*			
Total liabilities and net assets	$	1,481,373	1,471,708

See accompanying notes to financial statements.

THE WASHINGTON AND LEE UNIVERSITY

Statement of Activities

Year ended June 30, 2008 (with summarized comparative information for the year ended June 30, 2007)

(In thousands)

	2008				
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**	**2007 Total**
Operating revenue and gains:					
Tuition and fees	$ 75,908	—	—	75,908	67,600
Less donor funded student financial aid	(16,338)	—	—	(16,338)	(15,601)
Less institutionally funded student financial aid	(4,909)	—	—	(4,909)	(2,405)
Net tuition and fees	54,661	—	—	54,661	49,594
Endowment return allocated to operations *(note 8)*	27,370	3,434	—	30,804	28,942
Other investment income *(note 8)*	1,167	294	—	1,461	2,087
Income from funds held in trust by others allocated to operations *(note 10)*	8,270	56	—	8,326	7,689
Contributions	11,807	—	—	11,807	8,849
Auxiliary enterprises (net of $1,041 and $796 of institutionally funded student financial aid)	14,864	—	—	14,864	13,888
Governmental and other grants	12	2,826	—	2,838	1,146
Other	474	82	—	556	1,390
Net assets released from restrictions *(note 12)*:					
Satisfaction of program restrictions	3,567	(3,567)	—	—	—
Satisfaction of equipment acquisition restrictions	430	(430)	—	—	—
Total operating revenue and gains	122,622	2,695	—	125,317	113,585
Operating expenses *(note 13)*:					
Instruction	53,636	—	—	53,636	52,131
Research	1,951	—	—	1,951	1,713
Public service	661	—	—	661	543
Academic support	14,824	—	—	14,824	13,362
Financial aid	1,646	—	—	1,646	1,744
Student services	11,424	—	—	11,424	10,045
Institutional support	16,251	—	—	16,251	14,965
Auxiliary enterprises	16,808	—	—	16,808	15,390
Total operating expenses	117,201	—	—	117,201	109,893
Change in net assets from operating activities	5,421	2,695	—	8,116	3,692
Nonoperating activities:					
Investment returns, net of amount allocated to operations (note 8)	(16,937)	(496)	393	(17,040)	88,185
Investment returns from funds held in trust by others	—	453	(6,217)	(5,764)	53,306
Split interest agreements, net	(87)	(433)	(2,641)	(3,161)	(6,345)
Contributions *(note 4)*	—	8,292	18,994	27,286	135,411
Other, net	—	—	66	66	(157)
Net assets released for fixed asset acquisition *(note 12)*	9,054	(9,054)	—	—	—
Postretirement charge other than benefit cost *(note 16)*	922	—	—	922	—
Reclassifications	468	(148)	(320)	—	—
Total nonoperating activities	(6,580)	(1,386)	10,275	2,309	270,400
Change in net assets before effect of change in accounting principle	(1,159)	1,309	10,275	10,425	274,092
Effect of change in accounting principle *(note 16)*	—	—	—	—	1,781
Change in net assets	(1,159)	1,309	10,275	10,425	275,873
Net assets:					
Beginning of year	559,924	72,572	610,049	1,242,545	966,672
End of year	$ 558,765	73,881	620,324	1,252,970	1,242,545

See accompanying notes to financial statements.

THE WASHINGTON AND LEE UNIVERSITY

Statement of Cash Flows

Year ended June 30, 2008 (with comparative information for the year ended June 30, 2007)

(In thousands)

		2008	2007
Cash flows from operating activities:			
Change in net assets	$	10,425	275,873
Adjustments to reconcile change in net assets to net cash and cash equivalents used in operating activities:			
Effect of change in accounting principle		—	(1,781)
Realized and unrealized gains on investments		(1,686)	(103,638)
Unrealized losses (gains) on funds held in trust by others		4,667	(53,293)
Depreciation, amortization and accretion		8,524	8,855
Actuarial losses (gains) on annuity obligations, net		2,519	(1,707)
Noncash contributions of investments		(18,880)	(18,931)
Contributions restricted for long-term investment		(23,974)	(9,153)
Interest and dividends restricted for long-term investment		(1,750)	(278)
Changes in operating assets and liabilities:			
Accounts and other receivables, net		(1,222)	1,667
Contributions receivable, net		14,699	(108,316)
Inventories		(171)	(16)
Accounts payable and other accrued liabilities		15	486
Student and other deposits		(253)	518
Deferred revenue		(74)	(14)
U.S. Government grants refundable		(3)	(31)
Split interest agreement obligations		3,560	8,843
Net cash and cash equivalents used in operating activities		(3,604)	(916)
Cash flows from investing activities:			
Purchases of land, buildings, and equipment		(22,218)	(15,906)
Purchases of investments restricted to land, buildings, and equipment		(5,124)	(7,877)
Proceeds from sale of investments		1,519,440	513,432
Purchases of investments		(1,505,210)	(531,730)
Net cash and cash equivalents used in investing activities		(13,112)	(42,081)
Cash flows from financing activities:			
Interest and dividends restricted for long-term investment		1,750	278
Proceeds from contributions restricted for long-term investment in endowment and plant		23,974	28,084
Payments for debt issuance costs		—	(260)
Payments of split interest agreements		(6,443)	(5,239)
Proceeds from issuance of long-term debt		—	20,447
Payments on long-term debt		(3,538)	(6,511)
Net cash and cash equivalents provided by financing activities		15,743	36,799
Net decrease in cash and cash equivalents		(973)	(6,198)
Cash and cash equivalents:			
Beginning of year *(note 22)*		10,897	17,095
End of year	$	9,924	10,897
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	$	6,417	6,432
Noncash investing and financing activities:			
Contributions of investments	$	18,880	18,931

See accompanying notes to financial statements.

