KPMG

THE WASHINGTON AND LEE UNIVERSITY

Financial Statements

June 30, 2010

(With Independent Auditors' Report Thereon)

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, 2010, 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 prior year summarized comparative information has been derived from the University's 2009 financial statements, and in our report dated October 28, 2009, we expressed an unqualified opinion on those financial statements, which described the University's adoption of accounting standards related to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and fair value as of July 1, 2008.

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 financial statements referred to above present fairly, in all material respects, the financial position of The Washington and Lee University as of June 30, 2010, 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 25, 2010

THE WASHINGTON AND LEE UNIVERSITY

Statement of Financial Position

June 30, 2010 (with comparative information as of June 30, 2009)

(In thousands)

Assets		**2010**	**2009**
Cash and cash equivalents	$	4,329	3,335
Accounts and other receivables		2,168	1,523
Notes receivable, net *(note 3)*		4,679	4,687
Contributions receivable, net *(note 4)*		80,255	119,415
Inventories		1,103	895
Investments *(notes 8, 14 and 20)*		797,875	706,138
Funds held in trust by others *(notes 10, 18 and 20)*		288,035	272,461
Assets restricted to investment in land, buildings, and equipment *(note 5)*		837	2,809
Land, buildings, and equipment, net *(note 5)*		207,307	199,214
Debt issuance costs, net		829	871
Total assets	$	1,387,417	1,311,348
Liabilities and Net Assets			
Liabilities:			
Accounts and other payables *(notes 11 and 20)*	$	6,596	5,355
Accrued compensation		3,253	2,123
Student and other deposits		1,045	1,061
Deferred revenue		2,325	1,755
U.S. Government grants refundable		2,081	1,998
Split interest agreement obligations *(note 14)*		44,231	57,492
Asset retirement obligations		3,003	2,832
Postretirement benefit obligation *(note 16)*		13,717	11,499
Long-term debt *(note 11)*		119,429	122,750
Total liabilities		195,680	206,865
Commitments and contingencies *(notes 8, 17 and 19)*			
Net assets *(note 9)*:			
Unrestricted		245,205	215,304
Temporarily restricted *(note 6)*		290,151	258,754
Permanently restricted *(note 7)*		656,381	630,425
Total net assets		1,191,737	1,104,483
Total liabilities and net assets	$	1,387,417	1,311,348

See accompanying notes to financial statements.

THE WASHINGTON AND LEE UNIVERSITY

Statement of Activities

Year ended June 30, 2010 (with summarized comparative information for the year ended June 30, 2009)

(In thousands)

	2010				2009
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**	**Total**
Operating revenue and gains:					
Tuition and fees	$ 81,658	—	—	81,658	78,130
Less donor funded student financial aid	(16,279)	—	—	(16,279)	(17,828)
Less institutionally funded student financial aid	(11,147)	—	—	(11,147)	(5,735)
Net tuition and fees	54,232	—	—	54,232	54,567
Endowment return allocated to operations *(note 8)*	25,841	4,083	—	29,924	34,045
Other investment income *(note 8)*	769	121	—	890	737
Distributions from funds held in trust by others *(note 10)*	9,204	75	—	9,279	9,121
Contributions	9,987	—	—	9,987	7,764
Auxiliary enterprises (net of $1,535 and $1,259 of institutionally funded student financial aid)	14,983	—	—	14,983	15,293
Governmental and other grants	—	4,949	—	4,949	2,969
Other	503	125	—	628	479
Net assets released from restrictions *(note 12)*	7,740	(7,740)	—	—	—
Total operating revenue and gains	123,259	1,613	—	124,872	124,975
Operating expenses *(note 13)*:					
Instruction	60,923	—	—	60,923	57,955
Research	2,803	—	—	2,803	2,387
Public service	818	—	—	818	804
Academic support	14,946	—	—	14,946	17,120
Financial aid	2,800	—	—	2,800	2,335
Student services	11,501	—	—	11,501	12,055
Institutional support	17,051	—	—	17,051	17,775
Auxiliary enterprises	16,873	—	—	16,873	17,560
Total operating expenses	127,715	—	—	127,715	127,991
Change in net assets from operating activities	(4,456)	1,613	—	(2,843)	(3,016)
Nonoperating activities:					
Investment returns, net of amount allocated to operations *(note 8)*	28,677	34,107	3,745	66,529	(172,452)
Change in value of funds held in trust by others	—	2,600	12,646	15,246	(30,743)
Split interest agreements, net	(88)	(2,391)	(4,295)	(6,774)	2,903
Contributions	—	5,214	10,926	16,140	55,913
Other, net	—	—	570	570	157
Net assets released for fixed asset acquisitions *(note 12)*	8,895	(8,895)	—	—	—
Postretirement charge other than benefit cost *(note 16)*	(1,614)	—	—	(1,614)	(1,249)
Redesignated funds	(1,513)	(851)	2,364	—	—
Total nonoperating activities	34,357	29,784	25,956	90,097	(145,471)
Change in net assets	29,901	31,397	25,956	87,254	(148,487)
Net assets:					
Beginning of year	215,304	258,754	630,425	1,104,483	1,252,970
End of year	$ 245,205	290,151	656,381	1,191,737	1,104,483

See accompanying notes to financial statements.

