KPMG

# WAKE FOREST UNIVERSITY

OMB Circular A-133 Reports

Year ended June 30, 2007

EIN #1 – 56-053-2138-A1

**WAKE FOREST UNIVERSITY**

OMB Circular A-133 Reports

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**KPMG LLP**
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301 N. Elm Street
Greensboro, NC 27401

# Independent Auditors' Report

The Board of Trustees
Wake Forest University:

We have audited the accompanying consolidated statement of financial position of Wake Forest University as of June 30, 2007, 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 2006 consolidated financial statements and in our report dated October 31, 2006, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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, 2007, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 1, 2007 on our consideration of Wake Forest University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information included in the statements of financial position, activities and cash flows and the accompanying notes related to the College of Arts and Sciences of Law, Management, and Divinity, Wake Forest University Health Sciences, and the Reynolda House, Inc. (collectively the University) is presented for purposes of additional analysis of the financial statements rather than to present the financial position, changes in net assets and cash flows of the individual entities. Such supplementary information has been subjected to the auditing procedures applied in the audit of basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

The accompanying schedule of expenditures of federal and state awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States*, *Local Governments, and Non-Profit Organizations* and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

As discussed in note 1(s), Wake Forest University adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132 (R)*, during the year ended June 30, 2007.

KPMG LLP

October 1, 2007

**WAKE FOREST UNIVERSITY**

Consolidated Statement of Financial Position

June 30, 2007
(with summarized comparative financial information as of June 30, 2006)

(Dollars in thousands)

| | | Supplementary Information | | | | |
|---|---|---|---|---|---|---|
| **Assets** | | **Reynolda Campus** | **WFUHS** | **Reynolda House** | **2007** | **2006** |
| Cash and cash equivalents | $ | 12,754 | 13,603 | 994 | 27,351 | 37,895 |
| Accounts receivable, net | | 4,783 | 49,937 | 18 | 54,738 | 47,174 |
| Clinic receivables, net | | — | 51,030 | — | 51,030 | 45,049 |
| Grants receivable | | 2,144 | 4,686 | 132 | 6,962 | 8,759 |
| Contributions receivable, net | | 38,866 | 3,020 | 48 | 41,934 | 43,367 |
| Notes receivable, net | | 20,642 | 1,188 | — | 21,830 | 21,047 |
| Investments | | 682,833 | 693,756 | 46,907 | 1,423,496 | 1,171,418 |
| Investments in real estate | | 28,758 | 12,488 | — | 41,246 | 96,616 |
| Land, buildings, and equipment, less accumulated depreciation | | 226,291 | 301,971 | 23,430 | 551,692 | 540,383 |
| Other assets | | 14,395 | 14,056 | 119 | 28,570 | 18,457 |
| Total assets | $ | 1,031,466 | 1,145,735 | 71,648 | 2,248,849 | 2,030,165 |
| **Liabilities and Net Assets** | | | | | | |
| Liabilities: | | | | | | |
| Accounts payable and accruals | $ | 16,115 | 78,255 | 1,394 | 95,764 | 87,501 |
| Other liabilities and deferrals | | 35,049 | 121,286 | 16 | 156,351 | 106,128 |
| Annuities payable | | 24,080 | 6,499 | — | 30,579 | 27,824 |
| Notes payable | | 8,200 | 35,618 | — | 43,818 | 84,956 |
| Bonds payable | | 71,965 | 190,100 | — | 262,065 | 269,120 |
| Postretirement benefits | | 8,839 | 19,915 | — | 28,754 | 10,895 |
| Government grants refundable | | 10,604 | 514 | — | 11,118 | 11,310 |
| Total liabilities | | 174,852 | 452,187 | 1,410 | 628,449 | 597,734 |
| Net assets: | | | | | | |
| Unrestricted undesignated | | 290,601 | 404,578 | 59,404 | 754,583 | 643,110 |
| Net investment in plant | | 146,126 | 88,741 | — | 234,867 | 256,213 |
| Total unrestricted | | 436,727 | 493,319 | 59,404 | 989,450 | 899,323 |
| Temporarily restricted | | 234,317 | 83,576 | 2,480 | 320,373 | 256,365 |
| Permanently restricted | | 185,570 | 116,653 | 8,354 | 310,577 | 276,743 |
| Total net assets | | 856,614 | 693,548 | 70,238 | 1,620,400 | 1,432,431 |
| Total liabilities and net assets | $ | 1,031,466 | 1,145,735 | 71,648 | 2,248,849 | 2,030,165 |

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**

Consolidated Statement of Activities

Year ended June 30, 2007
(with summarized comparative financial information for the year ended June 30, 2006)

(Dollars in thousands)

| | 2007 | | | | |
|---|---|---|---|---|---|
| | **Unrestricted** | **Temporarily restricted** | **Permanently restricted** | **Total** | **2006 Total** |
| Revenues, gains, and other support: | | | | | |
| Educational and general: | | | | | |
| Student tuition and fees | $ 195,086 | — | — | 195,086 | 182,757 |
| Scholarship allowance | (52,689) | — | — | (52,689) | (53,802) |
| Net student tuition and fees | 142,397 | — | — | 142,397 | 128,955 |
| Federal grants and contracts | 143,848 | — | — | 143,848 | 141,211 |
| State grants and contracts | 15,508 | — | — | 15,508 | 14,318 |
| Private gifts, grants, and contracts | 31,863 | 21,644 | 24,674 | 78,181 | 83,438 |
| Dividends, interest, and rents | 16,420 | 6,947 | 529 | 23,896 | 22,493 |
| Interest on short-term investments and other income | 6,544 | 141 | 326 | 7,011 | 6,602 |
| Net realized and unrealized appreciation on investments | 111,653 | 69,896 | 11,514 | 193,063 | 124,028 |
| Organized activities relating to educational departments | 3,317 | 409 | 68 | 3,794 | 4,266 |
| Clinic services | 361,763 | — | — | 361,763 | 329,791 |
| Other sources | 98,178 | (27) | — | 98,151 | 79,042 |
| Total educational and general | 931,491 | 99,010 | 37,111 | 1,067,612 | 934,144 |
| Sales and services of auxiliary enterprises | 82,090 | 6,668 | 1,011 | 89,769 | 82,019 |
| Total revenues and gains | 1,013,581 | 105,678 | 38,122 | 1,157,381 | 1,016,163 |
| Net assets released from restrictions | 40,622 | (40,622) | — | — | — |
| Total revenues, gains, and other support | 1,054,203 | 65,056 | 38,122 | 1,157,381 | 1,016,163 |
| Expenses and losses: | | | | | |
| Educational and general: | | | | | |
| Instruction, departmental research, and clinical | 565,180 | — | — | 565,180 | 522,546 |
| Sponsored research, training, and other programs | 160,176 | — | — | 160,176 | 154,278 |
| Organized activities | 2,093 | — | — | 2,093 | 2,154 |
| Academic support | 18,484 | — | — | 18,484 | 20,496 |
| Libraries | 15,823 | — | — | 15,823 | 14,993 |
| Student services | 16,995 | — | — | 16,995 | 15,794 |
| Institutional support | 100,355 | — | — | 100,355 | 87,961 |
| Total educational and general | 879,106 | — | — | 879,106 | 818,222 |
| Auxiliary enterprises | 68,740 | — | — | 68,740 | 60,881 |
| Actuarial loss on annuity obligations | — | 181 | 6,476 | 6,657 | 1,265 |
| Unrealized gain on interest rate swap | (4,367) | — | — | (4,367) | (10,030) |
| Other | 2,709 | 867 | (2,188) | 1,388 | 1,052 |
| Total expenses and losses | 946,188 | 1,048 | 4,288 | 951,524 | 871,390 |
| Cumulative effect of changes in accounting principle | (17,888) | — | — | (17,888) | (10,036) |
| Increase in net assets | 90,127 | 64,008 | 33,834 | 187,969 | 134,737 |
| Net assets at beginning of year | 899,323 | 256,365 | 276,743 | 1,432,431 | 1,297,694 |
| Net assets at end of year | $ 989,450 | 320,373 | 310,577 | 1,620,400 | 1,432,431 |

