THE WASHINGTON AND LEE UNIVERSITY
AND ITS AFFILIATE

Consolidated Financial Statements

June 30, 2012

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 1010
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 consolidated statement of financial position of The Washington and Lee University and its affiliate (the University) as of June 30, 2012, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from the University's 2011 consolidated financial statements and, in our report dated October 27, 2011, we expressed an unqualified opinion on those consolidated financial statements.

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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Washington and Lee University and its affiliate as of June 30, 2012, and the changes in their net assets and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 30, 2012

THE WASHINGTON AND LEE UNIVERSITY AND ITS AFFILIATE

Consolidated Statement of Financial Position

June 30, 2012 (with comparative information as of June 30, 2011)

(In thousands)

Assets		**2012**	**2011**
Cash and cash equivalents	$	6,502	6,332
Accounts and other receivables		5,165	3,882
Notes receivable, net *(note 3)*		7,134	7,410
Contributions receivable, net *(note 4)*		53,923	58,355
Inventories		1,186	1,135
Investments *(notes 7, 13 and 19)*		911,822	924,926
Funds held in trust by others *(notes 9, 17 and 19)*		424,177	374,637
Assets restricted to investment in land, buildings, and equipment		2,572	724
Land, buildings, and equipment, net *(note 5)*		222,187	220,015
Debt issuance costs, net		929	982
Total assets	$	1,635,597	1,598,398
Liabilities and Net Assets			
Liabilities:			
Accounts and other payables *(notes 10 and 19)*	$	8,631	8,898
Accrued compensation		3,185	3,384
Student and other deposits		709	951
Deferred revenue		2,767	2,145
U.S. Government grants refundable		2,009	2,050
Split interest agreement obligations *(note 13)*		42,528	43,544
Asset retirement obligations		1,116	1,327
Postretirement benefit obligation *(note 15)*		15,054	14,742
Long-term debt *(note 10)*		127,589	130,945
Total liabilities		203,588	207,986
Commitments and contingencies *(notes 7, 16 and 18)*			
Net assets *(note 8)*:			
Unrestricted		273,372	279,145
Temporarily restricted *(note 6)*		333,210	345,388
Permanently restricted *(note 6)*		825,427	765,879
Total net assets		1,432,009	1,390,412
Total liabilities and net assets	$	1,635,597	1,598,398

See accompanying notes to consolidated financial statements.

THE WASHINGTON AND LEE UNIVERSITY AND ITS AFFILIATE

Consolidated Statement of Activities

Year ended June 30, 2012 (with summarized comparative information for the year ended June 30, 2011)

(In thousands)

	2012				2011
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**	**Total**
Operating revenue and gains:					
Tuition and fees	$ 89,996	—	—	89,996	85,369
Less donor funded student financial aid	(19,867)	—	—	(19,867)	(18,188)
Less institutionally funded student financial aid	(14,223)	—	—	(14,223)	(12,979)
Net tuition and fees	55,906	—	—	55,906	54,202
Endowment return allocated to operations *(note 7)*	31,325	5,097	—	36,422	33,267
Other investment income *(note 7)*	598	116	—	714	840
Distributions from funds held in trust by others *(note 9)*	10,179	78	—	10,257	9,809
Contributions	8,012	—	—	8,012	9,625
Auxiliary enterprises (net of $1,889 and $1,396 of institutionally funded student financial aid)	16,601	—	—	16,601	15,896
Governmental and other grants	—	2,353	—	2,353	2,134
Other	399	255	—	654	639
Net assets released from restrictions *(note 11)*	8,085	(8,085)	—	—	—
Total operating revenue and gains	131,105	(186)	—	130,919	126,412
Operating expenses *(note 12)*:					
Instruction	62,572	—	—	62,572	59,240
Research	2,725	—	—	2,725	2,536
Public service	884	—	—	884	659
Academic support	16,056	—	—	16,056	14,967
Financial aid	2,598	—	—	2,598	1,996
Student services	12,477	—	—	12,477	11,764
Institutional support	19,001	—	—	19,001	17,740
Auxiliary enterprises	18,316	—	—	18,316	16,803
Total operating expenses	134,629	—	—	134,629	125,705
Change in net assets from operating activities	(3,524)	(186)	—	(3,710)	707
Nonoperating activities:					
Investment returns, net of amount allocated to operations *(note 7)*	(8,775)	(20,347)	1,261	(27,861)	87,118
Change in value of funds held in trust by others	—	2,566	46,580	49,146	86,283
Split interest agreements, net	19	(769)	(386)	(1,136)	(4,917)
Contributions	—	14,252	11,747	25,999	25,672
Other, net	(1,348)	—	1	(1,347)	3,847
Net assets released for fixed asset acquisitions (note 11)	6,725	(6,725)	—	—	—
Postretirement charge other than benefit cost *(note 15)*	506	—	—	506	(35)
Redesignated funds	624	(969)	345	—	—
Total nonoperating activities	(2,249)	(11,992)	59,548	45,307	197,968
Change in net assets	(5,773)	(12,178)	59,548	41,597	198,675
Net assets:					
Beginning of year	279,145	345,388	765,879	1,390,412	1,191,737
End of year	$ 273,372	333,210	825,427	1,432,009	1,390,412