(1) Description of Organization

The Washington and Lee University (the University) is a private, liberal arts university in Lexington, Virginia. Founded in 1749, it is the ninth oldest institution of higher learning in the nation. The University is named after George Washington, as he gave the school its first major endowment, and after General Robert E. Lee, as a result of his strong leadership as president of the University. The University is comprised of the College, the Ernest Williams II School of Commerce, Economics and Politics, and the School of Law. There are approximately 1,730 undergraduate students and approximately 400 law students.

(2) Summary of Significant Accounting Policies

(a) Basis of Financial Statement Presentation

The University follows Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. SFAS No. 117 provides that net assets be classified as unrestricted, temporarily restricted, or permanently restricted based on the existence or absence of donor-imposed restrictions. The financial statements have been prepared on the accrual basis of accounting.

(b) Classification of Net Assets

In accordance with SFAS No. 117, the University's net assets have been grouped into the following three classes:

Unrestricted Net Assets – Unrestricted net assets generally result from revenues derived from providing services, receiving unrestricted contributions, unrealized and realized gains and losses, and receiving dividends and interest from investing in income-producing assets, less expenses incurred in providing services, raising contributions, and performing administrative functions.

Temporarily Restricted Net Assets – Temporarily restricted net assets generally result from contributions, unrealized and realized gains and losses, receiving dividends and interest from investing in income-producing assets, and other inflows of assets less expenses incurred in the programs supporting these assets whose use by the organization is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the University pursuant to those stipulations.

Permanently Restricted Net Assets – Permanently restricted net assets generally represent the historical cost (fair value at date of gift) of contributions and other inflows of assets whose use by the University is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by the University.

The University retains an interest in several funds held in trust by others (see note 10) which are classified as permanently restricted net assets. Annual adjustments to record the University's interest in such trusts at the current market value are also recorded as permanently restricted in the statement of activities and are, therefore, reflected as permanently restricted net assets in the statement of financial position.

(c) Summarized Comparative Information

The statement of activities includes certain summarized comparative information for the year ended June 30, 2007 in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2007 from which the summarized information was derived.

(d) Cash and Cash Equivalents

The University considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, except those cash equivalents held by investment managers as part of their long-term investment strategy.

(e) Inventories

Inventories are stated at the lower of cost or market with cost determined on the first-in, first-out (FIFO) basis.

(f) Investments

Investments in marketable equity securities and all investments in debt securities are reported at fair value based on quoted market prices at the reporting date.

Other investments, such as hedge fund investments, private equity and venture capital, natural resource and real estate investments, are measured at estimated fair value, based on valuations provided by external investment managers. The University believes the carrying amount of these financial instruments is a reasonable estimate of fair value. Because these alternative investments are not readily marketable, their estimated value is subject to additional uncertainty, and therefore values realized upon disposition may vary significantly from currently reported values.

Investments are exposed to several risks, such as interest rate, currency, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the University's financial statements.

Gifts of investments are recorded at their fair value (based upon quotations or appraisals) at the date of gift. Purchases and sales of investments are recorded on the trade date. All investment income is reported in the period earned as unrestricted revenues, temporarily restricted revenues, or permanently restricted revenues depending on donor restrictions. The amount of investment income necessary to satisfy the Board of Trustees (the Board) approved spending policy for the endowment fund is included in the endowment returns allocated to operations in the statement of activities. Any excess of income earned over the approved spending amount is retained in the endowment pool.

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Except for investments where donors specifically provide otherwise, investments are maintained in a pool. Gifts that are invested in the pool are assigned units of participation in the pool based upon their fair market value on the date of gift and the most recently determined unit market value for the existing units of participation. Subsequent distributions of annual income, based on the spending formula authorized by the Board, of the investment pool are based upon the number of units of participation. Withdrawals are based upon the most recently determined market value of the respective units of participation, which includes both realized and unrealized net gains or losses. The market value of the units of participation is calculated monthly.

(g) Split Interest Agreements

The University records split interest agreements such as charitable remainder trusts and charitable lead trusts in accordance with the AICPA's *Audit and Accounting Guide for Not-For-Profit Organizations*. Donors establish and fund a trust with specified distributions to be made to a designated beneficiary or beneficiaries over the trust's term. If applicable, liabilities to beneficiaries associated with these split interest agreements are calculated using the appropriate discount rate at the time they are established. If applicable under generally accepted accounting principles, liabilities for these split interest agreements are adjusted annually for changes in actuarial assumptions, amortization of the discount or to use a current discount rate. Upon termination of the trust, the University receives the portion of assets remaining in the trust as specified by the donor.

Charitable remainder trusts, for which the University is not the trustee, are recorded at the fair value of their beneficial interest. The University records revenue for charitable lead trusts, for which the University is the trustee, based on the present value of future cash flows expected to be received by the University. The fair value of the assets held in trust by the University are included in investments and the associated liability, representing the present value of the liability to the donor's estate, is included in split interest agreement obligations in the statement of financial position.

