



**WAKE FOREST UNIVERSITY**

Consolidated Financial Statements

June 30, 2012

(With Independent Auditors' Report Thereon)



KPMG LLP  
Suite 400  
300 North Greene Street  
Greensboro, NC 27401

## Independent Auditors' Report

The Board of Trustees  
Wake Forest University:

We have audited the accompanying consolidated balance sheet of Wake Forest University (the University) as of June 30, 2012, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from the University's 2011 consolidated financial statements and, in our report dated October 20, 2011, we expressed an unqualified opinion on those consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in the consolidated balance sheet, statement of activities, statement of cash flows, and the accompanying notes related to the College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc. (collectively Reynolda Campus); and Wake Forest University Health Sciences (WFUHS) is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

**KPMG LLP**

October 25, 2012

**WAKE FOREST UNIVERSITY**

Consolidated Balance Sheet

June 30, 2012

(with summarized comparative financial information as of June 30, 2011)

(Dollars in thousands)

Assets	Supplementary Information			
	Reynolda Campus	WFUHS	2012	2011
Cash and cash equivalents	\$ 43,400	32,200	75,600	145,104
Accounts receivable, net	9,852	171,339	181,191	154,740
Patient receivables, net	—	68,898	68,898	57,538
Contributions receivable, net	54,196	4,491	58,687	54,568
Notes receivable, net	23,728	4,073	27,801	29,574
Investments	743,577	609,538	1,353,115	1,348,311
Investments in real estate	27,199	—	27,199	25,670
Other assets	5,995	10,485	16,480	15,307
Deposits with bond trustee	5,347	—	5,347	13,782
Land, buildings, and equipment, net	361,594	341,557	703,151	654,478
<b>Total assets</b>	<b>\$ 1,274,888</b>	<b>1,242,581</b>	<b>2,517,469</b>	<b>2,499,072</b>
<b>Liabilities and Net Assets</b>				
Liabilities:				
Accounts payable and accruals	\$ 28,966	124,180	153,146	134,638
Other liabilities and deferrals	68,103	214,154	282,257	244,413
Annuities payable	24,299	4,189	28,488	26,217
Notes payable and capital leases	32,287	142,775	175,062	85,647
Bonds payable	162,776	89,110	251,886	349,893
Postretirement benefits	14,700	3,674	18,374	33,886
Government grants refundable	9,945	—	9,945	10,103
<b>Total liabilities</b>	<b>341,076</b>	<b>578,082</b>	<b>919,158</b>	<b>884,797</b>
Net assets:				
Unrestricted	470,845	483,673	954,518	966,367
Temporarily restricted	246,044	48,693	294,737	305,174
Permanently restricted	216,923	132,133	349,056	342,734
<b>Total net assets</b>	<b>933,812</b>	<b>664,499</b>	<b>1,598,311</b>	<b>1,614,275</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,274,888</b>	<b>1,242,581</b>	<b>2,517,469</b>	<b>2,499,072</b>

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**

Consolidated Statement of Activities

Year ended June 30, 2012

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

(Dollars in thousands)

	2012			Total	2011 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
Operating revenues:					
Student tuition and fees	\$ 286,251	—	—	286,251	267,803
Less student aid	(85,038)	—	—	(85,038)	(80,676)
Net student tuition and fees	201,213	—	—	201,213	187,127
Government grants and contracts	198,790	—	—	198,790	207,060
Private grants and contracts	15,781	24,117	—	39,898	85,880
Contributions	26,795	6,937	—	33,732	18,475
Investment return designated for current operations	38,674	21,984	—	60,658	63,988
Patient revenue, net	360,858	—	—	360,858	352,764
Other	155,980	—	—	155,980	167,857
Sales and services of auxiliary enterprises	75,712	—	—	75,712	67,467
Net assets released from restrictions	49,357	(49,357)	—	—	—
Total operating revenues	1,123,160	3,681	—	1,126,841	1,150,618
Operating expenses:					
Salaries and wages	570,883	—	—	570,883	533,781
Employee benefits	113,257	—	—	113,257	119,509
Student aid	12,480	—	—	12,480	11,310
Services	168,273	—	—	168,273	160,195
Clinical and laboratory supplies	51,516	—	—	51,516	56,850
Other operating expenses	112,879	—	—	112,879	144,324
Bad debt expense	1,190	—	—	1,190	(3,493)
Depreciation and amortization	51,224	—	—	51,224	47,684
Interest on debt	13,617	—	—	13,617	14,979
Total operating expenses	1,095,319	—	—	1,095,319	1,085,139
Operating excess	27,841	3,681	—	31,522	65,479
Nonoperating activities:					
Restricted contributions	—	13,482	18,317	31,799	44,881
Net assets released from restriction	5,176	(5,176)	—	—	—
Investment return (less than) in excess of amounts designated for current operations	(19,311)	(20,899)	(6,938)	(47,148)	107,574
Actuarial loss on annuity obligations	—	—	(3,791)	(3,791)	(40)
Unrealized (loss) gain on interest rate swaps	(34,664)	—	—	(34,664)	7,419
Postretirement related changes other than net periodic cost	8,787	—	—	8,787	9,353
Gain (loss) from affiliates, equity method	1,591	—	—	1,591	(1,060)
Contribution of affiliates	—	—	—	—	9,752
Donor designation changes	131	566	(697)	—	—
Other, net	(1,400)	(2,091)	(569)	(4,060)	(3,265)
(Decrease) increase from nonoperating activities	(39,690)	(14,118)	6,322	(47,486)	174,614
(Decrease) increase in net assets	(11,849)	(10,437)	6,322	(15,964)	240,093
Net assets at beginning of year	966,367	305,174	342,734	1,614,275	1,374,182
Net assets at end of year	\$ 954,518	294,737	349,056	1,598,311	1,614,275

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**

Statement of Activities

College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.  
(Supplementary Information)

Year ended June 30, 2012

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating revenues:				
Student tuition and fees	\$ 253,377	—	—	253,377
Less student aid	(73,345)	—	—	(73,345)
Net student tuition and fees	180,032	—	—	180,032
Government grants and contracts	10,252	—	—	10,252
Private grants and contracts	4,838	207	—	5,045
Contributions	19,685	6,937	—	26,622
Investment return designated for current operations	17,330	16,570	—	33,900
Patient revenue, net	—	—	—	—
Other	7,390	—	—	7,390
Sales and services of auxiliary enterprises	75,712	—	—	75,712
Net assets released from restrictions	23,234	(23,234)	—	—
Total operating revenues	<u>338,473</u>	<u>480</u>	<u>—</u>	<u>338,953</u>
Operating expenses:				
Salaries and wages	160,137	—	—	160,137
Employee benefits	38,308	—	—	38,308
Student aid	3,476	—	—	3,476
Services	39,671	—	—	39,671
Clinical and laboratory supplies	—	—	—	—
Other operating expenses	57,856	—	—	57,856
Bad debt expense	1,190	—	—	1,190
Depreciation and amortization	24,271	—	—	24,271
Interest on debt	6,568	—	—	6,568
Total operating expenses	<u>331,477</u>	<u>—</u>	<u>—</u>	<u>331,477</u>
Operating excess	<u>6,996</u>	<u>480</u>	<u>—</u>	<u>7,476</u>
Nonoperating activities:				
Restricted contributions	—	13,482	9,081	22,563
Net assets released from restriction	5,176	(5,176)	—	—
Investment return (less than) in excess of amounts designated for current operations	(7,697)	(15,761)	(885)	(24,343)
Actuarial loss on annuity obligations	—	—	(3,478)	(3,478)
Unrealized (loss) gain on interest rate swaps	(13,051)	—	—	(13,051)
Postretirement related changes other than net periodic cost	(282)	—	—	(282)
Gain (loss) from affiliates, equity method	—	—	—	—
Contribution of affiliates	—	—	—	—
Donor designation changes	131	566	(697)	—
Other, net	69	1,579	(1,116)	532
(Decrease) increase from nonoperating activities	<u>(15,654)</u>	<u>(5,310)</u>	<u>2,905</u>	<u>(18,059)</u>
(Decrease) increase in net assets	<u>(8,658)</u>	<u>(4,830)</u>	<u>2,905</u>	<u>(10,583)</u>
Net assets at beginning of year	479,503	250,874	214,018	944,395
Net assets at end of year	\$ <u>470,845</u>	<u>246,044</u>	<u>216,923</u>	<u>933,812</u>

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**  
Statement of Activities  
Wake Forest University Health Sciences  
(Supplementary Information)  
Year ended June 30, 2012  
(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating revenues:				
Student tuition and fees	\$ 32,874	—	—	32,874
Less student aid	(11,693)	—	—	(11,693)
Net student tuition and fees	21,181	—	—	21,181
Government grants and contracts	188,538	—	—	188,538
Private grants and contracts	10,943	23,910	—	34,853
Contributions	7,110	—	—	7,110
Investment return designated for current operations	21,344	5,414	—	26,758
Patient revenue, net	360,858	—	—	360,858
Other	148,590	—	—	148,590
Sales and services of auxiliary enterprises	—	—	—	—
Net assets released from restrictions	26,123	(26,123)	—	—
Total operating revenues	<u>784,687</u>	<u>3,201</u>	<u>—</u>	<u>787,888</u>
Operating expenses:				
Salaries and wages	410,746	—	—	410,746
Employee benefits	74,949	—	—	74,949
Student aid	9,004	—	—	9,004
Services	128,602	—	—	128,602
Clinical and laboratory supplies	51,516	—	—	51,516
Other operating expenses	55,023	—	—	55,023
Bad debt expense	—	—	—	—
Depreciation and amortization	26,953	—	—	26,953
Interest on debt	7,049	—	—	7,049
Total operating expenses	<u>763,842</u>	<u>—</u>	<u>—</u>	<u>763,842</u>
Operating excess	<u>20,845</u>	<u>3,201</u>	<u>—</u>	<u>24,046</u>
Nonoperating activities:				
Restricted contributions	—	—	9,236	9,236
Net assets released from restriction	—	—	—	—
Investment return (less than) in excess of amounts designated for current operations	(11,614)	(5,138)	(6,053)	(22,805)
Actuarial loss on annuity obligations	—	—	(313)	(313)
Unrealized (loss) gain on interest rate swaps	(21,613)	—	—	(21,613)
Postretirement related changes other than net periodic cost	9,069	—	—	9,069
Gain (loss) from affiliates, equity method	1,591	—	—	1,591
Contribution of affiliates	—	—	—	—
Donor designation changes	—	—	—	—
Other, net	(1,469)	(3,670)	547	(4,592)
(Decrease) increase from nonoperating activities	<u>(24,036)</u>	<u>(8,808)</u>	<u>3,417</u>	<u>(29,427)</u>
(Decrease) increase in net assets	<u>(3,191)</u>	<u>(5,607)</u>	<u>3,417</u>	<u>(5,381)</u>
Net assets at beginning of year	486,864	54,300	128,716	669,880
Net assets at end of year	<u>\$ 483,673</u>	<u>48,693</u>	<u>132,133</u>	<u>664,499</u>