See accompanying notes to consolidated financial statements.

THE WASHINGTON AND LEE UNIVERSITY AND ITS AFFILIATE

Consolidated Statement of Cash Flows

Year ended June 30, 2012 (with comparative information for the year ended June 30, 2011)

(In thousands)

	2012	2011
Cash flows from operating activities:		
Change in net assets	$ 41,597	198,675
Adjustments to reconcile change in net assets to net cash and cash equivalents used in operating activities:		
Realized and unrealized gains on investments	(2,675)	(116,307)
Change in value of funds held in trust by others	(49,146)	(86,283)
Depreciation and amortization	10,570	9,033
Actuarial losses on annuity obligations, net	(1,125)	(4,795)
Gain on sale of land, buildings and equipment	—	(2,496)
Contributions of investments	(13,271)	(34,231)
Contributions restricted for long-term investment	(14,836)	(11,032)
Interest and dividends restricted for long-term investment	(1,110)	(1,262)
Changes in operating assets and liabilities:		
Accounts and other receivables, net	(1,007)	(1,780)
Contributions receivable, net	4,432	21,900
Inventories	(51)	(32)
Accounts payable and other accrued liabilities	(148)	5,016
Student and other deposits	(242)	(94)
Deferred revenue	622	(180)
U.S. Government grants refundable	(41)	(31)
Split interest agreement obligations	2,746	10,861
Asset retirement obligations	312	(1,500)
Net cash and cash equivalents used in operating activities	(23,373)	(14,538)
Cash flows from investing activities:		
Purchases of land, buildings, and equipment, including interest capitalized	(13,390)	(24,763)
Proceeds from sale of land, buildings, and equipment	—	1,000
Purchases of investments restricted to land, buildings, and equipment	(9,674)	(5,981)
Proceeds from sale of investments	200,549	277,555
Purchases of investments	(163,472)	(248,071)
Net cash and cash equivalents provided by (used in) investing activities	14,013	(260)
Cash flows from financing activities:		
Interest and dividends restricted for long-term investment	1,110	1,262
Proceeds from contributions restricted for long-term investment in endowment and plant	14,836	11,032
Payments for debt issuance costs	—	(206)
Payments on split interest agreements	(3,234)	(6,973)
Proceeds from issuance of long-term debt	—	15,000
Principal payments on long-term debt	(3,182)	(3,314)
Net cash and cash equivalents provided by financing activities	9,530	16,801
Net increase in cash and cash equivalents	170	2,003
Cash and cash equivalents:		
Beginning of year	6,332	4,329
End of year	$ 6,502	6,332
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest, net of amounts capitalized	$ 5,924	5,966

Noncash investing and financing activities:

At June 30, 2012 and 2011, $432,000 and $749,000, respectively, of fixed asset purchases were included in accounts payable and other accrued liabilities.