THE WASHINGTON AND LEE UNIVERSITY

Statement of Cash Flows

Year ended June 30, 2010 (with comparative information for the year ended June 30, 2009)

(In thousands)

		2010	2009
Cash flows from operating activities:			
Change in net assets	$	87,254	(148,487)
Adjustments to reconcile change in net assets to net cash and cash equivalents used in operating activities:			
Realized and unrealized (gains) losses on investments		(92,190)	143,709
Unrealized (gains) losses on funds held in trust by others		(15,245)	31,055
Depreciation, amortization and accretion		9,097	9,086
Actuarial losses on annuity obligations, net		(6,657)	3,079
Contributions of investments		(37,872)	(14,640)
Contributions restricted for long-term investment		(16,413)	(40,231)
Interest and dividends restricted for long-term investment		(1,369)	(1,478)
Changes in operating assets and liabilities:			
Accounts and other receivables, net		(637)	(329)
Contributions receivable, net		39,160	(787)
Inventories		(208)	6
Accounts payable and other accrued liabilities		2,283	459
Student and other deposits		(16)	11
Deferred revenue		570	222
U.S. Government grants refundable		83	32
Split interest agreement obligations		13,309	(4,421)
Net cash and cash equivalents used in operating activities		(18,851)	(22,714)
Cash flows from investing activities:			
Purchases of land, buildings, and equipment		(14,840)	(9,627)
Purchases of investments restricted to land, buildings, and equipment		(7,370)	(4,848)
Proceeds from sale of investments		222,377	221,298
Purchases of investments		(190,285)	(223,402)
Net cash and cash equivalents provided by (used in) investing activities		9,882	(16,579)
Cash flows from financing activities:			
Interest and dividends restricted for long-term investment		1,369	1,478
Proceeds from contributions restricted for long-term investment in endowment and plant		16,413	40,231
Payments of split interest agreements		(4,668)	(5,805)
Payments on long-term debt		(3,151)	(3,200)
Net cash and cash equivalents provided by financing activities		9,963	32,704
Net increase (decrease) in cash and cash equivalents		994	(6,589)
Cash and cash equivalents:			
Beginning of year		3,335	9,924
End of year	$	4,329	3,335
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	$	6,086	6,240

Noncash investing and financing activities:

At June 30, 2010, $2,307,000 of fixed asset purchases were included in accounts payable and other accrued liabilities.

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 1,700 undergraduate students and approximately 400 law students.

(2) Summary of Significant Accounting Policies

(a) Basis of Financial Statement Presentation

The financial statements have been prepared on the accrual basis of accounting.

(b) Classification of Net Assets

Based on the existence or absence of donor-imposed restrictions, the University's net assets have been grouped into the following three classes:

Unrestricted – Net assets that are not subject to donor-imposed stipulations.

Temporarily Restricted – Net assets whose use 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 whose use 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 classifies the portion of donor-restricted endowment funds that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure.

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, 2009 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, 2009 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 reported at estimated fair value, based on valuations provided by external investment managers and evaluated for reasonableness by the University. Because these alternative investments are not readily marketable, their estimated fair value is subject to additional uncertainty, and therefore values realized upon disposition may vary significantly from currently reported fair 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.

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.

(Continued)

(g) Split Interest Agreements

The University is a participating beneficiary in a number of split interest agreements such as charitable remainder trusts and charitable lead trusts. 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.

(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) 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.

(j) 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 records 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.

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 “redesignated funds” in the statement of activities.

(k) Contributions Receivable

The University records 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 using discount 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.

(l) Asset Retirement Obligations

The University has recorded a liability for its asset retirement obligations (ARO), although the exact timing and method of settlement are unknown. The ARO was 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.

(m) 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.

(n) 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.

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.

(o) Operations

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

(p) 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.

(q) 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 are considered 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 believes that no significant uncertain tax positions have been taken in its tax returns.

(r) Fair Value Measurements

Certain assets and liabilities are reported or disclosed at fair value in the financial statements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note 20 for additional information with respect to fair value measurements.