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**  
Consolidated Statement of Cash Flows  
Year ended June 30, 2012  
(with summarized comparative financial information for the year ended June 30, 2011)  
(Dollars in thousands)

	<b>Supplementary Information</b>			
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>2012</b>	<b>2011</b>
Cash flows from operating activities:				
(Decrease) increase in net assets	\$ (10,583)	(5,381)	(15,964)	240,093
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:				
Depreciation and amortization	24,271	26,953	51,224	47,684
Net depreciation (appreciation) on investments	7,620	23,118	30,738	(149,006)
Noncash gifts	(129)	—	(129)	(41,252)
Private gifts restricted for capital and long-term investment	(22,563)	(9,236)	(31,799)	(44,881)
Other revenue restricted for long-term investment	(151)	(314)	(465)	(602)
Loss on disposals of property and equipment	438	1,538	1,976	6,490
Contribution of affiliates	—	—	—	(9,752)
(Gain) loss from equity method affiliates	—	(1,591)	(1,591)	1,060
Unrealized loss (gain) on interest rate swaps	13,051	21,613	34,664	(7,419)
Bad debt expense	1,190	32,238	33,428	26,803
Postretirement curtailment gain	—	(8,122)	(8,122)	—
Write-off of bond issuance costs and original discount	—	1,016	1,016	—
Changes in operating assets and liabilities:				
Accounts and patient receivables	(1,273)	(57,486)	(58,759)	(72,482)
Contributions receivable	(1,489)	(2,621)	(4,110)	3,412
Notes receivable	17	—	17	478
Other assets and other liabilities and deferrals	166	3,823	3,989	13,226
Accounts payable and accruals	(4,405)	12,080	7,675	21,128
Postretirement benefits	1,368	(8,758)	(7,390)	(8,295)
Annuities payable	2,629	(358)	2,271	(730)
Net cash provided by operating activities	<u>10,157</u>	<u>28,512</u>	<u>38,669</u>	<u>25,955</u>
Cash flows from investing activities:				
Purchases of land, buildings, and equipment	(44,920)	(56,424)	(101,344)	(59,048)
Proceeds from sale of land, buildings, and equipment	1,755	—	1,755	195
Notes receivable	—	730	730	488
Disbursements of loans to students and other	(2,287)	(222)	(2,509)	(3,536)
Repayments of loans to students and other	3,413	107	3,520	3,070
Purchases of investments	(532,057)	(108,775)	(640,832)	(261,326)
Net proceeds from sales and maturities of investments	470,493	128,757	599,250	239,496
Decrease in deposits with bond trustee	8,435	—	8,435	24,012
Net cash used in investing activities	<u>(95,168)</u>	<u>(35,827)</u>	<u>(130,995)</u>	<u>(56,649)</u>
Cash flows from financing activities:				
Change in government grants refundable	(158)	—	(158)	(219)
Proceeds from notes payable	4,912	104,158	109,070	14,593
Payments on notes payable	(2,071)	(17,584)	(19,655)	(9,409)
Payments on bonds payable	(4,725)	(93,241)	(97,966)	(8,460)
Proceeds from private gifts restricted for capital and long-term investment	21,479	9,236	30,715	29,034
Net realized gains restricted for long-term investment	137	214	351	5,312
Other revenue restricted for long-term investment	151	314	465	602
Net cash provided by financing activities	<u>19,725</u>	<u>3,097</u>	<u>22,822</u>	<u>31,453</u>
Net (decrease) increase in cash and cash equivalents	<u>(65,286)</u>	<u>(4,218)</u>	<u>(69,504)</u>	<u>759</u>
Cash and cash equivalents at beginning of year	<u>108,686</u>	<u>36,418</u>	<u>145,104</u>	<u>144,345</u>
Cash and cash equivalents at end of year	<u>\$ 43,400</u>	<u>32,200</u>	<u>75,600</u>	<u>145,104</u>
Supplemental disclosures of cash flow information:				
Cash paid for interest	\$ 6,440	7,049	13,489	14,690
Assets acquired under capital leases	65	—	65	—

See accompanying notes to consolidated financial statements.

# WAKE FOREST UNIVERSITY

## Notes to Consolidated Financial Statements

June 30, 2012

(Dollars in thousands)

### (1) Organization and Summary of Significant Accounting Policies

#### (a) *Description of Wake Forest University*

Wake Forest University (the University) is a private, coeducational, not-for-profit institution of higher education and research located in Winston-Salem, North Carolina. The consolidated financial statements of the University include the College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc. (collectively, Reynolda Campus), and Wake Forest University Health Sciences (WFUHS), and all entities over which the University has control, including all of the subsidiaries of WFUHS. All significant intercompany balances and transactions have been eliminated in consolidation.

Effective July 1, 2010 the Boards of WFUHS, North Carolina Baptist Hospital (NCBH), Wake Forest University Baptist Medical Center (WFUBMC) and the University approved the Medical Center Integration Agreement (the Integration Agreement or MCIA). The Integration Agreement allows for the leveraging of the combined resources of WFUHS and NCBH to fulfill a single mission, improve health and optimize performance of the combined organizations, while balancing patient care, education and research. The University and NCBH are the members of WFUBMC.

The Integration Agreement created an integrated academic medical center that combines clinical care, education and research under a single management and debt structure referred to as Wake Forest Baptist (WFB). One of the nation's preeminent academic medical centers, WFB is an integrated health care system that operates 46 subsidiaries. It provides a continuum of care that includes primary care centers, outpatient rehabilitation, dialysis centers and home health care.

To ensure alignment across the organization, WFUHS and NCBH unrestricted operating income are shared equally between the entities. Although the entities will be operated to maximize the value at the total WFB level, revenues, expenses, existing and new assets and debt will continue to be accounted for generally at the individual entity levels. Effective March 26, 2011, NCBH, WFUHS, and WFUBMC formed a single obligated group (Obligated Group) under the existing NCBH master trust indenture (MTI). The separate WFUHS MTI was discharged and new obligations were issued to WFUHS obligation holders under the MTI. In addition, substantially all of the subsidiaries of NCBH, WFUHS, and WFUBMC were included in the single credit group (Combined Group) as Designated Members. The effect of the new credit structure is that each member of the Obligated Group becomes jointly and severally liable for all debt and other obligations that are to be evidenced and secured under the MTI.

The WFUBMC Board is comprised of seven directors elected by NCBH from among its Board members, seven directors elected by the University from among the Board members of WFUHS, and two nonvoting directors elected by the WFUBMC Board from among the faculty of WFUHS. Subject to the reserved powers of the members, the WFB operates WFUHS (including all subsidiaries and affiliates) and NCBH (including all subsidiaries and affiliates), including day-to-day management, strategic direction, managed care contracting and other business activities conferred on WFUBMC.



## WAKE FOREST UNIVERSITY

### Notes to Consolidated Financial Statements

June 30, 2012

(Dollars in thousands)

**(b) Basis of Presentation**

The consolidated financial statements have been prepared on the accrual basis in conformity with U.S. generally accepted accounting principles (GAAP).

Net assets, revenues, and gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the University and changes therein are classified and reported as follows:

- *Unrestricted net assets* – net assets that are not subject to donor-imposed stipulations.
- *Temporarily restricted net assets* – net assets subject to donor-imposed stipulations that will be met either by actions of the University and/or the passage of time.
- *Permanently restricted net assets* – net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, the donors of these assets permit the University to use all, or part of, the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless their use is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Expirations of restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Income and realized and unrealized gains on investments of permanently restricted net assets are reported as follows:

- As increases in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanent endowment fund.
- As increases in temporarily restricted net assets until appropriated for expenditure by the University and donor restrictions for their use are met.

The University considers the following items to be nonoperating activities: restricted contributions for capital and long-term investment and related net assets released from restriction, investment return in excess of or less than amounts designated for current operations, actuarial gain or loss on annuity obligations, gain or loss on interest rate swaps, postretirement related changes other than net periodic cost, gain or loss from affiliates (equity method), contribution of affiliates, donor designation changes, and other, net.

## WAKE FOREST UNIVERSITY

### Notes to Consolidated Financial Statements

June 30, 2012

(Dollars in thousands)

(c) **Cash Equivalents**

Cash equivalents include highly liquid investments with original maturities at date of purchase of three months or less. Such assets, reported at fair value, primarily consist of depository account balances, money market funds and accounts. The University maintains bank accounts at various financial institutions covered by the Federal Depository Insurance Corporation (FDIC). At various times throughout the year, the University may maintain bank accounts in excess of the FDIC-insured limit. Management believes that the risk associated with the bank accounts is minimal.

(d) **Revenue Recognition**

The University's revenue recognition policies are as follows:

**Student tuition and fees** – Student tuition and fees are recorded as revenue during the year that the related services are rendered. Student tuition and fees received in advance of services to be rendered are recorded as deferred revenue. Student aid provided by the University is reflected as a reduction of student tuition and fee revenue. Student aid does not include payments made to students for services rendered to the University.

**Grants and contracts** – Revenues under government and private grants and contracts are recognized as expenses are incurred. The revenues include recoveries of direct and indirect costs, which are generally determined as a negotiated or agreed-upon percentage of direct costs with certain exclusions.

**Patient revenue, net** – WFUHS records patient revenue net of contractual adjustments. WFUHS has agreements with third-party payors that provide for payments to WFUHS at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Patient revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

WFUHS recognizes patient revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, WFUHS recognizes revenue on the basis of its discounted rates. On the basis of historical experience, a significant portion of WFUHS' uninsured patients will be unable or unwilling to pay for the services provided. Thus, WFUHS records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Approximately 36.2% and 38.5% of net patient revenues are from participation in the Medicare and state-sponsored Medicaid programs in 2012 and 2011, respectively. The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to

## WAKE FOREST UNIVERSITY

### Notes to Consolidated Financial Statements

June 30, 2012

(Dollars in thousands)

investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with these and other laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

Net patient revenue also includes reimbursements from affiliates for services performed under professional services agreements.

**Charity Care** – WFUHS provides care for patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. WFUHS does not pursue collection of amounts determined to qualify as charity care; accordingly, such amounts are not reported in net patient revenue.

