

**Washington University**  
**Financial Statements**  
**June 30, 2013 and 2012**

**Washington University**  
**Index**  
**June 30, 2013 and 2012**

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*(All amounts in thousands of dollars)*

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## **Independent Auditor's Report**

To the Board of Trustees of Washington University

We have audited the accompanying financial statements of Washington University (the "university"), which comprise the statements of financial position as of June 30, 2013 and June 30, 2012, and the related changes in its net assets and its cash flows for the years then ended.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Washington University at June 30, 2013 and June 30, 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

September 24, 2013



**Washington University**  
**Statements of Financial Position**  
**June 30, 2013 and 2012**

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*(thousands of dollars)*

	<u>2013</u>	<u>2012</u>
<b>Assets</b>		
Cash	\$ 198,977	\$ 148,316
Investments	6,909,408	6,334,827
Accounts and notes receivable, net	417,797	377,533
Pledges receivable, net	228,523	248,106
Other assets	150,839	154,482
Fixed assets, net	<u>1,901,786</u>	<u>1,895,389</u>
Total assets	<u>\$9,807,330</u>	<u>\$ 9,158,653</u>
<b>Liabilities</b>		
Accounts payable and accrued expenses	\$ 294,644	\$ 268,026
Deposits, advances and other	40,307	73,400
Professional liability	78,963	68,732
Deferred revenue	91,070	96,161
Liabilities under split-interest agreements	43,931	42,795
Government supported student loans	45,394	45,222
Notes and bonds payable	<u>1,352,538</u>	<u>1,261,447</u>
Total liabilities	<u>1,946,847</u>	<u>1,855,783</u>
<b>Net assets</b>		
Unrestricted	3,793,089	3,542,734
Temporarily restricted	2,577,327	2,329,002
Permanently restricted	<u>1,490,067</u>	<u>1,431,134</u>
Total net assets	<u>7,860,483</u>	<u>7,302,870</u>
Total liabilities and net assets	<u>\$9,807,330</u>	<u>\$ 9,158,653</u>

The accompanying notes are an integral part of these financial statements

**Washington University**  
**Statements of Activities**  
**June 30, 2013 and 2012**

<i>(thousands of dollars)</i>	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>June 30, 2013 Total</b>
<b>Revenues</b>				
Tuition and fees, gross	\$ 502,113	\$ -	\$ -	\$ 502,113
Less: Scholarships	(177,214)			(177,214)
Tuition and fees, net	324,899	-	-	324,899
Endowment spending distribution	231,197	4,500		235,697
Investment income	7,500	430		7,930
Gifts	53,211	109,508		162,719
Grants and contracts revenues				
Direct costs recovered	372,344			372,344
Facilities and administrative costs recovered	134,996			134,996
Patient services	821,849			821,849
Auxiliary enterprises-sales and services	88,719			88,719
Educational activities-sales and services	120,457			120,457
Affiliated hospital revenues	93,487			93,487
Other revenue	30,035			30,035
Net assets released	92,292	(92,292)		-
Total revenues and other support	<u>2,370,986</u>	<u>22,146</u>	<u>-</u>	<u>2,393,132</u>
<b>Expenses</b>				
Instruction	1,342,767			1,342,767
Research	471,609			471,609
Academic support	155,425			155,425
Student services	73,140			73,140
Institutional support	120,018			120,018
Auxiliary enterprises expenditures	100,413			100,413
Other deductions	24,438			24,438
Total expenses	<u>2,287,810</u>	<u>-</u>	<u>-</u>	<u>2,287,810</u>
Net operating results	<u>83,176</u>	<u>22,146</u>	<u>-</u>	<u>105,322</u>
<b>Nonoperating revenues and (expenses)</b>				
Investment returns net of endowment spending	172,745	227,547	3,549	403,841
Changes and reclassifications of split-interest agreements	1,648	(1,008)	(2,922)	(2,282)
Permanently restricted gifts			56,366	56,366
Other	(7,214)	(360)	1,940	(5,634)
Nonoperating, net	<u>167,179</u>	<u>226,179</u>	<u>58,933</u>	<u>452,291</u>
Change in net assets	250,355	248,325	58,933	557,613
<b>Net assets</b>				
Beginning of year	<u>3,542,734</u>	<u>2,329,002</u>	<u>1,431,134</u>	<u>7,302,870</u>
End of year	<u>\$ 3,793,089</u>	<u>\$ 2,577,327</u>	<u>\$ 1,490,067</u>	<u>\$ 7,860,483</u>

The accompanying notes are an integral part of these financial statements.

**Washington University**  
**Statements of Activities**  
**June 30, 2013 and 2012**

<i>(thousands of dollars)</i>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>June 30, 2012 Total</u>
<b>Revenues</b>				
Tuition and fees, gross	\$ 477,491	\$ -	\$ -	\$ 477,491
Less: Scholarships	(169,093)			(169,093)
Tuition and fees, net	308,398	-	-	308,398
Endowment spending distribution	223,334	3,915		227,249
Investment income	7,734	1,336		9,070
Gifts	33,961	100,510		134,471
Grants and contracts revenues				
Direct costs recovered	405,084			405,084
Facilities and administrative costs recovered	143,585			143,585
Patient services	757,955			757,955
Auxiliary enterprises-sales and services	85,539			85,539
Educational activities-sales and services	107,425			107,425
Affiliated hospital revenues	93,331			93,331
Other revenue	35,800			35,800
Net assets released	93,136	(93,136)		-
Total revenues and other support	<u>2,295,282</u>	<u>12,625</u>	<u>-</u>	<u>2,307,907</u>
<b>Expenses</b>				
Instruction	1,254,087			1,254,087
Research	494,741			494,741
Academic support	148,736			148,736
Student services	68,660			68,660
Institutional support	115,825			115,825
Auxiliary enterprises expenditures	97,375			97,375
Other deductions	23,211			23,211
Total expenses	<u>2,202,635</u>			<u>2,202,635</u>
Net operating results	<u>92,647</u>	<u>12,625</u>	<u>-</u>	<u>105,272</u>
<b>Nonoperating revenues and (expenses)</b>				
Investment returns net of endowment spending	(58,037)	(125,864)	(1,952)	(185,853)
Changes and reclassifications of split-interest agreements	3,265	(1,468)	(2,612)	(815)
Permanently restricted gifts			57,821	57,821
Other	(19,693)	(10,936)	4,942	(25,687)
Nonoperating, net	<u>(74,465)</u>	<u>(138,268)</u>	<u>58,199</u>	<u>(154,534)</u>
Change in net assets	18,182	(125,643)	58,199	(49,262)
<b>Net assets</b>				
Beginning of year	3,524,552	2,454,645	1,372,935	7,352,132
End of year	<u>\$ 3,542,734</u>	<u>\$ 2,329,002</u>	<u>\$ 1,431,134</u>	<u>\$ 7,302,870</u>

The accompanying notes are an integral part of these financial statements.