The University also manages gift annuities, which consist of nontrust assets donated to the University in exchange for a fixed payment for a specified period of time. The gift annuities are recognized at fair value when received, and included in investments in the statement of financial position. The associated liability is initially calculated at the present value of future cash flows and adjusted in subsequent periods to reflect changes in actuarial assumptions. Liabilities associated with gift annuities are included in split interest agreement obligations in the statement of financial position.

Pooled life income funds are donated funds received by the University and are assigned a specific number of units in the pool. The donor is paid the amount of income earned on the donor's assigned units. Pooled life income funds are recorded at their fair value and are included in investments in the statement of financial position. The University's interest is recognized as contribution revenue in the period in which the assets are received by the donor. The difference between the fair value of the assets when received and the revenue recognized is recorded as a liability and included in split interest agreement obligations in the statement of financial position.

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(h) Funds Held in Trust by Others

Funds held in trust by others represent resources neither in the possession nor under the control of the University, but held and administered by outside fiscal agents, with the University deriving income from such funds. The fair value of the University's share of the assets is reflected in the statement of financial position and the income (including unrealized appreciation and depreciation) is recorded in the statement of activities.

(i) Fair Value of Financial Instruments

The carrying amounts of student accounts receivables, other receivables, accounts payable, and accrued liabilities approximate fair value because of the short maturity of these financial instruments. The University has estimated the net realizable value of notes receivable, evaluated collection history, and has concluded the carry amount approximates fair value. The University has estimated the net realizable value of contributions receivable and split interest agreement obligations, and has concluded the carrying amounts approximate fair value. The fair value of investments and funds held in trust by others are estimated as noted above. Swap agreements are reported at their estimated fair value, which is based on the amount the University would pay or receive to settle the agreements at the reporting date, taking into account current interest rates. The fair value of the University's long-term debt is estimated as described in note 11.

(j) Land, Buildings, and Equipment

Land, buildings, and equipment, including art properties, are stated at cost at the date of acquisition or fair value at the date of gift, less accumulated depreciation, computed on a straight-line basis over the estimated useful lives of land improvements (15-30 years), buildings (30-50 years), and equipment (10 years). The University does not provide depreciation on its art properties because a decrease in economic benefit is not anticipated since the University expects to take the necessary steps to maintain their condition. Interest on borrowings is capitalized from the date of the borrowing until the specified qualifying assets acquired with those borrowings are ready for their intended use or the borrowing is retired, whichever occurs first. Capitalized interest is amortized over the useful life of the qualifying asset.

(k) Classification of Gifts

Contributions, including unconditional promises to give, are reported as increases in the appropriate category of net assets, except contributions that impose restrictions that are met in the same fiscal year. These contributions are received and included in unrestricted revenues.

The University reports gifts of cash and other assets at their fair value as restricted support if they are received with donor stipulations that limit their use. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Conditional promises to give are not recognized until the conditions on which they depend are substantially met.

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The University reports gifts of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support.

In the event a donor makes changes to the nature of a restricted gift which affects its classification among the net asset categories, such amounts are reflected as "reclassifications" in the statement of activities.

(l) Contributions Receivable

The University accounts for contributions in accordance with SFAS No. 116, *Accounting for Contributions Received and Contributions Made*. SFAS No. 116 requires the University to record a receivable to reflect the unconditional promises of donors to make future contributions. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are received. An allowance is made for uncollectible contributions based upon management's judgment after analysis of creditworthiness of the donors, past collection experience, and other relevant factors.

(m) Asset Retirement Obligations

The University accounts for asset retirement obligations in accordance with FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47), an interpretation of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*. FIN 47 requires that the fair value of the liability for the asset retirement obligations (ARO) be recognized in the period in which it is incurred and the settlement date is estimable, even if the exact timing or method of settlement is unknown. The ARO is capitalized as part of the carrying amount of the long-lived asset retroactively to the time at which legal or contractual regulations created the obligation. The ARO for the University is primarily associated with the cost of removal and disposal of asbestos and fuel tanks.

(n) Tuition and Fees

Tuition and fee revenues are recorded on the statement of activities net of student financial aid as unrestricted revenue. Student financial aid is provided from earnings on restricted funds and certain board-designated endowments, along with gifts and grants dedicated to providing student financial aid.

(o) Functional Expenses

The University has developed and implemented a system of allocating expenses related to more than one function. These expenses are depreciation, interest and operations and maintenance of plant. Depreciation is allocated by individual fixed assets to the function utilizing that asset. Interest is allocated based on the use of borrowed money in the individual functional category.

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Operations and maintenance of plant expenses are divided into those used for the total institution not charged back to the operating units, and those that are charged to some units but not all units. Allocation was determined though a study of departmental uses of the operations and maintenance budget within each functional category.

(p) Operations

Operating revenues and expenses include all transactions that increase or decrease unrestricted net assets, except those associated with long-term gifts for capital investments. Operating revenues include allocations appropriated in accordance with the University's endowment spending policy, as reflected in the statement of activities as investment returns.

(q) Derivative Instruments

All derivative instruments are recognized as either assets, included in accounts and other receivables, or liabilities, included in accounts and other payables, in the statement of financial position at their respective fair values. Changes in the fair value of derivative instruments are recorded as other nonoperating activities on the statement of activities.