WFUHS maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its charity care policy and equivalent service statistics. Costs incurred are estimated based on the ratio of patient-related operating expenses to gross charges applied to charity care charges. The amounts of direct and indirect costs incurred for services and supplies furnished under WFUHS' charity care policy totaled approximately \$15,040 and \$11,740 in 2012 and 2011, respectively.

*(e) Contributions*

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Contributions restricted for capital projects or permanent endowment funds and contributions under split-interest agreements or perpetual trusts are reported as nonoperating activities. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year, net of an allowance for uncollectible contributions receivable, are discounted to their present value at a risk-adjusted rate. Amortization of discounts is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for uncollectible contributions receivable is provided based upon management's judgment, considering such factors as prior collection history, type of contribution, relationship with donor, and nature of fund-raising activity.

*(f) Investments*

Investments in readily marketable debt and equity securities are stated at their fair values, which are determined based on quoted market prices. Investments in private equity and absolute return funds are reported at estimated fair value, utilizing their net asset values. Those net asset values are determined by the investment managers and are reviewed and evaluated by the University's or WFUHS's investment offices. These estimated fair values may differ from the values that would

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have been used had a ready market existed for these investments. Investments in equity method affiliates are accounted for using the equity method.

**(g) *Investments in Real Estate***

Investments in real estate are primarily comprised of operating assets of the University and are valued at the lower of net book value or market. Accordingly, if there is a decline in market value the carrying amount of the investment is reduced to market value. The University records depreciation on rental properties over 40 years. Depreciation is calculated using the straight-line method. Real estate gifts held for sale are recorded at fair value. Such fair value is primarily based on periodic external appraisals.

**(h) *Split-Interest Agreements***

The University's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts and charitable gift annuities for which the University serves as trustee. Assets held in these trusts are stated at fair value and are included in investments or investments in real estate. Contribution revenue is recognized at the dates the trusts are established. The University recognizes the change in value of split-interest agreements according to the fair value of assets that are associated with each trust and recalculates the liability for the present value of annuity obligations. Any change in fair value is recognized in the consolidated statement of activities.

The University is also the beneficiary of certain trusts and other assets held and administered by others. The University's share of these assets is recognized in investments at fair value.

**(i) *Fair Value Measurements***

The carrying amounts of cash and cash equivalents, patient receivables, and accounts receivable approximate fair value because of the terms and relatively short maturity of these financial instruments. The carrying amounts of contributions receivable represent the present value of estimated future cash flows, which approximates fair value. Investments and deposits with bond trustee are reported at fair value as of the date of the consolidated financial statements. A reasonable estimate of the fair value of notes receivable from students under government loan programs cannot be made because such loans are not sellable and can only be assigned to the U.S. government or its designees. The fair value of receivables from students under University loan programs approximates carrying value.

The carrying amounts of accounts payable and other accruals approximate fair value because of the relatively short maturity of these financial instruments. Annuities payable are recorded at fair value using a single discount rate equivalent to the University's nonexempt borrowing rate. The carrying amounts of notes and bonds payable with variable interest rates approximate their fair value because substantially all of these financial instruments bear interest at rates that approximate current market rates for borrowings with similar maturities and credit quality. The fair value of fixed-rate debt maturities is determined using a relative price approach, by discounting future principal and interest payments at the market yield to maturity, and at the market yield to each call date. The fair value of

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the Series 2009 fixed-rate tax-exempt bonds was \$119,701 and \$112,887 at June 30, 2012 and 2011, respectively.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The hierarchy requires the use of observable market data when available. The three levels of the fair value hierarchy are as follows:

Level 1 – Valuations for assets and liabilities traded in active exchange markets as of the reporting date. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuations for assets and liabilities are determined through direct or indirect observations other than quoted market prices. Level 2 also includes investments in funds reported at their net asset values when these investments are redeemable at or near the balance sheet date.

Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies including discounted cash flow models and similar techniques, and not based on market exchange, dealer or broker traded transactions. Level 3 also includes investments in funds reported at their net asset values when these investments are not redeemable at or near the balance sheet date.

**(j) Bond Issuance Costs**

Costs related to the registration and issuance of bonds are carried at cost less accumulated amortization and are amortized over the life of the bonds on a method that approximates the effective-interest method and are included in other assets on the consolidated balance sheet.

**(k) Deposits with Bond Trustee**

Deposits with bond trustee consist of unexpended proceeds of certain bonds payable. These funds are invested in a money rate savings account and are used for construction of certain facilities.

**(l) Land, Buildings, and Equipment**

Land, buildings, and equipment are recorded at cost at date of acquisition or estimated fair market value on the date received for donated items. Depreciation is calculated using the straight-line method over the estimated useful life of each class or component of depreciable asset. Estimated lives range from 3 to 60 years. Depreciation is not calculated on land and construction in progress. Gains or losses on the disposal of land, buildings, and equipment are included in the consolidated statement of activities. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring these assets.

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**(m) *Impairment of Long-Lived Assets***

The University periodically assesses the realizability of its long-lived assets and evaluates such assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. For assets to be held, impairment is determined to exist if estimated future cash flows, undiscounted and without interest charges, are less than the carrying amount. Reynolda Campus and WFUHS did not incur any impairment losses for the year ended June 30, 2012. Impairment losses for the year ended June 30, 2011 were \$368 and \$0, for Reynolda Campus and WFUHS, respectively. These losses are included in other operating expenses in the consolidated statement of activities.

**(n) *Asset Retirement Obligations***

The University has asset retirement obligations (AROs) arising from regulatory requirements to perform certain asset retirement activities at the time that certain buildings and equipment are disposed of or renovated. The liability was initially measured at fair value and subsequently is adjusted for accretion expense and changes in the amount or timing of the estimated cash flows. The corresponding asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset and depreciated over the asset's useful life.

**(o) *Government Grants Refundable***

Funds provided by the U.S. government under the Federal Perkins and Health Professions Student Loan Programs are loaned to qualified students and may be reloaned after collections. These funds are ultimately refundable to the U.S. government and are reported as liabilities.

**(p) *Derivative Instruments***

The University holds certain interest rate swap agreements to manage the fixed/variable mix of its debt portfolio. The notional amounts of the agreements dictate the payments between the counterparties based on agreed-upon rates as determined in the agreements. The University records all derivative instruments on the consolidated balance sheet at their respective fair values. All changes in fair value are reflected in the consolidated statement of activities. Cash payments and receipts are included in interest on debt.

**(q) *Postretirement Plans***

The University records annual amounts relating to its postretirement plans based on calculations that incorporate various actuarial and other assumptions including discount rates, mortality, assumed rates of return, turnover rates, and healthcare cost trend rates. The University reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The effect of modifications to those assumptions is recorded as a change in unrestricted net assets and amortized to net periodic benefit cost over future periods using the corridor method. The University believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions. The net periodic benefit costs are recognized as employees render the services necessary to earn the postretirement benefits.

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On June 2, 2011, WFUHS' Board of Directors approved that effective as of January 1, 2012, the postretirement medical and dental plan would be discontinued for most future retirees and was communicated to all employees on September 30, 2011. The minimum age required for postretirement benefits increased from 60 to 62. However, the additional requirement of the rule of 75 (age and service) remained unchanged. All current retirees and currently eligible employees previously grandfathered continued to be eligible for benefits under this plan. Any WFUHS employee who is within five years of meeting the new retirement eligibility of age 62 with combined age and years of service equal to at least 75 as of January 1, 2012 was grandfathered into this benefit plan. These events triggered a reassessment of the postretirement benefit plan obligations and costs as of June 30, 2012, to reflect the plan curtailment and plan changes. As a result of these changes, WFUHS recognized a one-time curtailment gain of \$8,097, which represents the immediate recognition of unrecognized prior service related to prior plan amendments. This gain is included in employee benefits expense in the consolidated statement of activities.

**(r) Use of Estimates**

The University prepares its consolidated financial statements in accordance with GAAP that requires management to make estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of land, buildings, and equipment, and the valuation of investments, investments in real estate, allowances for receivables, AROs, professional liabilities, interest rate swap obligations and obligations related to employee benefits. Actual results could differ from those estimates.

**(s) Income Taxes**

The University is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is generally exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Accordingly, no provision for income taxes is made in the consolidated financial statements. Unrelated business income of the University is reported on Form 990-T. The University recognizes the effect of income tax positions only if those positions are more likely than not of being sustained.

**(t) Reclassifications**

Certain amounts previously reported in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation. Such reclassifications have no effect on total assets, liabilities or net assets as previously reported.

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**(u) Comparative Financial Information**

The consolidated financial statements include certain prior year information for comparative purposes, which does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the University's consolidated financial statements for the year ended June 30, 2011 from which this information was derived.

**(v) Subsequent Events**

The University has evaluated events occurring after June 30, 2012 through October 25, 2012, which represents the date the consolidated financial statements were issued and determined that all significant events and disclosures are included in the consolidated financial statements.

**(w) Recently Adopted Accounting Standards**

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*, in August 2010. ASU No. 2010-24 amends ASC Subtopic 954-450, *Health Care Entities: Contingencies*, to clarify that a health care entity should not net insurance recoveries against a related liability and the claim liability should be determined without consideration of insurance recoveries. ASU No. 2010-24 was effective for WFUHS in fiscal year 2012. Estimated professional liability costs to recognize the potential for losses and offsetting reinsurance recoveries receivable of \$3,356 were recorded in other receivables in the consolidated balance sheet for fiscal year 2012.

In July 2011, the FASB issued ASU No. 2011-07, *Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. This ASU changed WFUHS' presentation of provision for bad debts in the consolidated statements of operations from operating expenses to a deduction from net patient revenue. The adoption of ASU No. 2011-07 resulted in the reclassification \$32,238 and \$30,296 from operating expenses to a deduction from net patient revenue for 2012 and 2011, respectively. It also expanded disclosures regarding policies for recognizing revenue, assessing contra revenue line items, and activity in the allowance for bad debts. WFUHS adopted ASU No. 2011-07 on July 1, 2011.

The FASB issued ASU No. 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*, in August 2010. ASU No. 2010-23 amends ASC Subtopic 954-605, *Health Care Entities: Revenue Recognition*, to require that cost be used as the measurement basis for charity care disclosure purposes. The method used to estimate such costs as well as any funds received to offset or subsidize charity services provided should be disclosed. WFUHS adopted ASU No. 2010-23 on July 1, 2011.