(s) New Accounting Pronouncements

Effective June 30, 2010, the University adopted the disclosure provisions of Accounting Standards Update No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)* (ASU 2009-12). The required disclosures include information about the investor's ability to redeem its investments at the measurement date, unfunded commitments, and investee strategy.

(t) 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.

(3) Notes Receivable

Notes receivable are carried at face value, less an allowance for doubtful accounts of $405,000 and $401,000 at June 30, 2010 and 2009, respectively. The interest rates on federal student financial aid ranged from 3% to 5% for the years ended June 30, 2010 and 2009. 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, 2010 and 2009 (in thousands):

		2010	2009
Receivable in less than one year	$	54,679	54,472
Receivable in one year to five years		29,534	70,850
Receivable in over five years		607	2,341
Total contributions receivable, gross		84,820	127,663
Less allowance for uncollectible contributions		(819)	(1,211)
Total contributions receivable, net of allowance		84,001	126,452
Discount to reduce contributions to present value		(3,746)	(7,037)
Total	$	80,255	119,415

The University discounts contributions to present value utilizing a discount rate on the date of the pledge, which remains constant for the life of a pledge. The discount rates ranged from 0.32% to 7.73% at June 30, 2010.

As of June 30, 2010, gross contributions receivable include $43,306,000 remaining to be collected on two permanently restricted contributions. 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, 2010 and 2009 consist of the following (in thousands):

		2010	2009
Land	$	2,712	2,712
Land improvements		8,191	7,992
Buildings and improvements		271,349	266,283
Equipment		39,827	38,417
Art properties		2,465	2,328
		324,544	317,732
Less accumulated depreciation		(133,264)	(124,297)
		191,280	193,435
Construction in progress		16,027	5,779
Total	$	207,307	199,214

(6) Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30, 2010 and 2009 are available for the following purposes (in thousands):

		2010	2009
Financial aid	$	6,169	8,120
Program support		49,156	42,011
Buildings and equipment		18,390	23,159
Other		3,182	2,103
Accumulated appreciation on donor-restricted endowment funds, principally for program support and financial aid		213,254	183,361
Total	$	290,151	258,754

(7) Permanently Restricted Net Assets

The return earned on permanently restricted net assets at June 30, 2010 and 2009 is available to support the following (in thousands):

		2010	2009
Financial aid	$	222,841	213,437
Program support		425,196	411,592
Other		8,344	5,396
Total	$	656,381	630,425

(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, 2010 and 2009 for each class of net assets is as follows (in thousands):

		Investment pool	Annuity and life income	Other	Total
2010:					
Net assets:					
Unrestricted	$	166,040	—	23,585	189,625
Temporarily restricted		217,115	41,133	—	258,248
Permanently restricted		326,651	23,351	—	350,002
Investments as of June 30, 2010	$	709,806	64,484	23,585	797,875
2009:					
Net assets:					
Unrestricted	$	145,130	—	20,125	165,255
Temporarily restricted		187,044	54,787	—	241,831
Permanently restricted		277,646	21,406	—	299,052
Investments as of June 30, 2009	$	609,820	76,193	20,125	706,138

(Continued)

The University has made commitments to certain investments for which capital contributions are drawn over time. The outstanding commitments to these investments were $14,152,000 as of June 30, 2010.

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 $56,369,000 and $52,344,000 as of June 30, 2010 and 2009, respectively. The interest rates on these loans range from 3.19% to 7.96% and maturity dates range up to 30 years. The face value of these loans as of June 30, 2010 and 2009 was approximately $56,115,000 and $55,837,000, 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.

As of June 30, 2010, the University has $592,056,000 of investments in both marketable and non-marketable alternative investment funds that are reported at estimated fair value.

Of the $592,056,000 of total alternative investments, $6,831,000 represents the marketable alternative investments that are redeemable at net asset value under the original terms of the partnership agreements and/or subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the underlying fund agreements. Due to the nature of the investments held by the funds, changes in market conditions and the economic environment may significantly impact the net asset value of the funds and, consequently, the fair value of the University’s interests in the funds. Furthermore, changes to the liquidity provisions of the funds may significantly impact the fair value of the University’s interest in the funds.

The remaining $585,225,000 represents the non-marketable alternative investments and, although a secondary market exists for non-marketable investments, it is not active and individual transactions are typically not observable. When transactions occur in this limited secondary market, they may occur at discounts to the reported net asset value. Therefore, if the redemption rights in the funds were restricted or eliminated and the University was to sell these investments in the secondary market, it is reasonably possible that a buyer in the secondary market may require a discount to the reported net asset value, and the discount could be significant.

