

THE REED INSTITUTE

Financial Statements

June 30, 2009 and 2008

(With Independent Auditors' Report Thereon)

Independent Auditors' Report

The Board of Trustees
The Reed Institute:

We have audited the accompanying statements of financial position of The Reed Institute as of June 30, 2009 and 2008, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of The Reed Institute's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Reed Institute as of June 30, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in note 10 to the financial statements, The Reed Institute adopted the provisions of FASB Staff Position No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act and Enhanced Disclosures for all Endowment Funds*. Also discussed in notes 2 and 12, The Reed Institute adopted SFAS No. 157, *Fair Value Measurements*, during 2009.

KPMG LLP

October 27, 2009

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Statements of Financial Position
June 30, 2009 and 2008

Assets	2009	2008
Current assets:		
Cash and cash equivalents	\$ 7,094,502	14,228,789
Accounts receivable – student and other (note 8)	473,915	364,014
Short-term investments (note 3)	—	103,217
Contributions receivable, net of allowance \$33,000 in 2009 and \$40,000 in 2008 (note 8)	634,605	758,178
Prepaid expenses and other assets	2,531,139	2,177,474
Total current assets	10,734,161	17,631,672
Noncurrent assets:		
Cash and cash equivalents whose use is limited	2,208,255	2,067,695
Accounts receivable noncurrent – student and other, net of allowance of \$60,000 in 2009 and 2008 (note 8)	4,799,126	4,721,657
Property, plant, and equipment, net (note 4)	115,553,119	111,861,840
Contributions receivable – noncurrent net of allowance of \$1,077,000 in 2009 and \$1,063,000 in 2008 (note 8)	20,437,444	20,191,773
Funds held in trust by others (note 7)	11,096,955	14,419,352
Long-term investments (note 3)	347,188,450	464,411,894
Other assets	510,393	458,578
Total noncurrent assets	501,793,742	618,132,789
Total assets	\$ 512,527,903	635,764,461
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 4,946,142	7,370,427
Postretirement benefits payable (note 6)	644,583	624,461
Debt and capital leases, current portion (note 5)	1,244,463	1,185,296
Deferred revenue	1,036,888	861,148
Total current liabilities	7,872,076	10,041,332
Long-term liabilities:		
Accrued liabilities	—	36,823
Liability for split-interest agreements	9,400,829	10,635,777
Postretirement benefits payable (note 6)	15,641,100	16,053,418
Refundable loan programs	3,019,784	3,064,870
Asset retirement obligation	2,892,350	2,829,607
Debt and capital leases, net of current portion costs (note 5)	64,889,465	66,122,539
Other liabilities	2,161,375	1,167,333
Total long-term liabilities	98,004,903	99,910,367
Total liabilities	105,876,979	109,951,699
Net assets (note 9):		
Unrestricted	224,075,841	303,566,419
Temporarily restricted	68,342,511	111,156,580
Permanently restricted	114,232,572	111,089,763
Total net assets	406,650,924	525,812,762
Total liabilities and net assets	\$ 512,527,903	635,764,461

See accompanying notes to financial statements.

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Statement of Activities and Changes in Net Assets

Year ended June 30, 2009

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2009</u>
Revenues, gains (losses), and other support:				
Tuition and fees	\$ 51,158,542	—	—	51,158,542
Less college-funded scholarships	(17,711,741)	—	—	(17,711,741)
Net tuition and fees	<u>33,446,801</u>	<u>—</u>	<u>—</u>	<u>33,446,801</u>
Auxiliary enterprises	11,398,173	—	—	11,398,173
Gifts and private grants	6,797,715	798,686	4,830,916	12,427,317
Government grants, contracts, and student aid	1,666,578	—	—	1,666,578
Realized and unrealized gains and losses	(70,322,842)	(29,429,444)	—	(99,752,286)
Other investment income	78,464	—	—	78,464
Other revenues and additions	<u>1,206,859</u>	<u>—</u>	<u>—</u>	<u>1,206,859</u>
Revenues and gains (losses)	<u>(49,175,053)</u>	<u>(28,630,758)</u>	<u>4,830,916</u>	<u>(72,974,895)</u>
Net assets released from restrictions	<u>8,235,197</u>	<u>(8,235,197)</u>	<u>—</u>	<u>—</u>
Total revenues, gains (losses), and other support	<u>(7,493,055)</u>	<u>(36,865,955)</u>	<u>4,830,916</u>	<u>(39,528,094)</u>
Expenses:				
Educational and general:				
Instruction	25,950,171	—	—	25,950,171
Research	1,033,580	—	—	1,033,580
Academic support	7,643,897	—	—	7,643,897
General institutional support	11,432,009	—	—	11,432,009
Student services	5,317,894	—	—	5,317,894
Public affairs	<u>4,793,607</u>	<u>—</u>	<u>—</u>	<u>4,793,607</u>
Total educational and general	<u>56,171,158</u>	<u>—</u>	<u>—</u>	<u>56,171,158</u>
Auxiliary enterprises	<u>15,544,428</u>	<u>—</u>	<u>—</u>	<u>15,544,428</u>
Total expenses	<u>71,715,586</u>	<u>—</u>	<u>—</u>	<u>71,715,586</u>
(Decrease) increase from operations	<u>(79,208,641)</u>	<u>(36,865,955)</u>	<u>4,830,916</u>	<u>(111,243,680)</u>
Nonoperating activity:				
Other interest expense	(107,674)	—	—	(107,674)
Change in value of split-interest agreements	—	(6,127,686)	(1,494,749)	(7,622,435)
Other additions (deductions)	<u>(174,263)</u>	<u>179,572</u>	<u>(193,358)</u>	<u>(188,049)</u>
Total nonoperating activity	<u>(281,937)</u>	<u>(5,948,114)</u>	<u>(1,688,107)</u>	<u>(7,918,158)</u>
(Decrease) increase in net assets	<u>(79,490,578)</u>	<u>(42,814,069)</u>	<u>3,142,809</u>	<u>(119,161,838)</u>
Net assets, beginning of year	<u>303,566,419</u>	<u>111,156,580</u>	<u>111,089,763</u>	<u>525,812,762</u>
Net assets, end of year	\$ <u><u>224,075,841</u></u>	<u><u>68,342,511</u></u>	<u><u>114,232,572</u></u>	<u><u>406,650,924</u></u>

See accompanying notes to financial statements.