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**

Statement of Activities

College of Arts and Sciences, Schools of Law, Management, and Divinity
(Supplementary Information)

Year ended June 30, 2007

(Dollars in thousands)

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|
| Revenues, gains, and other support: | | | | |
| Educational and general: | | | | |
| Student tuition and fees | $ 169,196 | — | — | 169,196 |
| Scholarship allowance | (43,412) | — | — | (43,412) |
| Net student tuition and fees | 125,784 | — | — | 125,784 |
| Federal grants and contracts | 7,242 | — | — | 7,242 |
| State grants and contracts | 1,310 | — | — | 1,310 |
| Private gifts, grants, and contracts | 12,722 | 4,487 | 13,965 | 31,174 |
| Dividends, interest, and rents | 5,775 | 5,436 | 440 | 11,651 |
| Interest on short-term investments and other income | 3,992 | 14 | 181 | 4,187 |
| Net realized and unrealized appreciation on investments | 39,218 | 48,691 | 6,106 | 94,015 |
| Organized activities relating to educational departments | 3,317 | 409 | 68 | 3,794 |
| Clinic services | — | — | — | — |
| Other sources | 3,018 | (27) | — | 2,991 |
| Total educational and general | 202,378 | 59,010 | 20,760 | 282,148 |
| Sales and services of auxiliary enterprises | 81,190 | 6,668 | 1,011 | 88,869 |
| Total revenues and gains | 283,568 | 65,678 | 21,771 | 371,017 |
| Net assets released from restrictions | 17,888 | (17,888) | — | — |
| Total revenues, gains, and other support | 301,456 | 47,790 | 21,771 | 371,017 |
| Expenses and losses: | | | | |
| Educational and general: | | | | |
| Instruction, departmental research, and clinical | 107,649 | — | — | 107,649 |
| Sponsored research, training, and other programs | — | — | — | — |
| Organized activities | 2,093 | — | — | 2,093 |
| Academic support | 6,644 | — | — | 6,644 |
| Libraries | 11,071 | — | — | 11,071 |
| Student services | 15,197 | — | — | 15,197 |
| Institutional support | 43,054 | — | — | 43,054 |
| Total educational and general | 185,708 | — | — | 185,708 |
| Auxiliary enterprises | 67,861 | — | — | 67,861 |
| Actuarial loss on annuity obligations | — | 181 | 4,571 | 4,752 |
| Unrealized gain on interest rate swap | (1,877) | — | — | (1,877) |
| Other | 2,844 | 867 | (2,188) | 1,523 |
| Total expenses and losses | 254,536 | 1,048 | 2,383 | 257,967 |
| Cumulative effect of changes in accounting principle | 661 | — | — | 661 |
| Increase in net assets | 47,581 | 46,742 | 19,388 | 113,711 |
| Net assets at beginning of year | 389,146 | 187,575 | 166,182 | 742,903 |
| Net assets at end of year | $ 436,727 | 234,317 | 185,570 | 856,614 |

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**

Statement of Activities

Wake Forest University Health Sciences
(Supplementary Information)

Year ended June 30, 2007

(Dollars in thousands)

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|
| Revenues, gains, and other support: | | | | |
| Educational and general: | | | | |
| Student tuition and fees | $ 25,890 | — | — | 25,890 |
| Scholarship allowance | (9,277) | — | — | (9,277) |
| Net student tuition and fees | 16,613 | — | — | 16,613 |
| Federal grants and contracts | 136,606 | — | — | 136,606 |
| State grants and contracts | 14,198 | — | — | 14,198 |
| Private gifts, grants, and contracts | 18,325 | 16,806 | 4,687 | 39,818 |
| Dividends, interest, and rents | 9,873 | 1,394 | 89 | 11,356 |
| Interest on short-term investments and other income | 2,522 | 125 | 145 | 2,792 |
| Net realized and unrealized appreciation on investments | 66,582 | 19,991 | 5,406 | 91,979 |
| Clinic services | 361,763 | — | — | 361,763 |
| Other sources | 94,849 | — | — | 94,849 |
| Total educational and general | 721,331 | 38,316 | 10,327 | 769,974 |
| Sales and services of auxiliary enterprises | 900 | — | — | 900 |
| Total revenues and gains | 722,231 | 38,316 | 10,327 | 770,874 |
| Net assets released from restrictions | 22,400 | (22,400) | — | — |
| Total revenues, gains, and other support | 744,631 | 15,916 | 10,327 | 770,874 |
| Expenses and losses: | | | | |
| Educational and general: | | | | |
| Instruction, departmental research, and clinical | 457,531 | — | — | 457,531 |
| Sponsored research, training, and other programs | 160,176 | — | — | 160,176 |
| Organized activities | — | — | — | — |
| Academic support | 7,943 | — | — | 7,943 |
| Libraries | 4,752 | — | — | 4,752 |
| Student services | 1,798 | — | — | 1,798 |
| Institutional support | 57,301 | — | — | 57,301 |
| Total educational and general | 689,501 | — | — | 689,501 |
| Auxiliary enterprises | 879 | — | — | 879 |
| Actuarial loss on annuity obligations | — | — | 1,905 | 1,905 |
| Unrealized gain on interest rate swap | (2,490) | — | — | (2,490) |
| Other | 1,461 | — | — | 1,461 |
| Total expenses and losses | 689,351 | — | 1,905 | 691,256 |
| Cumulative effect of change in accounting principle | (18,549) | — | — | (18,549) |
| Increase in net assets | 36,731 | 15,916 | 8,422 | 61,069 |
| Net assets at beginning of year | 456,588 | 67,660 | 108,231 | 632,479 |
| Net assets at end of year | $ 493,319 | 83,576 | 116,653 | 693,548 |