**Washington University**  
**Statements of Cash Flows**  
**June 30, 2013 and 2012**

<i>(thousands of dollars)</i>	<u>2013</u>	<u>2012</u>
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 557,613	\$ (49,262)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Realized and unrealized net gains on investments	(607,315)	(14,925)
Depreciation expense	153,757	154,265
Permanently restricted gifts	(56,366)	(57,821)
Investments received as gifts-not permanently restricted	(13,942)	(10,181)
Proceeds from sales of investments received as gifts	13,942	10,181
Other noncash adjustments	(2,018)	4,140
Changes in assets and liabilities		
Accounts and notes receivable, net	(30,782)	(2,204)
Pledges receivable, net	(8,835)	8,560
Accounts payable and accrued expenses	17,949	1,157
Deposits and advances	(16,867)	(9,057)
Professional liability	10,232	6,480
Other assets and liabilities	(14,072)	15,228
Net cash provided by operating activities	<u>3,296</u>	<u>56,561</u>
<b>Cash flows from investing activities</b>		
Proceeds from sales and maturities of investments	4,569,581	4,587,817
Purchases of investments	(4,574,440)	(4,548,417)
Purchases of fixed assets	(162,363)	(151,614)
Student loans disbursed	(21,614)	(24,023)
Student loan payments received	26,789	26,903
Other	(88)	106
Net cash used in investing activities	<u>(162,135)</u>	<u>(109,228)</u>
<b>Cash flows from financing activities</b>		
Principal payments of debt	(100,935)	(3,390)
Proceeds from long-term debt issuance	221,785	600
Contributions restricted for long-term investment	56,967	48,425
Proceeds from sales of investments received as gifts	31,512	9,877
Other	171	67
Net cash provided by financing activities	<u>209,500</u>	<u>55,579</u>
Net increase in cash	50,661	2,912
<b>Cash</b>		
Beginning of year	148,316	145,404
End of year	<u>\$ 198,977</u>	<u>\$ 148,316</u>
<b>Supplemental data</b>		
Interest paid in cash	\$ 47,725	\$ 49,638
<b>Noncash investing activities</b>		
Net change in securities lending	21,597	96,750
Contributions of securities and other noncash assets	46,926	20,565
Change in accounts payable for fixed assets	14,694	(2,016)
Change in accounts receivable for investments	(23,954)	43,603
Change in accounts payable for investments	(6,025)	(484)
Assets acquired by assuming directly related liabilities	-	293
Assets disposed net of offsetting liabilities	(6,951)	-

The accompanying notes are an integral part of these financial statements.



# Washington University

## Notes to the Financial Statements

### June 30, 2013 and 2012

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*(All amounts in thousands of dollars)*

#### 1. Summary of Significant Accounting Policies

##### **Organization**

Washington University in St. Louis (the “university”), is an institution of higher education that, in furtherance of its role as a charitable and educational institution, engages in various activities, including instruction, research and provision of medical care.

##### **Basis of Presentation and Use of Estimates**

The financial statements have been prepared on the accrual basis of accounting. The financial statements are consolidated to include the accounts of the university and its affiliates. Certain prior year amounts presented in the financial statements have been reclassified to be consistent with the basis of presentation in the current year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. Such estimates include, but are not limited to, the estimated useful lives of buildings and equipment, the fair value of certain investments, the degree of precision in calculation of self-insurance reserves and adequacy of allowances for doubtful accounts. Actual results could differ from those estimates.

##### **Net Assets**

Resources are classified for accounting and reporting purposes according to externally (donor) imposed restrictions. Descriptions of the net asset categories follow:

Unrestricted net assets are free of donor imposed restrictions.

Temporarily restricted net assets consist of gifts and related earnings that are subject to donor-imposed restrictions or legal stipulations that have not yet been met by actions of the university and/or passage of time.

Permanently restricted net asset balances include gifts and trusts which, by donor restriction, are required to be held in perpetuity.

Revenues from sources other than contributions and investment returns are reported as increases in unrestricted net assets. Contributions are reported as increases in the appropriate category of net assets, except that contributions which impose restrictions that are met in the same fiscal year they are received are included in unrestricted revenues. Gains and investment income that are limited to specific uses by donor-imposed restrictions are reported as increases in unrestricted net assets if the restrictions are met in the same reporting period as the gains and income are recognized, except for gains and investment income earned by investment of donor-restricted endowments. Such amounts are not reported as unrestricted net assets until appropriated for expenditure. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statements of Activities as net assets released from restrictions. Permanently restricted gifts received are reported in the nonoperating section of the Statements of Activities. 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. Absent explicit donor stipulations about how long those long-

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*(All amounts in thousands of dollars)*

lived assets must be maintained, the university reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. Expenses are reported as decreases in unrestricted net assets.

Temporarily and permanently restricted net assets are for the following purposes.

	<b>2013</b>		<b>2012</b>	
	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>
General activities	\$ 1,833,991	\$ 1,022,028	\$ 1,647,604	\$ 975,001
Student assistance	385,143	298,924	345,880	286,172
Buildings and renovations	346,133	146,825	324,036	146,956
Life income	12,060	22,290	11,482	23,005
Total	<u>\$ 2,577,327</u>	<u>\$ 1,490,067</u>	<u>\$ 2,329,002</u>	<u>\$ 1,431,134</u>

**Investment**

Investment gains/(losses) in excess of endowment spending distribution and the unrealized appreciation (depreciation) on investments are reported in the nonoperating section of the Statements of Activities. Investments acquired by gift or bequest are initially recorded at market or appraised value at the date so acquired.

At June 30, 2013 and 2012, investments include \$62,556 and \$0, respectively, which were purchased with unexpended proceeds from the Series 2012A Missouri Health and Educational Facilities Authority (MOHEFA) revenue bonds issued in July 2012. These funds may only be expended for specific construction project costs and costs of issuance related to the MOHEFA bonds.

**Fixed Assets**

Fixed assets are stated at cost or at fair market values if received as a gift, less accumulated depreciation, computed on a straight-line basis over the estimated useful lives of the assets. Fixed assets include equipment and other assets acquired through sponsored programs during which title is retained by the resource provider. It is probable the university will be permitted to keep the assets when the program terminates. The cost and accumulated depreciation of fixed assets are removed from the records at the time of disposal. Gains and losses on fixed asset disposals are reported in the nonoperating section of the Statements of Activities. Fixed assets by classification at June 30, 2013 and 2012 consist of the following:

	<b>2013</b>	<b>2012</b>
Construction in progress	\$ 158,432	\$ 95,485
Land and improvements to land	103,382	94,057
Buildings	2,947,446	2,891,408
Equipment	424,874	428,350
Total cost	<u>3,634,134</u>	<u>3,509,300</u>
Accumulated depreciation	<u>(1,732,348)</u>	<u>(1,613,911)</u>
Total, net	<u>\$ 1,901,786</u>	<u>\$ 1,895,389</u>

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*(All amounts in thousands of dollars)*

**Collections**

In addition to the Mildred Lane Kemper Art Museum, the university archives rare book collections, works of art, literary works, historical treasures and artifacts. These collections are protected and preserved for public exhibition, education, research and the furtherance of public service. They are neither disposed of for financial gain nor encumbered in any manner. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

**Financing Receivables**

Financing receivables are principally loans made to students or their parents utilizing gifts, endowment payout, and university resources designated for that purpose and from funds provided by the United States government under the Federal Perkins and Health Professional Student Loan programs. Loan funds are reported at estimated realizable value, as it is not practical to determine the fair value of loan fund receivables, which include a large component of federally sponsored student loans. Federally sponsored student loans have significant government restrictions as to marketability, interest rates, and repayment terms. Federal funds are ultimately refundable to the government and are recognized as a liability in the Statements of Financial Position.

The university's loan portfolio includes over 12,500 individual loans and is geographically diverse. Loans that are made due on the last business day of the month and are considered past due if the minimum payment is not received within forty-five days subsequent to the due date. At June 30, 2013 and 2012, more than 90% of the parent loans and 75% of the institutional student loans were considered current. Income earned on financing receivables is recorded on an accrual basis.