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Statement of Activities and Changes in Net Assets

Year ended June 30, 2008

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2008</u>
Revenues, gains, and other support:				
Tuition and fees	\$ 49,174,352	—	—	49,174,352
Less college-funded scholarships	<u>(16,278,569)</u>	<u>—</u>	<u>—</u>	<u>(16,278,569)</u>
Net tuition and fees	<u>32,895,783</u>	<u>—</u>	<u>—</u>	<u>32,895,783</u>
Auxiliary enterprises	10,625,648	—	—	10,625,648
Gifts and private grants	10,728,081	1,083,253	16,142,784	27,954,118
Government grants, contracts, and student aid	1,591,217	—	—	1,591,217
Realized and unrealized gains and losses	(14,644,646)	(9,023,106)	—	(23,667,752)
Other investment income	1,348,733	—	—	1,348,733
Other revenues and additions	<u>1,026,168</u>	<u>—</u>	<u>220</u>	<u>1,026,388</u>
Subtotal	<u>10,675,201</u>	<u>(7,939,853)</u>	<u>16,143,004</u>	<u>18,878,352</u>
Net assets released from restrictions	<u>7,575,356</u>	<u>(7,575,356)</u>	<u>—</u>	<u>—</u>
Total revenues, gains, and other support	<u>51,146,340</u>	<u>(15,515,209)</u>	<u>16,143,004</u>	<u>51,774,135</u>
Expenses:				
Educational and general:				
Instruction	25,553,682	—	—	25,553,682
Research	1,225,039	—	—	1,225,039
Academic support	7,910,323	—	—	7,910,323
General institutional support	10,178,604	—	—	10,178,604
Student services	5,210,226	—	—	5,210,226
Public affairs	<u>4,517,507</u>	<u>—</u>	<u>—</u>	<u>4,517,507</u>
Total educational and general	<u>54,595,381</u>	<u>—</u>	<u>—</u>	<u>54,595,381</u>
Auxiliary enterprises	<u>14,958,020</u>	<u>—</u>	<u>—</u>	<u>14,958,020</u>
Total expenses	<u>69,553,401</u>	<u>—</u>	<u>—</u>	<u>69,553,401</u>
(Decrease) increase from operations	<u>(18,407,061)</u>	<u>(15,515,209)</u>	<u>16,143,004</u>	<u>(17,779,266)</u>
Nonoperating activity:				
Other interest expense	(133,776)	—	—	(133,776)
Change in value of split-interest agreements	—	(2,532,869)	(611,487)	(3,144,356)
Other additions (deductions)	<u>791,049</u>	<u>—</u>	<u>(7,137)</u>	<u>783,912</u>
Total nonoperating activity	<u>657,273</u>	<u>(2,532,869)</u>	<u>(618,624)</u>	<u>(2,494,220)</u>
Net asset reclassification based on change in law	<u>(101,563,548)</u>	<u>101,563,548</u>	<u>—</u>	<u>—</u>
(Decrease) increase in net assets	<u>(119,313,336)</u>	<u>83,515,470</u>	<u>15,524,380</u>	<u>(20,273,486)</u>
Net assets, beginning of year	<u>422,879,755</u>	<u>27,641,110</u>	<u>95,565,383</u>	<u>546,086,248</u>
Net assets, end of year	<u>\$ 303,566,419</u>	<u>111,156,580</u>	<u>111,089,763</u>	<u>525,812,762</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Decrease in net assets	\$ (119,161,838)	(20,273,486)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation and amortization	4,410,326	3,765,674
Contributions restricted for long-term investment	(4,880,482)	(2,897,081)
Noncash contributions	(1,000,805)	(3,800,755)
Net realized and unrealized losses on investments	98,758,244	22,638,459
Change in value of split-interest agreements	7,622,435	3,144,356
Change in fair value of derivative instruments	994,042	1,029,293
Change in asset retirement obligation	62,743	648,490
Changes in operating assets and liabilities:		
Increase in cash and cash equivalents whose use is limited	(140,560)	(200,587)
Increase in accounts receivable – students and other	(187,370)	(28,714)
Increase in contributions receivable	(122,098)	(10,250,238)
Increase in prepaid expenses and other assets	(344,493)	(506,830)
(Decrease) increase in accounts payable and accrued liabilities	(2,461,108)	2,211,795
Decrease in postretirement benefits payable	(392,196)	(1,957,758)
Increase (decrease) in deferred revenue	175,740	(1,191,235)
Net cash used in operating activities	(16,667,420)	(7,668,617)
Cash flows from investing activities:		
Proceeds from maturities/sales of investments	236,221,833	159,956,617
Purchases of investments	(220,932,600)	(146,902,583)
Contracts/loans collected	(82,102)	34,672
Purchase of property, plant, and equipment	(8,080,490)	(25,370,233)
Net cash provided by (used in) investing activities	7,126,641	(12,281,527)
Cash flows from financing activities:		
Contributions restricted for long-term investment	4,880,482	2,897,081
Issuance of debt	—	77,060,000
Payment of debt principal and capital lease obligations	(1,173,907)	(47,467,316)
Payments of obligations for split-interest agreements	(1,434,287)	(1,467,535)
Increase in obligations for split-interest agreements	179,290	1,273,843
Changes in governmental loan funds	(45,086)	(43,306)
Net cash provided by financing activities	2,406,492	32,252,767
Net (decrease) increase in cash and cash equivalents	(7,134,287)	12,302,623
Cash and cash equivalents, beginning of year	14,228,789	1,926,166
Cash and cash equivalents, end of year	\$ 7,094,502	14,228,789
Supplemental disclosures:		
Interest paid	\$ 1,871,412	3,243,211
Assets acquired under capital leases	6,197	—

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2009 and 2008

(1) Background

The Reed Institute (Reed College) was founded in 1908 by Simeon and Amanda Reed, with one central commitment: to provide a balanced, comprehensive education in liberal arts and sciences, fulfilling the highest standards of intellectual excellence. Reed College offers a B.A. in one of 22 major fields and numerous interdisciplinary fields, as well as a master of arts in liberal studies degree. The Reed College educational program pays particular attention to a balance between broad study in the various areas of human knowledge and close, in-depth study in a recognized academic discipline.

(2) Summary of Significant Accounting Policies

(a) *Accrual Basis*

The financial statements of Reed College have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

(b) *Basis of Presentation*

Net assets, revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. The definitions used to classify and report net assets are as follows:

- **Unrestricted net assets** – net assets that are not subject to donor-imposed stipulations or donor-restricted contributions whose restrictions are met in the same reporting period.
- **Temporarily restricted net assets** – net assets subject to donor-imposed stipulations that will be met either by actions of Reed College or the passage of time.
- **Permanently restricted net assets** – net assets subject to donor-imposed stipulations that they be permanently maintained by Reed College. Generally, the donors of these assets permit Reed College 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. All expenses are reported as decreases in unrestricted net assets with the exception of activity related to life income agreements. 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 either by donor stipulation or by law. Expirations of temporary restrictions (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 and are reported as “net assets released from restriction” in the statements of activities. Restrictions related to contributions for the purchase of capital additions are released when the asset is placed in service.