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**

Statement of Activities

Reynolda House, Inc.
(Supplementary Information)

Year ended June 30, 2007

(Dollars in thousands)

| | | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|---|
| Revenues, gains, and other support: | | | | | |
| Educational and general: | | | | | |
| Student tuition and fees | $ | — | — | — | — |
| Scholarship allowance | | — | — | — | — |
| Net student tuition and fees | | — | — | — | — |
| Federal grants and contracts | | — | — | — | — |
| State grants and contracts | | — | — | — | — |
| Private gifts, grants, and contracts | | 816 | 351 | 6,022 | 7,189 |
| Dividends, interest, and rents | | 772 | 117 | — | 889 |
| Interest on short-term investments and other income | | 30 | 2 | — | 32 |
| Net realized and unrealized appreciation on investments | | 5,853 | 1,214 | 2 | 7,069 |
| Organized activities relating to educational departments | | — | — | — | — |
| Clinic services | | — | — | — | — |
| Other sources | | 311 | — | — | 311 |
| Total educational and general | | 7,782 | 1,684 | 6,024 | 15,490 |
| Sales and services of auxiliary enterprises | | — | — | — | — |
| Total revenues and gains | | 7,782 | 1,684 | 6,024 | 15,490 |
| Net assets released from restrictions | | 334 | (334) | — | — |
| Total revenues, gains, and other support | | 8,116 | 1,350 | 6,024 | 15,490 |
| Expenses and losses: | | | | | |
| Educational and general: | | | | | |
| Instruction, departmental research, and clinical | | — | — | — | — |
| Sponsored research, training, and other programs | | — | — | — | — |
| Organized activities | | — | — | — | — |
| Academic support | | 3,897 | — | — | 3,897 |
| Libraries | | — | — | — | — |
| Student services | | — | — | — | — |
| Institutional support | | — | — | — | — |
| Total educational and general | | 3,897 | — | — | 3,897 |
| Auxiliary enterprises | | — | — | — | — |
| Actuarial loss on annuity obligations | | — | — | — | — |
| Unrealized gain on interest rate swap | | — | — | — | — |
| Other | | (1,596) | — | — | (1,596) |
| Total expenses and losses | | 2,301 | — | — | 2,301 |
| Cumulative effect of changes in accounting principle | | — | — | — | — |
| Increase in net assets | | 5,815 | 1,350 | 6,024 | 13,189 |
| Net assets at beginning of year | | 53,589 | 1,130 | 2,330 | 57,049 |
| Net assets at end of year | $ | 59,404 | 2,480 | 8,354 | 70,238 |

See accompanying notes to consolidated financial statements.

**WAKE FOREST UNIVERSITY**

Consolidated Statement of Cash Flows

Year ended June 30, 2007
(with summarized comparative financial information for the year ended June 30, 2006)

(Dollars in thousands)

| | Supplementary information | | | | |
|---|---|---|---|---|---|
| | Reynolda Campus | WFUHS | Reynolda House | 2007 | 2006 |
| Cash flows from operating activities: | | | | | |
| Increase in net assets | $ 113,711 | 61,069 | 13,189 | 187,969 | 134,737 |
| Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities: | | | | | |
| Depreciation and amortization | 19,591 | 27,049 | 646 | 47,286 | 46,871 |
| Net realized and unrealized appreciation on investments | (94,015) | (91,466) | (7,069) | (192,550) | (124,028) |
| Noncash gifts of property | (3,631) | — | (196) | (3,827) | (14,017) |
| Private gifts restricted for long-term investment | (13,965) | (4,687) | (6,022) | (24,674) | (12,620) |
| Other revenue restricted for long-term investment | (1,700) | (234) | (2) | (1,936) | (1,732) |
| (Gain) loss on disposal of property and equipment | (1,205) | 1,654 | 82 | 531 | 1,804 |
| Unrealized gain on interest rate swap | (1,877) | (2,490) | — | (4,367) | (10,030) |
| Bad debt expense | — | 26,413 | — | 26,413 | 27,600 |
| Cumulative effect of changes in accounting principles | (661) | 18,549 | — | 17,888 | 10,036 |
| Changes in assets and liabilities: | | | | | |
| Accounts and clinic receivables | (293) | (39,658) | (8) | (39,959) | (24,682) |
| Grants receivable | (567) | 2,383 | (19) | 1,797 | 3,320 |
| Contributions receivable | (921) | 2,318 | 36 | 1,433 | 4,897 |
| Notes receivable | (180) | (195) | — | (375) | (219) |
| Other assets and other liabilities and deferrals | (1,739) | 14,749 | 30 | 13,040 | 15,413 |
| Accounts payable and accruals | 4,838 | 4,377 | (952) | 8,263 | 2,945 |
| Postretirement benefits | 893 | (922) | — | (29) | 2,167 |
| Annuities payable | 1,424 | 1,331 | — | 2,755 | 1,518 |
| Net cash provided by (used in) operating activities | 19,703 | 20,240 | (285) | 39,658 | 63,980 |
| Cash flows from investing activities: | | | | | |
| Purchases of land, buildings, and equipment | (17,722) | (46,187) | (53) | (63,962) | (24,637) |
| Proceeds from sale of equipment | 3,065 | 99,727 | — | 102,792 | 1,178 |
| Purchases of investments in real estate | (7,322) | — | — | (7,322) | (56,675) |
| Disbursements of loans to students, faculty, and staff | (3,541) | (83) | — | (3,624) | (4,149) |
| Repayments of loans from students, faculty, and staff | 2,991 | 225 | — | 3,216 | 4,210 |
| Purchases of investments | (411,753) | (46,101) | (26,949) | (484,803) | (477,428) |
| Net proceeds from sales and maturities of investments | 386,623 | 14,268 | 21,684 | 422,575 | 463,498 |
| Net cash provided by (used in) investing activities | (47,659) | 21,849 | (5,318) | (31,128) | (94,003) |
| Cash flows from financing activities: | | | | | |
| Change in government grants refundable | (51) | (140) | — | (191) | (319) |
| Payments on notes payable | (697) | (76,936) | — | (77,633) | (1,587) |
| Proceeds from notes payable | 2,429 | 34,066 | — | 36,495 | 39,656 |
| Payments on bonds payable | (4,005) | (3,050) | — | (7,055) | (6,625) |
| Proceeds from private gifts restricted for long-term investment | 13,965 | 4,687 | 6,022 | 24,674 | 12,620 |
| Net realized gains restricted for long-term investment | 1,159 | 1,541 | — | 2,700 | 1,908 |
| Other revenue restricted for long-term investment | 1,700 | 234 | 2 | 1,936 | 1,732 |
| Net cash provided by (used in) financing activities | 14,500 | (39,598) | 6,024 | (19,074) | 47,385 |
| Net increase (decrease) in cash and cash equivalents | (13,456) | 2,491 | 421 | (10,544) | 17,362 |
| Cash and cash equivalents at beginning of year | 26,210 | 11,112 | 573 | 37,895 | 20,533 |
| Cash and cash equivalents at end of year | $ 12,754 | 13,603 | 994 | 27,351 | 37,895 |
| Supplemental disclosure of cash flow information: | | | | | |
| Cash paid for interest | $ 2,931 | 8,573 | — | 11,504 | 12,529 |