Investments, at estimated fair value, are comprised of the following at June 30, 2010 and 2009 (in thousands):

	2010				
	Endowment	**Life income and annuities**	**Other**	**Total**	**2009 Total**
Short-term investments	$ 57,188	1,129	481	58,798	29,394
Equities	1,547	49,051	130	50,728	70,223
Fixed income	13,135	12,490	7,829	33,454	28,243
Real assets	48,632	216	1,154	50,002	53,083
Emerging markets	—	2,890	—	2,890	2,509
Hedge funds	5,992	—	24	6,016	26,573
Mortgage loans to staff and fraternities	56,146	—	223	56,369	52,344
Multi-Asset Class *(see below)* *	499,982	—	1,983	501,965	410,515
Private Equity/Venture Capital	37,504	—	149	37,653	33,254
Total	$ 720,126	65,776	11,973	797,875	706,138

* This represents the University's investments in Makena. Makena's Multi-Asset Class portfolio is diversified across geographics, strategies, and over 150 best-of-class investment managers.

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

	2010	**2009**
Interest and dividend income, net of investment expenses of $606 and $1,055 in 2010 and 2009, respectively	$ 5,153	6,039
Net appreciation (depreciation) in fair value of investments	92,190	(143,709)
Total investment return	97,343	(137,670)
Less investment return available under spending policy, including board-designated amount of $25,842 in 2010 and temporary restricted amount of $4,083 in 2010	(30,814)	(34,782)
Investment return in excess of (less than) amount available under spending policy, including permanently restricted amount of $3,745 in 2010 and temporarily restricted amounts of $34,107 in 2010	$ 66,529	(172,452)

The University maintains a statement of investment policies and objectives which is approved by the Investment Committee and the Board of Trustees. The policy, which is reviewed no less than every two years, provides guidance on investment objectives, appropriate investment vehicles, asset allocation and spending policy for the endowment investments. The University employed in December 2007, Makena Capital Management (Makena) to manage the majority of the University's endowment funds. In so doing, the University has delegated the authority for asset allocation and manager selection to Makena, and in the period since the selection of Makena, the University has redeemed holdings from other managers (legacy investments) and placed those funds with Makena. As of June 30, 2010, approximately 70% of the University's endowment funds were held at Makena.

Makena utilizes both traditional and non-traditional investment strategies for the implementation of asset allocation. The single investment pooled fund is invested in over 175 individual managers across 10 asset classes and within 40 sub-asset class investment strategies. The portfolio is structured across the asset and sub-asset classes to generate performance in excess of relevant benchmarks while realizing substantially lower volatility than equity markets.

The portfolio as of June 30, 2010 was allocated across the following asset classes as follows:

U.S. Equity	5%
International Equity	5%
Emerging Markets Equity	5%
Tactical Hedged Equity	7%
Real Estate	8%
Private Equity	16%
Natural Resources	9%
Absolute Return	31%
Fixed Income	12%
Cash	2%

Other investments held by the University are related to "legacy" assets of the endowment which are a series of hedge funds, private equity and venture capital funds and real asset funds. These are held with the University as a limited partner in each of the investments. These funds are structured to draw as needed capital commitments from the investors over a defined period of time. The University, as of June 30, 2010, had potential capital draws to be called in these investments of approximately $14.15 million. These funds were entered into with the expectation that their risk and return profiles were less correlated to equity indices and as a result could assist the portfolio in recognizing long-term real returns at lesser volatility than a simple equity portfolio could deliver. In addition, the University holds a portfolio of employee mortgages that serves as both an employee benefit and an investment. These assets most closely mirror fixed income investments with a defined earnings and principal repayment stream for each. Finally, the University holds cash and cash equivalents to address liquidity needs that are not as easily met under the Makena structure. The cash and cash equivalents are utilized to provide capital commitment funding on "legacy" investments and endowment payout.

In addition, the University has within its investments, those investments held by the University as trustee that provide payout to named beneficiaries but will ultimately be passed to the University. These funds are held at BNY Mellon and are invested primarily across a range of equity indexed products and fixed income indexed products in a more traditional investment approach. The majority of the funds are held in mutual fund products.

The following table provides outstanding unfunded commitments and fund redemption information by major asset class within the University's investment pool as of June 30, 2010 (in thousands):

	2010			
	Fair value	**Unfunded commitments**	**Redemption frequency (if currently available)**	**Redemption notice period**
Investments:				
Short-term investments	$ 58,798	—	Daily	1 day
Equities	50,728	—	Daily, monthly	1 to 30 days
Fixed income	33,454	—	Daily, monthly	1 to 30 days
Real assets	50,002	8,752	*	*
Emerging markets	2,890	—	Monthly	30 days
Hedge funds	6,016	—	Annual	90 days
Mortgage loans to staff and fraternities	56,369	—	N/A	N/A
Multi-Asset Class	501,965	—	Annual	1 year
Private Equity/Venture Capital	37,653	5,400	*	*
Total investments	$ 797,875	14,152		

* These are primarily limited partnerships where distributions are made to investors through the liquidation of the underlying assets. It is expected to take 10-15 years to fully distribute these assets.