During the year ended June 30, 2011, a portion of the sale of land, buildings, and equipment was financed through notes receivable from the buyers totaling $2,665,000.

See accompanying notes to consolidated financial statements.

(1) Description of Organization

The Washington and Lee University (W&L) is a private, liberal arts university in Lexington, Virginia. Founded in 1749, it is the ninth oldest institution of higher learning in the nation. W&L 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 W&L. W&L 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.

On November 15, 2010, Colonnade Restoration, LLC, a Virginia limited liability company and controlled affiliate of W&L, was formed for the purpose of restoring, rehabilitating, constructing and developing the historic buildings on W&L grounds known collectively as The Colonnade. Colonnade Restoration, LLC was formed so that the renovation expenditures incurred on the rehabilitation projects designated by the Virginia Department of Historic Resources will support Virginia Historic Tax Credits certified to Colonnade Restoration, LLC for allocation to its members. W&L has no membership interest in Colonnade Restoration, LLC but rather controls the affiliate through various leasing arrangements.

(2) Summary of Significant Accounting Policies

(a) Basis of Financial Statement Presentation and Consolidation

The consolidated financial statements include the financial statements of W&L and its affiliate (collectively, the University). The consolidated financial statements have been prepared on the accrual basis of accounting and all significant intercompany balances and transactions have been eliminated in consolidation.

(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 9) 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 consolidated statement of activities and are, therefore, reflected as permanently restricted net assets in the consolidated statement of financial position.

(c) Summarized Comparative Information

The consolidated statement of activities for the year ended June 30, 2012 is presented with certain summarized comparative information for the year ended June 30, 2011 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, 2011 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 consolidated 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 consolidated 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.

(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 consolidated 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 consolidated 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 consolidated 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 consolidated 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 consolidated 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 consolidated statement of financial position and the income (including unrealized appreciation and depreciation) is recorded in the consolidated 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 consolidated 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 consolidated statement of activities.

(Continued)

(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 consolidated 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 consolidated 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 consolidated 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 consolidated 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 Washington and Lee University has been classified as an organization described under Section 501(c)(3) of the Internal Revenue Code and thus exempt from federal income taxes on activities related to its exempt purpose. The University does not believe that there are any unrecognized tax benefits or costs that should be recorded in the consolidated financial statements. Accordingly, no provision for income taxes has been reflected in the consolidated financial statements.

The Internal Revenue Service (IRS) has held that a Virginia limited liability company, treated as a partnership for state income tax purposes, would also be treated as a partnership for federal income tax purposes. Therefore, income taxes are not provided with respect to the operations of Colonnade Restoration, LLC since each member is responsible for the income tax consequences associated with its proportionate share of such operations.

(r) Fair Value Measurements

Certain assets and liabilities are reported or disclosed at fair value in the consolidated 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 19 for additional information with respect to fair value measurements.

(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.

(3) Notes Receivable

Notes receivable are carried at unpaid principal balance, less an allowance for doubtful accounts, and consist of the following at June 30, 2012 and 2011 (in thousands):

	Maturity	Interest rates		2012	2011
Student Financial Aid:					
Federally funded aid, net of allowance for doubtful accounts of $262 and $444, respectively	up to 10 years	3% - 5%	$	1,618	1,566
University funded aid, net of allowance for doubtful accounts of $233 and $221, respectively	up to 10 years	3% - 9%		2,983	3,114
Other notes:					
Note receivable from sale of property	10/31/2020	5%		2,038	2,228
Miscellaneous notes	various	various		495	502
			$	7,134	7,410

(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, 2012 and 2011 (in thousands):

		2012	2011
Receivable in less than one year	$	26,603	30,533
Receivable in one year to five years		28,737	29,808
Receivable in over five years		527	607
Total contributions receivable, gross		55,867	60,948
Less allowance for uncollectible contributions		(554)	(606)
Total contributions receivable, net of allowance		55,313	60,342
Discount to reduce contributions to present value		(1,390)	(1,987)
Total	$	53,923	58,355

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 0.12% to 7.73% at June 30, 2012.