See accompanying notes to consolidated financial statements.

## (1) 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, Management, and Divinity (the Reynolda Campus), Wake Forest University Health Sciences (WFUHS), and the Reynolda House, Inc. (Reynolda House), 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. The consolidated financial statements have, in all material respects, been prepared on the accrual basis in conformity with the U.S. generally accepted accounting principles.

### *(b) Basis of Presentation*

Net assets and revenues, expenses, 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 may or 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 of, or part of, the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets 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. Contributions, including unconditional promises to give, are recognized as revenues in the period received. 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 are discounted to their present value at a risk–free investment rate, generally the 10-year Treasury bill rate for the Reynolda Campus (5.00 % at June 30, 2007) and the 3-year Treasury bill rate for WFUHS (4.98% at June 30, 2007). 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, based on such factors as prior collection history, type of contribution, and nature of fund–raising activity.

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 or the University's interpretation of relevant state law require that they be added to the principal of a permanent endowment fund;
- as increases in temporarily restricted net assets if the terms of the gifts impose restrictions on their use;
- as increases in unrestricted net assets in all other cases.

The University considers the following items to be nonoperating items: net unrealized and realized appreciation on investments, investment return less than amounts designated for current operations, actuarial loss on annuity obligations, unrealized gain (loss) on interest rate swap and postretirement related changes other than net periodic postretirement costs.

### *(c) Endowment Accounting*

Permanent endowment funds are subject to the restrictions of gift instruments, which require that the principal be invested in perpetuity. While quasi–endowment funds have been established by the Board of Trustees for the same purpose as permanent endowment funds, any portion of the quasi–endowment funds may be expended at the discretion of the Board of Trustees and, accordingly, such funds are reported as unrestricted net assets. Realized and unrealized gains of the permanent endowment funds are classified as temporarily restricted net assets if the income distributed from these funds is restricted and as unrestricted net assets if the income distributed from these funds is unrestricted.

The University has implemented a spending policy designed to stabilize annual spending levels and preserve the real value of the endowment over time. In accordance with the University's policy, a predetermined endowment spending rate consistent with the University's total return objective has been established and approved by the Board of Trustees. Should endowment yields prove to be insufficient to support this policy, the balance is provided from capital gains. Should endowment yields exceed the amounts necessary to maintain this objective, the balance is reinvested in the endowment. The endowment spending rate for the years ended June 30, 2007 and 2006 was 5.3%, calculated as a percentage of the average of the previous three-year semiannual moving market value per unit (see note 3).

### *(d) Temporarily Restricted Accounting*

Revenues, which have donor stipulations that limit their use, are recorded as temporarily restricted net assets and released from restriction when the purpose restriction is met or stipulated time restriction expires.

***(e) Cash Equivalents***

For purposes of reporting cash flows, the University considers interest-bearing deposits in financial institutions with remaining maturities at date of purchase of three months or less to be cash equivalents. Cash equivalents consist primarily of temporary investments in bank repurchase agreements and money market accounts.

***(f) Financial Instruments***

The carrying amounts of cash and cash equivalents; accounts, grants, and clinic receivables; and accounts payable approximate fair value because of the short maturity of these financial instruments.

The carrying value of investments in debt securities and equity securities is based upon fair value. In the limited cases where such values are not available, estimates of fair value are used.

The carrying amounts of contributions receivable and annuities payable represent the present value of estimated future cash flows, which approximates fair value.

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 notes and bonds payable with variable interest rates approximate their fair value because substantially all of these financial instruments bear interest at variable rates, which approximate current market rates for loans with similar maturities and credit quality.

***(g) Split-Interest Agreements***

The University's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts for which the University serves as trustee. Assets held in these trusts are included in investments or investments in real estate. Contribution revenues are recognized at the dates the trusts are established. Annuity and other split-interest obligations are adjusted annually at the end of each fiscal year.

***(h) Investments***

Investments are generally recorded at fair value, which are based on quoted market prices. In the case of certain less marketable investments, principally private equity investments, value is established based on certain external events that substantiate a change in value or a reasonable methodology that exists to capture and quantify changes in value. Where the University's ownership is considered to be more than minor, the equity method of accounting is used. The University receives income from perpetual trusts but will never gain control of the trusts. These trusts are recorded at fair value with carrying values adjusted annually for changes in fair value.

***(i) Investments in Real Estate***

Investments in real estate are valued at the lower of cost or market as they are considered to be operating assets of the University. Accordingly, if there is a decline in market value that is other than temporary, 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.

Under Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* the University records long-lived assets for which management and the Board of Trustees have committed to a plan to sell the asset. At June 30, 2007, $12,488 is included in investments in real estate, which is available for immediate sale in its present condition subject only to the terms that are usual and customary for sales of such assets. The University intends to complete the sale within one year with remaining actions unlikely to significantly change the plan to sell. At June 30, 2007, $28,758 is included in investments in real estate that is primarily related to real estate held for lease.