Income and net gains on investments of endowment and similar funds are reported as follows:

- Increases in permanently restricted net assets if the terms of the gift or Reed College’s interpretation of relevant state law require they be added to the principal of a permanently restricted net asset.

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- Increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income or if endowment income has not yet been appropriated for expenditure.
- Increases in unrestricted net assets in all other cases.

Reed College adopted the provisions of Financial Accounting Standards Board (FASB) Staff Position (FSP) No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP 117-1) during fiscal 2009. FSP 117-1 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and also requires disclosures about endowment funds, both donor-restricted endowment funds and board-designated endowment funds. See note 10 for further UPMIFA and FSP 117-1 disclosures.

(c) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets; allowances for student and contributions receivables; and the valuation of the interest rate swaps, investments, split-interest agreements, and actuarial assumptions. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

(d) Revenues

The principal sources of revenue, consisting of tuition, room and board, various other educational fees, unrestricted income from funds functioning as endowment, unrestricted gifts, and net assets released from restrictions, are accounted for in unrestricted net assets. Unrestricted net assets also include revenue from grants, auxiliary enterprises, and gains on disposal of assets.

The following assets have become available for general operating purposes from release from donor restrictions through the passage of time and through the maturation of various planned giving agreements for the years ended June 30, 2009 and 2008, respectively.

	<u>2009</u>	<u>2008</u>
Maturation of planned giving agreements	\$ 519,930	413,300
Passage of time	304,102	1,209,360
Endowment earnings appropriated for expenditure	7,411,165	5,952,696
Total net assets released from restrictions	<u>\$ 8,235,197</u>	<u>7,575,356</u>

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With a few exceptions, the monies in the endowment and similar funds are invested as a pool, and the related income of the pool is distributed to each participating fund based upon a spending formula and its relative proportion of the pool.

In addition, monies, which are not required to meet short-term demands, are combined and invested. The income earned on these intermediate investments is allocated to each participating fund based upon its relative proportion of the combined investment.

(e) ***Investments***

Investments in marketable equity securities with readily determinable fair values and all investments in debt securities are carried at fair value. In conjunction with the adoption of Statement No. 157, Reed College elected to early adopt the measurement provisions of Accounting Standards Update No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)* to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, and real estate. This guidance amends Statement No. 157 and allows for the estimation of the fair value of investments for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances may not equal fair value that would be calculated pursuant to Statement No. 157.

Realized and unrealized gains and losses arising from the sale, collection, or other disposition of investments, as well as all dividends, interest, and other investment income, are shown in the statements of activities. Gains and investment income that are limited to specific uses by donor-imposed restrictions are reported as increases in unrestricted net assets if the restrictions are met in the same reporting period that the gains and income are recognized. Losses on investments related to gifts that the donor required to be invested in perpetuity (i.e., endowment funds) are classified as decreases in temporarily restricted net assets until the investments fall below the original gift at which point they decrease unrestricted net assets. Subsequent gains that restore the fair value of the assets of the endowment funds to the required level are classified as increases in unrestricted net assets.

(f) ***Split-Interest Agreements***

Reed College has been named as a beneficiary for various split-interest agreements. Each agreement provides for contractual payments to stated beneficiaries for their lifetimes, after which remaining principal and interest revert to Reed College. Assets contributed are recorded at fair value. In addition, Reed College has recognized the present value of estimated future payments to be made to beneficiaries over their expected lifetimes as a long-term liability. The present values of these estimated payments were determined on the basis of published actuarial factors for ages of the respective beneficiaries discounted using various rate tables. Annual adjustments are made between the liability and the net assets to record actuarial gains or losses. Differences between the assets contributed and the expected payments to be made to beneficiaries have been recorded as contribution revenue in the year established. These donations are either temporarily restricted on the basis of time or permanently restricted based on the intent of the donor.

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(g) Contributions Receivable

Unconditional promises to give (contributions) are recorded as gifts and private grant income and contributions receivable. Promises to give are not recognized until they become unconditional, that is, when the donor-imposed restrictions are substantially met. Contributions other than cash are recorded at their estimated fair value. Management estimates an allowance for uncollectible contributions based on risk factors such as prior collection history, type of contribution, and the nature of the fund-raising activity. Contributions are generally receivable within five years of the date the commitment was made and through June 30, 2009 were discounted to present value using a discount rate commensurate with the risk involved, and for the year ended June 30, 2008 were discounted using the risk free rate. Amortization of the discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions.

(h) Derivative Instruments

Reed College accounts for derivatives of an interest rate swap in accordance with FASB Statement No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities*, as amended, which requires that all derivative instruments be recorded on the statements of financial position at their respective fair values. Changes in the fair value are recognized in unrealized gains and losses, unrestricted, in the statements of activities and changes in net assets.

(i) Property, Plant, and Equipment, Net

Property, plant, and equipment are stated at cost at the date of acquisition, if purchased, or at fair market value, at the date of receipt, if acquired by donation. Equipment under capital leases are stated at the present value of minimum lease payments. Depreciation is computed on a straight-line basis over the estimated useful lives of buildings (twenty to fifty years) and equipment and furnishings (five years). Plant and equipment held under capital leases are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Routine repair and maintenance expenses and equipment replacement costs are expensed as incurred.

(j) Donated Materials

Donated materials are included in the statements of activities and changes in net assets as "Gifts and private grants" at their estimated fair values at date of receipt. These materials are subsequently expensed when used.

(k) Income Tax Status

The Internal Revenue Service has recognized Reed College as exempt from tax under the provisions of Section 501(c)(3) of the Internal Revenue Code except to the extent of unrelated business income under Sections 511 through 515. Management believes that unrelated business income tax, if any, is immaterial and therefore, no tax provision has been made. In July 2006, FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more-likely than-not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 also provides related guidance on measurement, derecognition, classification, interest and

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penalties, and disclosure. As Reed College is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code as a qualified educational institution and is generally not subject to federal or state income taxes, the adoption of FIN 48 did not have a significant impact on the Reed College's financial statements.

(l) Cash and Cash Equivalents

Cash and cash equivalents represent cash in bank and other highly liquid investments with original maturities of three months or less. Cash and cash equivalents whose use is limited are restricted for the Federal Perkins Loan program.