**Tuition and Financial Aid**

Undergraduate students receive financial aid based upon demonstrated financial need and academic promise. Graduate students often receive tuition support in connection with research assistant, teaching assistant and fellowship appointments. Total financial aid granted to students by the university, including aid provided to employees and their dependents, was \$262,593 in 2013 and \$248,299 in 2012. The table below identifies student aid by type. Scholarships are reported net against tuition in the Statements of Activities. Other amounts are reported as expenses.

	<b>2013</b>	<b>2012</b>
Scholarships from unrestricted sources	\$ 135,654	\$ 128,218
Scholarship support from gifts, endowment and other restricted sources	41,560	40,875
Total scholarships	177,214	169,093
Employee and dependent tuition benefits	28,979	26,702
Stipends	53,878	49,868
Work study	2,522	2,636
Total	<u>\$ 262,593</u>	<u>\$ 248,299</u>

**Washington University**  
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*(All amounts in thousands of dollars)*

**Contributions**

Contributions, including unconditional promises to give, are recognized as revenues in the period the contribution or promise is received. Contributions received for permanent endowments or perpetual trusts are reported as nonoperating revenues. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift and, unless instructed otherwise by the donor, are liquidated upon receipt or as soon as practical thereafter.

Gifts and conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions, in the form of unconditional promises to give, to be received after one year are discounted at credit-adjusted tax exempt borrowing rates in accordance with fair value accounting. Pledges outstanding are discounted with rates ranging from 0.4% to 3.1%. Amortization of the discount is recorded as contribution revenue. An allowance is made for uncollectible unconditional promises to give based upon management's judgment, past collections experience and other relevant factors.

A summary of pledges receivable at June 30 is as follows:

	<u>2013</u>	<u>2012</u>
In one year or less	\$ 114,916	\$ 120,092
Between one year and five years	102,958	123,160
Five or more years	<u>22,859</u>	<u>21,620</u>
	240,733	264,872
Less:		
Discount	(4,076)	(4,995)
Allowance for uncollectible amounts	<u>(8,134)</u>	<u>(11,771)</u>
Total	<u>\$ 228,523</u>	<u>\$ 248,106</u>

**Patient Services Revenue**

The university recognizes revenues in the period in which services are rendered. The university has agreements with third-party payers that provide for payment to the university at amounts that are generally less than its established rates. Accordingly, patient revenue is reported net of contractual allowances, at estimated net realizable amounts from patients, third-party payers and others for services rendered.

**Tuition and Fee Revenue**

Tuition and fee revenue, net of scholarships, is recorded in the fiscal year in which the educational programs are conducted.

**Auxiliary Enterprises – Sales and Services**

Auxiliary enterprises sales and services revenue is recorded in the fiscal year in which earned. This revenue is composed primarily of on and off campus housing charges, dining services, board charges and parking and transportation fees.

**Educational Activities – Sales and Services**

Educational activities sales and services revenue is recorded in the fiscal year in which it is earned. This revenue is composed of a number of activities including clinical trial revenues, management services and salary reimbursements from affiliated hospitals, consulting, laboratory fees, conference center revenues and revenues from licensing and royalties.

# Washington University

## Notes to the Financial Statements

### June 30, 2013 and 2012

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*(All amounts in thousands of dollars)*

#### **Affiliated Hospital Revenues**

Affiliated hospital revenue is recorded in the fiscal year in which earned. This revenue is composed of amounts received from affiliated hospitals for various services as more fully described in Note 11.

#### **Sponsored Programs**

The university receives grant and contract revenue from governmental and private sources. Revenue associated with the direct costs of sponsored programs is generally recognized as the related costs are incurred. The university records revenue in unrestricted net assets upon its recovery of direct and indirect costs applicable to those sponsored programs that provide for the full or partial reimbursement of such costs. The recovery of indirect costs, also referred to as facilities and administrative costs is recognized primarily based on predetermined rates negotiated with the federal government. The university has submitted a rate proposal to its cognizant federal agency for purposes of negotiating a rate to be applied in future years.

During 2012, the university revised its accounting for revenue from certain private sources to recognize grant and contract revenue. Previously the revenue from these funds had been reported as gifts. The effect of this revision of \$20,356 is reported on the "Other" line item of the nonoperating section of the 2012 Statement of Activities.

#### **Operating Results and Allocation of Certain Expenses**

The university's measure of operations as presented in the Statements of Activities includes income from tuition and fees, grants and contracts, medical services, contributions for operating programs, the endowment spending distribution and other revenues. Operating expenses are reported on the Statements of Activities by functional categories, after allocating costs for operation and maintenance of plant, interest on indebtedness and depreciation expense. Operating results exclude investment gains/(losses) except for the portion of gains utilized for the endowment spending distribution, permanently restricted gifts, change in the value of split-interest agreements, gains/(losses) on fixed asset disposals and interest rate swaps. Operation and maintenance of plant and depreciation are allocated to functional categories largely based on square footage. Interest expense is allocated based on specific identification of the uses of debt proceeds. Instruction expenses include instruction, departmental research and patient care costs.

#### **Split-Interest Agreements**

The university's split-interest agreements with donors consist primarily of charitable gift annuities and irrevocable charitable remainder trusts for which the university serves as trustee. Assets are invested and payments are made to donors and/or other beneficiaries in accordance with the respective agreements. Contribution revenues for charitable gift annuities and charitable remainder trusts are recognized after recording liabilities for the present value of the estimated future payments to be made to the respective donors and/or other beneficiaries. The discount rate used is a credit-adjusted rate in existence at the date of the gift. The rates used range from .92% to 3.48% for 2013 and .63% to 4.04% for 2012. Annually, the university records the change in value of split-interest agreements by recording at fair value the assets that are associated with each trust and recalculating the liability for the present value of the estimated future payments to be made to the donors and/or other beneficiaries.

#### **Conditional Asset Retirement Obligation**

The asset retirement obligation for the university relates primarily to the removal of asbestos from certain of its buildings. Known asbestos sites are appropriately encapsulated or controlled in accordance with current environmental regulations pending ultimate removal. As of June 30, 2013

# Washington University

## Notes to the Financial Statements

### June 30, 2013 and 2012

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(All amounts in thousands of dollars)

and 2012, respectively, \$17,311 and \$16,865 of conditional asset retirement obligations are included within accounts payable and accrued expenses in the Statements of Financial Position. Additional obligation recognized, obligation settled, and accretion expense were not material to results reported in the Statements of Activities in any year.

#### **Cash and Cash Equivalents**

The university considers cash on hand and in banks and all highly liquid financial instruments with an original maturity of 90 days or less, except those amounts assigned to and invested by its investment managers, which amounts are classified as investments, to be cash and cash equivalents.

#### **Income Taxes**

The university is exempt from federal income taxes under Section 501 (c)(3) of the Internal Revenue Code except to the extent the university has unrelated business income. There was no provision for income taxes due on unrelated business income in the current year. The university has no uncertain tax positions that result in material unrecognized tax benefits.

#### **Recent Accounting Pronouncements**

There were no recent accounting pronouncements expected to have a material effect on the university's financial statements. The university chose to adopt early the provisions of Accounting Standards Update 2012-05, *Not-for-profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows*. ASU 2012-05 provides for classification of cash receipts from the sale of donated financial assets consistently with cash donations received in the statement of cash flows if those cash receipts were from the sales of donated financial assets that upon receipt were converted nearly immediately to cash. The effect of adopting 2012-05 appear on the Statements of Cash Flows in the "Proceeds from sales of investments received as gifts" line items.