As of June 30, 2012, gross contributions receivable include $7,704,000 remaining to be collected on a permanently restricted contribution. This contribution is restricted to fund faculty salaries and professorships.

(5) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30, 2012 and 2011 consist of the following (in thousands):

		2012	2011
Land	$	5,730	5,730
Land improvements		9,888	8,978
Buildings and improvements		300,628	290,045
Equipment		42,790	40,811
Art properties		2,946	2,666
		361,982	348,230
Less accumulated depreciation		(150,660)	(142,236)
		211,322	205,994
Construction in progress		10,865	14,021
Total	$	222,187	220,015

(6) Net Assets

Temporary Restricted Net Assets

Temporarily restricted net assets at June 30, 2012 and 2011 are available for the following purposes (in thousands):

		2012	2011
Financial aid	$	7,684	7,269
Faculty support		3,018	3,350
Program support		30,567	27,175
Buildings and equipment		3,611	1,474
Contributions receivable		33,029	29,633
Planned giving arrangements		10,445	11,581
Other		534	511
Accumulated appreciation on donor-restricted endowment funds, principally for program support and financial aid		244,322	264,395
Total	$	333,210	345,388

Permanently Restricted Net Assets

Permanently restricted net assets at June 30, 2012 and 2011 are comprised of the following (in thousands):

		2012	2011
Purpose restricted:			
Financial aid	$	231,667	228,820
Faculty support		32,586	24,120
Program support		518,313	464,684
Library and collections support		3,984	3,289
Buildings and equipment		2,800	2,645
Other		6,562	4,525
		795,912	728,083
Time restricted:			
Contributions receivable		22,165	29,568
Planned giving arrangements		7,350	8,228
		29,515	37,796
Total	$	825,427	765,879

(7) 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, 2012 and 2011 for each class of net assets is as follows (in thousands):

		Investment pool	Annuity and life income	Other	Total
2012:					
Net assets:					
Unrestricted	$	184,440	—	23,554	207,994
Temporarily restricted		249,354	37,012	—	286,366
Permanently restricted		393,602	23,860	—	417,462
Investments as of June 30, 2012	$	827,396	60,872	23,554	911,822
2011:					
Net assets:					
Unrestricted	$	191,606	—	26,247	217,853
Temporarily restricted		269,487	38,741	—	308,228
Permanently restricted		373,033	25,812	—	398,845
Investments as of June 30, 2011	$	834,126	64,553	26,247	924,926

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 consolidated statement of financial position, are carried at fair value of $53,537,000 and $52,252,000 as of June 30, 2012 and 2011, respectively. The interest rates on these loans range from 2.25% to 6.59% and maturity dates range up to 30 years. The face value of these loans as of June 30, 2012 and 2011 was approximately $49,770,000 and $51,747,000, respectively.

The non-marketable alternative investments represent approximately $673,933,000 of the University 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, 2012 and 2011(in thousands):

		2012				
		Endowment	**Life income and annuities**	**Other**	**Total**	**2011 Total**
Short-term investments	$	42,880	—	4,409	47,289	51,397
Equities		38,426	51,772	4,373	94,571	97,279
Fixed income		27,389	8,939	50	36,378	36,647
Real assets		43,780	—	1,111	44,891	48,250
Hedge funds		—	1,455	—	1,455	1,873
Mortgage loans to staff and fraternities		53,355	—	182	53,537	52,252
Multi-Asset Class *(see below)* *		592,963	—	2,023	594,986	592,671
Private Equity/Venture Capital		38,583	—	132	38,715	44,557
Total	$	837,376	62,166	12,280	911,822	924,926

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

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

		2012	2011
Interest and dividend income, net of investment expenses of $625 and $471 in 2012 and 2011, respectively	$	5,466	5,384
Net appreciation in fair value of investments		3,809	115,841
Total investment return		9,275	121,225
Less investment return available under spending policy, including board-designated amounts of $31,325 and $28,837 in 2012 and 2011, respectively, and temporarily restricted amounts of $5,097 and $4,430 in 2012 and 2011, respectively		(37,136)	(34,107)
Investment return less than the (in excess of) amount available under spending policy, including permanently restricted amounts of $1,261 and $3,044 in 2012 and 2011, respectively, and temporarily restricted amounts of $(20,347) and $50,251 in 2012 and 2011, respectively	$	(27,861)	87,118

