Engaging the culture, changing the world.

Seattle Pacific
UNIVERSITY

# Year Ending June 30, 2005
# Financial Report

## About Seattle Pacific University

Seattle Pacific University is a fully accredited institution of higher learning that offers degree programs in the liberal arts, professional, and graduate studies. The University was founded in 1891 to provide a place where young people could gain a comprehensive education rooted in the Christian faith. SPU serves more than 3,800 degree-seeking students, primarily at its Seattle campus, as well as 3,506 adult learners per academic quarter in continuing education centers across Washington state.

Academically, Seattle Pacific offers 53 undergraduate majors and 41 minors. The University's curriculum is carried out through the College of Arts and Sciences and the schools of Business and Economics; Education; Health Sciences; Theology; and Psychology, Family, and Community. Graduate studies include 11 master's degrees and two doctoral programs, one in educational leadership, the other in clinical psychology.

The University's physical plant includes a 43-acre main campus near the heart of downtown Seattle; a 965-acre wilderness campus on Blakely Island in the San Juan Islands; and the 330-acre Camp Casey campus on Whidbey Island.

## Contents

# Independent Auditors' Report

The Board of Trustees
Seattle Pacific University:

We have audited the accompanying consolidated statements of financial position of Seattle Pacific University (the University) as of June 30, 2005 and 2004, and the related consolidated statements of activities and cash flows for the years 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 audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Seattle, Washington
September 30, 2005

# Consolidated Statements of Financial Position

**For the Years Ended June 30, 2005 and 2004**

*(in thousands)*

| | June 30, 2005 | June 30, 2004 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 19,463 | $ 20,242 |
| Student accounts receivable, net | 2,239 | 2,320 |
| Governmental grants and other receivables | 1,188 | 1,150 |
| Current portion of student loans | 1,362 | 1,358 |
| Current portion of contributions receivable | 214 | 330 |
| Current portion of investments | 25,457 | 24,128 |
| Inventories and prepaid expenses | 1,018 | 826 |
| **Total current assets** | 50,941 | 50,354 |
| Student loans, net of allowance of $209 in 2005 and $184 in 2004 | 6,140 | 6,068 |
| Contributions receivable, net | 544 | 653 |
| Other receivables and prepaid expenses | 5,122 | 2,540 |
| Investments | 38,609 | 33,363 |
| Land, buildings and equipment, net | 119,375 | 122,886 |
| **Total assets** | $ 220,731 | $ 215,864 |
| **LIABILITIES AND NET ASSETS** | | |
| **Liabilities** | | |
| Note payable to bank — line of credit | $ 5,850 | $ 6,000 |
| Accounts payable, accrued expenses and other liabilities | 8,884 | 7,758 |
| Current portion of bonds payable | 3,170 | 2,770 |
| Current portion of trust and annuity obligations | 1,373 | 1,494 |
| Student deposits and prepaid fees | 1,220 | 1,228 |
| Deferred revenue | 3,661 | 3,326 |
| **Total current liabilities** | 24,158 | 22,576 |
| Bonds payable | 77,505 | 80,675 |
| Trust and annuity obligations | 8,565 | 9,313 |
| Investments managed on behalf of charities | 6,410 | 6,082 |
| Deferred unrealized loss on interest rate swaps | 4,920 | 3,521 |
| Other, principally trust funds held for others | 2,218 | 1,945 |
| Governmental student loan programs | 6,410 | 6,331 |
| **Total long-term liabilities** | 106,028 | 107,867 |
| **Total liabilities** | 130,186 | 130,443 |
| **Net assets** | | |
| **Unrestricted** | 56,855 | 55,390 |
| **Temporarily restricted** | 9,212 | 13,904 |
| **Permanently restricted** | 24,478 | 16,127 |
| **Total net assets** | 90,545 | 85,421 |
| **Total liabilities and net assets** | $ 220,731 | $ 215,864 |

