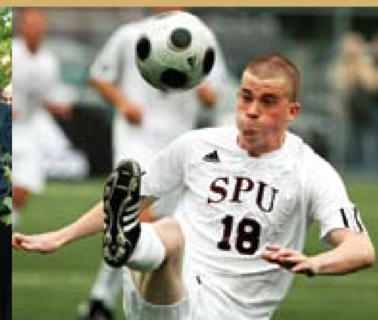
Engaging the culture, changing the world®

Seattle Pacific
UNIVERSITY

AUDITED FINANCIAL STATEMENTS

Year Ending June 30, 2008



About Seattle Pacific University

Founded in 1891, Seattle Pacific University is a premier Christian university that equips people to engage the culture and change the world. Its comprehensive academic program serves more than 3,800 undergraduate and graduate students at its main Seattle campus, as well as an average of 2,600 students per quarter online and in continuing education centers across Washington State. Known for both their competence and character, SPU graduates are bringing about positive change in communities around the globe.

Academically, Seattle Pacific University offers 57 undergraduate majors and 43 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 three doctoral programs: educational leadership, clinical psychology, and organizational 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.

Large cover photo: *Named for the first president of Seattle Pacific University, Alexander Beers, Alexander Hall was built in 1891 as the institution's first structure. In the early years, it served as residence hall, dining hall, and classroom. Today, the four-story red brick building houses the College of Arts and Sciences, the Division of Social and Behavioral Sciences, and the School of Theology.*

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KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

Independent Auditors' Report

Board of Directors
Seattle Pacific University:

We have audited the accompanying consolidated statements of financial position of Seattle Pacific University and affiliate (the University) as of June 30, 2008 and 2007, 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 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 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 and affiliate as of June 30, 2008 and 2007, and the changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

November 24, 2008

Consolidated Statements of Financial Position

For the Years Ended June 30, 2008 and 2007
(in thousands)

	June 30,	
Assets	2008	2007 (see note K)
Cash and cash equivalents	$ 14,240	$ 6,582
Investments	50,871	60,681
Student accounts receivable, net	2,329	2,419
Inventories and prepaid expenses	1,720	2,013
Grants and other receivables	1,162	1,249
Student loans	933	1,422
Total current assets	71,255	74,366
Student loans, net of allowance of $198 in 2008 and $196 in 2007	7,568	6,139
Other receivables and prepaid expenses	6,687	8,224
Investments	46,587	45,249
Investments — beneficial interest in perpetual trusts	3,665	4,085
Investments restricted for capital projects or debt retirement	–	4,742
Land, buildings and equipment, net	116,126	118,669
Total assets	$ 251,888	$ 261,474
Liabilities and Net Assets		
Liabilities		
Accounts payable, accrued expenses and other liabilities	10,487	10,957
Bonds payable	2,610	3,480
Trust and annuity obligations	1,629	1,561
Student deposits and prepaid fees	1,969	1,947
Deferred revenue	3,595	3,496
Total current liabilities	20,290	21,441
Bonds payable	78,780	83,120
Trust and annuity obligations	11,835	12,090
Investments managed on behalf of charities	7,772	7,415
Unrealized loss on interest rate swaps	4,382	957
Governmental student loan programs	6,709	6,614
Other liabilities	3,320	3,212
Total liabilities	133,088	134,849
Net Assets		
Unrestricted		
Available for operational activities	22,423	28,731
Funds held for long-term investment as endowment	23,019	24,410
Net investment in land, buildings and equipment	30,021	31,673
Total unrestricted net assets	75,463	84,814
Temporarily restricted		
Unexpended funds received for educational purposes	1,607	2,081
Split interest agreement funds	8,878	8,264
Total temporarily restricted net assets	10,485	10,345
Permanently restricted		
Endowment funds	24,084	22,857
Split interest agreement funds restricted for endowment	8,768	8,609
Total permanently restricted net assets	32,852	31,466
Total net assets	118,800	126,625
Total liabilities and net assets	$ 251,888	261,474

See accompanying notes to consolidated financial statements

Consolidated Statements of Activities

For the Years Ended June 30, 2008 and 2007
(in thousands)