Using derivative financial instruments may increase the University's exposure to credit risk and market risk. The University minimizes the credit (or repayment) risk in derivative instruments by (1) entering into transactions with high-quality counterparties, (2) limiting the amount of exposure to each counterparty, and (3) monitoring the financial condition of its counterparties. Market risk is the adverse effect on the value of a derivative financial instrument that results from a change in interest rates. The University manages the market risk associated with derivative financial instruments by requiring approval of the Board for all such activities.

(r) Income Taxes

The University is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. However, there are certain activities conducted by the University that fall under unrelated business activities which are not exempt from federal and state income tax. The University files timely federal and state returns for these activities and makes the necessary tax payments, if applicable.

The University adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on July 1, 2007. FIN 48 prescribes a threshold of more-likely-than-not for recognition and derecognition of tax positions taken or expected to be taken in a tax return. FIN 48 also provides related guidance on measurement, classification, interest and penalties, and disclosure. The implementation of FIN 48 had no impact on the University's financial statements.

(s) Use of Estimates

The preparation of financial statements in conformity with U.S. 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. Items subject to such estimates and assumptions primarily include the carrying value of nontraditional investments, certain real estate holdings, post-retirement benefits, land, buildings and equipment, and accounts and contributions receivable. In the near term, actual results could differ from those estimates.

(t) ***Reclassifications***

Certain reclassifications have been made to the prior year financial statements to conform with the 2008 presentation.

(3) Notes Receivable

Notes receivable are carried at face value, less an allowance for doubtful accounts of $405,000 and $452,000 at June 30, 2008 and 2007, respectively. The interest rates on federal student financial aid range from 3% to 5%. Maturity dates range up to 10 years.

(4) Contributions Receivable

Contributions receivable, which are reported net of an allowance for uncollectible amounts and a present value discount, are expected to be collected as follows at June 30, 2008 and 2007 (in thousands):

		2008	2007
Receivable in less than one year	$	25,135	37,628
Receivable in one year to five years		107,606	111,949
Receivable in over five years		1,093	2,347
Total contributions receivable, gross		133,834	151,924
Less allowance for uncollectible contributions		(1,215)	(1,367)
Total contributions receivable, net of allowance		132,619	150,557
Discount to reduce contributions to present value		(13,991)	(17,230)
Total	$	118,628	133,327

The University uses a discounting model that is consistent with industry guidelines. The discount rate is derived from the market value of the U.S. Treasury Bond on the date of the pledge which remains constant for the life of a pledge. The discount rates ranged from 1.74% to 8.47% at June 30, 2008.

During fiscal year 2007, the University received two permanently restricted contributions totaling $133,000,000. As of June 30, 2008, the balance remaining to be collected on these commitments is $100,000,000. These contributions are restricted to fund faculty salaries, scholarships, professorships, internships, lectures, and a special fund that enables the University to respond strategically to changing needs.

(5) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30, 2008 and 2007 consist of the following (in thousands):

		2008	2007
Land	$	2,288	2,288
Land improvements		7,585	7,585
Buildings and improvements		247,270	234,351
Equipment		37,314	35,074
Art properties		2,281	2,134
		296,738	281,432
Less accumulated depreciation		(115,488)	(106,907)
		181,250	174,525
Construction in progress		17,486	10,574
Total	$	198,736	185,099

The University has $2,354,000 and $6,246,000 in restricted assets at June 30, 2008 and 2007, respectively. The cash and other assets are restricted for use under the terms of agreements with donors that limits the funds to investments in land, building, and equipment.

(6) Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30, 2008 and 2007 are available for the following purposes (in thousands):

		2008	2007
Financial aid	$	13,500	11,092
Program support		40,940	44,704
Buildings and equipment		15,552	14,032
Other		3,889	2,744
Total	$	73,881	72,572

(7) Permanently Restricted Net Assets

The return earned on permanently restricted net assets at June 30, 2008 and 2007 is available to support the following (in thousands):

		2008	2007
Financial aid	$	204,445	212,221
Program support		408,245	387,480
Other		7,634	10,348
Total	$	620,324	610,049

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(8) Investments

Most of the University's long-term investments are held in an investment pool. Annuity and life income trusts and certain other investments are maintained separately from the investment pool.

The participation in the pool and ownership of the other investments at June 30, 2008 and 2007 for each class of net assets is as follows (in thousands):

		Investment pool	Annuity and life income	Other	Total
2008:					
Net assets:					
Unrestricted	$	495,802	—	14,027	509,829
Temporarily restricted		2,735	74,863	—	77,598
Permanently restricted		228,409	24,986	—	253,395
Investments as of June 30, 2008	$	726,946	99,849	14,027	840,822
2007:					
Net assets:					
Unrestricted	$	500,860	—	22,782	523,642
Temporarily restricted		2,824	75,019	—	77,843
Permanently restricted		196,121	24,307	—	220,428
Investments as of June 30, 2007	$	699,805	99,326	22,782	821,913

The University has made commitments to certain investments for which capital contributions are drawn over time. The outstanding commitments to these investments were $29,893,000 as of June 30, 2008.

Full time faculty members and administrative, professional and supervisory employees who are defined as exempt personnel under the terms of the Fair Labor Standards Act of 1938, as amended, are eligible for University housing loans. These housing loans may be used to purchase, build, or improve a principal residence in the Lexington-Rockbridge County area immediately upon entering the employ of the University. These mortgage loans, included in investments on the statement of financial position, are carried at fair value of $45,112,000 and $40,658,000 as of June 30, 2008 and 2007, respectively. The interest rates on these loans range from 3.38% to 7.96% and maturity dates range up to 30 years. The face value of these loans as of June 30, 2008 and 2007 was approximately $51,952,000 and $47,761,000, respectively.