(m) Deferred Revenue

Deferred revenues consist primarily of prepayments of tuition and fees related to future academic years.

(n) Postretirement Benefits

Reed College has a noncontributory defined postretirement benefit plan covering participating employees upon their retirement. Reed College maintains a postretirement benefit plan and accounts for the plan within the framework of Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, and still applicable, SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*, respectively.

Reed College records annual amounts relating to its postretirement plan based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, and healthcare cost trend rates. Reed College 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. Reed College believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions.

(o) Concentration of Risk

Reed College's standard financial instruments include commercial paper, U.S. government and agency securities, corporate obligations, equity securities, mutual funds, hedge funds, private equity, and real estate. These financial instruments may subject Reed College to concentrations of risk. Cash balances at June 30, 2009 exceed amounts insured by the Federal Deposit Insurance Corporation by approximately \$8,800,000.

(p) Recently Issued Accounting Pronouncements

On July 1, 2008, Reed College adopted the measurement provisions of SFAS 157, *Fair Value Measurements*, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of SFAS 157 did not have a significant impact to the Reed College's financial statements. Refer to note 12 for more information regarding the Reed College's fair value disclosures under SFAS 157.

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In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, which was effective immediately. FSP FAS 157-3 clarifies the application of SFAS 157 in cases where the market for a financial instrument is not active and provides an example to illustrate key considerations in determining fair value in those circumstances. Reed College has considered the guidance provided by FSP FAS 157-3 in its determination of estimated fair values during the fiscal year ended June 30, 2009.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which was effective for annual reporting periods ending after June 15, 2009. FSP FAS 157-4 clarifies the application of Statement 157 in cases where the market for a financial instrument is not active and provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, *Fair Value Measurements*, when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. Reed College has considered the guidance provided by FSP FAS 157-4 in its determination of estimated fair values during the fiscal year ended June 30, 2009.

Reed College elected to apply the measurement provisions of FASB Accounting Standard Update No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)*, to its alternative investments. The guidance amends Statement 157 and permits, as a practical expedient, fair value of investments within its scope to be estimated using net asset value or its equivalent.

In May 2009, the FASB issued FAS 165, *Subsequent Events*, which was effective for annual reporting periods ending after June 15, 2009. FAS 165 establishes principles and requirements for subsequent events, including; the period after the balance sheet date during which management of a reporting entity shall evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. Reed College has considered the guidance provided by FAS 165 in its subsequent events review and disclosures.

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(3) Investments

The fair value of investments at June 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Investments:		
Short-term investments	\$ —	103,217
Equity mutual funds	72,443,018	42,797,918
Government fixed income	25,000	25,000
Corporate fixed income	21,136,997	—
Hedge funds	148,560,450	252,210,824
Private equity	89,225,367	100,475,072
Real estate	5,544,745	5,587,637
Money market and other	10,252,873	63,315,443
Total investments	<u>\$ 347,188,450</u>	<u>464,515,111</u>

At June 30, 2009, Reed College has approximately \$243 million in investments which are not readily marketable. These investments represent 70% of total investments and 60% of net assets at June 30, 2009. These investment instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and nonmarketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed. Such difference could be material.

The alternative investments are reported at net asset value. These investments are redeemable at net asset value under the original terms of the partnership agreements and/or subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the underlying fund agreements. Due to the nature of the investments held by the funds, changes in market conditions and the economic environment may significantly impact the net asset value of the funds and, consequently, the fair value of the Reed College interests in the funds. Furthermore, changes to the liquidity provisions of the funds may significantly impact the fair value of the Reed College interest in the funds.

At June 30, 2009, Reed College has committed \$186,000,000 to private equity partnerships and hedge funds. As of June 30, 2009, Reed College has funded \$135,000,000 of these commitments. These commitments are due on demand from the general partners/advisors and are funded when called. The terminations of these partnerships/funds are based upon specific provisions in the agreements.

Included in investments are \$18,344,036 and \$23,909,168 of planned giving trusts held in equity mutual funds that are not available for spending as of June 30, 2009 and 2008, respectively.

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Within private equity and hedge funds, Reed College has funds invested in twenty-eight and twenty-three limited partnerships, respectively, with ownership interests ranging from 0.04% to 4.20% at June 30, 2009 and 0.04% to 2.73% at June 30, 2008. Included in the assets of the various partnerships is a small portion of derivative instruments.

Total investment income and realized and unrealized gains (losses) on investments that are not readily marketable was \$(86,715,898) and \$(7,743,635) for the years ended June 30, 2009 and 2008, respectively.

(4) Property, Plant, and Equipment, Net

Property, plant, and equipment at June 30, 2009 and 2008 consist of the following:

	<u>2009</u>	<u>2008</u>
Land and land improvements	\$ 13,187,625	11,203,950
Buildings	148,359,219	118,218,508
Construction in progress	335,039	24,455,101
Equipment, furniture, and fixtures	11,226,039	11,149,873
	<u>173,107,922</u>	<u>165,027,432</u>
Less accumulated depreciation	<u>(57,554,803)</u>	<u>(53,165,592)</u>
Net property, plant, and equipment	<u>\$ 115,553,119</u>	<u>111,861,840</u>

(5) Long-Term Debt

(a) Capital Lease Obligations

Reed College leases copiers over various terms. The book values of assets under capital lease at June 30, 2009 and 2008 are \$183,705 and \$269,792, respectively. Amortization costs of \$92,284 and \$91,871 are included in accumulated depreciation for the years ended June 30, 2009 and 2008, respectively.

The payment schedule for the capital lease obligation is as follows:

2010	\$ 98,071
2011	82,348
2012	9,289
2013	1,260
2014	840
	<u>191,808</u>
Less amount representing interest	<u>(8,103)</u>
	<u>\$ 183,705</u>

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(b) Notes Payable

Reed College borrowed \$20,000,000 from the State of Oregon on May 1, 2000. The purpose of the issuance was to finance the construction of certain renovations, additions, alterations and improvements to the premises and educational facilities of the College, and the equipping, furnishing, and landscaping thereof. The full amount borrowed, net of unamortized discount and issuance costs, was expended on projects during the year ended June 30, 2002. The notes bear interest from 5.00% to 5.75% and mature in varying amounts from 2003 to 2032.

Reed College borrowed \$14,825,000 from the State of Oregon on May 1, 1991. Effective December 1, 1995, Reed College refinanced all but \$1,565,000 of the 1991 State of Oregon notes and borrowed an additional \$7,105,000. Effective June 7, 2006, Reed College refinanced the callable portion of the 1995 State of Oregon notes payable in the amount of \$16,650,000. The 2006 State of Oregon notes mature on July 1, 2025 and bear interest at a variable rate set on a weekly basis by a dutch auction process or at a default rate if the auction is not successful.