	June 30, 2008	June 30, 2007 (see note K)
Operating Unrestricted Net Assets Activity		
Revenues and other support		
Student charges:		
Tuition and fees	$ 87,297	$ 80,785
Less: grants and scholarships	(27,402)	(24,799)
Net tuition and fees	59,895	55,986
Student housing and dining fees	12,361	11,871
Net student charges	72,256	67,857
Private gifts and grants	1,751	7,886
Public service activities	2,271	2,141
Government grants, primarily for student aid	2,110	1,952
Distributions from endowment to support operations, special programs and scholarships	1,834	1,613
Other revenue and support	2,640	3,007
Net assets released from restrictions	927	1,345
Total operating revenues and other support	83,789	85,801
Expenses		
Instruction	36,222	33,321
Student housing and dining	14,357	12,965
Student services	13,867	13,081
Institutional support	14,238	12,789
Academic support	4,527	3,885
Public service	1,744	1,426
Total operating expenses	84,955	77,467
Excess (deficit) of revenues and other support over expenses from operating activities	(1,166)	8,334
Nonoperating Unrestricted Net Assets Activity		
Investment income, realized and unrealized gains	301	9,115
Endowment distributions for operations, grants and scholarships	(1,834)	(1,613)
Unrealized loss on interest rate swaps	(3,425)	(306)
Change in value of split interest agreements	(354)	351
Loss on debt extinguishment	(2,817)	–
Net assets reclassified to permanently restricted due to donor redesignation	(56)	–
Increase (decrease) in unrestricted net assets from nonoperating activities	(8,185)	7,547
Net change in unrestricted net assets	(9,351)	15,881
Temporarily Restricted Net Assets Activity		
Private gifts and grants	1,476	932
Change in value of split interest agreements	4	381
Net assets reclassified to permanently restricted due to donor redesignation	(413)	–
Net assets released from restrictions	(927)	(1,345)
Net change in temporarily restricted net assets	140	(32)
Permanently Restricted Net Assets Activity		
Private gifts and grants	1,227	677
Change in value of split interest agreements	(310)	880
Net assets reclassified due to donor redesignation	469	–
Net change in permanently restricted net assets	1,386	1,557
Increase (decrease) in total net assets	(7,825)	17,406
Total net assets, beginning of year (see note K)	126,625	109,219
Total net assets, end of year	$ 118,800	$ 126,625

See accompanying notes to consolidated financial statements

Consolidated Statements of Cash Flows

For the Years Ended June 30, 2008 and 2007
(in thousands)

	June 30, 2008	June 30, 2007 (see note K)
Cash Flows From Operating Activities		
Fees from students, net of financial aid	$ 72,441	$ 67,857
Gifts and grants	4,596	9,232
Investment income	1,045	1,257
Other revenue	5,059	6,109
Payments for interest on debt	(5,813)	(3,886)
Payments to employees and suppliers	(69,204)	(65,132)
Net cash provided by operating activities	8,124	15,437
Investing Activities		
Loans issued to students	(1,893)	(1,627)
Collections on loans issued to students	1,046	1,573
Proceeds from sale of investments	18,438	24,429
Purchase of investments	(5,704)	(32,267)
Proceeds from collections of notes receivable	19	116
Issuance of notes receivable	(133)	(12)
Purchase of land, buildings and equipment	(7,081)	(8,143)
Net cash provided (used) by investing activities	4,692	(15,931)
Financing Activities		
Payments on long-term debt	(86,600)	(3,475)
Proceeds from issuance of long-term debt	81,390	–
Bond issuance costs	(806)	–
Contributions to temporarily restricted and permanently restrict net assets	1,239	1,369
Annuity payments and other	(381)	262
Net cash used by financing activities	(5,158)	(1,844)
Net increase (decrease) in cash and cash equivalents	7,658	(2,338)
Cash and Cash Equivalents		
Beginning of year (see note K)	6,582	8,920
End of year	$ 14,240	$ 6,582
Supplemental disclosure of cash flow information —		
Cash paid during the year for interest	$ 5,813	$ 3,886
Acquisition of property, plant and equipment through accounts payable	$ 602	$ 1,242

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 57 undergraduate major programs and 43 minor areas of study, 11 master's programs and three 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, 2008 and 2007, $9,060,000 and $8,543,000, respectively, are restricted by the passage of time, primarily related to net assets held in irrevocable trusts, and $1,425,000 and $1,802,000, 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 at June 30, 2008 and 2007, are irrevocable trusts restricted for endowment use at maturity valued at $8,768,000 and $8,609,000, respectively. 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.