In accordance with SFAS No. 144, the assets are not depreciated while classified as held–for–sale.

***(j) 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 on the straight-line basis over the estimated useful life of each class or component of depreciable asset. Estimated lives range from 3 to 60 years. Gains or losses on the disposal of land, buildings, and equipment are included in the consolidated statement of activities.

***(k) Works of Art and Historical Treasures***

Works of art and historical treasures include the original Reynolda House and its contents, as well as paintings and other items subsequently acquired. The Reynolda House has capitalized all such items since its inception. If purchased, they are capitalized at cost, and if donated, they are capitalized at their appraised or estimated fair value. The Reynolda House's paintings are cataloged for educational, research, scientific, and curatorial purposes, and activities verifying their existence and assessing their condition are performed on an ongoing basis. The works of art and historical treasures are included with buildings and other improvements and equipment and furnishings and are not depreciated (see note 5).

***(l) Clinic Services Revenue***

WFUHS records clinic services revenue net of contractual adjustments and discount allowances. 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 per discharge, reimbursed costs, discounted charges and per diem payments. Clinic services 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. The clinic receivables are recorded net of allowances for contractual adjustments and uncollectible accounts of $45,464 and $33,986, respectively, at June 30, 2007.

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 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.

***(m) Bond Issuance Costs***

Costs related to the registration and issuance of bonds are carried at cost less accumulated amortization, are being amortized over the life of the bonds on a method that approximates the effective–interest method, and are included in other assets in the consolidated statement of financial position.

***(n) Functional Expenses***

Expenses are reported in the consolidated statement of activities in functional categories recommended by the National Association of College and University Business Officers. The expenses are reported in these functional categories after the allocation for depreciation of plant assets, accretion expense, interest expense, and plant operation and maintenance expense. The University’s primary program services are instruction, clinical, 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. The University’s fund–raising expenses are immaterial and are included in institutional support.

Depreciation of plant assets, accretion expense, interest expense, and plant operation and maintenance expense is allocated to program and supporting activities based on periodic inventories of facilities.

***(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 government and are reported as liabilities.

***(p) Sponsored Grants and Contracts***

Revenue under grants and contracts with sponsoring organizations are recognized as expenses as incurred for agreement purposes. The revenues include recoveries of indirect costs and fringe benefits, which are generally determined as a negotiated or agreed-upon percentage of direct costs with certain exclusions.

***(q) Derivative Instruments***

Under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and *SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities–an Amendment of SFAS 133*, the University records all derivative instruments on the consolidated statement of financial position at their respective fair values. All changes in fair value are reflected in the consolidated statement of activities.

***(r) Allocated Net Assets***

WFUHS's unrestricted undesignated net asset balance is internally allocated for individual departmental research and development and for use in the clinical practices.

***(s) Pension and Other Postretirement Plans***

The University sponsors defined benefit postretirement medical and dental plans that cover all full-time employees who elect coverage and satisfy the plan's eligibility requirements.

The University records annual amounts relating to its pension and 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 in accumulated other nonoperating income beginning in 2007 and amortized to net periodic 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 costs are recognized as employees render the services necessary to earn the postretirement benefits.

Effective June 30, 2007, the University adopted the recognition and disclosure provisions of FASB Statement No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans– an amendment of FASB Statements No. 87, 88, 106 and 132 (R)* (Statement 158). Statement 158 requires entities to recognize the funded status of defined benefit pension and other postretirement plans as a net asset or liability and to recognize changes in that funded status in the year in which the changes occur through other nonoperating income to the extent those changes are not included in the net period cost. The funded status reported on the consolidated balance sheet as of June 30, 2007 under Statement 158 was measured as the difference between the fair value of plan assets and the benefit obligation on a plan-by-plan basis. The adoption of

(Dollars in thousands)

Statement 158 did not impact the University's compliance with debt covenants or its cash position. The incremental effect of applying Statement 158 on the University' financial position as of June 30, 2007 was as follows:

| | | Before application of Statement 158 | Adjustments | After application of Statement 158 |
|---|---|---|---|---|
| WFUHS: | | | | |
| Accrued benefit cost | $ | (1,366) | — | (1,366) |
| Accumulated other nonoperating expense | | — | (18,549) | (18,549) |
| Liability accrued for postretirement benefits | | (1,366) | (18,549) | (19,915) |
| WFU: | | | | |
| Accrued benefit cost | | (9,500) | — | (9,500) |
| Accumulated other nonoperating income | | — | 661 | 661 |
| Asset/(liability) accrued for postretirement benefits | | (9,500) | 661 | (8,839) |
| Total | $ | (10,866) | (17,888) | (28,754) |

***(t) Use of Estimates***

The University prepares its consolidated financial statements in accordance with U.S. generally accepted accounting principles that require 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 investments in real estate, valuation allowances for receivables, environmental liabilities, assets, and obligations related to employee benefits. Actual results could differ from those estimates.

***(u) Reclassifications***

In certain instances, amounts previously reported in the 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation. Such reclassifications have no effect on the increase in net assets as previously reported.

(Dollars in thousands)

### *(v) Comparative Financial Information*

The financial statements include certain prior year information for comparative purposes, which does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles.

Accordingly, such information should be read in conjunction with the University's consolidated financial statements for the year ended June 30, 2006 from which this information was derived.

## (2) Contributions Receivable

The following is an analysis of the maturities of the University's contributions receivable at June 30, 2007:

| | | Reynolda Campus | WFUHS | Reynolda House | Total |
|---|---|---|---|---|---|
| One year or less | $ | 5,948 | 940 | 40 | 6,928 |
| Between one and five years | | 32,872 | 1,880 | 11 | 34,763 |
| More than five years | | 12,295 | 1,199 | — | 13,494 |
| Gross contributions receivable | | 51,115 | 4,019 | 51 | 55,185 |
| Less estimated uncollectible amounts | | 6,460 | 229 | 2 | 6,691 |
| Less discount to present value | | 5,789 | 770 | 1 | 6,560 |
| Contributions receivable, net | $ | 38,866 | 3,020 | 48 | 41,934 |

## (3) Investments

Investments at June 30, 2007 consist of the following:

| | | |
|---|---|---|
| Short-term investments | $ | 209,124 |
| Real assets | | 105,200 |
| Real estate | | 44,580 |
| Fixed income securities | | 126,456 |
| Beneficial interests in perpetual trusts | | 27,932 |
| Public equity | | 649,611 |
| Private equity | | 75,241 |
| Hedge strategies | | 182,860 |
| Other investments | | 2,492 |
| Total investments | $ | 1,423,496 |

The University places a substantial portion of assets into a 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, 2007, a total of 17,927,616 units existed in the pool with a fair value of $61.13 per unit.