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**(2) Accounts Receivable**

The following is an analysis of accounts receivable at June 30, 2012 and 2011 (see note 19 for additional information):

	<b>2012</b>			<b>2011</b>
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>	
Accounts receivable	\$ 7,531	139,462	146,993	126,656
Grants receivable	2,729	32,636	35,365	29,977
Total accounts receivable	10,260	172,098	182,358	156,633
Less allowance for bad debts	(408)	(759)	(1,167)	(1,893)
Accounts receivable, net	\$ 9,852	171,339	181,191	154,740

**(3) Patient Receivables**

Patient receivables consist of the following at June 30, 2012 and 2011:

	<b>WFUHS</b>	
	<b>2012</b>	<b>2011</b>
Patient receivables	\$ 203,138	204,675
Less estimated uncollectible amounts	(35,499)	(56,912)
Less allowance for contractual adjustments	(98,741)	(90,225)
Patient receivables, net	\$ 68,898	57,538

Patient accounts receivable are reduced by an allowance for doubtful accounts. WFUHS' allowance for doubtful accounts includes estimates for amounts that ultimately result in charity care and are reviewed in tandem with those accounts that ultimately result in bad debt. In evaluating the collectability of accounts receivable, WFUHS analyzes its historical collections and write-offs to bad debt and charity and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and the corresponding provisions for bad debt and charity. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, WFUHS analyzes contractually due amounts and provides an allowance for doubtful accounts, an allowance for contractual adjustments, provision for bad debt and contractual adjustments on accounts for which the third-party payor has not yet paid or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely.

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For receivables associated with self-pay patients, which includes both patients without insurance and patients with deductible and copayment balances due after payment is received from the third-party payor, WFUHS records significant provisions for bad debts and charity in the period of service on the basis of historical collections, which indicates that many patients are unwilling or unable to pay the portion of their bill for which they are financially responsible. The difference between discounted rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

WFUHS' allowance for doubtful accounts for self-pay patients increased from 80% of self-pay accounts receivable at June 30, 2011 to 82% of self-pay accounts receivable at June 30, 2012. In addition, WFUHS' bad debt write-offs increased approximately \$1,942 from \$30,296 for fiscal year 2011, to approximately \$32,238 for fiscal year 2012. Both increases were the result of negative trends experienced in the collection of amounts from self-pay patients in fiscal year 2012. The allowance for doubtful accounts decreased approximately \$21,413 from \$56,912 in fiscal year 2011 to \$35,499 in fiscal year 2012 due to a change in accounting treatment of accounts referred to a third-party collection agency. Beginning in fiscal year 2012, the balance on accounts referred to a third-party collection agency are no longer reflected in patient receivables with a corresponding allowance for doubtful accounts and are now charged off against the allowance at the time of transfer.

WFUHS grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows as of June 30:

	<u>2012</u>	<u>2011</u>
Medicare	26%	21%
Medicaid	16%	14%
Self-pay	25%	41%
Other	33%	24%
	<u>100%</u>	<u>100%</u>

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**(4) Contributions Receivable**

The following is an analysis of the maturities of the University's contributions receivable at June 30, 2012 and 2011:

	<b>2012</b>			<b>2011 Total</b>
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>	
One year or less	\$ 20,478	1,409	21,887	17,575
Between one and five years	23,204	3,009	26,213	26,306
More than five years	56,715	631	57,346	56,374
Gross contributions receivable	100,397	5,049	105,446	100,255
Less estimated uncollectible amounts	(4,632)	(322)	(4,954)	(3,675)
Less discount to present value	(41,569)	(236)	(41,805)	(42,012)
Contributions receivable, net	\$ <u>54,196</u>	<u>4,491</u>	<u>58,687</u>	<u>54,568</u>

**(5) Notes Receivable**

The following is an analysis of notes receivable at June 30, 2012 and 2011:

	<b>2012</b>			<b>2011 Total</b>
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>	
Student loans receivable	\$ 20,773	831	21,604	22,070
Other notes receivable	3,315	5,253	8,568	10,132
Total notes receivable	24,088	6,084	30,172	32,202
Less estimated uncollectible amounts	(360)	(2,011)	(2,371)	(2,628)
Notes receivable, net	\$ <u>23,728</u>	<u>4,073</u>	<u>27,801</u>	<u>29,574</u>

The University makes uncollateralized loans to students based on financial need. Student loans are funded through Federal government loan programs or institutional resources. At June 30, 2012 and 2011, student loans receivable consisted of Federal loan programs of \$19,791 and \$20,334, respectively, and institutional loan programs of \$1,813 and \$1,736, respectively. The University participates in the Perkins federal revolving loan program. The availability of funds for loans under the program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the Federal government of \$9,945 and \$10,103 at June 30, 2012 and 2011, respectively, are ultimately refundable to the federal government and are reported as government grants refundable on the consolidated balance sheet. Outstanding loans canceled under the program result in a reduction of the funds available for loan

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and a decrease in the liability to the federal government. Amounts due under the Perkins loan program are guaranteed by the federal government and, therefore, no allowance for uncollectible amounts is reported under the program. Allowances for uncollectible institutional student loans are based on prior collection experience and current economic factors, which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. Institutional student loan balances are written off only when they are deemed to be permanently uncollectible. At June 30, 2012 and 2011, the allowance for uncollectible institutional student loan amounts was \$420 and \$352, respectively.

**(6) Investments**

Investments at June 30, 2012 and 2011 consist of the following:

	<u>2012</u>	<u>2011</u>
Short-term investments <sup>(a)</sup>	\$ 134,593	194,614
Absolute return <sup>(b)</sup>	221,348	201,088
Commodities: <sup>(c)</sup>		
Timberland	23,191	26,730
Energy	18,340	16,931
Other	16,085	14,456
Fixed income: <sup>(d)</sup>		
Domestic	381,356	296,699
International	82,750	59,374
Private equity <sup>(e)</sup>	108,655	114,762
Public equity: <sup>(f)</sup>		
Domestic	126,298	128,638
International	99,563	141,170
Real estate: <sup>(g)</sup>		
Commercial	35,721	69,111
Residential	22,142	22,462
Other	28,040	7,263
Beneficial interest in perpetual trusts and assets held by others <sup>(h)</sup>	24,936	25,798
Other	30,097	29,215
	<u>          </u>	<u>          </u>
Total investments	\$ <u>1,353,115</u>	<u>1,348,311</u>

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- (a) Includes short duration U.S. Treasury debt securities and other short-term, higher quality debt securities, cash and money market mutual funds.
- (b) Includes investments in hedge funds and hedge fund-of-funds that invest both long and short on a global basis primarily in: equity securities (common stocks), credit securities (both investment grade and noninvestment grade), commodities, and currencies. In aggregate, the expectation is that the returns of this segment should not be highly correlated to the broad equity market.
- (c) Includes primarily illiquid investments in timberland, oil and gas properties, and water rights and entitlements held through limited partnership interests. While many of the investments are U.S. focused, some are more global. The category also includes more liquid allocations made to commodity (precious metals, industrial materials, and energy) mutual funds.
- (d) Includes long only, hedge strategies, and illiquid investments in various fixed income strategies (both U.S. and non-U.S.) including: investment grade securities, noninvestment grade securities, mortgage backed securities, asset backed securities, Treasury Inflation Protected Securities (TIPS), distressed debt, senior loans, and bank loans. The long only position also includes mutual funds that have daily liquidity in U.S. and non-U.S. fixed income markets.
- (e) Includes illiquid investments primarily in buyout, growth equity, and venture capital (both U.S. and non-U.S.) held through limited partnership interests.
- (f) Includes investments primarily in U.S. and non-U.S. common stocks (including emerging markets) as well as funds that invest in U.S. and non-U.S. common stocks (including emerging markets), mutual funds, and exchange traded funds. While most of the assets are invested long only, some assets are invested on a hedged basis (both long and short).
- (g) Includes illiquid investments in commercial real estate, residential real estate, and farmland held through limited partnership interests. While many of the investments are U.S. focused, some are more global.
- (h) Includes trusts and certain other assets held and administered by others which the University has an unconditional right to receive all or a portion of the specified cash flows.

The University invests a substantial portion of assets into an internal long-term pool on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of each quarter within which the transaction took place. At June 30, 2012, a total of 21,482,088 units existed in the long-term pool with a fair value of \$47.60 per unit. At June 30, 2011, a total of 20,977,572 units existed in the long-term pool with a fair value of \$49.92 per unit.

In addition to the long-term pool, the University also manages other investment portfolios. Generally, these portfolios are invested in mutual funds, U.S. Treasury debt securities, and fixed income securities with daily liquidity. Each portfolio's asset allocation is customized based upon the return and risk objectives and distribution requirements of the portfolio.

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The components of total investment return as reflected in the consolidated statement of activities are as follows:

	<u>2012</u>	<u>2011</u>
Investment income, net	\$ 21,877	21,027
Realized gains, net	27,560	37,444
Changes in unrealized (depreciation) appreciation	<u>(35,927)</u>	<u>113,091</u>
Total investment return	13,510	171,562
Investment return designated for current operations	<u>(60,658)</u>	<u>(63,988)</u>
Investment return (less than) in excess of amounts designated for current operations	<u>\$ (47,148)</u>	<u>107,574</u>

Investment income has been reduced by investment fees of \$9,414 and \$8,027 in 2012 and 2011, respectively.

#### (7) Endowment

The University's pooled endowment consists of approximately 1,500 individual funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. Gift annuities, beneficial interest in perpetual trusts and assets held by others, and contributions receivable are not considered components of the endowment.

The Board of Trustees has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as allowing the University to appropriate for expenditure or accumulate so much of an endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. As a result of this interpretation, the University's policy is to report 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.

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The portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Board of Trustees considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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

The University has adopted investment and spending policies for endowment assets that support the objectives of optimizing long-term returns and providing a sustainable level of endowment income distribution to support the University's activities through the annual operating budget while preserving the real (inflation adjusted) purchasing power of the endowment. The University's primary investment objective is to maximize total return within reasonable and prudent levels of risk while maintaining sufficient liquidity to meet disbursement needs.

The portfolio is constructed on a foundation of modern portfolio theory and strategic asset allocation. The University diversifies its investments among various asset classes incorporating multiple strategies and investment advisors to help manage risk. Major investment decisions are approved by the Board's Investment Policy Committee, which oversees the University's investments in accordance with established guidelines. Management and investment decisions are not made in isolation, but in the context of the portfolio of investments as a whole and as part of the overall investment strategy.

The endowment spending rate for the years ended June 30, 2012 and 2011 was 5.3%, calculated as a percentage of the average of the previous three-year semiannual moving market value per unit and subject to a 10% maximum annual growth or decline in per-unit spending.