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. In December 2007, the University employed Makena Capital Management, LLC (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, 2012, approximately 71% 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 approximately 167 individual managers across 7 asset classes and over 42 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, 2012 and 2011 was allocated across the following asset classes as follows:

	2012	**2011**
Equity	13%	15%
Tactical Hedged Equity	10%	10%
Real Estate	12%	10%
Private Equity	21%	19%
Natural Resources	8%	9%
Absolute Return	23%	24%
Fixed Income	9%	10%
Cash	4%	3%

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, 2012 and 2011, had potential capital draws to be called on these investments of approximately $4.0 million and $8.14 million, respectively. 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.

(Continued)

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, 2012 (in thousands):

	2012			
	Fair value	Unfunded commitments	Redemption frequency (if currently available)	Redemption notice period
Investments:				
Short-term investments	$ 47,289	—	Daily	1 day
Equities	94,571	—	Daily, monthly	1 to 30 days
Fixed income	36,378	—	Daily, monthly	1 to 30 days
Real assets	44,891	1,299	*	*
Hedge funds	1,455	—	Annual	90 days
Mortgage loans to staff and fraternities	53,537	—	N/A	N/A
Multi-Asset Class	594,986	—	Annual	1 year
Private Equity/Venture Capital	38,715	2,663	*	*
Total investments	$ 911,822	3,962		

* These are primarily limited partnerships where distributions are made to investors through the liquidation of the underlying assets. It is expected to take 10-12 years to fully distribute these assets.

(8) 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, 2012, the University holds 1,219 endowment funds, of which 1,131 are true endowments (restricted by the donor) and 88 are quasi-endowments (designated by the Board).

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, 2012 (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (1,658)	246,747	393,602	638,691
Board-designated endowment funds	198,685	—	—	198,685
Total endowed net assets	$ 197,027	246,747	393,602	837,376

Included in temporarily restricted net assets at June 30, 2012 is $244,322,000, which will be released from restriction when appropriated by the Board of Trustees.

Endowment net assets consist of the following at June 30, 2011 (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (683)	266,743	373,033	639,093
Board-designated endowment funds	204,402	—	—	204,402
Total endowed net assets	$ 203,719	266,743	373,033	843,495

Changes in endowment net assets for the year ended June 30, 2012 are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2011	$ 203,719	266,743	373,033	843,495
Investment return:				
Investment income	6,567	19,594	—	26,161
Net depreciation	(5,024)	(11,840)	—	(16,864)
Contributions and pledge payments	345	89	20,569	21,003
Appropriation for expenditure	(8,580)	(27,839)	—	(36,419)
Endowment net assets, June 30, 2012	$ 197,027	246,747	393,602	837,376

Changes in endowment net assets for the year ended June 30, 2011 are as follows (in thousands):

		Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2010	$	179,003	214,472	326,651	720,126
Investment return:					
Investment income		4,544	13,585	—	18,129
Net appreciation		28,550	62,556	—	91,106
Contributions and pledge payments		(76)	1,095	46,382	47,401
Appropriation for expenditure		(8,302)	(24,965)	—	(33,267)
Endowment net assets, June 30, 2011	$	203,719	266,743	373,033	843,495

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 $1,658,000 and $683,000 as of June 30, 2012 and 2011, 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 model is often referred to as a constant growth spending formula.

(9) 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, 2012 and 2011, the fair value of the University's interest was reported by the trustees as

$376,531,000 and $325,924,000, respectively. During the years ended June 30, 2012 and 2011, the University received distributions of $9,157,000 and $8,634,000, respectively, from the Lettie Pate Evans Foundation, Inc. Restricted Fund.

At June 30, 2012 and 2011, the University maintained an interest in 45 and 47, respectively, other trusts with fair values reported by the trustees of $47,646,000 and $48,713,000, respectively, and received distributions for the years ended June 30, 2012 and 2011 of $1,100,000 and $1,175,000, respectively.