(Dollars in thousands)

Net realized and unrealized appreciation on investments is decreased by $5,011 in investment fees.

## (4) Investments in Real Estate

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:

| | Reynolda Campus | WFUHS | Total |
|---|---|---|---|
| Year ending June 30: | | | |
| 2008 | $ 8,413 | 2,900 | 11,313 |
| 2009 | 8,846 | 2,750 | 11,596 |
| 2010 | 9,706 | 2,677 | 12,383 |
| 2011 | 9,833 | 2,635 | 12,468 |
| 2012 | 9,964 | 2,547 | 12,511 |
| | $ 46,762 | 13,509 | 60,271 |

Total income from rental real estate was $8,257 for the Reynolda Campus and $2,565 for WFUHS for the year ended June 30, 2007.

## (5) Land, Buildings, and Equipment

Land, buildings, and equipment are summarized as follows at June 30, 2007:

| | Reynolda Campus | WFUHS | Reynolda House | Total |
|---|---|---|---|---|
| Land | $ 6,120 | 42,696 | 1,122 | 49,938 |
| Buildings and other improvements | 346,546 | 366,473 | 14,926 | 727,945 |
| Equipment and furnishings | 147,475 | 118,589 | 10,889 | 276,953 |
| Construction in progress | 11,223 | 21,553 | 9 | 32,785 |
| | 511,364 | 549,311 | 26,946 | 1,087,621 |
| Less accumulated depreciation | (285,073) | (247,340) | (3,516) | (535,929) |
| | $ 226,291 | 301,971 | 23,430 | 551,692 |

Total depreciation expense on buildings and equipment was $46,489 for the year ended June 30, 2007.



(Continued)

(Dollars in thousands)

## (6) 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. The following table represents that activity for the AROs for the year ended June 30, 2007.

| | | Reynolda Campus | WFUHS | Total |
|---|---|---|---|---|
| Balance at beginning of year | $ | 10,296 | 3,241 | 13,537 |
| Additional obligations | | 120 | — | 120 |
| Obligations settled in current period | | (525) | — | (525) |
| Accretion expense | | 657 | 203 | 860 |
| Change in estimates | | — | (417) | (417) |
| Balance at end of year | $ | 10,548 | 3,027 | 13,575 |

In March 2005, FASB issued Interpretation No. 47 (FIN), *Accounting for Conditional Asset Retirement Obligations*, which is an interpretation of Statement of Financial Accounting Standards No. 143 (SFAS 143), *Accounting for Asset Retirement Obligations*. FIN 47 clarifies terminology within SFAS 143 and requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN 47 was effective for the University for fiscal year ended June 30, 2006.

For fiscal year ended June 30, 2007, the Reynolda Campus recorded site improvements of $2,548, related accumulated depreciation of $962, an asset retirement obligation (included in other liabilities and deferrals) of $10,296, and a cumulative effect of change in accounting principle of $8,666. WFUHS recorded site improvements of $3,330, related accumulated depreciation of $1,651, an asset retirement obligation (included in other liabilities and deferrals) of $3,241, and a cumulative effect of change in accounting principle of $1,370, totaling $10,036 for the University.

## (7) Assets Held for Sale

WFUHS entered into a sale-leaseback agreement to sell and lease back certain assets reported in June 30, 2006 as investments in real estate. 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 2008 to 2012 are $7,010, $7,080, $7,151, $7,223, and $7,295, respectively. The transaction resulted in net cash proceeds of $99,777 and a deferred gain of $38,925, which is being amortized as a reduction to rent expense on a straight-line basis over the initial lease term of 20 years.

(Dollars in thousands)

## (8) Notes and Bonds Payable

Notes and bonds payable at June 30, 2007 consist of the following:

| | | Reynolda Campus | WFUHS | Total |
|---|---|---|---|---|
| Variable rate loan (6.07% at June 30, 2007) with principal of $77 and interest payable monthly and final balloon payment due December 31, 2011 | $ | — | 13,800 | 13,800 |
| Fixed rate loan (4.19% at June 30, 2007) with $480 of principal and interest payable semiannually through 2014 | | 5,771 | — | 5,771 |
| Variable rate construction loan agreement (5.57% at June 30, 2007) with interest payable quarterly and final principal and interest balloon payment due March 31, 2009 | | 2,429 | — | 2,429 |
| Fixed rate loan (6.38%) with interest payable monthly through January 31, 2009. Principal payments of $60 with interest begin February 1, 2009, with final payment due January 1, 2017 | | — | 14,500 | 14,500 |
| Fixed rate equipment loan agreement (6.05%) with principal of $261 and interest payable monthly with final payment due September 15, 2013 | | — | 6,518 | 6,518 |
| Noninterest–bearing promissory note due September 2012 | | — | 800 | 800 |
| Notes payable | $ | 8,200 | 35,618 | 43,818 |
| Series 1997 taxable bonds payable | $ | 5,200 | — | 5,200 |
| Series 2002 tax-exempt bonds payable | | — | 190,100 | 190,100 |
| Series 2004A tax-exempt bonds payable | | 36,605 | — | 36,605 |
| Series 2004B tax-exempt bonds payable | | 30,160 | — | 30,160 |
| Bonds payable | $ | 71,965 | 190,100 | 262,065 |

The University entered into a construction loan financing agreement in fiscal year 2007 with a commercial bank that permits the University to borrow up to $40,000, bearing interest at LIBOR plus .25% (5.57 % at June 30, 2007). Accrued interest is payable monthly. Upon completion of the construction, permanent financing will be obtained to repay the existing construction loan. The amount outstanding at June 30, 2007 is $2,429.

WFUHS received a grant from the City of Winston-Salem (the City) for $800 in 2003, the purpose of which was to fund the development of the Green Park Courtyard (the Park). As part of this grant, WFUHS executed a noninterest–bearing promissory note to the City in the amount of $800 and a deed of trust subjecting the Park to the lien of the promissory note. The grant states that in the event that an additional $17,400 in taxable property value is created within the Park within ten years, then the promissory note shall be marked satisfied in full and canceled of record. At such time that this condition is fulfilled, the note will be recorded as a contribution in the consolidated statement of activities.