*See accompanying notes to consolidated financial statements*

# Consolidated Statements of Activities

**For the Years Ended June 30, 2005 and 2004**
*(in thousands)*

| | June 30, 2005 | June 30, 2004 |
|---|---|---|
| **OPERATING UNRESTRICTED NET ASSETS ACTIVITY** | | |
| **Revenues and other support** | | |
| Student charges: | | |
| Regular academic term degree programs: | | |
| Undergraduate tuition and fees | $ 58,076 | $ 52,761 |
| Less: grants and scholarships | (20,745) | (18,152) |
| Net undergraduate tuition and fees | 37,331 | 34,609 |
| Graduate tuition and fees | 7,673 | 7,512 |
| Continuing education, summer school and other special programs | 3,240 | 3,446 |
| Net tuition and fees | 48,244 | 45,567 |
| Student housing and dining fees | 11,558 | 11,250 |
| Net student charges | 59,802 | 56,817 |
| Private gifts and grants | 2,872 | 2,391 |
| Public service activities | 2,055 | 2,078 |
| Government grants, primarily for student aid | 1,335 | 1,240 |
| Distributions from endowment to support operations, grants and scholarships | 1,133 | 1,427 |
| Other revenue and support | 2,659 | 2,137 |
| Net assets released from restrictions | 1,009 | 1,824 |
| **Total operating revenues and other support** | 70,865 | 67,914 |
| **Expenses** | | |
| Instruction: | | |
| Regular academic term degree programs | 28,657 | 26,440 |
| Continuing education, summer school and other special programs | 2,173 | 2,313 |
| Total instruction | 30,830 | 28,753 |
| Student housing and dining expenses | 12,877 | 12,576 |
| Student services | 12,403 | 11,450 |
| Institutional support | 11,534 | 11,960 |
| Academic support | 2,902 | 2,821 |
| Public service | 1,370 | 1,468 |
| **Total operating expenses** | 71,916 | 69,028 |
| **Deficit of unrestricted revenues and other support over expenses from operating activities** | (1,051) | (1,114) |
| **NONOPERATING UNRESTRICTED NET ASSETS ACTIVITY** | | |
| Investment income, realized and unrealized gains | 4,954 | 3,226 |
| Endowment distributions for operations, grants and scholarships | (1,133) | (1,427) |
| Other, principally unrealized gain (loss) on interest rate swaps related to bonds | (1,399) | 3,330 |
| Change in value of split interest agreements | 94 | 10 |
| **Increase in unrestricted net assets from nonoperating activities** | 2,516 | 5,139 |
| **Net change in unrestricted net assets** | 1,465 | 4,025 |
| **TEMPORARILY RESTRICTED NET ASSETS ACTIVITY** | | |
| Private gifts and grants | 2,887 | 743 |
| Change in value of split interest agreements | 1,218 | 1,285 |
| Net assets reclassified to permanently restricted | (7,788) | – |
| Net assets released from restrictions | (1,009) | (1,824) |
| **Net change in temporarily restricted net assets** | (4,692) | 204 |
| **PERMANENTLY RESTRICTED NET ASSETS ACTIVITY** | | |
| Private gifts and grants | 563 | 722 |
| Net assets reclassified from temporarily restricted | 7,788 | – |
| **Net change in permanently restricted net assets** | 8,351 | 722 |
| **Increase in total net assets** | 5,124 | 4,951 |
| Total net assets, beginning of year | 85,421 | 80,470 |
| **Total net assets, end of year** | $ 90,545 | $ 85,421 |