## **2. Fair Value**

The university follows FASB guidance for fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The FASB guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the university and unobservable inputs reflect the university's assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the university for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

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*(All amounts in thousands of dollars)*

- Level 1 Quoted prices in active markets for identical assets or liabilities, such as exchange traded equity securities.
- Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities. Examples of Level 2 include U.S. Treasury securities and corporate bonds.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities including investments in certain hedge and all private market strategies.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following table presents the financial instruments carried at fair value as of June 30, 2013 by caption on the Statements of Financial Position and by the valuation hierarchy defined above. Under applicable accounting guidance, certain alternative investments, such as hedged strategies, that do not have readily determinable fair values, but are redeemable in the near term at investee-reported net asset value per share or its equivalent, are reportable at Level 2. Also, included as Level 2 fixed income are U.S. Treasury securities of approximately \$655,150.

	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Balance June 30, 2013</b>
<b>Investments</b>				
Public equity				
Domestic	\$ 279,615	\$ 927,382	\$ 45,190	\$ 1,252,187
International	1,039,859	50,083	95,935	1,185,877
Fixed income				
Nominal	-	670,798	-	670,798
Real	-	183,399	73,262	256,661
Hedged strategies	-	959,220	727,625	1,686,845
Private equity	-	-	984,653	984,653
Short-term investments	99,486	9,161	-	108,647
Deposits with bond trustees	62,556	-	-	62,556
Split-interest agreements	37,963	43,251	3,757	84,971
Beneficial interest trusts	-	-	27,904	27,904
Real assets	-	-	526,433	526,433
Other investments	-	(5,444)	24,676	19,232
Total investments at fair value	<u>1,519,479</u>	<u>2,837,850</u>	<u>2,509,435</u>	<u>6,866,764</u>
Fixed income assets received from security borrowers	-	19,351	-	19,351
Total assets reported at fair value	<u>\$ 1,519,479</u>	<u>\$ 2,857,201</u>	<u>\$ 2,509,435</u>	<u>\$ 6,886,115</u>

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Other investments classified as Level 2 in the table above is principally the unfavorable fair value of the interest rate swap as discussed in Note 7.

The following table presents the financial instruments carried at fair value as of June 30, 2012, by caption on the Statements of Financial Position by the valuation hierarchy defined above. Also, included as Level 2 fixed income are U.S. Treasury securities of approximately \$720,000.

	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Balance June 30, 2012</b>
<b>Investments</b>				
Public equity				
Domestic	\$ 369,795	\$ 656,557	\$ 7,000	\$ 1,033,352
International	1,077,725	-	63,948	1,141,673
Fixed income				
Nominal	-	738,025	-	738,025
Real	-	223,215	78,546	301,761
Hedged strategies	-	805,596	616,688	1,422,284
Private equity	-	-	933,553	933,553
Short-term investments	-	103,772	-	103,772
Deposits with bond trustees	-	-	-	-
Split-interest agreements	37,372	42,166	3,271	82,809
Beneficial interest trusts	-	-	26,351	26,351
Real assets	-	-	487,240	487,240
Other investments	-	(8,842)	24,829	15,987
Total investments at fair value	<u>1,484,892</u>	<u>2,560,489</u>	<u>2,241,426</u>	<u>6,286,807</u>
Fixed income assets received from security borrowers	-	40,949	-	40,949
Total assets reported at fair value	<u>\$ 1,484,892</u>	<u>\$ 2,601,438</u>	<u>\$ 2,241,426</u>	<u>\$ 6,327,756</u>

Other investments classified as Level 2 in the table above is principally the unfavorable fair value of the interest rate swap as discussed in Note 7.

Included as Investments on the Statements of Financial Position, at June 30, 2013 and 2012, respectively, but not reported in the tables above, are accrued investment income of \$6,342 and \$7,187 and investments in affiliates of \$36,302 and \$40,833, which are recorded on the equity basis of accounting. A portion of Level 2 and 3 equity amounts reported above as of June 30, 2013 and 2012 are in hedge-type strategies and a portion of real assets are invested in private equity-type structures. Beneficial interests in perpetual trusts held by third parties are valued at the present value of the future distributions expected to be received over the term of the agreement. The university has recorded within investments the market value of assets held by third parties in perpetual trusts of \$27,904 and \$26,351 in 2013 and 2012, respectively.



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Following is a description of the university's valuation methodologies for assets and liabilities measured at fair value. The methods described below 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 estimate of fair value at the reporting date. Fair value for Level 1 is based upon quoted prices in active markets that the university has the ability to access for identical assets and liabilities. Market price data is generally obtained from exchange or dealer markets. The university does not adjust the quoted price for such assets and liabilities.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Certain alternative investments, such as hedge funds, that do not have readily determinable fair values, but are redeemable in the near term at investee-reported net asset value per share or its equivalent, are also reported at this level. An alternative investment is considered redeemable in the near term if the university has the ability to redeem the investment or a portion thereof up to 180 days beyond the measurement date at net asset value. If the redemption extends beyond 180 days, the investment is categorized as Level 3. Inputs are obtained from various sources including market participants, dealers, and brokers.

Fair value for Level 3 is based on valuation techniques that use significant inputs that are unobservable as they trade infrequently or not at all.

Investments included in Level 3 primarily consist of the university's ownership in alternative investments (principally limited partnership interests in hedge, private equity strategies, real assets, and other similar funds). The fair values (Net Asset Value ("NAV") or partner's capital per share) of the securities held by limited partnerships that do not have readily determinable fair values are determined by the respective general partners and are based on appraisals or other estimates that require varying degrees of judgment. If no public market exists for the investments, the fair value is determined by the general partners taking into consideration significant unobservable inputs including, among other things, the cost of the investments, prices of recent significant placements of investments of the same issuer, and subsequent developments concerning the companies to which the investments relate. Excluding the cost of the investment, significant increases or decreases in the remainder of those inputs could result in a significantly higher or lower fair value measurement. The university has performed due diligence with respect to these investments to ensure NAV or partner's capital per share is an appropriate measure of fair value as of June 30. NAV calculated by the investee in a manner consistent with generally accepted accounting principles for investment companies is reported as the fair value of the investment.

Valuation and other considerations concerning the major classes of investments are provided in the following paragraphs.

# Washington University

## Notes to the Financial Statements

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*(All amounts in thousands of dollars)*

#### **Equity**

The equity class of investments is globally diversified across public markets including domestic, international developed and international emerging. The majority of equity assets are valued at quoted market price in accordance with Level 1 valuation techniques as described above. A moderate component is held in hedge-like strategies which are valued at NAV in accordance with techniques for Levels 2 and 3 valuations as described above.

#### **Fixed Income and Short-Term Investments**

Investments in this class include domestic and international nominal fixed income (nominal) and inflation indexed bonds (real). Fixed income investments are held principally as liquid vehicles for operating needs and as a source of diversification. A significant component of nonendowment fixed income investments is held in highly liquid funds. The valuation of these funds is determined using a market approach in accordance with the techniques for Level 2 as described above.