Reed College borrowed \$30,000,000 through the Oregon Facilities Authority of the State of Oregon on August 1, 2007. The purpose of the issuance was to finance the construction of five residence halls, construction of a pedestrian bridge, and certain other renovations, additions, alterations, and furnishing and landscaping thereof. These bonds were issued initially as auction rate certificates (ARC's), and were scheduled to mature on July 1, 2038 and bear interest at a variable rate set on a weekly basis by a dutch auction process. These bonds were subsequently refinanced by the 2008 State of Oregon notes.

Effective April 23, 2008, Reed College refinanced the 2006 and the 2007 State of Oregon Bonds in the amount of \$47,060,000. The 2008 State of Oregon notes mature on July 1, 2038 and bear interest based on a weekly basis set through the remarketing process. In connection with the extinguishment of 2006 and 2007 State of Oregon bonds, Reed College expensed \$761,016 of remaining unamortized financing costs as a loss on refinancing, which is included in the accompanying statements of activities during the year ended June 30, 2008.

Wells Fargo Bank is the liquidity facility provider for the 2008 Bond Issue should the bonds fail to remarket. The Liquidity Facility agreement remains in effect until April 22, 2011, unless renewed or terminated pursuant to the conditions set forth in the 2008 Liquidity Facility.

Notes payable are summarized as follows:

	2009	2008
2000 State of Oregon notes	\$ 19,215,000	19,345,000
1995 State of Oregon notes	685,000	1,335,000
2008 State of Oregon notes	46,710,000	47,060,000
	66,610,000	67,740,000
Less discount	(659,777)	(701,957)
	\$ 65,950,223	67,038,043

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Principal payments on the notes payable become due as follows:

	2000 State of Oregon notes	1995 State of Oregon notes	2008 State of Oregon notes	Total
2010	\$ 135,000	685,000	375,000	1,195,000
2011	140,000	—	1,085,000	1,225,000
2012	155,000	—	1,145,000	1,300,000
2013	160,000	—	1,185,000	1,345,000
2014	165,000	—	1,210,000	1,375,000
Thereafter	18,460,000	—	41,710,000	60,170,000
	<u>\$ 19,215,000</u>	<u>685,000</u>	<u>46,710,000</u>	<u>66,610,000</u>

Interest on the State of Oregon notes payable bonds and amortization of discount and issuance costs are as follows:

	2009	2008
Interest	\$ 1,871,412	3,243,211
Amortization of discount and issuance costs	63,695	426,647
Total interest expensed	<u>\$ 1,935,107</u>	<u>3,669,858</u>

Notes payable discount, net of amortization was \$659,777 and \$701,957 at June 30, 2009 and 2008, respectively. Issuance costs, net of amortization were \$379,775 and \$401,291 at June 30, 2009 and 2008, respectively. Amortization is calculated over the life of the notes.

(c) Interest Rate Risk Management

In order to take advantage of fluctuations in long-term interest rates, Reed College has entered into an interest rate swap agreement with a notional amount \$16,650,000, which allows Reed College to change the variable interest rate to a fixed interest rate on State of Oregon notes payable.

In June 2006, Reed College refinanced the callable portion of its 1995 State of Oregon notes by issuing \$16.65 million of auction rate debt through the Oregon Facilities Authority. The College entered into an interest rate swap of like term, amortization, and notional amount with an investment bank to hedge this underlying variable rate debt. Reed College has subsequently refinanced the 2006 notes, however, retained this swap arrangement for interest rate risk management. Pursuant to this swap, Reed College works with a consulting firm to aid in monitoring changes in interest rates and the impact they may have on long-term debt.

During the years ended June 30, 2009 and 2008, \$311,707 and \$62,830 was paid, respectively, and is recorded in the statements of activities and changes in net assets as other investment expense. The change in unrealized gain and loss on the swap agreements for the years ended June 30, 2009 and 2008 was a loss of \$994,042 and \$1,029,293, respectively, and is recorded in the statements of

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activities and changes in net assets as realized and unrealized losses. The fair value of the swap agreement as of June 30, 2009 and 2008 was a liability of \$2,161,375 and \$1,167,333, respectively, which is recorded in the statements of financial position as other long-term liabilities.

(6) Postretirement Benefits

Reed College has a defined contribution noncontributory pension plan administered through Teachers Insurance and Annuity Association – College Retirement Equities Fund. Certain employees are eligible to participate and must be employed one year and have attained the age of twenty-one. All contributions vest immediately with the employee at the rate of 10% of the participating employees' monthly compensation. Reed College's policy is to fund pension expenses as incurred. Expenditures relating to the plan were \$2,590,841 and \$2,431,842 for the years ended June 30, 2009 and 2008, respectively, and are included in education and general expenses in the accompanying statements of activities.

Reed College maintains a defined benefit retiree medical insurance plan, which is administered by Pioneer Educators Health Trust (PEHT) and is not funded. In order to participate, employees hired prior to September 2, 2001 must retire from Reed College at or after age fifty-five with at least ten years of continuous service. Employees hired after September 1, 2001 must retire from Reed College at or after age fifty-five with twenty years of continuous service. Employees are covered for the lowest premium plan for his or her lifetime and spouses/domestic partners are covered at the rate of fifty percent of the lowest premium plan for his or her lifetime. Employer premium expenses were \$692,141 and \$618,058 for the years ended June 30, 2009 and 2008, respectively, and are included in education and general expenses in the accompanying statements of activities.

The accrued liability for postretirement benefits at year-end is as follows:

	2009	2008
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 16,677,879	18,635,637
Service cost	341,242	431,134
Interest cost	1,117,437	1,080,133
Benefits paid	(624,461)	(672,639)
Actuarial gain	(1,226,414)	(2,796,386)
Benefit obligation at end of year	16,285,683	16,677,879
Funded status	\$ 16,285,683	16,677,879
Amounts recognized in the balance sheet consist of:		
Postretirement benefits payable-current	\$ 644,583	624,461
Postretirement benefits payable	15,641,100	16,053,418
	\$ 16,285,683	16,677,879

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Net periodic benefit cost for the years ended June 30 included the following components:

	<u>2009</u>	<u>2008</u>
Interest cost	\$ 1,117,437	1,080,133
Service cost	341,242	431,134
Amortization of gain	(171,056)	(78,633)
Net periodic benefit cost	<u>\$ 1,287,623</u>	<u>1,432,634</u>