The University has outstanding $5,200 of Wake Forest University taxable variable demand rate bonds Series 1997 (the Series 1997 taxable bonds) pursuant to a trust agreement with a commercial bank. The Series 1997 taxable bonds mature annually from 2010 through 2015 in varying amounts of $800 to $900. The variable interest rate is determined weekly and at the option of the University may be converted to an alternative variable option or to a fixed rate. (A letter of credit has been issued by a commercial bank for $5,313, which expires on September 5, 2007). The University's obligation under the loan agreement is unsecured and unconditional. The interest rate on the bonds at June 30, 2007 was 5.32%.

WFUHS has outstanding $190,100 Wake Forest University Healthcare Facilities Revenue Bonds, Series 2002 issued by the North Carolina Medical Care Commission in the original principal amount of $198,800 and are made up of Subseries A and Subseries B, each in the amount of $99,400. The obligations of WFUHS are evidenced by a promissory note issued under a Master Trust Indenture, dated August 1, 2002, by and between WFUHS and First Citizens Bank and Trust Company, as master trustee. These security agreements in the Series 2002 offering requires WFUHS, as a member of the obligated group, pledged, assigns, and grants to the master trustee a security interest in its pledged assets. Pledged assets are defined as all accounts and all accounts are defined as assets for which WFUHS has right to payment for goods or services sold or leased. The Series 2002 tax-exempt bonds mature in full in 2034. At the option of WFUHS, the bonds may be converted to various interest rates or to a fixed rate. Subject to certain provisions regarding serialization, the Series 2002 bonds are subject to mandatory redemption through 2034 in increasing annual amounts of $3,250 to $12,950. The interest rates on the bonds at June 30, 2007 were variable at 3.80% and 3.75% for the Subseries A and variable at 3.74% and 3.75% for Subseries B (see note 15).

The University has outstanding $66,765 of tax-exempt North Carolina Facilities Finance Agency Revenue Bonds, Series 2004. The bonds are made up of Subseries A in the amount of $36,605, and Subseries B, in the amount of $30,160. The obligations of the University are evidenced by a Loan Agreement dated December 1, 2004, by and between the University and First Citizens Bank and Trust Company, as trustee. The Series 2004 tax-exempt bonds are due annually through 2020 in varying amounts from $315 to $7,340. 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 interest rates on the bonds at June 30, 2007 were variable at 3.67% for the Subseries A and at 3.72% for the Subseries B.

(Dollars in thousands)

Trust indentures underlying the Series 1997 taxable bonds, Series 2002 and Series 2004 tax-exempt bonds contain certain covenants and restrictions. At June 30, 2007, management believes the University is in compliance with such requirements.

Aggregate annual maturities of notes and bonds payable for each of the five fiscal years subsequent to June 30, 2007 and thereafter are as follows:

| | Reynolda Campus | WFUHS | Total |
|---|---|---|---|
| 2008 | $ 1,041 | 5,213 | 6,254 |
| 2009 | 5,495 | 5,665 | 11,160 |
| 2010 | 6,008 | 6,288 | 12,296 |
| 2011 | 6,192 | 6,488 | 12,680 |
| 2012 | 6,481 | 15,888 | 22,369 |
| Thereafter | 54,948 | 186,176 | 241,124 |
| | $ 80,165 | 225,718 | 305,883 |

Total interest costs incurred on indebtedness were $11,479 for the year ended June 30, 2007.

## (9) Postretirement Benefits

The University sponsors defined benefit postretirement medical and dental plans that cover all its full-time employees who elect coverage and satisfy the plans' eligibility requirements when they retire. To be eligible, retired employees of the 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 employee's age and years of service must equal or exceed 75 at retirement with a minimum age of 55. Employees of the Reynolda House 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(s), effective June 30, 2007, the University adopted the recognition and disclosure provisions of Statement 158. Statement 158 requires an entity to recognize the funded status of defined benefit pension and other postretirement plans as a net asset or liability on its balance sheet. Actuarial gains and losses are generally amortized subject to the corridor, over the average remaining service life of the University's active employees.

In May 2004, the Financial Accounting Standards (FASB) issued FASB Staff Position No. 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (the Act). The Act introduces a prescription drug benefit under Medicare (Medicare Part D). The Act also provides that a nontaxable federal subsidy will be paid to sponsors of the postretirement benefit plans that provide retirees with a drug benefit that is at least "actuarially equivalent" to the Medicare Part D benefit. The University is not entitled to and does not intend to apply for the federal subsidies. The University deems the drug coverage provided by the plans superior to Medicare Part D and, as such, there is no impact on the accumulated postretirement benefit obligation.

(Dollars in thousands)

The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at June 30, 2007:

| | | Reynolda Campus | WFUHS | Total |
|---|---|---|---|---|
| Benefit obligations at June 30 | $ | (8,839) | (47,774) | (56,613) |
| Fair value of plan assets at June 30 | | — | 27,859 | 27,859 |
| Funded status at year-end | $ | (8,839) | (19,915) | (28,754) |

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 year ended June 30, 2007:

| | | Reynolda Campus | WFUHS | Total |
|---|---|---|---|---|
| Change in benefit obligation: | | | | |
| Benefit obligation at beginning of year | $ | 8,481 | 34,291 | 42,772 |
| Service cost | | 532 | 1,708 | 2,240 |
| Interest cost | | 519 | 2,106 | 2,625 |
| Participants' contributions | | — | 676 | 676 |
| Actuarial (gain) loss | | (449) | 10,877 | 10,428 |
| Benefits paid | | (244) | (1,884) | (2,128) |
| Benefit obligation at end of year | | 8,839 | 47,774 | 56,613 |
| Change in plan assets: | | | | |
| Fair value of plan assets at beginning of year | | — | 20,694 | 20,694 |
| Actual return on plan assets | | — | 4,877 | 4,877 |
| Employer contributions | | 244 | 3,496 | 3,740 |
| Participants' contributions | | — | 676 | 676 |
| Benefits paid | | (244) | (1,884) | (2,128) |
| Fair value of plan assets at end of year | | — | 27,859 | 27,859 |
| Funded status | $ | (8,839) | (19,915) | (28,754) |
| Amounts recognized in net assets: | | | | |
| Prior cost | $ | (362) | (1,787) | (2,149) |
| Net actuarial gain (loss) | | 1,023 | (16,762) | (15,739) |
| Total increase (decrease) | $ | 661 | (18,549) | (17,888) |

(Dollars in thousands)

The following table provides the components of net periodic benefit cost for the year ended June 30, 2007:

| | | Reynolda Campus | WFUHS | Total |
|---|---|---|---|---|
| Service cost | $ | 532 | 1,708 | 2,240 |
| Interest cost | | 519 | 2,106 | 2,625 |
| Expected return on plan assets | | — | (2,017) | (2,017) |
| Amortization of unrecognized amounts | | 87 | 367 | 454 |
| Recognized net actuarial loss | | — | 409 | 409 |
| Net periodic benefit cost | $ | 1,138 | 2,573 | 3,711 |

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 net loss and prior service credit for the defined postretirement benefits plans that will be amortized from accumulated nonoperating income into net periodic benefit cost over the next fiscal year for the Reynolda Campus and WFUHS is $76 and $1,223, respectively.