Prior to fiscal year 2008, the University invested in multiple managers to meet the University's long-term asset allocation. In January 2008, the University initiated a transition from investing in multiple managers to primarily investing in one manager, Makena Capital Management, LLC (Makena). Makena is the primary investment asset manager for the University. Makena offers a single pooled investment fund utilizing a multi-asset manager structure.

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Investments are comprised of the following at June 30, 2008 and 2007 (in thousands):

		2008	2007
Short-term investments	$	30,334	65,755
Commonfund		1,509	1,458
Domestic equities		78,921	195,303
International equities		18,798	184,516
U.S. Government and agency obligations		54	63,718
Fixed income taxable		14,004	13,326
Corporate and other obligations		264	27,505
Energy natural resources		44,609	70,217
Emerging markets		3,229	4,347
Hedge funds		71,670	116,599
Mortgage loans to exempt employees		45,112	40,658
Multi-Asset Class *(see above)*		480,233	—
Real estate trusts and partnerships		6,590	7,560
Land and other investments		3,205	3,205
Other alternative investments		42,290	27,746
Total	$	840,822	821,913

The following table summarizes the investment return and its classification in the statement of activities (in thousands):

		2008				2007
		Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Income on long-term investments	$	5,705	3,479	1,726	10,910	12,458
Net realized and unrealized (loss) gain		4,728	(1,379)	(1,663)	1,686	103,638
Other investment income		1,167	1,132	330	2,629	3,118
Total investment return		11,600	3,232	393	15,225	119,214
Endowment return allocated to operations (spending policy distributions)		(27,370)	(3,434)	—	(30,804)	(28,942)
Other investment income allocated to operations		(1,167)	(294)	—	(1,461)	(2,087)
(Deficiency) excess of investment return over spending rate amount	$	(16,937)	(496)	393	(17,040)	88,185

(9) Endowment

Endowment is a term used commonly to refer to the resources that have been restricted by the donor or designated by the Board of Trustees that will be invested to provide future revenue to support the University's activities. As of June 30, 2008, the University holds 1,139 endowment funds, of which 1,052 are true endowments (restricted by the donor) and 87 are quasi-endowments (designated by the Board). The fair value of true endowments at June 30, 2008 and 2007 was $504,299,000 and $483,622,000, respectively. The fair value of quasi-endowments at June 30, 2008 and 2007 was $218,617,000 and $209,175,000, respectively.

The Board-approved spending formula for the endowment provides for spending the lesser of the prior-year allocation incremented by a Consumer Price Index-based inflator, 6% of the three-year average of fair values at December 31, or a 5% ceiling related to the June 30 fair value. This single formula model is often referred to as a constant growth spending formula.

The total allocation to operations based on the spending formula for fiscal years 2008 and 2007 was $30,804,000 and $28,942,000, respectively. The total fair value of true and quasi-endowments as of June 30, 2008 and 2007 was $722,917,000 and $692,797,000, respectively. The payout rate defined as allocation divided by the beginning fair value was 4.67% for 2008, which was down from 4.95% in 2007.

(10) Funds Held in Trust by Others

The majority of the funds held in trust by others (FHTBO) balance comes from the bequest of Letitia P. Evans of 15% of the annual net income of the Lettie Pate Evans Foundation, Inc. Restricted Fund. At June 30, 2008 and 2007, the fair value of the University's interest was reported by the trustees as $254,881,000 and $258,686,000, respectively. During the years ended June 30, 2008 and 2007, the University received income of $7,021,000 and $6,400,000, respectively, from the Lettie Pate Evans Foundation, Inc. Restricted Fund.

At June 30, 2008 and 2007, the University maintained an interest in 45 and 46 other trusts, respectively, with fair values reported by the trustees of $48,333,000 and $49,195,000, respectively, and income for the years ended June 30, 2008 and 2007 of $1,305,000 and $1,289,000, respectively.

(11) Long-Term Debt

Long-term debt consists of the following obligations at June 30, 2008 and 2007 (in thousands):

	Final maturity	Interest rates	2008	2007
Virginia College Building Authority:				
1998 Note, includes premium of $1,322 and $1,366, respectively	January 2031	5.03% – 5.05%	$ 53,527	53,571
2001 Note, includes premium of $2,512 and $2,612, respectively	January 2034	5.0% – 5.75%	45,512	45,612
2006 Note, includes premium of $361 and $381, respectively	January 2016	4.0% – 5.0%	18,026	19,581
Industrial Development Authority:				
1997 Note	December 2012	Variable	3,184	4,108
2003 Note	April 2018	Variable	2,568	2,897
SunTrust Bank:				
2003 Commercial Note	December 2008	Variable	3,300	4,050
			$ 126,117	129,819

Aggregate principal payments due for the next five fiscal years are: 2009 - \$5,951,000; 2010 – \$2,551,000; 2011 - \$2,588,000; 2012 - \$2,446,000; 2013 - \$1,960,000 and thereafter - \$106,426,000.