*See accompanying notes to consolidated financial statements*

## Consolidated Statements of Cash Flows

**For the Years Ended June 30, 2005 and 2004**
*(in thousands)*

| | June 30, 2005 | June 30, 2004 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Increase in net assets | $ 5,124 | $ 4,951 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation | 7,290 | 6,725 |
| Amortization of bond issuance costs | 33 | 33 |
| Provision for doubtful accounts | 101 | 20 |
| Net realized and unrealized (gain) on investments | (4,495) | (2,816) |
| Contributions restricted for endowments and capital projects | (606) | (812) |
| Contributions of remainder interest in trusts managed by others | (2,269) | – |
| Loss on disposal of plant assets | 291 | 259 |
| Contributions of land | – | (657) |
| Change in value of split interest agreements | (1,312) | (1,295) |
| Other, principally unrealized (gain) loss on interest rate swaps related to bonds | 1,399 | (3,330) |
| Cash provided (used) by changes in operating assets and liabilities: | | |
| Student accounts receivable | 5 | 266 |
| Government grants and other receivables | (27) | 1,169 |
| Student loans | (101) | (120) |
| Inventories and prepaid expenses | (192) | 92 |
| Contributions receivable | 225 | (24) |
| Accounts payable, accrued liabilities and other liabilities | 457 | (384) |
| Student deposits and prepaid fees | 42 | 32 |
| Deferred revenue | 285 | (161) |
| Investments managed on behalf of charities | 328 | 509 |
| Governmental student loan programs | 79 | 221 |
| **Net cash provided by operating activities** | 6,657 | 4,678 |
| **INVESTING ACTIVITIES** | | |
| Proceeds from sale of investments | 4,907 | 43,260 |
| Purchase of investments | (4,895) | (36,126) |
| Proceeds from collections of notes receivable | 39 | 8 |
| Notes issued | (338) | (743) |
| Purchase of land, buildings and equipment | (4,365) | (11,475) |
| **Net cash used by investing activities** | (4,652) | (5,076) |
| **FINANCING ACTIVITIES** | | |
| Payment of short-term line of credit | (6,000) | (10,000) |
| Proceeds from borrowing under short-term line of credit | 5,850 | 6,000 |
| Payments on long-term debt | (2,771) | (2,375) |
| Mortgage assumed related to property acquisition | 300 | – |
| Contributions restricted for endowments and capital projects | 606 | 812 |
| Annuity payments and other | 191 | 6 |
| Net cash transactions related to split interest agreements | (960) | 435 |
| **Net cash provided by financing activities** | (2,784) | (5,122) |
| **Net decrease in cash and cash equivalents** | (779) | (5,520) |
| **CASH AND CASH EQUIVALENTS** | | |
| Beginning of year | 20,242 | 25,762 |
| End of year | $ 19,463 | $ 20,242 |
| *Supplemental disclosure of cash flow information —* | | |
| *Cash paid during the year for interest, net of amount capitalized* | $ 4,555 | $ 4,284 |
| *Acquisition of property, plant and equipment through accounts payable* | $ 256 | $ 383 |

*See accompanying notes to consolidated financial statements*

## NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

### General

Seattle Pacific University is a private nonprofit institution of Christian higher education based in Seattle, Washington. The University offers degree programs for undergraduate and graduate students through the College of Arts and Sciences and the schools of Business and Economics; Education; Health Sciences; Theology; and Psychology, Family, and Community. The University offers degrees in 53 undergraduate major programs and 41 minor areas of study, 11 master's degree programs and two doctoral programs.

### Basis of Presentation

The accompanying financial statements are the consolidated statements of Seattle Pacific University (the University) and Seattle Pacific Foundation (the Foundation). The University has a controlling financial interest in the Foundation through direct ownership of the majority voting interest in the Foundation. The University's Board of Trustees appoints Foundation directors.

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of the University and the Foundation. All significant inter-company transactions and balances have been eliminated.

Resources received by the University are classified into three net asset categories according to the presence or absence of donor-imposed restrictions. A description of the three net asset categories follows.

#### Unrestricted net assets

Unrestricted net assets include amounts not subject to donor-imposed restrictions and net assets received during the year that were subject to temporary donor-imposed restrictions satisfied during the same year.

#### Temporarily restricted net assets

Temporarily restricted net assets include amounts that are subject to donor-imposed time or use restrictions that have not been met. At June 30, 2005 and 2004, $6,209,000 and $10,591,000, respectively, are restricted by the passage of time, primarily related to net assets held in irrevocable trusts, and $3,003,000 and $3,313,000, respectively, are restricted by use requirements.

#### Permanently restricted net assets

Permanently restricted net assets include amounts subject to donor-imposed restrictions where the corpus is invested in perpetuity and only the income is made available for program operations and scholarships in accordance with donor restrictions. Included are irrevocable trusts restricted for endowment use at maturity valued at $3,866,000 on June 30, 2005. Generally only the original gift value of an endowment that has donor restrictions is considered permanently restricted, unless otherwise expressly stipulated in the agreement with the donor.

### Revenue and Expense Recognition

Revenues from sources other than contributions are reported as increases in unrestricted net assets. Contributions, including unconditional promises to give, are recognized as revenue in the period received and reported as increases in the appropriate category of net assets based on the presence or absence of donor-imposed restrictions. Contributions other than cash are recorded at their fair market value at the date of gift or at net realizable value if the assets are intended for sale. Contributions that the donor restricts where the restrictions are met within the same fiscal year as the contribution is received are recorded as increases in unrestricted net assets. Expirations of temporary restrictions on net assets are reported as reclassifications from temporarily restricted net assets to unrestricted net assets. All expenses are reported as decreases in unrestricted net assets. Except as restricted by donors, gains and losses on investments are reported as increases or decreases in unrestricted net assets. Temporary restrictions on gifts to acquire long-lived assets are considered met in the period the assets are acquired or placed into service.