Consolidated Statements of Cash Flows

Effective July 1, 2007, the University changed its method for reporting operating activities on the consolidated statements of cash flows from the indirect method to the direct method. The University believes this change provides more complete and useful information relating to Seattle Pacific's cash flows. The consolidated statement of cash flows for the year ended June 30, 2007 is shown consistent in a format with the 2008 presentation.

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.

Operating Revenues and Expenses

The University reports operating revenues and expenses in the unrestricted net assets section of the consolidated statements of activities. Operations are those activities that support the core activities of the University; "to engage the culture and change the world."

Operating revenues include charges for tuition and fees, net of financial aid, housing and dining, gifts and grants, public service activities, spending policy income, other income, and releases of temporarily restricted net assets for operations.

Operating expenses (for which the operating revenues are used) include salaries and benefits, departmental expenses, depreciation, amortization and interest. These expenses are classified into six cost centers called: Instruction, Student Housing and Dining, Student Services, Institutional Support, Academic Support, and Public Service.

All other revenues and expenses are considered non-operating.

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 $12,938,000 and $6,129,000 at June 30, 2008 and 2007, respectively.

Investments

Investments are stated at fair value. The fair value of all equity and debt securities with readily determinable fair market values are based on quotations obtained from national securities exchanges. Real estate held for investment or sale is reported based on independent appraisals.

Alternative investments are investments for which there is no readily determinable published value. They include institutional funds, private equity funds, and limited liability companies. Institutional funds are multi-strategy, commingled equity and bond funds. Private equity funds are primarily comprised of investments in limited partnerships. The partnerships generally represent restricted investment securities whose values have been estimated by the managing partner of the partnership in the absence of readily ascertainable market values. The limited liability companies are primarily invested in real estate. The Foundation reviews and evaluates the values provided by the investment managers and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Because of the inherent uncertainty of the valuation of nonmarketable and restricted investments, the estimated fair values of these investments may differ significantly from the values that would have been used had a ready market for the securities existed.

Investments Restricted for Capital Projects or Debt Retirement

Investments restricted for capital projects or debt retirement as of June 30, 2007 include unspent proceeds from bond issues that are invested in guaranteed investment contracts and are restricted for future construction, capital project and required reserve funds.

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 receivable, 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 2005 and 2008 WHEFA Bonds. Amortization of issuance costs is calculated using the straight-line method over the 23-year term of the 2008 bonds. Remaining unamortized bond issuance costs related to the refinanced series 2005 bonds of $2,817,000 were recorded as loss on debt extinguishment during 2008. Amortization expense related to bond issuance costs in the years 2008 and 2007 was $127,000 and $127,000, respectively.

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 three 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.

Perpetual trusts in which the University is named as beneficiary and which are irrevocable in perpetuity, are recorded in the consolidated financial statements as contribution income when the trustee notifies the University and the ownership percentage and valuation are determined. These trusts distribute income to the University that is recorded as investment income and the fair value of these trusts is recorded in the change in split interest agreements on the consolidated statements of activities. These perpetual trusts are invested in cash equivalents, fixed income and equity securities and are classified as permanently restricted net assets.

Deferred Revenues

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

Investements 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 a remainder beneficiary. Those assets and a corresponding liability are included in the accompanying consolidated financial statements. The revenue and corresponding expense are included in the consolidated statements of activities.

Taxes

The University and the Foundation are exempt from federal income taxes pursuant to Section 501(c)(3) and 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 consolidated financial statements do not include a provision for federal income tax. In addition, the University presently is exempt from Washington State real and personal property taxes pursuant to WAC 458-16-270 on the majority of its educational and other noncommercial properties of the University and the Foundation.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. 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.