In December 1997, the Industrial Development Authority of the City of Lexington, Virginia (the Lexington Authority) issued bonds in the amount of \$8,500,000. The proceeds derived from the sale were loaned to the University in exchange for its note payable. Such proceeds were used primarily to finance the renovation, furnishing and equipping of various buildings; to construct and renovate various entrances and parking areas; and to acquire campus-based motor vehicles. Semi-annual principal and interest payments continue until maturity in 2012. Interest on the note is payable semi-annually at variable rates equal to 67% of the LIBOR plus 0.20% (the Variable Rate). Concurrently with the issuance, the University entered into an interest rate swap agreement (the Swap) on all \$8,500,000 of its variable rate debt under the note payable to the Lexington Authority, at a fixed rate of 4.56%. The Swap is used to minimize cash flow fluctuations of interest payments caused by the volatility of LIBOR. The interest rate swap is not considered a cash-flow hedging instrument under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* and therefore changes in fair value are recorded in changes in net assets each year. The change in fair value of the Swap was a loss of approximately \$65,000 for the year ended June 30, 2008, and a gain of approximately \$11,000 for the year ended June 30, 2007. The fair value of the Swap as of June 30, 2008 was \$154,000 in favor of the financial institution.

In April 1998, the Virginia College Building Authority (VCBA) issued \$52,205,000 in Educational Facilities Revenue Bonds, Series of 1998 (the 1998 Bonds). The proceeds derived from the sale of the 1998 Bonds were loaned to the University in exchange for its Note. Such proceeds were used primarily to finance the construction of a new parking facility and to complete the extinguishment of \$7,870,000 of the Series 1992 Note and \$36,030,000 of the Series 1994 Note.

In June 2001, the VCBA issued bonds in the amount of \$43,000,000. The proceeds derived from the sale were loaned to the University in exchange for its unsecured note payable. Such proceeds were used to assist in the financing of the construction of a University Commons, renovation of Reid Hall, renovation of a portion of Doremus Gymnasium, renovation of Law rooms, the construction of an Arts and Music building, renovation of the University Co-op Building, relocation of utilities necessary for the construction of the aforementioned projects, and upgrades and improvements to the University central heating and cooling plant. Semi-annual interest payments began January 1, 2002 with annual principal payments commencing January 1, 2016 and continuing until maturity in January 2034. Interest on the note is at a per annum rate of 5.375% through January 2021, 5.00% through January 2025, and 5.75% through January 2034.

In March 2003, the Rockbridge IDA issued bonds in the amount of \$3,950,000. The proceeds derived from the sale were loaned to the University in exchange for its Note and such proceeds were used to extinguish the Series 2000 Note. Principal payments on this note are due in installments of \$65,833 on each January 1, April 1, July 1 and October 1, beginning July 1, 2003 and continuing until April 1, 2018. Interest on the unpaid principal is payable on these same dates at a variable annual rate equal to the sum of (a) 65% of the LIBOR and (b) 0.59%. Concurrently with the issuance, the University entered into an interest rate swap agreement (Swap 2) on all \$3,950,000 of its variable rate debt under the note payable to the Lexington Authority, at a fixed rate of 3.48%. Swap 2 is used to minimize cash flow fluctuations of interest payments caused by the volatility of LIBOR. The interest rate swap is not considered a cash-flow hedging instrument under SFAS No. 133. The change in fair value of Swap 2 was a loss of approximately $112,000 and $25,000 for the years ended June 30, 2008 and 2007, respectively. The fair value of Swap 2 as of June 30, 2008 was $26,000 in favor of the financial institution.

In December 2003, the University entered into a refinancing of its 1998 commercial taxable loan for the principal balance of $6,000,000. The 2003 Commercial Note is payable in quarterly installments with interest computed at a rate equal to LIBOR plus 0.60%. The interest rate will be changed on the first day of the month and accrued interest is paid quarterly to bondholders. SunTrust Bank and the University each have the option to continue the loan beyond December 2008 to December 2013, with the rate reset at the option renewal date. Concurrently with the issuance, the University entered into an interest rate swap agreement (Swap 3) on all $6,000,000 of its variable rate debt under the note payable to SunTrust Bank, at a fixed rate of 4.32%. Swap 3 is used to minimize cash flow fluctuations of interest payments caused by the volatility of LIBOR. The interest rate swap is not considered a cash-flow hedging instrument under SFAS No. 133. The change in fair value of Swap 3 was a loss of approximately $122,000 and $81,000 for the years ended June 30, 2008 and 2007, respectively. The fair value of Swap 3 as of June 30, 2008 was $26,000 in favor of the financial institution.

In August 2006, the VCBA issued Educational Facilities Revenues Bonds for $20,045,000 (2006 Bonds), the proceeds of which were loaned to the University in exchange for a promissory note and such proceeds were used to refund the 1994 Note and will be used to pay for certain campus projects consisting of (a) the remodeling of the Co-op building to provide additional faculty offices, administrative assistant stations, student meeting rooms, and small lounge areas; (b) capital improvements pursuant to the University's Three Year Capital Plan, including the renovation and improvement of buildings, mechanical system replacements and improvements, computing system replacements and enhancements, and the maintenance and upgrade of health and safety systems; (c) capital improvement projects in connection with the creation of an energy performance program, including water conservation, lighting system improvements, various boiler enhancements, and a cover for the pool in the Warner Center; and (d) to pay costs of issuance of the 2006 Bonds. Annual principal and semi-annual interest payments on this note began January 1, 2007. The 2006 Bonds may not be called for redemption at the option of the Authority before January 1, 2016. 2006 Bonds maturing on or after January 1, 2017, may be redeemed at the option of the Authority with direction of the University prior to their respective maturities in whole or in part at any time, on or after July 1, 2016.