(10) Long-Term Debt and Derivative Instruments

Long-term debt consists of the following obligations at June 30, 2012 and 2011(in thousands):

	Final maturity	Interest rates	2012	2011
Virginia College Building Authority:				
1998 Note, includes premium of $1,122 and $1,176, respectively	January 2031	5.03% – 5.05%	$ 53,327	53,381
2001 Note, includes premium of $2,110 and $2,210, respectively	January 2034	5.00% – 5.75%	45,110	45,210
2006 Note, includes premium of $281 and $301, respectively	January 2016	4.00% – 5.00%	11,561	13,016
Industrial Development Authority:				
1997 Note	December 2012	Variable	387	1,135
2003 Note	April 2018	Variable	1,514	1,778
2010 Note	January 2035	Variable	14,740	14,875
Bank of America				
2008 Commercial Note	January 2014	2.76%	950	1,550
			$ 127,589	130,945

Aggregate principal payments due for the next five fiscal years are: 2013 – $2,705,000; 2014 – $2,138,000; 2015 – $1,868,000; 2016 – $4,148,000; 2017 – $3,924,000; and thereafter – $109,293,000.

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 December 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 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 September 2010, 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. Annual principal and semi-annual interest payments on this note began January 1, 2012 and will mature January 1, 2035. The 2010 Bonds may be called for redemption upon notification by the University to the Lexington Authority. The interest rates for the year ended June 30, 2012 ranged from 0.03% to 0.23%.

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 2013 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, 2012, the University had $15,000,000 available under this facility.

In April 2011, the University entered into a Revolving Credit agreement with Branch Banking and Trust Company as a dedicated line of credit covering the variable rate debt Series 2010 bonds in the event of a remarketing failure. In April 2012, the Revolving Credit agreement was modified to reflect the reduction of outstanding principal. This agreement permits the University to borrow from April 2012, with automatic extensions at each anniversary until April 2014, up to $14,740,000, 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%). At June 30, 2012, the University had $14,740,000 available under this facility.

The following table summarizes the fair values of the University's interest rate swaps at June 30, 2012 and 2011 (liabilities in both years) and changes in the fair values of those swaps for the years ended June 30, 2012 and 2011(in thousands):

		2012	2011
Fair values:			
Swap 1	$	8	48
Swap 2		123	122
Total	$	131	170
Changes in fair values (loss (gain)):			
Swap 1	$	(40)	(62)
Swap 2		1	(23)
Total	$	(39)	(85)

(11) 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, 2012 were as follows (in thousands):

Financial aid	$	1,850
Program support		2,514
Other		3,721
		8,085
Buildings and equipment		6,725
Total	$	14,810

(12) Expenses

Expenses for the years ended June 30, 2012 and 2011 were incurred for the following (in thousands):

		2012	2011
Salaries, wages and benefits	$	81,897	79,613
Supplies and services		32,204	28,253
Depreciation		11,840	9,540
Asset retirement obligation gain		(1,264)	(1,500)
Costs of sales, auxiliary enterprises		4,661	4,606
Interest		5,291	5,193
Total	$	134,629	125,705

(13) 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, 2012, the fair value of the Trusts' assets and the related income for the year then ended were $17,775,000 and $455,000, respectively. As of June 30, 2011, the fair value of the Trusts' assets and the related income for the year then ended were $17,208,000 and $404,000, 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 consolidated statement of financial position.

(14) 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) and Fidelity Management Trust Company (Fidelity). 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 or

Fidelity. The University's cost under this plan amounted to approximately $5,315,000 and $5,254,000 for the years ended June 30, 2012 and 2011, 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, 2012 and 2011 totaled $183,000 and $159,000, respectively.