New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109.* FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB No. 109, *Accounting for Income Taxes.* FIN 48 also prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption. FIN 48 also provides guidance on measurement, derecognition, classification, interest and penalties, and disclosure. The provisions of FIN 48 were effective for the University in fiscal year 2008. As the University is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code as a qualified educational institution and is generally not subject to federal income taxes, the adoption of FIN 48 did not have a material impact on the University's consolidated financial statements.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements.* This standard is effective for fiscal years beginning after November 15, 2007. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The University has not yet determined the impact of adopting SFAS No. 157 might have on its consolidated financial statements.

In February 2007, the Financial Accounting Standard Board issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB statement No. 115*. This statement permits companies to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The University has not yet determined the impact of adopting SFAS No. 159 might have on its consolidated financial statements.

In August 2008, FASB released FASB Staff Position—117-1, *Endowments of Not-for-Profit Organizations.* This position provides for an update of Statement of Financial Accounting Standards 117 relating to the treatment of permanently restricted net assets to be consistent with the Uniform Prudent Management of Institutions Funds Act of 2006 ("UPMIFA") legislation, which has not been passed as law in the State of Washington. This position also provides disclosure about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA. The implementation date of FASB 117-1 is for fiscal years ending after December 15, 2008. The University is currently evaluating the effect of future legislation of UPMIFA and FASB 117-1.

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, 2008 and 2007, 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,	
	2008 ($000)	2007 ($000)
Amounts from student accounts receivable	$ 2,979	$ 3,044
Allowance for doubtful accounts	(650)	(625)
Net student accounts receivable balance	$ 2,329	$ 2,419

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,	
	2008 ($000)	2007 ($000)
Pooled investments:		
Cash and short-term investments	$ 6,572	$ 17,836
Institutional funds, common stock	49,961	48,990
Institutional funds, bond mutual funds	6,651	9,265
Private equities	11,514	10,595
Notes receivable	2,989	2,634
Real estate	12,632	10,260
Total pooled investments	90,319	99,580
Equity securities	454	79
Debt securities	66	76
Real estate held for investment or sale	6,619	6,195
Total investments	$ 97,458	$105,930

The following schedule summarizes investment return and its classification on the consolidated statement of activities:

	June 30, 2008 ($000)	June 30, 2007 ($000)
Investment income	$ 1,045	$ 1,257
Net realized and unrealized gain (loss) on investments	(744)	7,858
Investment income, realized and unrealized gains	$ 301	$ 9,115
Operating:		
Endowment distributions for operations, grants and scholarships	$ 1,834	$ 1,613
Nonoperating:		
Net gain (loss) on endowment investments, net of distributions	(2,817)	5,946
Net gains on other investments	1,284	1,556
Investment income, realized and unrealized gains	$ 301	$ 9,115

NOTE D – Contributions Receivable:

Contributions receivable in current and non-current other receivables, include pledges that have been discounted at a rate of 2–5%, based on the risk-free rate of return and are due to be collected as follows:

	June 30, 2008 ($000)	June 30, 2007 ($000)
Contributions expected to be collected:		
Within one year	$ 170	$ 225
One to five years	713	450
More than five years	10	–
	893	675
Less discount to present value	(47)	(60)
Less allowance for uncollectible contributions receivable	(38)	(25)
Total contributions receivable	$ 808	$ 590

NOTE E – Land, Buildings and Equipment:

Land, buildings and equipment consist of the following:

	June 30, 2008 ($000)	June 30, 2007 ($000)
Land	$ 17,486	$ 17,620
Buildings and improvements	138,737	136,889
Equipment	14,510	14,271
Library books	7,449	6,972
Construction in progress	1,259	1,699
	179,441	177,451
Less accumulated depreciation	(63,315)	(58,782)
Land, buildings and equipment, net	$ 116,126	$ 118,669

NOTE F – Notes and Bonds Payable:

As of June 30, 2008 and 2007, bonds payable issued through the Washington Higher Education Facilities Authority (WHEFA) consist of:

			June 30, 2008 ($000)	June 30, 2007 ($000)
	Interest Rate Mode	Maturity Dates		
Series 2005 Bonds	Auction Rate Securities	2005-2030	–	$ 86,600
Series 2008 Bonds	Variable Rate Demand	2008-2030	$ 81,390	
			$ 81,390	$ 86,600

The weekly variable demand rate in effect on June 30, 2008 was 1.6% and the weekly variable auction rate on June 30, 2007 was 3.85%.