(9) Endowment

Endowment is a term used commonly to refer to the resources that have been restricted by donors 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, 2010, the University holds 1,171 endowment funds, of which 1,084 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, 2010 and 2009 was $533,396,000 and $448,187,000, respectively. The fair value of quasi-endowments at June 30, 2010 and 2009 was $186,730,000 and $176,493,000, respectively.

Interpretation of Relevant Law

Based on the interpretation of Virginia's legislation, which incorporates the provisions of the Uniform Prudent Management of Institutional Funds Act (the Act or UPMIFA), by the Board of Trustees of the University, and absent explicit donor stipulations to the contrary, the University classifies the original value of gifts donated to the permanent endowment, as well as accumulations to the permanent endowment made at the direction of the donor, as permanently restricted net assets.

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 appropriated for expenditure by the Board of Trustees in a manner consistent with the standard of prudence prescribed by the Act. In accordance with the Act, the University considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund;
2. The purposes of the University and the donor-restricted endowment fund;
3. General economic conditions;
4. The possible effect of inflation or deflation;
5. The expected total return from income and the appreciation of investments;
6. Other resources of the University; and
7. The investment policies of the University.

Endowment net assets consist of the following at June 30, 2010 (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (7,727)	214,472	326,651	533,396
Board-designated endowment funds	186,730	—	—	186,730
Total endowed net assets	$ 179,003	214,472	326,651	720,126

Included in temporarily restricted net assets at June 30, 2010 is $213,254,000, which will be released from restriction when appropriated by the Board of Trustees.

Endowment net assets consist of the following at June 30, 2009 (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (13,909)	184,513	277,583	448,187
Board-designated endowment funds	176,493	—	—	176,493
Total endowed net assets	$ 162,584	184,513	277,583	624,680

Changes in endowment net assets for the year ended June 30, 2010 are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2009	$ 162,584	184,513	277,583	624,680
Investment return:				
Investment income	7,898	21,200	—	29,098
Net appreciation	19,141	30,745	—	49,886
Contributions and pledge payments	1,994	21	49,068	51,083
Appropriation for expenditure	(7,917)	(22,007)	—	(29,924)
Transfer Board-designated funds	(4,697)	—	—	(4,697)
Endowment net assets, June 30, 2010	$ 179,003	214,472	326,651	720,126

Changes in endowment net assets for the year ended June 30, 2009 are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, July 1, 2008	$ 493,641	1,253	228,410	723,304
Net assets reclassification due to adoption of FSP 117-1	(278,393)	278,393	—	—
Endowment net assets after reclassification	215,248	279,646	228,410	723,304
Investment return:				
Investment income	1,650	2,387	—	4,037
Net depreciation	(50,581)	(73,873)	—	(124,454)
Contributions and pledge payments	6,506	14	49,318	55,838
Appropriation for expenditure	(10,116)	(23,929)	—	(34,045)
Redesignations	(123)	268	(145)	—
Endowment net assets, June 30, 2009	$ 162,584	184,513	277,583	624,680

Funds with Deficiencies

From time to time, the fair value of assets associated with an individual donor-restricted endowment fund may fall below the original value of the fund. Deficiencies of this nature that are reported in unrestricted net assets were $7,727,000 and $13,909,000 as of June 30, 2010 and 2009, respectively. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

Return Objectives and Risk Parameters

The University has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The University targets a diversified asset allocation that places emphasis on investments in equities, bonds and absolute return strategies to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

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 June 30, 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.

(Continued)

(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, 2010 and 2009, the fair value of the University's interest was reported by the trustees as \$246,114,000 and \$235,343,000, respectively. During the years ended June 30, 2010 and 2009, the University received distributions of \$8,110,000 and \$7,742,000, respectively, from the Lettie Pate Evans Foundation, Inc. Restricted Fund.

At both June 30, 2010 and 2009, the University maintained an interest in 46 and 45 other trusts with fair values reported by the trustees of \$41,921,000 and \$37,118,000, respectively, and received distributions for the years ended June 30, 2010 and 2009 of \$1,169,000 and \$1,379,000, respectively.