### Cash and Cash Equivalents

Cash and cash equivalents consist of all cash balances and short-term, highly liquid investments with original maturities at the date of purchase of three months or less. Cash equivalents totaled $19,036,000 and $14,287,000 at June 30, 2005 and 2004, respectively.

### Investments

Investments in equity securities with readily determinable fair market values and all investments in debt securities are reported at fair market value. Real estate held for investment or sale is reported at fair market value. If an independent appraisal is not available for real estate, the investment is recorded at an amount that approximates fair market value based on the judgment of University management. These investments are intended by management to be long-term investments primarily held or maintained for use as endowments managed by the Foundation.

At June 30, 2005, the University had certain endowment investments related to donor-restricted endowment funds for which the fair value of assets was $3,320,000, which was less than the cost basis of $3,388,000.

### Credit Risk and Fair Value of Financial Instruments

The University grants credit primarily to student borrowers in the Pacific Northwest in the normal course of operations. The credit risk with respect to these receivables is generally considered minimal due to the wide dispersion of receivables.

The carrying amount of cash and cash equivalents, student loans and accounts receivables, governmental grants and other receivables, and accounts payable approximates fair market value due to the short-term maturities of these instruments. The carrying amount of the University's notes receivable and notes payable approximates fair value as they bear interest at variable interest rates or fixed rates which approximate current market rates for notes with similar maturities and credit quality.

### Bond Issuance Costs

Bond issuance costs include amounts paid by the University in connection with the issuance of the Series 2000A and 2000B WHEFA Bonds. Amortization of issuance costs is calculated using the straight-line method over the 30-year term of the bonds. Amortization expense related to bond issuance costs in the years 2005 and 2004 was $33,000.

### Land, Buildings and Equipment

Land, buildings and equipment are carried at cost, or if donated, at the fair market value on the date of donation. The University uses the straight-line method of depreciation to allocate the cost of assets over the estimated useful lives. Estimated useful lives range from 3 years for computers to 50 years for buildings.

### Estates and Trusts

Trusts in which either the University or the Foundation is named as irrevocable remainder beneficiary, but not as trustee, are recorded in the consolidated financial statements as contribution income when the trustee notifies the University and the ownership percentage and valuation are determined. The portions of these trusts that are restricted for endowment use at the time of trust maturity are classified as permanently restricted net assets.

### Deferred Revenues

Deferred revenues consist primarily of payments of tuition and fees related to future academic terms.

### Investments Managed on Behalf of Charities

The Foundation manages the assets of an unrelated foundation and is trustee for several special needs trusts in which the University is remainder beneficiary. Those assets and a corresponding liability are included in the accompanying consolidated financial statements.

### Taxes

The University and the Foundation are exempt from federal income taxes pursuant to Section 501(c)(3) and Section 509(a)(3) of the Internal Revenue Code except for unrelated business taxable income as defined in sections 511 through 515 of the Internal Revenue Code. Accordingly, the financial statements do not include a provision for Federal income tax. In addition, the University presently is exempt from real and personal taxes on educational and other noncommercial properties of the University and the Foundation.

### Reclassifications

Certain reclassifications have been made to the 2004 consolidated financial statements to conform to the classifications used in 2005.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the consolidated balance sheet date and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**NOTE B – STUDENT ACCOUNTS RECEIVABLE:**

Student accounts receivable consists of amounts due from students for tuition, room, board and other enrollment-related charges. At June 30, 2005 and 2004, amounts due for subsequent summer term charges are recorded as a receivable with the related revenue reflected as deferred revenue. Student accounts receivable consists of the following balances:

| | June 30, 2005 ($000) | June 30, 2004 ($000) |
|---|---|---|
| Amounts due from charges for prior academic terms | $ 1,367 | $ 1,753 |
| Amounts due for summer term earned subsequent to year-end | 1,457 | 1,229 |
| | 2,824 | 2,982 |
| Allowance for doubtful accounts | (585) | (662) |
| Net student accounts receivable balance | $ 2,239 | $ 2,320 |