The estimated fair value of the University's long-term debt was $130,431,000 and $135,149,000 as of June 30, 2008 and 2007, respectively. Fair values for 2008 and 2007 were estimated based on an average interest rate of 4.47% and 4.49%, respectively, the bond buyer municipal index rate for June 30, 2008 and 2007. Using the remaining principal amortization structure of each series of bonds and interest rates, a calculation was performed to get a bond yield and then a discount rate for each existing series of bonds. Each discount rate was then used to calculate the present value of debt service, reflecting average interest rates that are slightly above current rates for similar indebtedness.

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(12) Net Assets Released from Restrictions

Net assets are released from donor restrictions when expenses are incurred to satisfy the restricted purposes or by occurrence of other events as specified by donors. Purpose restrictions accomplished during the year ended June 30, 2008 were as follows (in thousands):

Financial aid	$	1,900
Program support		1,599
Other		68
		3,567
Buildings and equipment		9,484
Total	$	13,051

(13) Expenses

Expenses for the years ended June 30, 2008 and 2007 were incurred for the following (in thousands):

		2008	2007
Salaries, wages and benefits	$	66,689	61,751
Supplies and services		31,417	29,632
Depreciation		8,581	8,822
Costs of sales, auxiliary enterprises		4,447	4,060
Interest		6,067	5,628
Total	$	117,201	109,893

(14) Lead Annuity Trust Agreements

The University has entered into certain lead annuity trust agreements (the Trusts) with donors whereby the University will receive a percentage of the Trusts' fair values each year. Upon termination of the Trusts, the remaining assets will be remitted to the beneficiaries named by the donors. As of June 30, 2008, the fair value of the Trusts' assets and the related income for the year then ended were $44,995,000 and $835,000, respectively. As of June 30, 2007, the fair value of the Trusts' assets and the related income for the year then ended were $41,945,000 and $849,000, respectively. The fair value of the charitable lead annuity trusts agreements are included in investments and the associated liabilities to beneficiaries are included in split interest agreement obligations in the statement of financial position.

(15) Retirement Plan

Academic and nonacademic personnel of the University are included in the 403(b) contributory retirement plan of the Teachers Insurance and Annuity Association and College Retirement Equities Fund (TIAA-CREF). The University matches optional employee contributions up to 5% of their annual salary. In addition, the University makes a mandatory contribution of 5% of the employee's annual salary. Contributions are paid currently to TIAA-CREF. The University's cost under this plan amounted to approximately $4,176,000 and $3,879,000 for the years ended June 30, 2008 and 2007, respectively.

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(16) Postretirement Benefits

The University currently provides health insurance in the form of a retiree medical benefit (the Plan) to certain retired employees and their dependents. The costs of postretirement benefits are accrued during the service lives of employees. Employees of record prior to April 1, 2003 are eligible to qualify for this benefit. Those hired on or after April 1, 2003 cannot participate in the Plan. The plan is unfunded.

The components of net periodic postretirement benefit cost for the years ended June 30, 2008 and 2007 were as follows (in thousands):

		2008	2007
Service cost (benefits attributed to employee service during the year)	$	387	391
Interest cost on accumulated postretirement benefit obligation		637	609
Amortization of actuarial gain		(72)	(63)
Net periodic postretirement benefit cost	$	952	937

The amortized actuarial gain results from changes in certain assumptions and will be amortized over a period based on the average future service of participants expected to receive plan benefits.

The discount rate used in determining the accumulated postretirement benefit obligation (APBO) as of June 30, 2008 and 2007 was 6.25%. The assumed health care cost trend used in measuring the accumulated postretirement benefit obligation was 9.5% in 2008, decreasing to 5% over the next ten years. Beginning January 1, 2008, contributions for retirees were increased to $65.00 per month, which represents 35% of the premium paid by the University each month to fund the Plan. The postretirement benefit obligation calculation assumes the retiree contribution will increase next year to 40% of the premium paid by the University to fund the Plan.

The following information summarizes activity in the unfunded postretirement benefit plan:

		2008	2007
Change in benefit obligation:			
Accumulated benefit obligation, beginning of year	$	9,978	9,572
Service cost		387	391
Interest cost		637	609
Actuarial gain		(994)	(168)
Net benefits paid		(355)	(426)
Accumulated benefit obligation, end of year	$	9,653	9,978
Amount not yet recognized in net periodic benefit cost and included in unrestricted net assets:			
Net actuarial gain	$	2,703	1,781

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statement No. 87, 88, 106 and 132R*. SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. The June 30, 2007 adoption of SFAS No. 158 resulted in the University recording a credit of $1,781,000 as the effect of a change in accounting principle.

Projected postretirement health benefits expected to be paid in each of the next five fiscal years are: 2009 – $348,000; 2010 – $370,000; 2011 – $421,000; 2012 – $465,000; 2013 – $517,000. An additional $3,625,000 is expected to be paid for the fiscal years 2014 through 2018.

Total employer and participant contributions are $355,000 and $164,000, respectively, for the year ended June 30, 2008. Total benefits paid for the year ended June 30, 2008 are $519,000. The expected employer and participant contributions for the year ending June 30, 2009 is expected to be $348,000 and $178,000, respectively, for a total of $526,000 in benefits paid. The expense discount rates for June 30, 2008 and 2007 are 6.25% and 6.25%, respectively. The measurement date was June 30, 2008.