In June 2008, the University issued the Series 2008 bonds for the purposes of refinancing the Series 2005 bonds and moving the interest rate mode of the bonds from auction rate securities to variable rate demand bonds. The Series 2008 bonds are supported by a letter of credit from US Bank through June 26, 2011 and the 2005 bonds were supported by an underlying insurance policy with Radian Asset Assurance, Inc. The underlying supporting documents for both series of bonds contain restrictive defined financial ratios and measures as defined in the letter or policy. As of June 30, 2008 and 2007, the University was in compliance with the ratios and measures required under the letter and insurance policy. 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.

Principal payment obligations are due as follows during the next five fiscal years and thereafter:

	Principal ($000)
2008-2009	$ 2,610
2009-2010	3,485
2010-2011	3,495
2011-2012	3,500
2012-2013	3,510
Thereafter	64,790
	$ 81,390

For the fiscal years ended June 30, 2008 and 2007, the University incurred $5,408,000 and $3,973,000, respectively, in total interest costs related to long-term debt.

The University maintains a $10,000,000 revolving line of credit at a floating interest rate. As of June 30, 2008, there were no draws outstanding against this line. Short-term and other interest costs for the years ended June 30, 2008 and 2007, were $45,000 and $33,000, 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. To meet this intent, the University entered into interest rate swaps to manage fluctuations in cash flows resulting from interest rate risk.

The University swapped its variable-rate cash flow exposure on its 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 amortizing swap from Lehman Brothers Special Financing, Inc. with a June 30, 2008, value of $19,400,000 at a fixed rate of 4.85%. 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%, respectively. In January 2006, the University acquired a 25-year accreting and amortizing swap from Bank of America at 3.71%. The value of this swap will increase over time and the previous swaps expire and decrease as principal payments are made on the bonds to maintain a consistent level of overall variable rate exposure. As of June 30, 2008, the accreting and amortizing swap had a notional amount of zero and it will remain at this level until April 1, 2009 when goes to a notional value of $9,095,000. There was no cash exchanged at the time of acquisition of these swaps 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 swaps are reported as unrealized gains or losses on interest rate swaps on the consolidated statement of activities. For the year ended June 30, 2008, the valuation of the swaps resulted in a net unrealized loss of $3,425,000 due to fixed interest rates projected for the remaining term of the swap being lower than they were projected to be at June 30, 2007, relative to the stated fixed rate for the swaps. The liability of $4,382,000 related to a cumulative loss is reported on the consolidated statements of financial position as unrealized loss on interest rate swaps. 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.

NOTE H – Split Interest Agreements:

The University and Foundation have entered into a variety of charitable remainder trusts (CRT) for which the Foundation is the trustee. These CRTs have annual obligations to donors or others for the life of the trust based on either a fixed percentage of the trust asset value updated annually or the lower of a fixed percentage or actual annual income received by the trust. A liability has been recorded for these payments at the net present value of expected annual cash flows to named beneficiaries, discounted from 4.6% to 11.4% as determined by published actuarial factor for ages of the respective beneficiaries discounted using Internal Revenue Service established rates. In the year assets are transferred into the CRT the difference between the fair value of the assets received and the net present value of the payments to beneficiaries is recorded as contribution income to the University or Foundation. Annual adjustments to the net present value of the payment liability based on actuarial and income factors is recorded as changes in split interest agreements on the consolidated statements of activities. Investments related to these agreements are reflected as investments in the accompanying consolidated financial statements as $27,599,000 and $25,948,000 at June 30, 2008 and 2007, respectively.