#### **Hedged Strategies**

Investments in hedged strategies are made in sub-strategies including event driven, distressed/credit, relative value, long/short equity, and global macro funds. The redemption frequency for these funds varies from monthly to every 2 years. Similarly, the required redemption notice period varies from 3 to 180 days. The total fair value of hedged strategies, including equity and fixed income investments with a hedge fund structure, held at June 30, 2013 and 2012 was \$2,445,363 and \$2,088,272, respectively. Of this amount, \$154,231 and \$129,283 at June 30, 2013 and 2012, respectively, were in side pockets with indeterminate redemption periods. Another \$209,797 and \$144,912 were subject to initial investment lock-ups that at June 30, 2013 and 2012, respectively, will expire over the next 3 to 16 months. Some funds subject to lock-up permit early redemptions subject to a fee. At June 30, 2013, the university had commitments outstanding of \$15,750 for hedged strategy funds and \$30,000 for equity investments with a hedge fund structure.

#### **Private Equity**

Investments in private equity strategies are made in targeted categories including buyout, venture capital, and corporate finance. Redemptions of such funds are not permitted and distributions are received as underlying investments are liquidated. The remaining lives of the agreements under which these investments are made vary from 1 to 14 years assuming all extension options under the agreements are exercised and approved. At June 30, 2013, the university had total private equity investment commitments outstanding of \$829,984, but only a portion of this amount is expected to be funded in 2014.

#### **Real Assets**

Investments in the real assets class are made in targeted categories including natural resources and real estate. Such accounts represent approximately 8% of total investments. The majority of these assets are not held directly but are held in private-equity-type structures that invest primarily in real estate and natural resources. The valuation of these funds is determined using a market approach in accordance with the techniques for Level 3 as described above.

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The following tables roll forward the Statements of Financial Position amounts for financial instruments classified by the university within Level 3 of the fair value hierarchy defined above for the years ended June 30, 2013 and 2012.

	Balance June 30, 2012	Net Realized and Unrealized Gains (Losses)	Purchases	Sales	Transfers in/(out) of Level 3, Net	Balance June 30, 2013
<b>Investments</b>						
Public equity						
Domestic	\$ 7,000	\$ 5,973	\$ 35,149	\$ (2,932)	\$ -	\$ 45,190
International	63,948	6,165	57,500	-	(31,678)	95,935
Fixed income						
Nominal	-	-	-	-	-	-
Real	78,546	(5,284)	-	-	-	73,262
Hedged strategies	616,688	70,511	278,000	(72,318)	(165,256)	727,625
Private equity	933,553	95,207	143,263	(187,370)	-	984,653
Short-term investments	-	-	-	-	-	-
Deposits with bond trustees	-	-	-	-	-	-
Split-interest agreements	3,271	261	350	(125)	-	3,757
Beneficial interest trusts	26,351	2,183	4,858	(4,968)	(520)	27,904
Real assets	487,240	34,267	91,101	(86,175)	-	526,433
Other investments	24,829	3,301	1,800	(5,254)	-	24,676
Total	\$2,241,426	\$ 212,584	\$ 612,021	\$ (359,142)	\$ (197,454)	\$ 2,509,435

During 2013, transfers out of and into Level 3 from Level 2 of \$223,550 and \$26,616, respectively, and transfers out of Level 1 to Level 2 of \$207,631 were made as a result of changes in redemption periods. Additional transfers out of Level 3 of \$520 were made as a result of payments from beneficial interest trusts to beneficiaries. The university recognizes transfers as of the end of the reporting period.

Included in the change in net assets is the amount of net realized and unrealized gains/(losses) which includes net unrealized gains/(losses) for Level 3 investments for the period relating to assets still held at June 30, 2013. Net realized and unrealized gains/(losses) are reported as investment returns net of endowment spending in the Statements of Activities. The amounts of net unrealized gains/(losses) for Level 3 investments held at June 30, 2013 by type are as follows:

Public equity	
Domestic	\$ 5,929
International	4,025
Fixed income	
Nominal	-
Real	(509)
Hedged strategies	110,426
Private equity	11,040
Short-term investments	-
Deposits with bond trustees	-
Split-interest agreements	261
Beneficial interest trusts	1,553
Real assets	1,335
Other investments	(182)
Total	\$ 133,878

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	Balance June 30, 2011	Net Realized and Unrealized Gains (Losses)	Purchases	Sales	Transfers in/(out) of Level 3, Net	Balance June 30, 2012
<b>Investments</b>						
Public equity						
Domestic	\$ 87,589	\$ (25,150)	\$ 45	\$ (55,534)	\$ 50	\$ 7,000
International	44,835	(3,543)	42,500	(19,844)	-	63,948
Fixed income						
Nominal	1,844	(210)	-	-	(1,634)	-
Real	-	70,124	86,968	-	(78,546)	78,546
Hedged strategies	661,210	7,203	83,355	(16,868)	(118,212)	616,688
Private equity	793,898	70,685	187,633	(118,663)	-	933,553
Short-term investments	-	-	-	-	-	-
Deposits with bond trustees	-	-	-	-	-	-
Split-interest agreements	3,344	(198)	125	-	-	3,271
Beneficial interest trusts	28,159	(689)	2,320	(2,645)	(794)	26,351
Real assets	438,911	7,075	88,551	(47,297)	-	487,240
Other investments	24,776	(52)	126	(21)	-	24,829
Total	<u>\$2,084,566</u>	<u>\$ 125,245</u>	<u>\$ 491,623</u>	<u>\$(260,872)</u>	<u>\$(199,136)</u>	<u>\$2,241,426</u>

During 2012, \$200,635 of transfers were made from Level 3 to Level 2 and \$1,499 from Level 2 to Level 3 primarily as a result of hedge funds becoming available for redemption. The university recognizes transfers as of the end of the reporting period

Included in the change in net assets is the amount of net realized and unrealized gains/(losses) which includes net unrealized gains/(losses) for Level 3 investments for the period relating to assets still held at June 30, 2012. Net realized and unrealized gains/(losses) are reported as investment returns net of endowment spending in the Statements of Activities. The amounts of net unrealized gains/(losses) for Level 3 investments held at June 30, 2012 by type are as follows:

Public equity	
Domestic	\$ (412)
International	(4,131)
Fixed income	
Nominal	(210)
Real	35,062
Hedged strategies	18,612
Private equity	3,854
Short-term investments	-
Deposits with bond trustees	-
Split-interest agreements	(197)
Beneficial interest trusts	(1,245)
Real assets	(4,848)
Other investments	(48)
Total	<u>\$ 46,437</u>

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**3. Investment Return**

The following summarizes the return on investments. Investment income represents earnings on nonendowed funds. Return on investments is presented net of investment management fees. Certain investments, including some but not all of those in the hedged and private equity categories, report investment returns net of fees. Other fees paid directly to investment managers and internal investment management costs were \$34,943 and \$35,662 for 2013 and 2012, respectively.

	<u>2013</u>	<u>2012</u>
Investment income	\$ 7,930	\$ 9,070
Pooled Endowment dividends and interest income	32,223	26,471
Pooled Endowment distribution in excess of income	<u>203,474</u>	<u>200,778</u>
Pooled Endowment spending distribution	235,697	227,249
Investment gains, net	607,315	14,925
Gains distributed as endowment distribution	<u>(203,474)</u>	<u>(200,778)</u>
Investment returns net of endowment spending distribution	<u>403,841</u>	<u>(185,853)</u>
Net investment gains	<u>\$ 647,468</u>	<u>\$ 50,466</u>

At June 30, 2013 and 2012, investments with a fair value of \$27,740 and \$51,997, respectively, were loaned to various brokers on an open-ended basis for average periods varying from several days to several months, depending on the type of loan. The university receives lending fees and continues to earn interest and dividends on the loaned securities. These securities are returnable on demand and are collateralized by cash deposits amounting to 102% and 103% of the market value of the securities loaned at June 30, 2013 and 2012, respectively. The university is indemnified against borrower default by the financial institution that is acting as its lending agent. The borrowers provided \$28,332 and \$53,469 of cash collateral for the loaned securities at June 30, 2013 and 2012, respectively, and is reported in Deposits, advances and other on the Statements of Financial Position. Most, if not all, of the cash is reinvested in other vehicles by the lending agent. Such collateral was invested in fixed income securities and had a fair value of \$19,351 and \$40,949 at June 30, 2013 and 2012, respectively, and is reported in Other assets on the Statements of Financial Position.