(17) Commitments

The University's contractual commitments for capital expenditures totaled approximately $3,795,000 at June 30, 2008, and were comprised of the following (in thousands):

Wilson Stadium	$	2,348
Hillel House Design		348
Newcomb Hall Design		230
Leyburn Information Commons		220
Various other projects		649
	$	3,795

(18) Concentration Risk

Financial instruments that potentially subject the University to concentration of risk consist primarily of an equity investment in a large U.S. company. This investment comprised 79% and 78% of total funds held in trust by others as of June 30, 2008 and 2007, respectively.

At times during the year, the University maintains cash balances at financial institutions in excess of Federal Deposit Insurance Corporation (FDIC) limits.

(19) Contingencies

The University receives revenues under U.S. Government grants and contracts. The ultimate determination of amounts received under these programs generally is based upon allowable costs, which are subject to audit, and are reported to the U.S. Government. Recovery of indirect costs is based on predetermined rates negotiated with the government. The University is of the opinion that adjustments, if any, arising from such audits will not have a material effect on the financial statements.

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From time to time, the University is involved in various legal proceedings which is in the normal course of operations. In management's opinion, the University is not currently involved in any legal proceedings which individually or in the aggregate could have a material effect on the financial condition, results of operations and/or liquidity of the University.

(20) Recently Enacted Endowment Legislation

Through June 30, 2008, the University's management and investment of donor-restricted endowment funds was subject to the provisions of the National Conference of Commissioners on Uniform State Laws (NCCUSL) which was enacted by the Commonwealth of Virginia in 1973. In March 2008, the Commonwealth of Virginia replaced these NCCUSL provisions with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which was enacted by the Commonwealth of Virginia effective July 1, 2008. UPMIFA expands the scope of the prior law, applying to all charitable institutions holding institutional funds, including trusts without noncharitable beneficiaries; clarifies and expands the duties and obligations concerning the conduct of investment and expenditures of institutional funds; imposes express standards on any delegation of the management or investment of institutional funds; and updates the standards for when a court may order the release or modification of the purpose of or restrictions contained in a gift instrument through which a donor contributes to an institutional fund. Among UPMIFA's most significant changes is the elimination of NCCUSL's important concept of historic dollar value threshold, the amount below which an organization could not spend from the fund in favor of a more robust set of guidelines about what constitutes prudent spending.

In August 2008, FASB Staff Position No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act and Enhanced Disclosures for All Endowment Funds* (FSP), was issued, and its guidance is effective for fiscal years ending after December 15, 2008. A key component of that FSP is a requirement to classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure. The University will adopt the FSP for the year ending June 30, 2009, which will require the June 30, 2008 financial statements to be retrospectively adjusted to reflect a reclassification of net assets from unrestricted to temporarily restricted of approximately $275,000,000. The University does not believe this net asset reclassification will be operationally significant. Another key component of the FSP is a requirement for expanded disclosures for all endowment funds.

(21) Other Recently Issued Accounting Standards

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurement* (SFAS 157). SFAS 157 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The Statement does not require any new fair value measures. The Statement is effective for fair value measures already required or permitted by other standards for fiscal years beginning after November 15, 2007. The University is required to adopt SFAS 157 beginning on July 1, 2008. SFAS 157 is required to be applied prospectively, except for certain financial instruments. Any transition adjustment will be recognized as an adjustment to opening net assets in the year of adoption. The University is currently evaluating the impact of adopting SFAS 157 on its financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 gives the University the irrevocable option to carry most financial assets and liabilities at fair value that are not currently required to be measured at fair value. If the fair value option is elected, changes in fair value would be recorded in the statement of activities and changes in net assets at each subsequent reporting date. SFAS 159 is effective for the University's 2009 fiscal year. The University is currently evaluating the impact the adoption of this Statement could have on its financial statements.

(22) Subsequent Events

On September 29, 2008, the University was notified that Wachovia Bank, N.A., as trustee of the Commonfund for Short-Term Investments (the Fund), is resigning as trustee and has initiated the process of terminating the Fund and has established procedures for an orderly liquidation and distribution of the assets of the Fund over a period of time. The liquidation and distribution of the assets of the Fund would allow for withdrawal of 40% of the University's investment as of September 29, 2008 by October 7, 2008. It is expected that the University will be able to withdraw approximately 62% of the funds by December 31, 2008 and 74% by December 31, 2009 as the value of the underlying securities of the Fund reach maturity. At June 30, 2008 and September 29, 2008, the University had $1,509,000 and $1,515,000, respectively, invested in the Fund. Management believes that it has sufficient liquidity within its other investment portfolios to meet its obligations as they become due.

Historically, the University has classified its investment in the Fund and certain other short-term investments as cash equivalents on the statements of financial position, and cash flows; however, in order to conform with the classification adopted in 2008, prior years balances related to the Fund and certain other short-term investments have been reclassified as investments.

As described in note 2(f), the University's investments are exposed to several risks. With the known market volatility since June 30, 2008, the University is aware that the market values of the majority of the underlying assets have declined and in some cases liquidity of normally liquid short-term investments has been impaired. The University recognizes that these conditions may result in a reduction of spending from the endowment payout formula as described in note 9 for 2009-10, and changes to the investment options for short-term instruments that may reduce yield and impact investment earnings available for operations in 2008-09. The University plans to assess the magnitude of these outcomes during 2008-09 and factor such outcomes into future financial planning decisions.