**NOTE C – INVESTMENTS:**

Investments are composed of pooled investment funds, marketable securities and real estate. The University's pooled investments are composed of three investment pools maintained by the Foundation for various trusts, annuities, pooled income, and endowment funds. The investment pools are managed by the Foundation through an investment committee of its directors.

| | June 30, 2005 ($000) | June 30, 2004 ($000) |
|---|---|---|
| Pooled investments: | | |
| Cash and short-term investments | $ 1,435 | $ 2,029 |
| Marketable securities, common stock | 34,247 | 29,503 |
| Marketable securities, bond mutual funds | 7,192 | 7,039 |
| Private equities | 7,496 | 6,215 |
| Notes receivable | 1,823 | 2,064 |
| Real estate | 6,246 | 4,652 |
| Total pooled investments | 58,439 | 51,502 |
| Equity securities | 189 | 207 |
| Debt securities | 64 | 283 |
| Real estate held for investment or sale | 5,374 | 5,499 |
| Total investments | $ 64,066 | $ 57,491 |

The following schedule summarizes investment return and its classification on the Statement of Activities:

| | June 30, 2005 ($000) | June 30, 2004 ($000) |
|---|---|---|
| Investment income | $ 459 | $ 410 |
| Net realized and unrealized gains on investments | 4,495 | 2,816 |
| Investment income, realized and unrealized gains | $ 4,954 | $ 3,226 |
| Operating: | | |
| Endowment distributions for operations, grants and scholarships | $ 1,133 | $ 1,427 |
| Nonoperating: | | |
| Net gain on endowments, net of distributions | 3,246 | 1,377 |
| Net gains on other investments | 575 | 422 |
| Investment income, realized and unrealized gains | $ 4,954 | $ 3,226 |

**NOTE D – CONTRIBUTIONS RECEIVABLE:**

Contributions receivable at June 30, 2005 and 2004, include pledges that have been discounted at a range of 3–5%, based on the risk free rate of return and are due to be collected as follows:

| | June 30, 2005 ($000) | June 30, 2004 ($000) |
|---|---|---|
| Contributions expected to be collected: | | |
| Within one year | $ 214 | $ 330 |
| One to five years | 597 | 665 |
| More than five years | 100 | 200 |
| | 911 | 1,195 |
| Less discount to present value | (108) | (152) |
| Less allowance for uncollectible contributions receivable | (45) | (60) |
| Total contributions receivable | $ 758 | $ 983 |

**NOTE E – LAND, BUILDINGS AND EQUIPMENT:**

Land, buildings and equipment consist of the following:

| | June 30, 2005 ($000) | June 30, 2004 ($000) |
|---|---|---|
| Land | $ 17,207 | $ 17,312 |
| Buildings and improvements | 131,784 | 134,058 |
| Equipment | 13,141 | 12,438 |
| Library books | 6,122 | 5,706 |
| Construction in progress | 887 | 259 |
| | 169,141 | 169,773 |
| Less accumulated depreciation | (49,766) | (46,887) |
| Net land, buildings and equipment | $ 119,375 | $ 122,886 |

**NOTE F – NOTES AND BONDS PAYABLE:**

As of June 30, 2005 and 2004, bonds payable issued through the Washington Higher Education Facilities Authority (WHEFA) and associated interest rates and maturities consist of the following:

| | Interest rates | Maturity dates | June 30, 2005 ($000) | June 30, 2004 ($000) |
|---|---|---|---|---|
| Series 2000A Bonds | Weekly variable rate | 2003-2030 | $ 60,375 | $ 62,745 |
| Series 2000B Bonds | Weekly variable rate | 2005-2030 | 20,300 | 20,700 |
| | | | $ 80,675 | $ 83,445 |

The weekly variable rate in effect on June 30, 2005 and 2004, was 2.62% and 1.08%, respectively.

As of June 30, 2005, required annual principal payments through retirement will be $3,170,000.

For the fiscal years ended June 30, 2005 and 2004, the University incurred $4,451,000 and $4,304,000, respectively, in total interest costs related to long-term debt. In 2004, $58,000 of interest incurred was capitalized and $4,246,000 was charged against operations. Of the amount charged to operations, $189,000 was paid out of bond proceeds. In 2005, there was no capitalized interest or interest paid out of bond proceeds, and all interest incurred in 2005 was charged against operations.