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Endowment net assets consist of the following at June 30, 2012 and 2011:

	2012			Total	2011 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Reynolda Campus:					
Donor-restricted endowment funds	\$ (8,113)	169,295	199,965	361,147	372,816
Board-designated endowment funds	254,501	—	—	254,501	267,186
Endowment net assets	246,388	169,295	199,965	615,648	640,002
WFUHS:					
Donor-restricted endowment funds	(1,631)	41,707	108,482	148,558	146,593
Board-designated endowment funds	235,927	—	—	235,927	245,857
Endowment net assets	234,296	41,707	108,482	384,485	392,450
Total endowment net assets	\$ 480,684	211,002	308,447	1,000,133	1,032,452

Changes in endowment net assets for the years ended June 30, 2012 and 2011 are as follows:

	2012			Total	2011 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Reynolda Campus:					
Beginning balance	\$ 261,079	187,368	191,555	640,002	559,710
Investment return:					
Investment income net of fees	1,469	2,447	21	3,937	4,473
Net appreciation (depreciation)	1,322	(832)	97	587	67,821
Total investment return	2,791	1,615	118	4,524	72,294
Contributions	20,184	—	9,149	29,333	12,796
Appropriation for expenditure	(12,739)	(16,708)	(160)	(29,607)	(29,798)
Transfers due to donor redesignations	—	(2,980)	(697)	(3,677)	—
Transfers (from) to Board-designated funds	(24,927)	—	—	(24,927)	25,000
Ending balance	\$ 246,388	169,295	199,965	615,648	640,002



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Notes to Consolidated Financial Statements

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(Dollars in thousands)

	2012			Total	2011 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
WFUHS:					
Beginning balance	\$ 244,789	46,525	101,136	392,450	355,828
Investment return:					
Investment income net of fees	3,903	2,011	210	6,124	6,121
Net appreciation (depreciation)	(2,638)	(1,770)	405	(4,003)	43,802
Total investment return	1,265	241	615	2,121	49,923
Contributions	109	—	7,310	7,419	6,177
Appropriation for expenditure	(11,867)	(5,059)	(579)	(17,505)	(19,222)
Transfers due to donor redesignations	—	—	—	—	(256)
Transfers (from) to Board-designated funds	—	—	—	—	—
Ending balance	\$ <u>234,296</u>	<u>41,707</u>	<u>108,482</u>	<u>384,485</u>	<u>392,450</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the original gift. Deficiencies of this nature are reported in unrestricted net assets as follows: Reynolda Campus and WFUHS, respectively, were \$8,113 and \$1,631 as of June 30, 2012; and \$6,107 and \$1,068 as of June 30, 2011.

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### Notes to Consolidated Financial Statements

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#### (8) Fair Values of Assets and Liabilities

The following table summarizes the valuation of the University's assets and liabilities within the fair value hierarchy levels as of June 30, 2012 and 2011:

	2012				2011
	Level 1	Level 2	Level 3	Total	Total
Financial assets:					
Cash and cash equivalents	\$ 75,600	—	—	75,600	145,104
Investments:					
Short-term investments	134,593	—	—	134,593	194,614
Absolute return	—	75,656	145,692	221,348	201,088
Commodities:					
Timberland	—	—	23,191	23,191	26,730
Energy	3,437	—	14,903	18,340	16,931
Other	11,229	—	4,856	16,085	14,456
Fixed income:					
Domestic	235,798	—	145,558	381,356	296,699
International	50,938	9,896	21,916	82,750	59,374
Private equity	—	—	108,655	108,655	114,762
Public equity:					
Domestic	75,893	14,601	35,804	126,298	128,638
International	64,285	17,302	17,976	99,563	141,170
Real estate:					
Commercial <sup>(a)</sup>	—	—	35,721	35,721	69,111
Residential	—	—	22,142	22,142	22,462
Other	6,207	—	21,833	28,040	7,263
Beneficial interest in perpetual trusts and assets held by others					
Other	—	—	24,936	24,936	25,798
Other	—	—	30,097	30,097	29,215
Deposits with bond trustee	5,347	—	—	5,347	13,782
<b>Total assets</b>	<b>\$ 663,327</b>	<b>117,455</b>	<b>653,280</b>	<b>1,434,062</b>	<b>1,507,197</b>
Financial liabilities:					
Other liabilities and deferrals:					
Interest rate swap agreements	\$ —	68,849	—	68,849	34,185
Annuities payable	—	28,488	—	28,488	26,217
<b>Total liabilities</b>	<b>\$ —</b>	<b>97,337</b>	<b>—</b>	<b>97,337</b>	<b>60,402</b>

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Most investments classified in Levels 2 and 3 consist of shares or units in investment funds as opposed to direct interests in the University underlying holdings, which may be marketable. Because the net asset value reported by each fund is used as a practical expedient to estimate fair value of the University's interest therein, its classification in Level 2 or 3 is based on the University's ability to redeem its interest at or near June 30. If the interest can be redeemed in the near term, the investment is classified as Level 2. The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities. In general, for Level 2 and Level 3 investments, the University utilizes the investment manager to provide a valuation estimate based on disclosed techniques and processes, which have been reviewed for propriety and consistency with consideration given to type and investment strategy.

The University's policy is to recognize transfers into and out of Levels 1, 2, and 3 as of the end of the year or change in circumstances that caused the transfer. There were no significant transfers between Level 1 and Level 2 securities during the year ended June 30, 2012.

Fair market value for LIBOR-based interest rate swaps is determined using a relative price approach, by discounting the future expected cash flows at the market discount rate. For the variable leg of a swap, the expected cash flows are based on implied market forward rates for the appropriate underlying index. A credit value adjustment is applied to the total market value of the swap and quantifies the default risk of a counterparty using a default probability assumption based on the counterparty's credit default swap pricing at June 30, 2012.

Obligations under split-interest agreements reported in annuities payable were discounted at a rate that is equivalent to the University's nonexempt borrowing rate of 3.02% at June 30, 2012, and 4.53% as of June 30, 2011.

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(Dollars in thousands)

The following table presents the reconciliation of Level 3 assets measured at fair value for the year ended June 30, 2012. Both observable and unobservable inputs may be used to determine the fair value of positions that the University has classified as Level 3.

	<b>Balance as of June 30, 2011</b>	<b>Total realized and unrealized gains (losses)</b>	<b>Purchases</b>	<b>Sales</b>	<b>Net transfers into (out of) Level 3</b>	<b>Balance as of June 30, 2012</b>
Investments:						
Absolute return	\$ 73,276	(601)	62,041	(1,743)	12,719	145,692
Commodities:						
Timberland	26,730	(539)	1,080	(4,080)	—	23,191
Energy	11,977	(305)	5,808	(2,577)	—	14,903
Other	5,087	106	—	(337)	—	4,856
Fixed income:						
Domestic	135,462	10,333	20,031	(20,268)	—	145,558
International	15,794	(741)	15,774	(8,911)	—	21,916
Private equity	114,762	734	17,452	(24,293)	—	108,655
Public equity:						
Domestic	19,238	276	18,534	(2,244)	—	35,804
International	9,698	(285)	8,677	(114)	—	17,976
Real estate:						
Commercial	28,931	3,110	12,568	(8,888)	—	35,721
Residential	22,462	1,237	9,066	(10,623)	—	22,142
Other	5,045	(291)	18,381	(1,302)	—	21,833
Interests in perpetual trusts and assets held by others	25,798	1,315	1,766	(2,323)	(1,620)	24,936
Other	29,215	(6,690)	8,383	(811)	—	30,097
Total assets	<u>\$ 523,475</u>	<u>7,659</u>	<u>199,561</u>	<u>(88,514)</u>	<u>11,099</u>	<u>653,280</u>

For the year ended June 30, 2012, the University's ability to redeem investments in the near term at net asset value represents almost all of the net transfers into (out of) Level 3.

The University's aggregate unfunded private capital commitments are approximately \$130,549 or 9.6% of total investments at June 30, 2012. Of these commitments, \$55,980 relates to private equity, \$23,961 relates to real estate, \$17,412 relates to commodities, \$5,210 relates to absolute return, and \$27,986 relates to fixed income. These commitments are expected to be called over a multiyear time frame. The University believes it has adequate liquidity to meet these obligations.

Private investments are generally made through limited partnership agreements where the University is normally one of many limited partners. Under the terms of such agreements, the University is required to provide funding, up to the total amount committed by the University, when capital calls are made by fund managers. These partnerships have a stated maturity date, but can provide for annual extensions for the purpose of disposing remaining portfolio positions and returning capital to investors. Alternatively, the fund may dispose of all portfolio investments and return all capital to investors before the stated maturity

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(Dollars in thousands)

date. While the timing and amount of future capital calls and distributions in any particular year are inherently uncertain, the University takes these factors into consideration when allocating to private investments and believes that it has adequate liquidity to meet its obligations.

Investment liquidity as of June 30, 2012 is aggregated below based on redemption or sale period:

Daily, with 1 – 5 days notice	\$	552,968
Monthly, with 5 – 15 days notice		102,431
Quarterly, with 5 – 95 days notice		65,249
Semi-annually, with 45 – 95 days notice		60,172
Yearly, with 60 – 180 days notice		142,359
Liquidity within 2 years, with 60 – 95 days notice		79,550
Illiquid		<u>350,386</u>
Total as of June 30, 2012	\$	<u><u>1,353,115</u></u>

**(9) Land, Buildings, and Equipment**

Land, buildings, and equipment are summarized as follows at June 30, 2012 and 2011:

	<b>2012</b>			<b>2011 Total</b>
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>	
Land	\$ 21,814	97,910	119,724	93,185
Buildings and other improvements	483,283	385,910	869,193	828,699
Equipment and furnishings	74,770	157,252	232,022	209,551
Construction in progress	36,570	35,098	71,668	72,881
	<u>616,437</u>	<u>676,170</u>	<u>1,292,607</u>	<u>1,204,316</u>
Less accumulated depreciation	<u>(254,843)</u>	<u>(334,613)</u>	<u>(589,456)</u>	<u>(549,838)</u>
	<u>\$ 361,594</u>	<u>341,557</u>	<u>703,151</u>	<u>654,478</u>

Total depreciation expense on buildings, improvements, equipment, and furnishings was \$50,184 and \$46,789 for the years ended June 30, 2012 and 2011, respectively.

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The University's policy is to capitalize interest cost incurred on debt during the construction of major projects exceeding one year. Interest cost of \$2,446 and \$2,231 was capitalized in the years ended June 30, 2012 and 2011, respectively.

The liabilities associated with AROs for the years ended June 30, 2012 and 2011, respectively, were \$13,142 and \$12,436 for Reynolda Campus, and \$3,659 and \$3,521 for WFUHS. These liabilities are reported in other liabilities and deferrals on the consolidated balance sheet.