(15) 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, 2012 and 2011 were as follows (in thousands):

		2012	2011
Service cost (benefits attributed to employee service during the year)	$	411	427
Interest cost on accumulated postretirement benefit obligation		782	696
Amortization of prior service cost		155	155
Net periodic postretirement benefit cost	$	1,348	1,278

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, 2012 and 2011 were 3.75% and 5.25%, respectively. The assumed health care cost trend used in measuring the accumulated postretirement benefit obligation was 8% in 2012, decreasing to 5% over the next ten years. Effective July 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 34% of the plan costs to 32% 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, 2012 and 2011(in thousands):

		2012	2011
Change in benefit obligation:			
Accumulated benefit obligation, beginning of year	$	14,742	13,717
Service cost		411	427
Interest cost		782	696
Actuarial (gain)loss		(351)	345
Net benefits paid		(530)	(443)
Accumulated benefit obligation, end of year	$	15,054	14,742
Amount not yet recognized in net periodic benefit cost and included in unrestricted net assets:			
Net actuarial gain	$	(1,238)	(887)
Prior service cost		928	1,083
	$	(310)	196

Projected postretirement health benefits expected to be paid in each of the next five fiscal years are: 2013 – $583,000; 2014 – $712,000; 2015 – $829,000; 2016 – $918,000; and 2017 – $1,017,000. An additional $6,400,000 is expected to be paid for the fiscal years 2018 through 2022.

Total employer and participant contributions are $530,000 and $242,000, respectively, for the year ended June 30, 2012. Total benefits paid for the year ended June 30, 2012 are $772,000. The employer and participant contributions for the year ending June 30, 2013 are expected to be $519,000 and $64,000, respectively, for a total of $583,000 in benefits paid. The expense discount rates as of June 30, 2012 and 2011 were 3.75% and 5.25%, respectively. The measurement date was June 30, 2012.

(16) Commitments

The University's contractual commitments for capital expenditures totaled approximately $4,469,000 at June 30, 2012, and were comprised of the following (in thousands):

Colonnade Renovation	$	1,446
Gas utilities commitments		930
Utility efficiency replacements and upgrades		781
Facilities mechanical maintenance		731
Residence halls upgrades		183
Various other projects		398
	$	4,469

The renovation of The Colonnade is designed to occur over three distinct project phases: Newcomb Hall (Project 1); Payne, Washington and Robinson Halls (Project 2); and Tucker Hall (Project 3). The Newcomb Hall Project 1 was completed in fiscal year 2011. Renovations of the Payne Hall portion of Project 2 were complete in fiscal year 2012. Renovations of the Washington Hall portion of Project 2 were in progress as of June 30, 2012 and approximately $1.16 million relating to this project is included in the contractual commitments for the Colonnade Renovation above. The University's Board of Trustees has approved a budget for renovations relating to the Washington Hall portion of Project 2 of approximately $7.47 million. As of June 30, 2012, formal action by the Board of Trustees has not been taken to authorize the renovation of the proposed Robinson Hall portion of Project 2 or the proposed Tucker Hall Project 3.

(17) 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 85% and 83% of total funds held in trust by others as of June 30, 2012 and 2011, respectively.

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

(18) 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 consolidated 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.

(19) 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 0.12% to 7.73% at June 30, 2012 and 2011.

- **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 $151,475,000 and $143,130,000 as of June 30, 2012 and 2011, respectively. Fair values for 2012 and 2011 were estimated based on an average interest rate of 2.54% and 3.08%, respectively, the bond buyer municipal index rate for June 30, 2012 and 2011. 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.

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements,* which provides additional disclosures for transfers in and out of Levels 1 and 2 and for activity in Level 3. This ASU also clarifies certain other existing disclosure requirements including level of desegregation and disclosures around inputs and valuation techniques. The provisions of the ASU are effective for annual or interim reporting periods beginning after December 15, 2009, except for the requirement to provide the Level 3 activity for purchases, sales, issuances, and settlements on a gross basis, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. In the period of initial adoption, the reporting entity shall not be required to provide the disclosures required for any previous periods presented for comparative purposes. The University adopted the provisions of the ASU in 2011, except for the requirements to provide the Level 3 activity for purchases, sales, issuances, and settlements on a gross basis, which were adopted in 2012. The adoption of ASU 2010-06 did not have a material effect on the University's consolidated financial statements.