(11) Long-Term Debt and Derivative Instruments

Long-term debt consists of the following obligations at June 30, 2010 and 2009 (in thousands):

	Final maturity	Interest rates	2010	2009
Virginia College Building Authority:				
1998 Note, includes premium of \$1,227 and \$1,276, respectively	January 2031	5.03% – 5.05%	\$ 53,432	53,481
2001 Note, includes premium of \$2,312 and \$2,411, respectively	January 2034	5.00% – 5.75%	45,310	45,411
2006 Note, includes premium of \$321 and \$341, respectively	January 2016	4.00% – 5.00%	14,646	16,272
Industrial Development Authority:				
1997 Note	December 2012	Variable	1,850	2,532
2003 Note	April 2018	Variable	2,041	2,304
Bank of America				
2008 Commercial Note	January 2014		2,150	2,750
			\$ 119,429	122,750

Aggregate principal payments due for the next five fiscal years are: 2011 – \$3,188,000; 2012 – \$3,047,000; 2013 – \$2,560,000; 2014 – \$1,983,000; 2015 – \$1,703,000 and thereafter – \$103,089,000.

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 (Swap 1) 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%. Swap 1 is used to minimize cash flow fluctuations of interest payments caused by the volatility of LIBOR.

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.

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 was refinanced in December 2008 and Swap 3 expired.

In August 2006, the VCBA issued Educational Facilities Revenue 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.

In December 2008, the University entered into a refinancing of its 2003 commercial taxable loan for the principal balance of $3,000,000. The 2008 Commercial Note is payable in monthly installments of $50,000 plus interest based on a fixed annual rate of 2.76%.

In December 2009, the University entered into a Revolving Credit agreement with Branch Banking and Trust Company that permits the University to borrow through December, 2011 up to $15,000,000, bearing interest at an adjusted LIBOR rate by adding 30-day LIBOR plus one and one-quarter of one percent (1.25%) per annum; however, the interest rate shall not be less than two and one-quarter of one percent (2.25%). The University paid an origination fee of $5,000 for access to this liquidity. At June 30, 2010, the University had $15,000,000 available under this facility.

The following table summarizes the fair values of the University's interest rate swaps at June 30, 2010 and 2009 and changes in the fair values of those swaps for the years ended June 30, 2010 and 2009 (in thousands):

		2010	2009
Fair values (liability (asset)):			
Swap 1	$	110	172
Swap 2		145	115
Total	$	255	287
Changes in fair values (loss (gain)):			
Swap 1	$	(62)	18
Swap 2		29	89
Swap 3		—	(26)
Total	$	(33)	81

(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, 2010 were as follows (in thousands):

Financial aid	$	1,882
Program support		2,060
Other		3,216
		7,158
Buildings and equipment		9,477
Total	$	16,635

(13) Expenses

Expenses for the years ended June 30, 2010 and 2009 were incurred for the following (in thousands):

		2010	2009
Salaries, wages and benefits	$	79,092	74,756
Supplies and services		29,829	33,570
Depreciation		9,102	9,088
Costs of sales, auxiliary enterprises		4,200	4,647
Interest		5,492	5,930
Total	$	127,715	127,991

(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. During the year ended June 30, 2010, two of the Trusts matured. Of these two Trusts, one has been distributed and the other is currently in the process of being distributed to beneficiaries. As of June 30, 2010, the fair value of the Trusts' assets and the related income for the year then ended were $17,300,000 and $820,000, respectively. As of June 30, 2009, the fair value of the Trusts' assets and the related income for the year then ended were $32,604,000 and $835,000, respectively. The fair value of the charitable lead annuity trusts agreements is included in investments and the associated liabilities to beneficiaries are included in split interest agreement obligations in the statement of financial position.

(15) Retirement Plans

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 $5,088,000 and $4,636,000 for the years ended June 30, 2010 and 2009, respectively.

The University also maintains a discretionary defined contribution retirement plan, The Emeriti Retiree Health Plan for Washington and Lee University (the Plan), for the purpose of providing postretirement medical benefits to eligible academic and nonacademic personnel of the University. Employer contributions for the years ended June 30, 2010 and 2009 totaled $51,000 and $29,000, respectively.