#### (10) Notes, Capital Leases, and Bonds Payable

Notes, capital leases, and bonds payable at June 30, 2012 and 2011 consist of the following:

<u>Reynolda Campus</u>	<u>Years to nominal maturity</u>	<u>Interest rate at June 30, 2012</u>	<u>2012</u>	<u>2011</u>
Notes payable and capital leases:				
Construction loan	<1	0.60% variable	\$ 28,747	23,899
1994 Construction loan	3	4.19 fixed	1,823	2,680
Promissory note	7	4.00 fixed	1,175	2,025
Capital leases	4	7.57 to 13.70 fixed	542	842
Total notes payable and capital leases			<u>32,287</u>	<u>29,446</u>
Bonds payable:				
2004 Series A tax-exempt	<1 to 8	0.17% variable	29,785	31,455
2004 Series B tax-exempt	<1 to 8	0.12 variable	20,640	23,695
2009 Series serial tax-exempt	28	4.00 to 5.00 fixed	49,430	49,430
2009 Series term tax-exempt	27	5.00 fixed	60,570	60,570
Unamortized bond premium			2,351	2,438
Total bonds payable			<u>162,776</u>	<u>167,588</u>
Total notes payable, capital leases, and bonds payable			<u>\$ 195,063</u>	<u>197,034</u>

Reynolda Campus has a construction loan financing agreement with Wells Fargo Bank, N.A. that permits the University to borrow up to \$50,000, bearing interest at one-month LIBOR plus 0.35%. The loan agreement requires annual reviews on the March 31 anniversary date with interest payable quarterly. The Reynolda Campus intends to renew the agreement in 2013 eliminating the required principal and interest balloon payment at March 31, 2013.

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Reynolda Campus has outstanding \$50,425 of tax-exempt North Carolina Facilities Finance Agency Revenue Bonds, Series 2004A and Series 2004B. The obligations of the University are evidenced by a Loan Agreement dated December 1, 2004, by and between the University and Branch Banking and Trust Company, as trustee. The Series 2004 tax-exempt bonds are due annually through 2020 in varying amounts from \$4,880 to \$11,070. The interest rate on the bonds is determined weekly, and at the option of the University may be converted to a fixed rate. The University's obligation under the Loan Agreement is an unsecured, unconditional obligation.

The North Carolina Facilities Finance Agency Revenue Bonds, Series 2009, are evidenced by a Loan Agreement dated May 1, 2009, by and between the University and Branch Banking and Trust Company, as trustee. The Series 2009 tax-exempt bonds have final maturities of January 1, 2039 for the serial bonds and January 1, 2038 for the term bonds. The 2009 bonds maturing on January 1, 2038 are subject to mandatory redemption through 2038 in increasing annual amounts of \$7,410 to \$10,005. Interest is payable each January 1 and July 1. The University's obligation under the Loan Agreement is an unsecured, unconditional obligation.

WFUHS	Years to nominal maturity	Interest rate at June 30, 2012	2012	2011
Notes payable and capital leases:				
Loan agreement	<1	0.59% variable	\$ 89,115	—
Commercial loan	<1	0.92% variable	29,340	29,184
Loan agreement	<1	3.07% variable	9,241	10,120
Equipment loan	2	6.05% fixed	1,304	2,346
Loan agreement	5	6.38% fixed	11,962	12,688
Promissory note	5	non-interest bearing	400	480
Related party note	9	8.00% fixed	1,354	1,276
Capital leases	2	4.69% fixed	59	107
Total notes payable and capital leases			<u>142,775</u>	<u>56,201</u>
Bonds payable:				
2008 Series A tax-exempt	23	0.13% variable	59,500	60,855
2008 Series B tax-exempt	23	0.13% variable	29,610	30,285
2008 Series C tax-exempt	23	— variable	—	30,260
2008 Series D tax-exempt	23	— variable	—	60,905
Total bonds payable <sup>(a)</sup>			<u>89,110</u>	<u>182,305</u>
Total notes payable, capital leases, and bonds payable			<u>\$ 231,885</u>	<u>238,506</u>

<sup>(a)</sup> Issued under the Master Trust Indenture

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The Series 2008 Revenue Bonds referenced in the table above represent funds borrowed by the entities pursuant to loan agreements with the North Carolina Medical Care Commission (NCMCC). As a conduit issuer, the NCMCC loans the debt proceeds to the borrower and the bonds are issued by the NCMCC under a MTI structure. The MTI provides the flexibility for multiple parties to participate in debt issuances as part of an obligated group.

Effective March 26, 2011, NCBH, WFUHS, and WFUBMC formed a single obligated group (Obligated Group) under the existing NCBH MTI. New obligations were issued to WFUHS obligation holders under the NCBH MTI. In addition, substantially all of the subsidiaries of NCBH, WFUHS, and WFUHS were included in the single credit group as Designated Members (Combined Group). The effect of the new credit structure is that each member of the Obligated Group becomes jointly and severally liable for all debt and other obligations that are to be evidenced and secured under the MTI. WFUHS is jointly and severally liable for \$307,185 of bonds payable borrowed by NCBH as of June 30, 2012.

Bonds issued under the MTI are payable solely from the Obligated Group's revenues (as defined by the MTI). Additionally, the Combined Group must remain compliant with certain covenants and restrictions required by the MTI and loan agreements underlying the bonds. The Combined Group is subject to covenants under the MTI containing restrictions or limitations with respect to indebtedness, property encumbrance, consolidation or merger or transfer of assets. In addition, the Combined Group has agreed that it will not create any lien upon its property, accounts, or revenue now owned or hereafter acquired other than "permitted liens" as described in the MTI. WFUHS believes it is in compliance with such covenants and restrictions as of June 30, 2012.

The Series 2008 bonds mature in full in fiscal year 2035. The bonds are secured by an irrevocable, direct-pay letter of credit issued by the Branch Banking and Trust Company with an expiry date of October 2013. The bonds are variable rate demand obligations in which the interest rates reset on a periodic basis as determined by the remarketing agent on each computation date. At the option of WFUHS, the bonds may be converted to various interest rate modes. Subject to certain provisions regarding serialization, the Series 2008 bonds are subject to mandatory redemption through fiscal year 2035 in increasing annual amounts of \$3,890 to \$12,610.

In June 2012, WFUHS entered into a variable rate loan agreement with J.P. Morgan Chase Bank, N.A. based on one-month LIBOR plus a premium of 0.39% to provide funding of \$89,115 with a one year maturity date. The loan proceeds were used to redeem the Series 2008 C and D bonds that were previously supported by Bank of America, N.A. direct-pay letter of credit. The effect of redeeming the Series 2008 C and D bonds was a write-off of the unamortized bond issuance costs and original issue discount of \$1,016. Per the agreement, interest payments are due monthly with the principal balance due in full at maturity. This taxable loan is guaranteed by both NCBH and WFUBMC and is expected to be fully refinanced with tax-exempt debt in fiscal year 2013.



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Effective February 2012, WFUHS renewed the variable rate credit facility with Wells Fargo Bank, N.A. for a total commitment amount of \$30,000 and a maturity date of February 2013. The unsecured variable rate loan is based on the one-month LIBOR plus a premium of 0.60%. Interest payments are due monthly with the principal balance due in full at maturity. As of June 30, 2012, the balance on this facility was \$29,340.

In October 2011, WFUHS entered into a fixed rate term note with Fifth Third Bank, N.A. for \$9,900 to refinance the previously outstanding variable rate loan agreement. Per the term note, fixed payments of interest and principal are due monthly with a final maturity date of October 2021. This taxable loan is guaranteed by both NCBH and WFUBMC.

Aggregate annual maturities of notes and bonds payable for each of the five fiscal years subsequent to June 30, 2012 and thereafter are as follows:

	<u>Reynolda Campus</u>	<u>WFUHS</u>	<u>Total</u>
2013	\$ 34,744	123,636	158,380
2014	6,201	4,325	10,526
2015	6,420	4,217	10,637
2016	6,630	4,376	11,006
2017	6,850	12,874	19,724
In total thereafter	<u>131,325</u>	<u>82,398</u>	<u>213,723</u>
	<u>\$ 192,170</u>	<u>231,826</u>	<u>423,996</u>

The 2013 maturities include \$28,747 and \$118,455 for Reynolda Campus and WFUHS, respectively, of notes payable that management intends to renew in 2013 with a maturity date beyond 2013.

#### (11) Interest Rate Swap Agreements

To manage the fixed/variable mix of its debt portfolio, including hedging exposure to increasing interest expense from variable rate debt, the University utilizes interest rate swap agreements. The University has only limited involvement with derivative instruments and does not use them for trading purposes. The University has entered into four interest rate swap agreements to manage interest cost and risks associated with its variable rate debt portfolios.

Parties to interest rate swap agreements are subject to market risk for changes in interest rates as well as credit loss in the event of nonperformance by the counterparty. To minimize this exposure, the University verifies that the counterparties for these swap transactions are major financial institutions that meet the University's criteria for financial stability and creditworthiness. Additionally, the University is exposed to tax basis risk since a change in tax rate environments will change the level of correlation between the interest rate payments made on the variable rate bonds and the percentage of LIBOR payments being received from the counterparties.

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The following table summarizes the general terms for each of the University's swap agreements:

	<u>Reynolda Campus</u>		<u>WFUHS</u>	
	<u>November 2006</u> <u>interest rate swap</u>	<u>October 2008</u> <u>interest rate swap</u>	<u>August 2002</u> <u>interest rate swap</u>	<u>February 2007</u> <u>interest rate swap</u>
Notional amount	\$ 29,785	50,000	79,700	96,350
Effective date	November 6, 2006	October 1, 2008	August 20, 2002	February 26, 2007
Maturity date	January 1, 2020	January 1, 2038	July 1, 2034	July 1, 2034
Rate received	67% of one-month LIBOR	67% of one-month LIBOR	67% of one-month LIBOR	67% of one-month LIBOR
Rate paid	3.38%	3.61%	3.67%	3.52%
Collateral provisions	None	100% liability if > \$20,000	100% asset/liability – \$250 min	100% asset/liability – \$250 min
Settlement frequency	Monthly	Monthly	Weekly	Weekly

The University records all interest rate swap agreements in other liabilities and deferrals on the consolidated balance sheet at their respective fair values. The fair value of the interest rate swap agreements is the estimated amount the University would pay to terminate the swap agreements at the reporting date, taking into account current forward interest rates and the current forward creditworthiness of the swap counterparties. All changes in fair value are reflected as a gain or loss in nonoperating activities in the consolidated statement of activities. Periodic net cash settlement amounts with counterparties are accounted for as adjustments to interest expense on the related debt and collateral to support the swaps is included in investments on the consolidated balance sheet. Collateral held by counterparties at June 30, 2012 and 2011, respectively, was \$300 and \$0 for Reynolda Campus, and \$45,580 and \$26,400 for WFUHS.