**4. Endowment**

The state of Missouri has adopted legislation that incorporates the provisions outlined in the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The statutory guidelines contained in this legislation relate to the prudent management, investment, and expenditure of donor-restricted endowment funds held by charitable organizations. Additionally, the legislation specifies factors for fiduciaries to consider prior to making a decision to appropriate from or accumulate into an institution's endowment funds.

At June 30, 2013, the university's endowment consists of 2,971 individual donor-restricted endowment funds and Board of Trustees or management-designated endowment funds for a variety of purposes plus split interest agreements and other net assets where the assets have been designated for endowment. The net assets associated with endowment funds, including funds designated by the Board of Trustees or management to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions.

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The university has interpreted Missouri UPMIFA as requiring the preservation of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the university classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted until the donor-imposed stipulations attached to those amounts have been met by actions of the university and or passage of time and appropriated for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA.

Endowment net asset composition, which includes the effect of changes in endowment investments as well as other endowment-related assets and liabilities, by type of fund as of June 30, 2013:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (1,919)	\$ 2,304,891	\$ 1,421,348	\$ 3,724,320
Board-designated endowment funds	<u>1,868,933</u>	<u>124,456</u>	<u>-</u>	<u>1,993,389</u>
Total endowment funds	<u>\$ 1,867,014</u>	<u>\$ 2,429,347</u>	<u>\$ 1,421,348</u>	<u>\$ 5,717,709</u>

Changes in endowment net assets for the year ended June 30, 2013:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>Endowment net assets at beginning of year</b>	\$ 1,727,705	\$ 2,178,356	\$ 1,330,301	\$ 5,236,362
Investment return				
Net investment income	12,819	21,023	-	33,842
Net appreciation (realized and unrealized)	<u>241,211</u>	<u>366,898</u>	<u>3,182</u>	<u>611,291</u>
Total investment return	254,030	387,921	3,182	645,133
Gifts	291	7,122	89,368	96,781
Appropriation of endowment assets for expenditure	(93,683)	(142,013)	-	(235,696)
Net transfers to create board designated funds	32,053	1,654	670	34,377
Allocation of endowment return to Treasurers Investment Pool	(44,890)	-	-	(44,890)
Reclassification of deficits in donor-designated funds	3,032	(3,032)	-	-
Other activity	<u>(11,524)</u>	<u>(661)</u>	<u>(2,173)</u>	<u>(14,358)</u>
<b>Endowment net assets at end of year</b>	<u>\$ 1,867,014</u>	<u>\$ 2,429,347</u>	<u>\$ 1,421,348</u>	<u>\$ 5,717,709</u>

Of the amount classified as temporarily restricted endowment net assets, \$1,924,775 represents the portion of endowment funds subject to time restrictions under Missouri's enacted version of UPMIFA.

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Endowment net asset composition by type of fund as of June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (4,951)	\$ 2,062,877	\$ 1,330,301	\$ 3,388,227
Board-designated endowment funds	<u>1,732,656</u>	<u>115,479</u>	<u>-</u>	<u>1,848,135</u>
Total endowment funds	<u>\$ 1,727,705</u>	<u>\$ 2,178,356</u>	<u>\$ 1,330,301</u>	<u>\$ 5,236,362</u>

Changes in endowment net assets for the year ended June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>Endowment net assets at beginning of year</b>	\$ 1,774,845	\$ 2,281,045	\$ 1,271,617	\$ 5,327,507
Investment return				
Net investment income	10,730	17,983	-	28,713
Net appreciation (realized and unrealized)	<u>8,463</u>	<u>5,561</u>	<u>(1,376)</u>	<u>12,648</u>
Total investment return	19,193	23,544	(1,376)	41,361
Gifts	396	6,386	59,953	66,735
Appropriation of endowment assets for expenditure	(92,013)	(135,236)	-	(227,249)
Net transfers to create board designated funds	34,662	3,042	1,323	39,027
Allocation of endowment return to Treasurers Investment Pool	(10,171)	-	-	(10,171)
Reclassification of deficits in donor-designated funds	1,702	(1,702)	-	-
Other activity	<u>(909)</u>	<u>1,277</u>	<u>(1,216)</u>	<u>(848)</u>
<b>Endowment net assets at end of year</b>	<u>\$ 1,727,705</u>	<u>\$ 2,178,356</u>	<u>\$ 1,330,301</u>	<u>\$ 5,236,362</u>

Of the amount classified as temporarily restricted endowment net assets, \$1,732,678 represents the portion of endowment funds subject to time restrictions under Missouri's enacted version of UPMIFA.

**Permanently Restricted Net Assets**

The portion of perpetual endowment funds net assets that is required to be retained permanently by explicit donor stipulation:

	<u>2013</u>	<u>2012</u>
Restricted for general activities	\$ 955,267	\$ 880,455
Restricted for student assistance	296,966	279,885
Restricted for buildings and renovations	146,825	146,956
Life income	<u>22,290</u>	<u>23,005</u>
Total endowment net assets classified as permanently restricted net assets	<u>\$ 1,421,348</u>	<u>\$ 1,330,301</u>

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**Temporarily Restricted Net Assets**

Temporarily restricted endowment funds net assets:

	<b>2013</b>	<b>2012</b>
Restricted for general activities	\$ 1,748,593	\$ 1,572,327
Restricted for student assistance	378,820	337,325
Restricted for buildings and renovations	288,616	257,716
Life income	<u>13,318</u>	<u>10,988</u>
Total endowment net assets classified as temporarily restricted net assets	<u>\$ 2,429,347</u>	<u>\$ 2,178,356</u>

**Endowment Funds With Deficits**

As determined under UPMIFA, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (i.e., deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. Deficits of this nature reported in unrestricted net assets were \$1,919 and \$4,951 as of June 30, 2013 and 2012, respectively. The deficits resulted largely from unfavorable market fluctuations that occurred shortly after the investment of newly established endowments.

**Return Objectives and Risk Parameters**

The university has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to meet or exceed the return of various indices, based on the endowment's target allocation applied to the appropriate individual benchmarks. The university expects its endowment funds over time, to provide an average rate of return of approximately 8.0% to 9.0% annually. Actual returns in any given year may vary from this amount.

**Strategies Employed for Achieving Investment Objectives**

To achieve 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 gains) and current yield (interest and dividends). The university targets a diversified asset allocation that places greater emphasis on equity-based and alternative investments to achieve its long-term objectives within prudent risk constraints.

**Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives**

The university has an endowment spending distribution policy designed to stabilize annual spending levels and preserve the real value of the endowment over time. Under this policy, earnings of the pooled endowment are distributed at a rate set annually to the schools and other units of the university. Consideration is given to the provisions of UPMIFA in determining the amount to appropriate. This spending rate must fall within the range of 3.0% to 5.5% of the five-year average market value of a unit of the pooled endowment. For 2013, the spending rate from the pooled endowment was 4.5% of the beginning market value of the pooled endowment. The spending rate is funded from current earnings and, in years when current earnings are insufficient, from previously accumulated earnings of the endowment.