The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2012 (in thousands):

	Total	Fair Value Measurements at Reporting Date Using		
	June 30, 2012	**Level 1**	**Level 2**	**Level 3**
Assets:				
Investments:				
Short-term investments	$ 47,289	46,984	305	—
Equities	94,571	94,457	—	114
Fixed income	36,378	36,283	20	75
Real assets	44,891	—	4,658	40,233
Hedge funds	1,455	—	1,455	—
Mortgage loans to staff and fraternities	53,537	—	53,537	—
Multi-Asset Class	594,986	—	—	594,986
Private Equity/Venture Capital	38,715	—	—	38,715
Total investments	911,822	177,724	59,975	674,123
Funds held in trust by others	424,177	—	—	424,177
Total assets	$ 1,335,999	177,724	59,975	1,098,300
Liabilities:				
Interest rate swaps	$ 131	—	131	—
Total liabilities	$ 131	—	131	—

The University's investment with Multi-Asset Class manager (Makena Capital Management) is reported as a Level 3 investment; however, it is estimated that the underlying portfolio is structured such that the assets as they would report would be allocated with 13% in Level 1, 9% in Level 2 and 78% in Level 3 as of June 30, 2012.

There were no significant transfers between Level 1 and Level 2 investments for the year ended June 30, 2012.

The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2011 (in thousands):

	Total	Fair Value Measurements at Reporting Date Using		
	June 30, 2011	Level 1	Level 2	Level 3
Assets:				
Investments:				
Short-term investments	$ 51,397	51,080	317	—
Equities	97,279	97,140	—	139
Fixed income	36,647	36,553	19	75
Real assets	48,250	842	4,489	42,919
Hedge funds	1,873	—	1,873	—
Mortgage loans to staff and fraternities	52,252	—	52,252	—
Multi-Asset Class	592,671	—	—	592,671
Private Equity/Venture Capital	44,557	—	—	44,557
Total investments	924,926	185,615	58,950	680,361
Funds held in trust by others	374,637	—	—	374,637
Total assets	$ 1,299,563	185,615	58,950	1,054,998
Liabilities:				
Interest rate swaps	$ 170	—	170	—
Total liabilities	$ 170	—	170	—

The University’s investment with Multi-Asset Class manager (Makena Capital Management) is reported as a Level 3 investment; however, it is estimated that the underlying portfolio is structured such that the assets as they would report would be allocated with 15% in Level 1, 10% in Level 2 and 75% in Level 3 as of June 30, 2011.

There were no significant transfers between Level 1 and Level 2 investments for the year ended June 30, 2011.

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 consolidated 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, 2012 (in thousands):

		Investments	Funds held in trust by others	Total
Beginning balance at June 30, 2011	$	680,361	374,637	1,054,998
Net realized and unrealized (losses) gains		(3,881)	58,866	54,985
Net purchases		1,544	—	1,544
Contributions		—	931	931
Distributions		(3,902)	(10,257)	(14,159)
Ending balance at June 30, 2012	$	674,122	424,177	1,098,299

For the period from July 1, 2011 to June 30, 2012, there was approximately $58,994,000 of unrealized gains included in the change in net assets that were attributable to Level 3 assets still held at June 30, 2012.

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, 2011 (in thousands):

		Investments	Funds held in trust by others	Total
Beginning balance at June 30, 2010	$	591,469	288,035	879,504
Unrealized gains		91,829	96,097	187,926
Net purchases		4,184	—	4,184
Contributions		—	314	314
Distributions		(7,121)	(9,809)	(16,930)
Ending balance at June 30, 2011	$	680,361	374,637	1,054,998

For the period from July 1, 2010 to June 30, 2011, there was approximately $187,271,000 of unrealized gains included in the change in net assets that were attributable to Level 3 assets still held at June 30, 2011.

(20) Subsequent Events

The University has evaluated and concluded that there are no subsequent events for potential recognition and/or disclosure in the June 30, 2012 consolidated financial statements through October 30, 2012, the date the consolidated financial statements were issued.