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 $3,091,000 and $3,173,000 at June 30, 2008 and 2007, respectively. Investments related to the annuity obligations and Washington State reserve requirements totaled $3,400,000 and $3,490,000 at June 30, 2008 and 2007, respectively.

NOTE J – Retirement Plan:

The University participates in an Internal Revenue Code – (IRC) 401(a) defined contribution retirement plan. The plan provides for employer contributions that are directed by participants to investment funds of TIAA-CREF 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 $2,730,000 and $2,467,000 for the years ended June 30, 2008 and 2007, respectively. The University also provides a IRC 403(b)(7) supplemental retirement plan funded by individual employee contributions. These contributions are voluntary, and the plan is open to all employees.

The University is a participant in Emeriti Retirement Health Solutions (EMERITI), a consortium of colleges and universities organized to provide retiree health care benefits through a Voluntary Employees Benefit Assocation (VEBA) recognized under IRC 501(c)(9). The Emeriti program is a defined contribution plan whose assets are restricted for use toward qualified medical expenses upon retirement. All faculty and staff over the age of 35 with one year of employment participate in the plan. The University contributes a monthly fixed amount to a VEBA investment account with Fidelity Investments for all plan participants and the total annual contribution to EMERITI was $291,000 for the year ended June 30, 2008. During December 2007, the University made a one-time lump-sum contribution to certain eligible employees who were at least age 35 with at least one year of service as of July 1, 2006. The total amount contributed for those individuals was approximately $998,000. Employees eligible to participate in EMERITI can make voluntary contributions to the same VEBA account.

NOTE K – Correction of Immaterial Errors:

During 2008, the University identified the following errors on its June 30, 2007 consolidated financial statements. Management has concluded that these errors are immaterial, but warranted correction in its financial statements.

a) The University identified four perpetual trusts where the University is named as a partial beneficiary, for which the University was receiving distributions in prior years. The value of those trusts at June 30, 2007 and 2006 was $4,085,000 and $3,680,000, respectively. The change in split interest agreements was understated by $405,000 for the year ended June 30, 2007 due to this error.

b) The University reported certain short-term investments as cash equivalents rather than as a current investment. The value of this short-term investment as of June 30, 2007 was $20,892,000. For the year ended June 30, 2007, purchases of investments and proceeds from the sales of investments were understated by $30,461,000 and $20,437,000, respectively in the consolidated statements of cash flows.

The following table sets forth the effects of the restatement adjustment on the University's consolidated financial statements for the year ended June 30, 2007:

	As Reported ($000)	Adjustment ($000)	As Adjusted ($000)
Consolidated Statements of Financial Position			
Cash and cash equivalents	$ 27,474	$ (20,892)	$ 6,582
Investments — current	39,789	20,892	60,861
Beneficial interest in perpetual trusts	–	4,085	4,085
Total assets	257,389	4,085	261,474
Split interest agreement funds restricted for endowment	4,524	4,085	8,609
Permanently restricted net assets	27,381	4,085	31,466
Total net assets	122,540	4,085	126,625
Consolidated Statements of Activities Impact to Unrestricted Net Assets			
Unrestricted private gifts and grants	$ 8,063	$ (177)	$ 7,886
Distributions from endowment to support operations, special programs and scholarships	1,436	177	1,613
Investment income, realized and unrealized gains	8,938	177	9,115
Endowment distributions for operations, grants and scholarships	(1,436)	(177)	(1,613)
Net change in unrestricted net assets	15,881	–	15,881
Consolidated Statements of Activities Impact to Permanently Restricted Net Assets			
Change in value of split interest agreements	$ 475	$ 405	$ 880
Net change in permanently restricted net assets	1,152	405	1,557
Consolidated Statements of Cash Flows			
Beginning cash and cash equivalents	$ 19,788	$ (10,868)	$ 8,920
Ending cash and cash equivalents	27,474	(20,892)	6,582
Purchase of investments	(1,806)	(30,461)	(32,267)
Proceeds from sale of investments	3,992	20,437	24,429
Net cash used by investing activities	(5,907)	(10,024)	(15,931)

NOTE L – Fundrasing Expense:

Institutional support expense reflected on the consolidated statements of activities include approximately $2,518,000 and $2,421,000 of fundraising expenses for the years ended June 30, 2008 and 2007, respectively.