Reed College used the following actuarial assumptions to determine its employee benefit obligations at and net periodic benefit cost for the years ended June 30, 2009 and 2008, as measured at June 30:

	<u>2009</u>	<u>2008</u>
Benefit obligation:		
Weighted average discount rate	7.00%	6.60%
Rate of increase in per capita cost of covered healthcare benefits	8% trending to 5% in 2014	8% trending to 5% in 2013
Net periodic benefit cost:		
Weighted average discount rate	6.60%	6.25%
Rate of increase in per capita cost of covered healthcare benefits	8% trending to 5% in 2013	9% trending to 5% in 2013

Reed College's policy is to fund the plan as claims payments are made. In the 2009-2010 fiscal year, Reed College expects to contribute, from ongoing cash flows and current assets, \$644,583 to the plan. Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows for the years ending June 30:

Year:	
2010	\$ 644,583
2011	700,935
2012	753,992
2013	811,956
2014	860,180
2015 – 2019	5,232,439

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 provides an employer subsidy of 28% of gross annual prescription drug costs between \$250 and \$5,000 for actuarially equivalent plans. FSP 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, requires that the estimated impact of this subsidy be reflected in the Accrued Postretirement Benefit Obligation (APBO) for periods beginning after June 15, 2004. This reduction in APBO reduces the net periodic postretirement benefit cost due to corresponding reductions in the service cost and interest cost. Actuaries have determined that the Reed College Postretirement Medical Plans are actuarially equivalent to the Medicare Part D plan. Reed College applied

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for the employer subsidy and Reed College expects to receive a subsidy, in October of 2009 in the amount of \$14,389.

(7) Funds Held in Trust by Others

Reed College has been named beneficiary of a portion of the remainder of six trusts maturing at specified dates in the future. These trusts are administered by other entities. Reed College revalues the receivables using the fair value of expected future cash flows. At June 30, 2009 and 2008, the trusts receivable were \$11,096,955 and \$14,419,352, respectively, and were included under funds held in trust by others, noncurrent.

(8) Contributions and Accounts Receivable

Contributions receivable consist of the following:

	<u>2009</u>	<u>2008</u>
Annual fund	\$ 1,971,805	2,488,610
Campaign fund	152,549	257,865
Endowment fund	19,529,467	18,835,892
Campus center	2,294,500	2,310,248
Gross contributions receivable	<u>\$ 23,948,321</u>	<u>23,892,615</u>

Contributions receivable reported on the statements of financial position were as follows:

	<u>2009</u>	<u>2008</u>
Current:		
Gross contributions receivable	\$ 667,605	798,178
Less allowance for doubtful accounts	(33,000)	(40,000)
Total current net contributions receivable	<u>634,605</u>	<u>758,178</u>
Long-term (one to five years):		
Gross contributions receivable	23,280,716	23,094,437
Less allowance for doubtful accounts	(1,077,000)	(1,063,000)
Net long-term contributions receivable	<u>22,203,716</u>	<u>22,031,437</u>
Less discount to present value	(1,766,272)	(1,839,664)
Total long-term net contributions receivable	<u>20,437,444</u>	<u>20,191,773</u>
Total net contributions receivable	<u>\$ 21,072,049</u>	<u>20,949,951</u>

Reed College expects to receive \$6,300,000 in fiscal year 2010 and \$17,600,000 over the following three fiscal years, related to receivables outstanding at June 30, 2009.

Contributions receivable due in excess of one year are discounted at 3.3% to 4.5% and 3.2% to 3.5% for the years ended June 30, 2009 and 2008, respectively.

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Of the net unconditional promises to give included above, \$17,309,274 represents an unconditional promise to give from 19 members of the Reed College board of trustees due in one to three years.

Accounts receivable consist of the following at June 30, 2009:

	<u>Unrestricted</u>	<u>Restricted</u>	<u>Loan fund</u>	<u>Endowment</u>	<u>Total</u>
Current:					
Student accounts receivable	\$ 74,130	—	—	—	74,130
Related parties	—	94,220	—	—	94,220
Grants and contracts receivable	—	165,508	—	—	165,508
Other receivables	140,057	—	—	—	140,057
	<u>214,187</u>	<u>259,728</u>	<u>—</u>	<u>—</u>	<u>473,915</u>
Noncurrent:					
Student accounts receivable	—	—	30,715	—	30,715
Reed loans	—	—	1,081,353	—	1,081,353
Related parties	—	—	6,053	—	6,053
Federal Perkins loans	—	—	3,741,244	—	3,741,244
	<u>—</u>	<u>—</u>	<u>4,859,365</u>	<u>—</u>	<u>4,859,365</u>
Less allowance for doubtful accounts	<u>—</u>	<u>—</u>	<u>(60,239)</u>	<u>—</u>	<u>(60,239)</u>
	<u>\$ 214,187</u>	<u>259,728</u>	<u>4,799,126</u>	<u>—</u>	<u>5,273,041</u>

Accounts receivable consist of the following at June 30, 2008:

	<u>Unrestricted</u>	<u>Restricted</u>	<u>Loan fund</u>	<u>Endowment</u>	<u>Total</u>
Current:					
Student accounts receivable	\$ 102,745	—	—	—	102,745
Related parties	—	116,999	—	—	116,999
Grants and contracts receivable	—	1,993	—	—	1,993
Other receivables	142,277	—	—	—	142,277
	<u>245,022</u>	<u>118,992</u>	<u>—</u>	<u>—</u>	<u>364,014</u>
Noncurrent:					
Student accounts receivable	—	—	22,866	—	22,866
Reed loans	—	—	996,038	—	996,038
Related parties	—	—	2,236	—	2,236
Federal Perkins loans	—	—	3,760,756	—	3,760,756
	<u>—</u>	<u>—</u>	<u>4,781,896</u>	<u>—</u>	<u>4,781,896</u>
Less allowance for doubtful accounts	<u>—</u>	<u>—</u>	<u>(60,239)</u>	<u>—</u>	<u>(60,239)</u>
	<u>\$ 245,022</u>	<u>118,992</u>	<u>4,721,657</u>	<u>—</u>	<u>5,085,671</u>

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The Federal Perkins loans and Reed loans are generally payable at interest rates of 5% to 9% over approximately ten years. Repayment begins after a designated grace period following the student's college attendance. Principal payments, interest, and losses due to cancellation are shared by Reed College and the U.S. government in proportion to their share of funds provided. The Federal Perkins loan program provides for cancellation of loans if the student is employed in certain occupations following graduation (employment cancellations). Such employment cancellations are absorbed in full by the U.S. government.