(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, 2010 and 2009 were as follows (in thousands):

		2010	2009
Service cost (benefits attributed to employee service during the year)	$	386	367
Interest cost on accumulated postretirement benefit obligation		731	615
Amortization of actuarial gain and prior service cost		5	(9)
Net periodic postretirement benefit cost	$	1,122	973

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 rates used in determining the accumulated postretirement benefit obligation (APBO) as of June 30, 2010 and 2009 were 5% and 6.25%, respectively. The assumed health care cost trend used in measuring the accumulated postretirement benefit obligation was 9.5% in 2010, decreasing to 5% over the next ten years. Effective September 1, 2008, the postretirement benefit plan changed from self-insured to fully insured. In conjunction with this change, 1) the retiree premium rate decreased from 40% of the plan costs to 34% of the Medicare Advantage premium rate, and 2) the lifetime benefit maximum changed from an accumulation of claims paid to an accumulation of employer premiums paid. The increase in APBO as a result of these changes is amortized in benefit costs using the straight-line method over ten years, which is the approximate average of future years of service to full eligibility for active participants. As a result of the change to a fully insured plan, the University no longer receives a prescription drug subsidy under Medicare Part D.

The following information summarizes activity in the unfunded postretirement benefit plan for the years ended June 30, 2010 and 2009 (in thousands):

		2010	2009
Change in benefit obligation:			
Accumulated benefit obligation, beginning of year	$	11,499	9,653
Service cost		386	367
Interest cost		731	615
Prior service cost for plan changes		—	1,548
Actuarial loss (gain)		1,464	(307)
Net benefits paid		(363)	(377)
Accumulated benefit obligation, end of year	$	13,717	11,499
Amount not yet recognized in net periodic benefit cost and included in unrestricted net assets:			
Actuarial gain and prior service cost, net (gain) loss	$	(161)	1,454

Projected postretirement health benefits expected to be paid in each of the next five fiscal years are: 2011 – $458,000; 2012 – $560,000; 2013 – $665,000; 2014 – $759,000; and 2015 – $862,000. An additional $5,985,000 is expected to be paid for the fiscal years 2016 through 2020.

Total employer and participant contributions are $363,000 and $181,000, respectively, for the year ended June 30, 2010. Total benefits paid for the year ended June 30, 2010 are $544,000. The employer and participant contributions for the year ending June 30, 2011 are expected to be $458,000 and $203,000, respectively, for a total of $661,000 in benefits paid. The expense discount rate for June 30, 2010 and 2009 are 5% and 6.25%, respectively. The measurement date was June 30, 2010.

(17) Commitments

The University's contractual commitments for capital expenditures totaled approximately $6,951,000 at June 30, 2010, and were comprised of the following (in thousands):

Colonnade Renovation	$	1,911
Sorority House Construction		3,567
Residence Halls Upgrades		456
Jewish Life Center – Hillel House		330
Various other projects		687
	$	6,951

(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 77% and 81% of total funds held in trust by others as of June 30, 2010 and 2009, 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.

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, change in net assets and/or liquidity of the University.

(20) Fair Value Measurements

(a) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of the University's financial instruments.

- **Cash and cash equivalents, student accounts receivables, other receivables, accounts payable, other payables, and accrued liabilities:** The carrying amounts approximate fair value because of the short maturity of these financial instruments.

- **Notes receivable:** The University has estimated the net realizable value of notes receivable, evaluated collection history, and has concluded the carrying amount approximates fair value.

- **Contributions receivable and split interest agreement obligations:** 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 discount rates used in calculation of split interest agreement obligations ranged from 2.60% to 10.60% at June 30, 2010 and 2009.

- **Investments and funds held in trust by others:** The fair values of marketable equity and debt securities are determined using quoted market prices at the reporting date multiplied by the quantity held. The fair value of mortgage loans to exempt employees is determined as the present value of future contractual cash flows discounted at an interest rate that reflects the risks inherent in those cash flows. The discount rate approximates rates currently offered by local lending institutions for loans of similar terms with comparable credit risk. The fair values of other investments without a readily determinable fair value, such as hedge fund investments, private equity and venture capital, natural resource and real estate investments, are estimated based on the investment's net asset value of shares or units held by the University at the reporting date as a practical expedient. The various net asset values are based on valuations provided by external investment managers, which are reviewed by the University for reasonableness. Short-term investments are comprised of short-term fixed income securities. Because of the nature of these assets, carrying amounts approximate fair values, which have been determined from public quotations, when available.

- **Interest rate swaps:** The fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data, adjusted to reflect nonperformance risk of both the counterparty and the University.