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Based on market values, the total return for the endowment fund investments that are administered by the university was 10.5% in 2013 and 1.7% in 2012.

The university's endowed assets at June 30 are as follows:

	<b>Fair Market Value at June 30, 2013</b>	<b>Fair Market Value at June 30, 2012</b>
Pooled endowment	\$ 5,631,086	\$ 5,184,931
Life income trusts and pools	82,335	80,259
Externally administered trusts	27,904	26,351
Separately invested endowment	7,972	11,655
Total	<u>\$ 5,749,297</u>	<u>\$ 5,303,196</u>

**5. Accounts and Notes Receivable**

Accounts and notes receivable at June 30 were as follows:

	<b>2013</b>	<b>2012</b>
Patient services	\$ 214,455	\$ 201,638
Student and parent loans		
Parent loan fund	54,437	62,203
Government student loans	47,590	46,553
Institutional student loans	23,080	22,642
Due from affiliates	80,437	83,721
Other	115,377	74,896
	<u>535,376</u>	<u>491,653</u>
Less: Allowance for concessions and doubtful accounts	<u>(117,579)</u>	<u>(114,120)</u>
Total	<u>\$ 417,797</u>	<u>\$ 377,533</u>

The university is exposed to credit risk on amounts receivable from student and parent loans. Parent loan funds are offered by the university as a way for parents to finance their children's education at a fixed rate. Institutional student loans are offered by the university based on financial need. Both parent and institutional loans typically have ten year terms and, in the case of parent loans, existing economic conditions are evaluated annually in determining the interest rates for these loans. Government sponsored student loans carry minimal risk for the university.

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*(All amounts in thousands of dollars)*

The principal credit quality indicator used by the university for the portfolio of nongovernment student and parent loans is collection experience. In order to reduce its credit risk, the university has adopted credit policies which include a review of credit limits and maintaining an active collections process with the assistance of third party collection agencies as necessary. At June 30, 2013, the allowance for parent and institutional student loans was \$4,137 compared to \$3,973 at June 30, 2012. Accounts are considered past due if a scheduled payment is forty-five days late. The balance in such accounts was \$10,100 and \$8,797 at June 30, 2013 and June 30, 2012, respectively. Allowances are established based on management's best estimate of exposure at June 30 and are influenced by historical losses, existing economic conditions, and the current payment activity on loans. Activity in these allowances was not significant.

Parent loans and institutional student loans are sent to a third party collection agency if the loan is past due for a period of time and the university has been unable to collect payment. As these loans are nondischargeable in bankruptcy, accounts are not typically considered uncollectible until all collection efforts have been exhausted with no receipt of payment. At this time, a loan will be written off.

# Washington University

## Notes to the Financial Statements

### June 30, 2013 and 2012

(All amounts in thousands of dollars)

#### 6. Notes and Bonds Payable

Outstanding principal on bonds and notes payable at June 30, 2013 and 2012 consists of the following:

Missouri Health and Educational Facilities Authority	Rates at June 30, 2013	Maturity	2013	2012
\$142,400 of 1996A, B, C and D Series Variable Rate Bonds, due in full	.01% - .25%	September 1, 2030	\$ 142,400	\$ 142,400
\$88,000 of 2000B and C Series Variable Rate Bonds, due in full	.01% - .23%	March 1, 2040	88,000	88,000
\$176,490 of 2001A Series Bonds, due in full	5.50%	June 15, 2016	48,250	48,250
\$93,430 of 2003A Series Bonds, due in full	5.00%	February 15, 2033	-	93,430
\$25,135 of 2003B Series Variable Rate Bonds, due in full	.01% - .24%	February 15, 2033	25,135	25,135
\$100,000 of 2004 Series A and B Variable Rate Bonds, due annually	.01% - .24%	February 15, 2034	83,600	86,000
\$20,780 of 2005A Series Refunding Bonds due annually	3.00% - 5.00%	February 15, 2022	12,720	13,850
\$104,020 of 2007 A Series Bonds, due in full	5.00%	January 15, 2037	104,020	104,020
\$126,975 of 2007B Series Refunding Bonds, due serially from January 15, 2021 to January 15, 2041	4.20% - 4.50%	January 15, 2041	126,975	126,975
\$193,625 of 2008A Series Educational Facilities Revenue Bonds, due March 15, 2018 (\$44,000) and March 15, 2039 (\$149,625)	5.25% - 5.38%	March 15, 2018 and 2039	193,625	193,625
\$93,770 of 2009A Series Educational Facilities Revenue Bonds, due November 15, 2030 (\$20,000) and November 15, 2039 (\$73,770)	4.50% - 5.00%	November 15, 2030 and 2039	93,770	93,770
\$22,985 of 2011A Series Revenue Bonds due in full November 15, 2041	5.00%	November 15, 2041	22,985	22,985
\$96,350 of 2011B Series Revenue Bonds due in full November 15, 2030 (\$39,050) and November 15, 2037 (\$57,300)	5.00%	November 15, 2030 and 2037	96,350	96,350
\$77,495 of 2011C Series Revenue Bonds due serially from November 15, 2012 to November 15, 2037	.75% - 5.06%	November 15, 2037	74,360	77,495
\$200,785 of 2012A Series Revenue Bonds due serially from February 15, 2023 to February 15, 2047	2.39% - 3.69%	February 15, 2047	200,785	-
Other notes payable			21,600	30,419
Total outstanding notes and bonds payable			1,334,575	1,242,704
Unamortized original issue premiums/discounts, net			17,963	18,743
Total			\$ 1,352,538	\$ 1,261,447

# Washington University

## Notes to the Financial Statements

### June 30, 2013 and 2012

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*(All amounts in thousands of dollars)*

Bonds payable are redeemable at the option of the university at various times from 2014 through 2047. The university is required to maintain certain ratios and comply with other restrictive covenants principally that the university maintain a ratio of expendable financial resources to debt of at least 1.25 times. The university is in compliance with this covenant. During 2013 and 2012, interest, accretion of debt discount and related fees incurred on notes and bonds payable totaled \$50,029 and \$51,082, respectively.

Maturities on notes and bonds payable for the next five fiscal years are as follows:

2014	\$	28,490
2015		7,070
2016		55,530
2017		7,500
2018		51,770
Thereafter		1,184,215

During fiscal 2013, through the Missouri Health and Educational Facilities Authority (MOHEFA), the university issued \$200,785 of Series A bonds. \$98,102 of net proceeds from the issuance and other funds were placed in an irrevocable trust to be used to satisfy all interest and principal payments, including principal to be paid at the first scheduled call date, for \$93,430 of the 2003 Series A MOHEFA Bonds. In accordance with the terms of the 2003A Bond indentures and loan agreements, establishment of the trust results in the legal defeasance of the university's obligation under the bonds. The transaction was accounted for as an extinguishment with a recognized loss of \$3,033 reported on the Other line of the Statements of Activities, while the university reduced its aggregate debt service by \$25,709 over the life of the Series 2003A Bonds. This represents a net present value savings of \$17,205.

The university has other unused lines of credit, which expire annually, aggregating \$173,000, of which \$152,000 is available at June 30, 2013. The university expects that these lines of credit will be renewed but can make no assurances.