(9) Net Assets

At June 30, 2009 and 2008, net assets consisted of the following:

	<u>2009</u>	<u>2008</u>
Unrestricted:		
Operating	\$ 8,560,419	7,368,710
Designated for special programs	17,091,744	15,395,977
Institutional loan programs	3,967,578	3,708,748
Funds functioning as endowment	89,981,723	88,772,976
Accumulated quasi-endowment gains	72,814,162	156,325,588
Net investment in plant	31,660,215	31,994,420
Total unrestricted	<u>\$ 224,075,841</u>	<u>303,566,419</u>
Temporarily restricted:		
Educational and general programs	\$ 93,244	84,771
Annuity and life income funds	16,472,473	22,426,403
Accumulated endowment gains	49,747,137	86,587,746
Other temporarily restricted net assets	2,029,657	2,057,660
Total temporarily restricted	<u>\$ 68,342,511</u>	<u>111,156,580</u>
Permanently restricted:		
True endowment funds	\$ 110,652,188	105,858,805
Annuity and life income funds	3,580,384	5,230,958
Total permanently restricted	<u>\$ 114,232,572</u>	<u>111,089,763</u>

(10) Endowments

Through December 31, 2007, Reed College's management and investment of donor-restricted endowment funds were subject to the provisions of the Uniform Management of Institutional Funds Act (UMIFA). In 2006, the Uniform Law Commission approved the model act, Uniform Prudent Management of Institutional Funds Act (UPMIFA) that serves as a guideline to states using the enacted legislation. Among UPMIFA's most significant changes is the elimination of UMIFA's concept of historic dollar value threshold, the amount below which an organization could not spend from the endowment fund, in favor of a more robust set of guidelines about what constitutes prudent spending. Effective January 1, 2008, the State of Oregon enacted UPMIFA, the provisions of which apply to endowment funds existing on or established after that date.

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In August 2008, the FASB issued FASB Staff Position (FSP) No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act and Enhanced Disclosures for all Endowment Funds* (FSP 117-1). FSP 117-1 is effective for fiscal years ending after December 15, 2008. The major change in net assets classification resulting from FSP 117-1 relates to the portion of the fund not stipulated by the donor to be restricted in perpetuity. In the absence of explicit donor instructions on the use of such funds, the earnings previously classified as either permanently restricted or unrestricted must be reported as temporarily restricted until appropriated for spending. Reed College reviewed its net asset accounts to identify the cumulative amount of unspent endowment earnings that had not yet been appropriated for expenditure as of July 1, 2007. As such, during fiscal year 2008, management recorded a reclassification of net assets from unrestricted to temporarily restricted of \$101,563,548.

The adoption of FSP 117-1 resulted in three reclassifications from unrestricted net assets to temporarily restricted net assets for a net change of \$74,865,181 compared to what was previously reported in the prior year statement of changes in net assets. During fiscal year 2008, after the State of Oregon's enactment of UPMIFA and prior to Reed College's adoption of FSP 117-1, management reclassified \$11,722,565 from unrestricted net assets to temporarily restricted net assets, which consisted of the cumulative unappropriated income on Reed College's endowment. During fiscal year 2009, upon the adoption of FSP 117-1, Reed College determined that the fiscal year 2008 reclassification of \$11,722,565 should have also included the accumulated unappropriated net appreciation on these endowments of \$89,840,983. The fiscal 2008 reclassification has been adjusted for this amount resulting in a total revised opening net asset reclassification from unrestricted net assets to temporarily restricted net assets of \$101,563,548. In addition, two other reclassifications were made in the 2008 financials upon the retrospective adoption of FSP 117-1 for the 2008 endowment activity. Reed College reclassified \$9,023,106 of endowment realized and unrealized net losses during fiscal year 2008 from unrestricted revenues to temporarily restricted revenues, and \$5,952,696 of endowment earnings were appropriated for expenditure and were therefore presented as additional amounts released from temporarily restricted net assets to unrestricted net assets as compared to the amounts previously reported.

Also in connection with the adoption of FSP 117-1, management performed a thorough review of all of its net assets during 2009. During this review, management determined that they had improperly reclassified \$6,151,320 from permanently restricted net assets to unrestricted net assets in the 2008 statement of activities and changes in net assets. As such, the accompanying 2008 financial statements include adjustments to decrease unrestricted net assets and increase permanently restricted net assets by \$6,151,320. The adjustment did not impact the statement of cash flows reported as of June 30, 2008. The effect of this correction was not material to the financial statements.

Reed College's endowment consists of approximately 355 individual funds of which approximately 30% or 107 funds are donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence of those donor restrictions. Endowment funds are invested on the basis of a total return policy to provide income and to realize appreciation on invested assets. Under this policy, a portion of realized and unrealized gains, in addition to interest and dividend income, can be used to support operations. Investment income used to support operations is allocated from funds that have a fair value in excess of historical value and are utilized in accordance with donor-imposed restrictions.

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Reed College spends endowment income and capital gains within a spending policy that preserves principal in accordance with the UPMIFA. The policy on spending endowment income is to spend 5.3% of the average net assets over a rolling 13 quarter period. If losses reduce the assets of a donor-restricted endowment fund below the donor-restricted corpus, temporarily restricted net assets will be reduced until the accumulated gains associated with a fund are reduced to zero. At that point, further losses reduce unrestricted net assets. The value of donor-restricted endowment funds with a fair value of associated assets that is less than the original gift amount is \$10,631,078 at June 30, 2009. Future gains that restore the corpus value will be recorded as increases in temporarily restricted net assets after replacing any losses charged to unrestricted net assets.

Endowment net assets by type of fund as of June 30, 2009:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (10,631,078)	49,747,137	110,652,188	149,768,247
Board-designated endowment funds	<u>173,426,963</u>	<u>—</u>	<u>—</u>	<u>173,426,963</u>
Total funds	<u>\$ 162,795,885</u>	<u>49,747,137</u>	<u>110,652,188</u>	<u>323,195,210</u>

Endowment net assets by type of fund as of June 30, 2008:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ —	86,587,746	105,858,805	192,446,551
Board-designated endowment funds	<u>245,098,564</u>	<u>—</u>	<u>—</u>	<u>245,098,564</u>
Total funds	<u>\$ 245,098,564</u>	<u>86,587,746</u>	<u>105,858,805</u>	<u>437,545,115</u>