WHEFA is a financing conduit through the State of Washington for private higher education institutions in the State. The tax-exempt bonds are obligations of the University and are not guaranteed by the State. The bonds are supported by an underlying Letter of Credit with Bank of America. The reimbursement agreement for the Letter of Credit contains restrictive covenants as to the maintenance of certain financial ratios and measures as defined in the agreement. As of June 30, 2005 and 2004, the University was in compliance with these ratios and measures.

The University maintains a $10,000,000 revolving line of credit at a floating interest rate. As of June 30, 2005, there were draws of $5,850,000 outstanding against this line. The variable rate in effect at June 30, 2005, related to this borrowing was 6.25%. The balance on the revolving line of credit was subsequently repaid in July 2005. Short-term and other interest costs for the years ended June 30, 2005 and 2004, were $20,000 and $38,000, respectively.

**NOTE G – ACCOUNTING FOR INTEREST RATE SWAPS:**

The University uses variable-rate debt to finance the acquisition of property, plant, and equipment as indicated in Note F. These debt obligations expose the University to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases.

The University believes it is prudent to limit the variability of a portion of its interest payments. In addition, the reimbursement agreement related to the underlying Letter of Credit to the University's bond issue requires some form and level of interest rate hedging. It is the University's objective to hedge a minimum of 30-50% of its variable-rate interest payments related to this debt, depending on the existing interest rate environment. To meet this objective, the University entered into various types of derivative instruments to manage fluctuations in cash flows resulting from interest rate risk. These instruments include interest rate swaps.

The University swapped its variable-rate cash flow exposure on the debt obligations for fixed-rate cash flows by entering into receive-variable, pay-fixed interest rate swaps. Under the interest rate swaps, the University receives variable interest rate payments and makes fixed interest rate payments, thereby creating the equivalent of fixed-rate debt. In September 2000, the University acquired a 20-year swap from Lehman Brothers at a fixed rate of 4.85% on $20,700,000 of the outstanding variable-rate debt. In November 2001, the University acquired 10-year and 7-year swaps from Bank of America for $40,000,000 at 3.89% and $12,000,000 at 3.58%. There was no cash exchanged at the time of acquisition due to the relationship between the variable rates and the swap rate at that time.

Changes in the fair market value of the interest rate swap are reported as unrealized gains or losses on interest rate swaps related to bonds on the Statement of Activities. For the year ended June 30, 2005, the valuation of the swaps resulted in a net unrealized loss of $1,399,000 due to fixed interest rates for the remaining term of the swap being lower than they were at June 30, 2004, relative to the stated fixed rate for the swaps. The offsetting liability related to the cumulative loss is reported on the Statement of Financial Position as deferred unrealized loss on interest rate swap. Providing that the University holds the swaps to maturity, the value of the derivatives will be zero. These swapping transactions can be terminated at market rates at any time during the term of the swap.

The University does not enter into these derivative instruments for any purpose other than cash flow hedging purposes and does not speculate for investment purposes using derivative instruments.

**NOTE H – SPLIT INTEREST AGREEMENTS:**

The University has entered into a variety of charitable remainder trusts for which the University is the trustee. For trusts with a fixed percentage payment obligation (straight unitrusts) established prior to and including 1998, an estimated liability has been recorded representing the expected cash flow to named beneficiaries, discounted primarily at 11.4%. Expected cash flows are based upon estimated earnings of 11.4% and a life expectancy of a pool of similar trusts. For all unitrusts established after 1998, the present value of these estimated payments was determined on the basis of published actuarial factors for ages of the respective beneficiaries discounted using current Internal Revenue Service established rates, which have ranged between 4.6% and 8.0%. For trusts where payments are dependent on realization of future income (net income trusts), the University has recorded its estimated remainder interest in these trusts as contribution revenue, discounted at 5.5%. The difference between the fair value of the assets received and the estimated remainder interest has been recorded as deferred revenue. The estimated remainder interest is based upon estimated earnings of 9.0-11.4% and a life expectancy based on the weighted average life expectancy of a pool of similar trusts. Investments related to these agreements are reflected as long-term investments in the accompanying consolidated financial statements.

**NOTE I – ANNUITY OBLIGATIONS:**

The University and Foundation have entered into a variety of charitable gift annuities where the University agrees to pay a donor and named beneficiaries a fixed amount per year for the life of the annuitant(s), or a stated term. In exchange, the University receives assets valued in excess of the present value of the annuity. The charitable gift annuity payments are general obligations of the University, and the present value of these gift annuity obligations totaled $592,000 and $565,000 at June 30, 2005 and 2004, respectively.