#### **7. Derivative and Other Financial Instruments**

In accordance with the university's investment policies, derivative instruments may be purchased and sold to manage the risk and return of investment market positions. Investment managers purchase and sell derivatives on various fixed income instruments to control the risk of fluctuations in interest rates, relative to portfolio benchmarks, on the university's fixed income investments. Certain equity investment managers purchase derivatives to obtain cost efficient exposure to equity markets or to hedge currency. These contracts are valued at periodic intervals (daily, monthly, quarterly, etc.) as well as at June 30, with the resulting changes in the values of the contracts either added to or deducted from the university's custodial account. In addition, derivative transactions (primarily futures, options and swaps) can be entered into using a derivatives administrator for multiple purposes including hedging, rebalancing or tactical trading. Hedging derivatives are utilized in the event that the university determines that the endowment should hedge market exposures. Rebalancing derivatives are utilized to synthetically adjust the university's investment allocation towards its policy allocation. Tactical trading derivatives are utilized to implement a view that the university may have on a particular market. Derivative activity, when initiated by the university is executed, settled and managed by the derivatives administrator on a nondiscretionary basis. Such instruments are not designated as hedges for accounting purposes. Gains or losses

# Washington University

## Notes to the Financial Statements

### June 30, 2013 and 2012

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*(All amounts in thousands of dollars)*

from these derivative instruments are reported as realized and unrealized gains or losses in the Statements of Activities. The contracts and gains or losses they generate are not material to the university's financial statements.

The university has investments in certain funds, generally in the form of limited partnerships, that participate directly, or have the option to participate, in derivative instruments. The university regularly reviews the performance of these funds in the context of its overall investment objectives.

In order to reduce exposure to floating interest rates on variable rate debt, the university entered into a thirty-year interest rate swap agreement in 2004. The agreement has the effect of fixing the rate of interest on borrowings at approximately 4.26% for \$86,000 of debt. The fair value of the swap is the estimated amount that the university would receive or pay to terminate the agreement at the reporting date, taking into account current interest rates and the current credit-worthiness of the swap counter party. The fair value of the interest rate swap, reported on the Investments line of the Statements of Financial Position, was a liability of \$4,517 and \$7,338 at June 30, 2013 and 2012, respectively, and is considered a Level 2 financial instrument under the FASB guidance on fair value measurements. The change in fair value resulted in a gain of \$2,821 and loss of \$1,110 in 2013 and 2012, respectively, that are reported in investment returns net of endowment spending on the Statements of Activities. These financial instruments necessarily involve counterparty credit exposure and the university's own nonperformance risk. The counterparties for these swap transactions are major financial institutions that meet the university's criteria for financial stability and creditworthiness.

#### **8. Fair Value of Financial Instruments**

The carrying amount of accrued investment income and accounts receivable approximate fair value because of the short maturity of these financial instruments. The carrying amount of accounts payable and other various accruals approximate fair value because of the short maturity of these financial instruments. The carrying amount of notes and bonds payable with variable interest rates approximates their fair value because the variable rates reflect current market rates for bonds with similar maturities and credit quality. The fair value of notes and bonds payable with fixed interest rates, reportable as Level 2 in the valuation hierarchy discussed in Note 2, represents the quoted market value. The estimated fair value and carrying amount of all notes and bonds payable at June 30, 2013 approximated \$1,380,135 and \$1,352,538 and at June 30, 2012 approximated \$1,350,859 and \$1,261,447, respectively.

#### **9. Commitments and Contingencies**

At June 30, 2013, the university had outstanding commitments under certain construction contracts in the amount of \$99,214, the majority of which will be payable during the year ending June 30, 2014.

The university maintains a self-insurance program for professional liability. This program is supplemented with commercial excess insurance above the university's self-insurance retention. Funding for the program reserves is based on claims made. The assets supporting the funded reserve are reported as investments in the Statements of Financial Position. The university also accrues for an estimate of claims incurred but not reported. Reserves, funded and unfunded, are based upon actuarial studies and represent undiscounted estimated claims and related costs. The total self-insurance reserves at June 30, 2013 and 2012, respectively, were \$78,963 and \$68,732.

# Washington University

## Notes to the Financial Statements

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*(All amounts in thousands of dollars)*

Self-insurance reserves are necessarily estimates based on historical loss experience and other factors, and while management believes that the reserves are adequate, the ultimate liabilities may be in excess of or less than the amounts provided.

The university is a party, along with other universities, to an agreement with a captive insurance company and a reciprocal risk retention group for purposes of obtaining general liability and auto liability insurance coverage in excess of a pre-determined retention level. Under the terms of these agreements, the university can be called upon to make additional capital contributions. In management's view, any such capital calls would not be material.

The university is involved in various legal proceedings arising in the normal course of operations. Although the outcome of any legal proceeding cannot be predicted with certainty, it is the opinion of the university's management that the outcome of these proceedings individually or in the aggregate, will not have a material adverse effect on the business, Statement of Activities, financial position or liquidity of the university.

#### **10. Retirement Plan**

The university provides its faculty and staff with a defined contribution (403(b)) retirement savings plan in which employee contributions, university contributions and investment earnings accumulate to assist employees at retirement. Participating employees own individual retirement accounts through the Teachers Insurance and Annuity Association (TIAA), College Retirement Equity Fund (CREF), and/or the Vanguard Group, Inc. Under this arrangement, the university and plan participants make monthly contributions to TIAA-CREF and/or Vanguard. For employees who were benefits eligible as of August 31, 2006, the amount of contribution made by the university, commencing after two years of eligible service, is based upon the employee's age and salary. For benefits-eligible employees hired or rehired on or after August 31, 2006, the university contribution commences after two years of eligible service and is based upon the employee's years of eligible service and salary. Vesting provisions are full and immediate. The university's share of the cost of these benefits in 2013 and 2012 was \$64,805 and \$62,130, respectively.

#### **11. Agreements With Affiliated Hospitals**

The university has affiliation agreements with Barnes Jewish Hospital (BJH) and St. Louis Children's Hospital (SLCH), collectively the Hospitals. This includes operating activities of Barnes Jewish Hospital at Barnes Jewish West County Hospital (BJWCH), Barnes Jewish Orthopedic Center (OC) in Chesterfield, and the Siteman South County Cancer Center.

The terms of the affiliation agreements provide for the university to be responsible for providing professional medical staff and direction, supervision of residents and interns, appropriate resources for research and medical education, and participation in joint clinical planning. BJH and SLCH are responsible for the hospitals and health care delivery facilities. BJH and SLCH compensate the university for services provided by the university through a fixed annual base payment (adjusted annually for inflation) and an additional contingent payment equal to a share of the combined BJH and SLCH adjusted net operating income. The combined revenue is reported as affiliated hospital revenue on the Statements of Activities. There are also agreements between BJH, SLCH and the university for leased space. The rental payments to SLCH for 2013 and 2012 were \$1,084 and \$782, respectively, and vary annually based on a formula defined in the agreement. Rental

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*(All amounts in thousands of dollars)*

payments received from SLCH in 2013 and 2012 were \$546 and \$370, respectively. Rental payments to BJH in 2013 and 2012 were \$5,372 and \$6,582, respectively. Rental payments received from BJH in 2013 and 2012 were \$2,303 and \$2,841, respectively. During 2013, BJH agreed to fund on a cost-reimbursement basis over a period of years, certain expenditures of up to \$129,400 by the university in connection with recruitment of faculty at the university's School of Medicine. Payments of \$18,348 were received or accrued under the agreement during 2013.

**12. Subsequent Events**

The university has performed an evaluation of subsequent events through September 24, 2013, which is the date the financial statements were issued. No events have been identified that require disclosure.