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Changes in endowment net assets for the year ended June 30, 2009 and 2008 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, July 1, 2008	\$ 245,098,564	86,587,746	105,858,805	437,545,115
Investment return:				
Net investment loss	(868,719)	(2,465,961)	—	(3,334,680)
Net depreciation of investments	(68,140,390)	(26,963,483)	—	(95,103,873)
Contributions	—	—	4,419,742	4,419,742
Contributions from trust terminations	132,502	—	387,427	519,929
Appropriation of endowment assets for expenditure	(14,502,318)	(7,411,165)	—	(21,913,483)
Transfers to create board-designated endowment fund	1,175,236	—	—	1,175,236
Transfers and other reclassifications	(98,990)	—	(13,786)	(112,776)
Endowment net assets, June 30, 2009	<u>\$ 162,795,885</u>	<u>49,747,137</u>	<u>110,652,188</u>	<u>323,195,210</u>

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, July 1, 2007	\$ 370,667,132	—	90,203,264	460,870,396
Net asset reclassification based on change in law	(101,563,548)	101,563,548	—	—
Investment return:				
Net investment loss	(280,747)	(682,647)	—	(963,394)
Net depreciation of investments	(13,116,857)	(8,340,459)	—	(21,457,316)
Contributions	—	—	15,662,459	15,662,459
Contributions from trust terminations	413,300	—	—	413,300
Appropriation of endowment assets for expenditure	(13,861,211)	(5,952,696)	—	(19,813,907)
Transfers to create board-designated endowment funds	2,618,280	—	—	2,618,280
Transfers and other reclassifications	222,215	—	(6,918)	215,297
Endowment net assets, June 30, 2008	<u>\$ 245,098,564</u>	<u>86,587,746</u>	<u>105,858,805</u>	<u>437,545,115</u>

(11) Commitments and Contingencies

Reed College has placed certain of its medical and dental insurance coverage with the Pioneer Educators Health Trust (PEHT), formulated by seven similar western colleges and universities for the purpose of providing medical and dental insurance to higher education institutions. Under the agreement, member institutions are required to make contributions to the fund at such times and in an amount as determined by the Trustees' for the various benefit programs sufficient to provide the benefits, pay the administrative expenses of the Plan, which are not otherwise paid by Reed College directly, and to establish and maintain a minimum reserve as determined by the Trustee. In the event losses of PEHT exceed its capital and

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secondary coverage's, the maximum contingent liability exposure to Reed College is approximately \$170,914. This exposure fluctuates based on changes in actuarial assumptions, medical trend rates, and reinsurance amounts. The level of reinsurance is not expected to fluctuate significantly in the future.

On July 1, 1988, Reed College elected to place its liability insurance coverage with the College Liability Insurance Company, Ltd. (CLIC). CLIC was formed by seven similar western colleges and universities for the purpose of providing liability insurance to higher education institutions. As a portion of its capital, CLIC has placed a \$2,000,000 standby letter of credit of which Reed College is contingently liable for a pro rata portion based upon premium contributions from covered institutions. In the event the losses of CLIC exceed its capital and secondary coverages, the maximum contingent liability exposure to Reed College is approximately \$200,520. As of June 30, 2009 and 2008, there were no amounts outstanding against the standby letter of credit.

From time to time, Reed College is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, most of these claims and legal actions are covered by insurance and the ultimate disposition of these matters will not have a material effect on Reed College's financial position, statements of activities, or cash flow.

(12) Fair Value Measurements

(a) *Fair Value of Financial Instruments*

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, and accounts receivable: The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

Contributions receivable, funds held in trust by others and liability for split-interest agreements: The fair value is determined as the present value of future contractual cash flows discounted at an interest rate that reflects the risks inherent in those cash flows. The discount rates range from 1.37% to 4.71% and approximate rates currently offered by local lending institutions for loans of similar terms to companies with comparable credit risk.

Investments: Equity securities are measured using quoted market prices at the reporting date multiplied by the quantity held. Debt securities are measured using quoted market prices multiplied by the quantity held when quoted market prices are available. Investments in real estate for which fair value is not readily determinable are carried at estimated fair values, if purchased, or at fair value at the date of receipt, if acquired by donation. Alternative investments, which are not readily marketable, are carried at estimated fair values. Reed College reviews and evaluates the values provided by the investment managers and estimates the fair value of the alternative investments.

Interest rate swaps: The fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data. The value was determined after considering the potential impact of collateralization and netting agreements, adjusted to reflect nonperformance risk of both the counterparty and Reed College.

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Long-term debt: The fair value of the Reed College's long-term debt is measured using quoted offered-side prices when quoted market prices are available.

(b) Fair Value Hierarchy

Reed College adopted SFAS 157 on July 1, 2008 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Reed College has the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

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The following table presents assets and liabilities that are measured at fair value on a recurring basis at June 30, 2009:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	<u>Total</u>	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Assets:				
Cash and equivalents	\$ 9,302,757	9,302,757	—	—
Equity mutual funds	72,443,018	56,456,983	15,986,035	—
Government fixed	25,000	25,000	—	—
Corporate fixed	21,136,997	—	21,136,997	—
Hedge funds	148,560,450	—	11,947,940	136,612,510
Private equity	89,225,367	—	—	89,225,367
Real estate	5,544,745	—	—	5,544,745
Money market and other	10,252,873	10,252,873	—	—
Funds held in trust	11,096,955	—	—	11,096,955
	<u>\$ 367,588,162</u>	<u>76,037,613</u>	<u>49,070,972</u>	<u>242,479,577</u>
Liabilities:				
Interest rate swap	\$ <u>2,161,375</u>	<u>—</u>	<u>2,161,375</u>	<u>—</u>

The following table presents Reed College's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in SFAS 157 for the year ended June 30, 2009:

Balance at June 30, 2008	\$ 389,409,873
Total realized and unrealized losses	(99,094,805)
Purchases, issuances, and settlements (net)	<u>(47,835,491)</u>
Balance at June 30, 2009	\$ <u>242,479,577</u>
Total losses for 2009 included in income related to assets held at June 30, 2009	\$ <u>(72,285,982)</u>

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(13) Split-Interest Agreements

The following schedule summarizes the change in value and its presentation in the statements of activities as related to the change in value of split-interest agreements:

Dividends and interest	\$ 701,503
Beneficiary payments	(1,434,287)
Investment fees	(172,452)
Net realized gain	149,276
Net unrealized loss	<u>(6,866,475)</u>
Total change in value	\$ <u><u>(7,622,435)</u></u>

(14) Fund-Raising Expense

The college expended \$2,769,531 and \$2,573,084 for the years ended June 30, 2009 and 2008, respectively, for payroll and benefits, informational materials, travel, and special events relating to fund-raising activities. These costs are all classified as external affairs in the financial statements.

(15) Subsequent Events

Reed College evaluated subsequent events after the balance sheet date of June 30, 2009 through October 27, 2009, which was the date the financial statements were issued.