NOTE M – Related Party Transactions:

On December 21, 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 made under an equity sharing agreement based on the current fair market value of the property. The agreement provides the right to the University to purchase the property back at its option for price below market value.

NOTE N –Cash Flow Reconciliation:

The change in the University's net assets is reconciled to net cash provided by operations for the years ended June 30, 2008 and 2007 as follows:

	2008	2007
Increase (decrease) in net assets	$ (7,825)	$ 17,406
Adjustments to total change in net assets to net cash provided by operating activities:		
Depreciation	8,153	7,734
Amortization of bond issuance costs and loss on debt extinguishment	2,944	127
Provision for doubtful student accounts and pledges	40	35
Net realized and unrealized (gain) loss on investments	744	(7,858)
Contributions to temporarily restricted and premanently restricted net assets	(1,239)	(1,369)
Contributions of remainder interest in trusts managed by others	(582)	(661)
Loss on disposal of plant assets	869	–
Change in value of split interest agreements	660	(1,612)
Investments managed on behalf of charities	357	591
Unrealized loss on interest rate swaps	3,425	306
Changes in operating assets and liabilities:		
Student accounts receivable	65	(222)
Grants and other receivables	66	8
Inventories and prepaid expenses	293	(230)
Other receivables	(232)	54
Accounts payable, accrued liabilities and other liabilities	266	862
Student deposits and prepaid fees	22	421
Deferred revenue	98	(155)
Net cash provided by operating activities	$ 8,124	$ 15,437

NOTE O – Commitments and Contingencies:

Commitments

The investment pools managed by the Foundation participate in twenty-two 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 $28,993,000 in these programs. At June 30, 2008, a cumulative total of $19,014,000 has been invested. The remaining $9,979,000 will be invested in 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, 2008, the University had a $345,730 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 accumulated los reserves and net assets of CLIC are substantially above historical claim losses and the University believes a call on the CLIC letter of credit is unlikely in the foreseeable future.

The University receives and expends monies under Federal grant programs and is subject to audits by cognizant governmental agencies.The University 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 Seattle Metropolitan Credit Union on 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 2008 and 2018. Since the inception of the HAP in 1991, no guarantees have been exercised by the credit union. As of June 30, 2008, the loan portfolio balance held by the credit union was

$410,000. 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, 2008.

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 U.S. accounting principles generally accepted in the United States of America.

NOTE P – Subsequent Event:

On September 15, 2008, Lehman Brothers Holding Inc. (LBH) filed for Chapter 11 bankruptcy, LBH serves as a credit guarantor for Lehman Brothers Special Financing Inc (LBSF) in LBSF's interest rate swap with the University. While filing for bankruptcy is an event of default under the swap documents, the event of default doesn't trigger a mandatory termination of the swap. Rather, it puts the option of termination in the hands of the non-defaulting party (in this instance, the University). Given the current variable interest rate environment for tax-exempt debt relative to the counterparty fixed rate of 4.85% in the swap, the University does not believe the default of LBSF will have a material impact on the University's financial statements. The University is working with several advisors to evaluate options to terminate and replace the LBSF swap in a financially neutral manner for the University.

The University pools its operating cash and invests in a short term investment fund. On September 29, 2008, this fund's trustee made a decision to discontinue as trustee of the Fund, which resulted in a liquidity restriction. At June 30, 2008, the University had approximately $4,000,000 invested in this fund. The trustee has established procedures for an orderly liquidation and distribution of the assets of the fund over a period of time. Management does not anticipate that this delay in their ability to retrieve these funds from this investment will create any adverse effects on the day-to-day operations of the University. Currently the University has $2,388,000 restricted in this fund.

Subsequent to June 30, 2008, there has been instability in the financial markets and the markets have declined significantly between July 1, 2008 and October 23, 2008. Management is monitoring the market conditions and related unrealized losses on investments. Due to volatility of the U.S. economy and the financial markets as of the date of this report,there is uncertainty regarding the long-term impact of the market condition on the University's investment portfolio.

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