The related financial information on each of these instruments is as follows:

	<u>2012</u>		<u>2011</u>	
	<u>Fair value</u>	<u>Loss</u>	<u>Fair value</u>	<u>Gain</u>
Reynolda Campus:				
November 2006 interest rate swap	\$ (3,999)	(987)	(3,012)	430
October 2008 interest rate swap	(19,793)	(12,064)	(7,729)	2,892
Total	<u>(23,792)</u>	<u>(13,051)</u>	<u>(10,741)</u>	<u>3,322</u>
WFUHS:				
August 2002 interest rate swap	(21,098)	(9,867)	(11,231)	1,853
February 2007 interest rate swap	(23,959)	(11,746)	(12,213)	2,244
Total	<u>(45,057)</u>	<u>(21,613)</u>	<u>(23,444)</u>	<u>4,097</u>
Grand total	<u>\$ (68,849)</u>	<u>(34,664)</u>	<u>(34,185)</u>	<u>7,419</u>

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As of June 30, 2012, the University's adjusted debt portfolio, after taking into account the aforementioned swap agreements, was 100% fixed rate for Reynolda Campus, and approximately 86% fixed rate for WFUHS.

**(12) Net Assets**

Temporarily restricted net assets are composed of the following at June 30, 2012 and 2011:

	<b>2012</b>			<b>2011 Total</b>
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>	
Gifts and pledges	\$ 76,749	4,651	81,400	69,329
Grants and contracts	—	2,335	2,335	1,952
Donor-restricted endowments	169,295	41,707	211,002	233,893
	<u>\$ 246,044</u>	<u>48,693</u>	<u>294,737</u>	<u>305,174</u>

Such temporarily restricted net assets are available for the following purposes as of June 30, 2012 and 2011:

	<b>2012</b>			<b>2011 Total</b>
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>	
Student scholarships	\$ 87,629	4,056	91,685	105,757
Instruction and research	64,617	36,078	100,695	93,539
Academic support	41,735	8,559	50,294	40,807
Subsequent period operations, capital, and other	52,063	—	52,063	65,071
	<u>\$ 246,044</u>	<u>48,693</u>	<u>294,737</u>	<u>305,174</u>

Permanently restricted net assets are composed of the following at June 30, 2012 and 2011:

	<b>2012</b>			<b>2011 Total</b>
	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>	
Donor-restricted endowments	\$ 199,965	108,482	308,447	292,691
Gifts and pledges	6,272	3,296	9,568	6,927
Student loan funds	1,069	4,797	5,866	5,794
Interests in perpetual trusts and assets held by others	3,307	13,157	16,464	22,756
Annuity and other split-interest agreements	6,310	2,401	8,711	14,566
	<u>\$ 216,923</u>	<u>132,133</u>	<u>349,056</u>	<u>342,734</u>

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The return from donor-restricted endowments is available for the following purposes as of June 30, 2012 and 2011:

	2012			2011 Total
	Reynolda Campus	WFUHS	Total	
Student scholarships	\$ 136,688	21,243	157,931	146,239
Instruction and research	42,639	70,441	113,080	105,806
Academic support	14,563	16,798	31,361	33,764
Subsequent period operations and other	6,075	—	6,075	6,882
	\$ 199,965	108,482	308,447	292,691

**(13) Functional Expenses**

Expenses are reported in the consolidated statement of activities in natural categories. Functional expenses for the years ended June 30, 2012 and 2011 are categorized as follows:

	2012			2011 Total
	Reynolda Campus	WFUHS	Total	
Instruction and departmental research	\$ 121,943	59,911	181,854	277,579
Patient services	—	450,852	450,852	362,317
Sponsored research, training, and other programs	—	190,303	190,303	183,213
Organized activities	2,006	—	2,006	1,932
Academic support	20,561	11,901	32,462	25,597
Libraries	12,412	3,522	15,934	15,504
Student services	26,198	1,883	28,081	24,921
Institutional support	72,979	45,470	118,449	117,024
Auxiliary enterprises	75,378	—	75,378	77,052
Total operating expenses	\$ 331,477	763,842	1,095,319	1,085,139

Functional expenses are reported in categories recommended by the National Association of College and University Business Officers. The expenses are reported in these functional categories after the allocation of plant operation and maintenance expense, depreciation expense, accretion expense, and interest expense. The University's primary program services are instruction, patient services, sponsored research, and organized activities. Expenses reported as academic support, libraries, student services, institutional support, and auxiliary enterprises are incurred in support of these primary program services.

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Plant operation and maintenance expense, depreciation expense, accretion expense, and interest expense are allocated to program and supporting activities based on a percentage allocation and periodic assessment of facilities usage, for Reynolda Campus and WFUHS, respectively.

#### (14) Contingencies and Other Commitments

The University maintains rental properties and has entered into long-term operating lease agreements for this real estate providing for future rental income as follows:

	<b>Reynolda Campus</b>	<b>WFUHS</b>	<b>Total</b>
Year ending June 30:			
2013	\$ 9,670	1,439	11,109
2014	9,863	243	10,106
2015	10,060	149	10,209
2016	10,261	89	10,350
2017	10,466	50	10,516
In total thereafter	—	86	86
	\$ 50,320	2,056	52,376

Total income from real estate was \$9,756 and \$9,465 for Reynolda Campus and \$3,531 and \$3,843 for WFUHS for the years ended June 30, 2012 and 2011, respectively.

The estimated cost to complete construction in progress at June 30, 2012 and 2011, respectively, were \$84,119 and \$81,743 for Reynolda Campus, and \$9,560 and \$25,576 for WFUHS.

Grant awards not yet funded and for which services have not yet been performed are not recorded until services have been performed. At June 30, 2012, such grant awards amounted to \$9,693 and \$239,308 for Reynolda Campus and WFUHS, respectively.

Expenditures and indirect costs related to federal and state grants and contracts are subject to adjustment based upon review by the granting agencies. The amounts, if any, of expenditures, which may be disallowed by the granting agencies cannot be determined at this time, although management expects they will not have a material effect on the University's consolidated financial statements.

The University is involved in various legal actions occurring in the normal course of activities. While the final outcomes cannot be determined at this time, management is of the opinion that the resolution of these legal actions will not have a material effect on the University's consolidated financial statements.

#### (15) Sale-Leaseback Agreement

In 2006, WFUHS entered into a sale-leaseback agreement to sell and lease back certain assets. The initial lease term is 20 years with four renewal options of five years each and the lease is classified as an operating lease. Operating lease payments in each year from 2013 to 2017 are \$7,368, \$7,441, \$7,516, \$7,591, and \$7,667, respectively.

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In 2010, WFUHS entered into a sale-leaseback agreement to sell and lease back certain assets. The initial lease term is 16 years with three 5 year renewal options. The lease is classified as an operating lease. Operating lease payments are due monthly and expected payments each year from 2013 to 2017 are \$4,983, \$5,107, \$5,236, \$5,366, and \$5,501, respectively.

WFUHS has a deferred gain related to the sale and lease back of certain assets. The deferred gain was \$28,911 and \$30,858 for 2012 and 2011, respectively, and is included in other liabilities and deferrals on the consolidated balance sheet.

#### **(16) Retirement Plans**

Substantially all employees of the University are eligible to participate in defined contribution benefit plans. The University contributes a specified percentage of each employee's salary to the plans. Contributions for the year ended June 30, 2012 and 2011, respectively, were \$10,408 and \$9,839 for Reynolda Campus and \$27,219 and \$23,847 for WFUHS.

Reynolda Campus and WFUHS have accrued \$1,860 and \$2,513 at June 30, 2012, respectively, for a liability associated with a defined benefit supplemental executive retirement plan. These liabilities are included in other liabilities and deferrals on the consolidated balance sheet.

WFUHS' Board of Directors additionally approved various changes to other existing retirement plans, including a permanent freeze of the WFUHS Money Purchase Pension Plan, the merger of the existing Tax-Deferred Annuity Plan and the Private 457(b) Deferred Compensation Plan with the NCBH sponsored 403(b) and 457(b) plans. All changes were effective January 1, 2012.

#### **(17) Postretirement Benefits**

The University sponsors defined benefit postretirement medical and dental plans that cover all of its full-time employees who elect coverage and satisfy the plans' eligibility requirements when they retire. In addition, Reynolda Campus sponsors a death benefit plan which pays a \$2 benefit for each retiree. To be eligible, retired employees of Reynolda Campus must be at least 62 years of age with ten or more years of service or be at least 65 years of age with five or more years of service. Retired employees of WFUHS must satisfy the "Rule of 75," meaning that the employees' age and years of service must equal or exceed 75 at retirement with a minimum age of 60. Employees of Reynolda House, Inc. are not eligible for the plans. The plans are contributory with retiree contributions established based on the University contributions being fixed amounts. As discussed in note 1, the WFUHS plan was frozen on January 1, 2012.

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The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at June 30, 2012 and 2011:

	2012			2011 Total
	Reynolda Campus	WFUHS	Total	
Benefit obligations at June 30	\$ (14,700)	(42,604)	(57,304)	(72,812)
Fair value of plan assets at June 30	—	38,930	38,930	38,926
Funded status at June 30	<u>\$ (14,700)</u>	<u>(3,674)</u>	<u>(18,374)</u>	<u>(33,886)</u>

The following table provides a reconciliation of the changes in each plan's benefit obligation, fair value of plan assets, and funded status for the years ended June 30, 2012 and 2011:

	2012			2011 Total
	Reynolda Campus	WFUHS	Total	
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 13,332	59,480	72,812	69,717
Service cost	740	1,344	2,084	3,590
Interest cost	694	2,220	2,914	3,658
Plan amendments	—	(26,847)	(26,847)	—
Participants' contributions	652	1,522	2,174	1,768
Actuarial loss (gain)	257	8,122	8,379	(2,328)
Benefits paid	<u>(975)</u>	<u>(3,237)</u>	<u>(4,212)</u>	<u>(3,593)</u>
Benefit obligation at end of year	<u>14,700</u>	<u>42,604</u>	<u>57,304</u>	<u>72,812</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	—	38,926	38,926	27,536
Actual return on plan assets	—	4	4	7,719
Employer contributions	323	1,715	2,038	5,496
Participants' contributions	652	1,522	2,174	1,768
Benefits paid	<u>(975)</u>	<u>(3,237)</u>	<u>(4,212)</u>	<u>(3,593)</u>
Fair value of plan assets at end of year	<u>—</u>	<u>38,930</u>	<u>38,930</u>	<u>38,926</u>
Funded status	<u>\$ (14,700)</u>	<u>(3,674)</u>	<u>(18,374)</u>	<u>(33,886)</u>
Amounts recognized in net assets:				
Prior service (cost) credit	\$ (5)	17,379	17,374	3,247
Net actuarial gain (loss)	<u>526</u>	<u>(25,340)</u>	<u>(24,814)</u>	<u>(19,509)</u>
Total increase (decrease)	<u>\$ 521</u>	<u>(7,961)</u>	<u>(7,440)</u>	<u>(16,262)</u>

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The following table provides the components of net periodic benefit cost for the years ended June 30, 2012 and 2011:

	2012			2011 Total
	Reynolda Campus	WFUHS	Total	
Service cost	\$ 740	1,344	2,084	3,590
Interest cost	694	2,220	2,914	3,658
Expected return on plan assets	—	(2,547)	(2,547)	(2,423)
Amortization of prior service cost (credit)	10	(4,633)	(4,623)	(267)
Amortization of net actuarial loss	—	5,616	5,616	1,836
Curtailment gain	—	(8,097)	(8,097)	—
Net periodic benefit cost	\$ 1,444	(6,097)	(4,653)	6,394

The prior service costs are amortized on a straight-line basis over the average remaining service period of active participants. Gains in excess of 10% of the greater of the benefit obligation and the market-related value of assets are amortized over the average remaining service period of active participants.