**NOTE J – RETIREMENT PLAN:**

The University participates in a 401(a) defined contribution retirement plan. The plan provides for employer contributions that are directed by participants to investment funds of Teachers Insurance and Annuity Association or Fidelity Investments. All faculty and staff at least 21 years of age with one year of full-time employment participate in the plan Contributions to the plan are made by the University and are funded as the liability occurs. The University's contributions to the plan were $2,159,000 and $2,033,000 for the years ended June 30, 2005 and 2004, respectively. The University also provides a 403(b)(7) supplemental retirement plan funded by individual employee contributions. These contributions are voluntary, and the plan is open to all employees.

**NOTE K – NET ASSETS:**

At June 30, 2005, restrictions on net assets were as follows:

| | June 30, | |
|---|---|---|
| | 2005 ($000) | 2004 ($000) |
| Unrestricted: | | |
| Available for operational activities | $ 8,093 | $ 11,260 |
| Funds held for long-term investment as endowment | 13,513 | 10,422 |
| Net investment in land, buildings and equipment | 35,249 | 33,708 |
| | $ 56,855 | $ 55,390 |
| Restricted: | | |
| Split interest agreement funds | $ 5,965 | $ 10,107 |
| Other temporarily restricted funds | 3,247 | 3,797 |
| | $ 9,212 | $ 13,904 |
| Permanently restricted: | | |
| True endowment funds | $ 20,612 | $ 16,127 |
| Split interest agreement funds restricted for endowment | 3,866 | – |
| | $ 24,478 | $ 16,127 |

**NOTE L – FUNDRAISING EXPENSE:**

Institutional support expense reflected on the Statement of Activities includes approximately $2,167,000 and $2,570,000 of fund-raising expenses for the years ended June 30, 2005 and 2004, respectively.

**NOTE M – RELATED PARTY TRANSACTIONS:**

In December, 2004, the University issued a market-rate amortizing 20-year mortgage note in the amount of $329,000 in connection with the sale of residential real estate on University land to a member of management. The sale was in conjunction with the University's housing assistance programs for employees and was made under an equity sharing agreement based on the current fair market value of the property. This agreement provides the right to the University to purchase the property back at its option for price below market value.

**NOTE N – COMMITMENTS AND CONTINGENCIES:**

**Commitments**

The investment pools managed by the Foundation participate in fifteen venture and private equity investment programs through Commonfund Asset Management Company, Inc., a wholly owned subsidiary of The Common Fund for Nonprofit Organizations, and through Alexander Hutton Venture Partners. The University has committed to invest $20,243,000 in these programs. At June 30, 2005, a cumulative total of $13,992,000 has been invested. The remaining $6,251,000 will be invested in one or more installments, and in amounts and on dates specified by the private equity investment managers.

**Contingencies**

The University is an equity owner of the College Liability Insurance Company (CLIC). For the fiscal year ending June 30, 2006, the University had a $210,000 contingent liability for its portion of a $2,000,000 letter of credit issued to CLIC by a bank. The University is a guarantor of this letter of credit and would be liable for its share of the contingency if CLIC were to fail to repay amounts borrowed under the letter of credit.

The University receives and expends monies under Federal grant programs and is subject to audits by cognizant governmental agencies. Management believes that any liabilities resulting from such audits would not have a material impact on the consolidated financial statements of the University.

The University provides a guarantee to Credit Union Northwest on the loans they provide in support of the University's Housing Assistance Program (HAP) for faculty and staff. The HAP provides down payment assistance loans on a need basis to faculty and staff moving into the Seattle area or purchasing a first home. These loans are supported with a secured deed of trust against the underlying property. There are currently 12 such loans outstanding that are due between 2005 and 2015. Since the inception of the HAP in 1991, no guarantees have been exercised by the credit union. As of June 30, 2005, the loan portfolio balance held by the credit union was $395,000. The University's exposure under the loan guarantees is limited to the difference between the value of the secured deed of trust held by the credit union and the remaining principal balance of the related loan. The University believes the value of the secured deeds of trust held by the credit union exceeds the loan balances as of June 30, 2005.

The University is subject to legal proceedings and claims that arise in the ordinary course of its business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the financial position of the University, the changes in their net assets, and their cash flows in conformity with accounting principles generally accepted in the United States of America.