- **Long-term debt:** The estimated fair value of the University's long-term debt was $133,070,000 and $127,200,000 as of June 30, 2010 and 2009, respectively. Fair values for 2010 and 2009 were estimated based on an average interest rate of 3.21% and 4.32%, respectively, the bond buyer municipal index rate for June 30, 2010 and 2009. 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.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the University believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

(b) Fair Value Hierarchy

The inputs to valuation techniques used to measure fair value are delineated within a fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the University has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2010 (in thousands):

	Total	Fair Value Measurements at Reporting Date Using		
	June 30, 2010	**Level 1**	**Level 2**	**Level 3**
Assets:				
Investments:				
Short-term investments	$ 58,798	57,831	967	—
Equities	50,728	50,555	20	153
Fixed income	33,454	33,356	23	75
Real assets	50,002	—	4,395	45,607
Emerging markets	2,890	2,890	—	—
Hedge funds	6,016	—	—	6,016
Mortgage loans to staff and fraternities	56,369	—	56,369	—
Multi-Asset Class	501,965	—	—	501,965
Private Equity/Venture Capital	37,653	—	—	37,653
Total investments	797,875	144,632	61,774	591,469
Funds held in trust by others	288,035	—	—	288,035
Total assets	$ 1,085,910	144,632	61,774	879,504
Liabilities:				
Interest rate swaps	$ 255	—	255	—
Total liabilities	$ 255	—	255	—

The University's investment with Multi-Asset Class manager (Makena Capital Management) is appropriately reported as a Level 3 investment; however, Makena estimates that the underlying portfolio is structured such that the assets as they would report would be allocated with 17% in Level 1, 9.6% in Level 2 and 73.4% in Level 3 as of June 30, 2010.

The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2009 (in thousands):

		Total June 30, 2009	Fair Value Measurements at Reporting Date Using Level 1	Level 2	Level 3
Assets:					
Investments:					
Short-term investments	$	29,394	28,558	836	—
Equities		70,223	61,899	20	8,304
Fixed income		28,243	27,964	37	242
Real assets		53,083	—	5,901	47,182
Emerging markets		2,509	2,509	—	—
Hedge funds		26,573	—	—	26,573
Mortgage loans to staff and fraternities		52,344	—	52,344	—
Multi-Asset Class		410,515	—	—	410,515
Private Equity/Venture Capital		33,254	—	—	33,254
Total investments		706,138	120,930	59,138	526,070
Funds held in trust by others		272,461	—	—	272,461
Total assets	$	978,599	120,930	59,138	798,531
Liabilities:					
Interest rate swaps	$	287	—	287	—
Total liabilities	$	287	—	287	—

The University owns interests in alternative investment funds rather than in the securities underlying each fund, and therefore it is generally required to consider such investments as Level 2 or 3, even though the underlying securities may not be difficult to value or may be readily marketable. Because net asset value is used as a practical expedient to estimate fair value, the level in the fair value hierarchy in which each fund's fair value measurement is classified is based primarily on the University's ability to redeem all or a portion of its interest in each fund at or near the date of the statement of financial position. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risk associated with investing in those investments or a reflection on the liquidity of each fund's underlying assets and liabilities.

The following table presents the University's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended June 30, 2010 (in thousands):

		Investments	Funds held in trust by others	Total
Beginning balance at June 30, 2009	$	526,070	272,461	798,531
Realized gains		15,512	—	15,512
Unrealized gains		48,924	24,525	73,449
Net purchases		63,650	—	63,650
Contributions		—	328	328
Distributions		(62,687)	(9,279)	(71,966)
Ending balance at June 30, 2010	$	591,469	288,035	879,504

For the period from July 1, 2009 to June 30, 2010, there was approximately $78,295,000 of net unrealized gains included in the change in net assets that were attributable to Level 3 assets still held at June 30, 2010.

The following table presents the University's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended June 30, 2009 (in thousands):

		Investments	Funds held in trust by others	Total
Beginning balance at July 1, 2008	$	667,975	303,214	971,189
Realized losses		(4,248)	—	(4,248)
Unrealized losses		(136,311)	(21,934)	(158,245)
Net purchases		82,458	—	82,458
Contributions		—	302	302
Net sales		(83,804)	—	(83,804)
Distributions		—	(9,121)	(9,121)
Ending balance at June 30, 2009	$	526,070	272,461	798,531

For the period from July 1, 2008 to June 30, 2009, there was approximately $123,744,000 of net unrealized losses included in the change in net assets that were attributable to Level 3 assets still held at June 30, 2009.

(21) Subsequent Event

In September 2010, the Industrial Development Authority of the City of Lexington, Virginia (the Lexington Authority) issued bonds in the amount of $15,000,000. These bonds have been structured as variable rate demand bonds with a weekly reset. The proceeds derived from the sale were loaned to the University in exchange for its note payable. Such proceeds will be used primarily to finance a series of energy performance projects; facility renovations, updates, and repairs; general furniture, fixture, and equipment replacement; information technology upgrades; and, infrastructure and midlevel renovations such as modifications for classroom space, replace air handling system and waterproofing.

The University evaluated subsequent events for potential recognition and/or disclosure in the June 30, 2010 financial statements through October 25, 2010, the date the financial statements were issued.