The actuarial net loss and prior service cost (credit) for the defined postretirement benefits plans that will be amortized from accumulated nonoperating income into net periodic benefit cost (credit) over the next fiscal year for Reynolda Campus and WFUHS are \$5 and \$(2,119), respectively.

The weighted average discount rate used to determine the accumulated postretirement benefit obligation at June 30, 2012 for Reynolda Campus and WFUHS, respectively, was 4.56% and 4.47%, and at June 30, 2011 was 5.31% and 5.54%, respectively. The discount rate reflects the current yield curve results as of June 30, 2012 and 2011. For management purposes, Reynolda Campus used 9.50% and 10.00%, and WFUHS used 9.00% and 9.00% for 2012 and 2011, respectively, for the annual rate of increase in the per capita cost of covered healthcare benefits for the first year, and a 4.50% rate was assumed in each year as the ultimate rate. The expected healthcare costs trend for the post-65 assumed an annual rate of 3.5% for 2012 and 2011. The expected return assumed on plan assets for WFUHS was 8.00% for 2012 and 2011. The rate is reviewed annually and adjusted as appropriate to reflect changes in the expected market performance of the investments.

Plan assets for WFUHS are held in trust and almost all are invested in equity securities that would be considered Level 1 in the fair value hierarchy.



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Assumed healthcare cost trend rates have a significant effect on the amounts reported for the postretirement benefit plan. A 1% change in assumed healthcare cost trend rates would have the following effects:

	<u>One percentage increase</u>	<u>One percentage decrease</u>
Reynolda Campus:		
Effect on total service and interest cost components of net periodic benefit cost	\$ 47	(39)
Effect on postretirement benefit obligation	259	(226)
WFUHS:		
Effect on total service and interest cost components of net periodic benefit cost	\$ 163	(141)
Effect on postretirement benefit obligation	331	(291)

Aggregate benefits expected to be paid by the University in each of the next five fiscal years subsequent to June 30, 2012 and thereafter are as follows:

	<u>Reynolda Campus</u>	<u>WFUHS</u>	<u>Total</u>
2013	\$ 545	1,749	2,294
2014	627	2,024	2,651
2015	713	2,270	2,983
2016	766	2,445	3,211
2017	856	2,654	3,510
Five years thereafter	5,184	13,967	19,151
	<u>\$ 8,691</u>	<u>25,109</u>	<u>33,800</u>

The expected benefits to be paid are based on the same assumptions used to measure the University's benefit obligation at June 30, 2012 and include estimated future employee service.

Recent federal health care legislation includes several provisions that may affect the University's benefit plans, including imposing an excise tax on high cost coverage, eliminating lifetime and annual coverage limits, and imposing inflation-adjusted fees for each person covered by a health insurance policy for each policy plan year ending after September 30, 2012, through September 30, 2019. For the postretirement benefit plan, the changes due to recent federal health care legislation increase the postretirement benefit obligation by approximately \$57 and \$61 for Reynolda Campus, and \$130 and \$235 for WFUHS, respectively, for June 30, 2012 and 2011. This change has been reflected as an actuarial loss.

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### (18) Related-Party Transactions

WFUHS and NCBH participate in various expansion projects, share certain facilities and provide various services, and incur certain expenses on behalf of each other. The transactions are recorded at fair value and the costs associated with operating and maintaining jointly occupied facilities are ultimately paid by the party having beneficial occupancy.

These transactions are recorded as follows in the consolidated financial statements:

	<u>2012</u>	<u>2011</u>
Revenue from NCBH, excluding MCIA <sup>(a)</sup>	\$ 67,395	67,676
Other sources, MCIA	63,218	13,960
Expenses incurred from NCBH <sup>(b)</sup>	45,452	38,093
Accounts receivable from NCBH, net	4,671	26,067

(a) NCBH provided reimbursement for services provided or expenses incurred by WFUHS on behalf of NCBH. Such services or expenses include physician salaries, facility expenses, library expenses, printing services, laboratory services, and materials.

(b) WFUHS paid NCBH for reimbursement of services provided or expenses incurred by NCBH on behalf of WFUHS. Such services or expenses include purchased materials, computer services, telephone service, insurance costs, and certain facility expenses.

Effective on June 27, 2011, NCBH transferred membership interest in Wake Forest Baptist Medical Center Community Physicians (WFBMCCP), including a wholly owned subsidiary, WFBMCCP Primary Care, LLC, to WFUHS. The transfer was recorded as an equity transfer of affiliate in the consolidated statements of activities.

Effective June 30, 2012, WFUHS transferred its membership interest in Davison Healthcare, Inc. which also merged with several subsidiaries and reorganized as Lexington Medical Center, totaling \$7,034 to WFUBMC. Prior to June 30, 2012, WFUHS recognized its 36% interest in Davidson Healthcare, Inc. and Subsidiaries under the equity method of accounting.

Beginning in 2011, in addition to planning and supervising joint construction projects, WFUBMC began acquiring property and constructing property directly. WFUHS and NCBH equally provide the required funding for the acquisition and construction costs. Receivables from WFUBMC for this funding were \$16,075 and \$10,807 at June 30, 2012 and 2011, respectively.

The Medical Center, a North Carolina nonprofit corporation formed to act on behalf of WFUHS and NCBH in connection with facilities planning, informational services, fund-raising, and budget formulation and review, is directing the planning and supervision of numerous construction projects as well as the fund-raising campaigns in connection therewith. Construction costs are paid in accordance with the respective occupancy percentages of the facilities. WFUHS and NCBH have negotiated a land and facilities sharing agreement whereby WFUHS and NCBH independently hold title to certain land and facilities, as designated by the agreement.

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#### **(19) Royalties Receivable**

Management has recorded revenue and a related receivable for licensing fees for “VAC System” technologies. On October 6, 1993, WFU (later WFUHS) and Kinetic Concepts, Inc. (KCI) entered into a license agreement that grants the licensee the exclusive worldwide right and license to make, sell and sublicense products and services related to the patented technologies. WFUHS and KCI jointly brought various suits for patent infringement against a number of entities. One such suit was brought against Smith & Nephew, Inc. (S&N) for infringement of certain asserted claims of certain patents based on a wound healing device made and sold by S&N. Following a jury trial in the Western District of Texas, the jury held that the asserted claims of the patents were valid and infringed by S&N. Subsequently, the district court granted S&N’s motion for judgment as a matter of law and overturned the jury verdict, concluding that the asserted claims of the patents were invalid for obviousness. WFUHS and KCI appealed that decision to the United States Court of Appeals for the Federal Circuit. The Court of Appeals reversed the District Court’s judgment as a matter of law, finding the asserted claims of the patents valid and remanding back to the Texas District Court to address certain outstanding motions and to determine damages. S&N has the option to request a rehearing by the Court of Appeals and to petition for an appeal to the U.S. Supreme Court.

In February 2011, KCI failed to pay royalties under its license and brought a declaratory judgment suit in the Western District of Texas against WFUHS seeking a judgment that the patents are invalid and not infringed and that KCI owes no royalties on them. WFUHS subsequently terminated KCI’s license on March 18, 2011 and sued KCI for patent infringement in the Middle District of North Carolina, as well as for breach of contract, among other causes of action. These unpaid royalties for the period July 1, 2010 through March 18, 2011 are accrued under other long-term receivables in the consolidated balance sheets and amount to \$65,919 at June 30, 2012 and 2011. The receivable balance includes the inventors’ share, which represents 50% of the amount after expenses or a gross amount of \$30,315. A matching liability for amounts due to the inventors is included in other long-term liabilities in the 2012 and 2011 consolidated balance sheets. WFUHS believes the KCI suit is without merit and will vigorously defend its rights under the license agreement. If the Court of Appeals ruling stands that the patents are valid that will enhance WFUHS’ ability to be successful in the KCI lawsuits.

#### **(20) Professional Liability Insurance**

WFB maintains professional liability coverage, which included a \$4,000 per occurrence and a \$16,000 annual aggregate self-insurance retention for the year ended June 30, 2012. WFUHS estimates its professional liability on an actuarial basis. The discount rate at June 30, 2012 was 4.0%. WFUHS accrued professional liability costs, including estimated claims incurred but not reported, amounted to approximately \$38,538 and \$36,281 at June 30, 2012 and 2011, respectively, and are included in other liabilities and deferrals on the consolidated balance sheet. In the opinion of management, adequate provision has been made for the related risk.

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#### **(21) Subsequent Event**

In July 2012, Reynolda Campus issued Series 2012 taxable bonds in the amount of \$125,000 to provide funds to finance all or a portion of the costs of construction, expansion, and renovation of various facilities, including two new residence halls, a dining facility, and a new building to host the Schools of Business, fund a portion of the interest on the 2012 bonds, and pay certain expenses incurred in connection with the issuance of the 2012 bonds. The 2012 taxable bonds are fixed-rate premium bonds issued in the amounts of \$20,425 (serial bonds) and \$104,575 (term bonds), with final maturities of January 15, 2027 and January 15, 2042, respectively. The 2012 term bonds maturing on January 15, 2032 and January 15, 2042 are subject to mandatory redemption through 2032 and 2042 in increasing annual amounts of \$5,445 to \$6,205 and \$6,405 and \$8,830, respectively. Interest is payable each January 15 and July 15, beginning January 15, 2014. The annual interest rates on the bonds were fixed at 2.60% to 3.10% for the serial bonds and 3.45% to 3.70% for the term bonds.