The weighted average discount rate used to determine the accumulated postretirement benefit obligation was 6.25% at June 30, 2007 and 2006. The discount rate is determined based on analysis of various high quality fixed income indices, such as the Moody's AA Corporate Bond rate. For management purposes, a 10.5% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for the first year, and a 4.5% rate was assumed as the ultimate rate. The expected healthcare costs trend for the post-65 assumed an annual rate of 3.5%. The expected return assumed on plan assets for WFUHS is 9%. 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 are invested in commingled mutual funds that preclude the ability to analyze the precise composition of the investments, thus no asset detail is presented.

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:

| | | 1% increase | 1% decrease |
|---|---|---|---|
| Effect on total service and interest cost components of net periodic benefit cost | $ | 286 | (248) |
| Effect on postretirement benefit obligation | | 1,779 | (1,564) |



(Continued)

(Dollars in thousands)

Aggregate benefits expected to be paid by the University in each of the next ten fiscal years subsequent to June 30, 2007 are as follows:

| | Reynolda Campus | WFUHS | Total |
|---|---|---|---|
| 2008 | $ 347 | 1,352 | 1,699 |
| 2009 | 421 | 1,562 | 1,983 |
| 2010 | 487 | 1,791 | 2,278 |
| 2011 | 533 | 1,984 | 2,517 |
| 2012 | 596 | 2,272 | 2,868 |
| Five years thereafter | 4,134 | 16,716 | 20,850 |
| | $ 6,518 | 25,677 | 32,195 |

The expected benefits to be paid are based on the same assumptions used to measure the University's benefit obligation at June 30, 2007 and include estimated future employee service.

**(10) Net Assets**

Temporarily restricted net assets are available for the following purposes at June 30, 2007:

| | Reynolda Campus | WFUHS | Reynolda House | Total |
|---|---|---|---|---|
| Instruction, research, scholarships and operations | $ 24,479 | 23,067 | — | 47,546 |
| Term endowment funds | 205,994 | 60,509 | 2,480 | 268,983 |
| Interests in other trusts | 3,844 | — | — | 3,844 |
| | $ 234,317 | 83,576 | 2,480 | 320,373 |

During 2007, net assets of $40,622 were released from donor restrictions by incurring expenses satisfying the restricted purposes or by the passage of time.

Permanently restricted net assets consist of the following at June 30, 2007:

| | Reynolda Campus | WFUHS | Reynolda House | Total |
|---|---|---|---|---|
| Student loan funds | $ 8,210 | 4,209 | — | 12,419 |
| Permanent endowment funds | 173,853 | 84,442 | 8,354 | 266,649 |
| Interests in perpetual and other trusts | 3,507 | 28,002 | — | 31,509 |
| | $ 185,570 | 116,653 | 8,354 | 310,577 |

The income from these investments in perpetuity is expendable for research, instruction, scholarships, and operations.

## (11) Benefit 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. Total contributions for the year ended June 30, 2007 were $7,213, $18,654, and $124 for the Reynolda Campus, WFUHS, and Reynolda House, respectively.

WFUHS has accrued $1,927 at June 30, 2007 for a liability associated with a defined benefit supplemental executive retirement plan. This liability is included in other liabilities and deferrals in the consolidated statements of financial position.

## (12) Related–Party Transactions

WFUHS and the North Carolina Baptist Hospital, Inc. and subsidiaries (the Hospital) participate in various expansion projects, share certain facilities and provide various services, and incur certain expenses on behalf of each other. The costs associated with operating and maintaining jointly occupied facilities are ultimately paid by the party having beneficial occupancy.

During the year ended June 30, 2007, $54,391 was received from the Hospital for reimbursement of services provided or expenses incurred by WFUHS on behalf of the Hospital. Such services or expenses include physician salaries, facility expenses, library expenses, printing services, laboratory services and materials. Accounts receivable at June 30, 2007 include $98 due from the Hospital for such items. During the year ended June 30, 2007, $47,643 was paid to the Hospital for reimbursement of services provided or expenses incurred by the Hospital on behalf of WFUHS. Such services or expenses include laboratory fees collected by the Wake Forest University Physicians business office, computer services, telephone service, insurance premiums, and certain utilities. Accounts payable and accruals at June 30, 2007 include $353 due to the Hospital for such items.

The Medical Center Corporation (the Center), a North Carolina nonprofit corporation formed to act on behalf of WFUHS and the Hospital 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 the Hospital have negotiated a land and facilities sharing agreement whereby WFUHS and the Hospital independently hold title to certain land and facilities, as designated by the agreement.

## (13) Contingencies and Other Commitments

The estimated cost to complete construction in progress at June 30, 2007 is $40,337 and $5,607 for the Reynolda Campus and WFUHS, respectively.

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, 2007, such grant awards amounted to $3,496 and $175,580 for the 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 position.

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 position.

## (14) Professional Liability Insurance

WFUHS maintains professional liability coverage on a combined basis with the North Carolina Baptist Hospital, Inc. (see note 12), which included a $4,000 per occurrence and a $16,000 annual aggregate for the year ended June 30, 2007. WFUHS estimates its professional liability on a discounted actuarial basis. The discount rate at June 30, 2007 was 5.5%. Accrued professional liability costs, including estimated claims incurred but not reported, amounted to approximately $30,540 at June 30, 2007, and are included in other liabilities and deferrals in the accompanying consolidated statements of financial position. In the opinion of management, adequate provision has been made for the related risk.

## (15) Derivative Instruments and Other Financial Instruments

The University has only limited involvement with derivative financial instruments and does not use them for trading purposes.

In the normal course of its business, WFUHS entered into a long-term interest rate swap agreement having a notional amount of $86,060, which effectively fixed the interest rate on the Series 2002B variable rate bond issue at 3.67% through July 1, 2034. WFUHS receives 67% of LIBOR (London InterBank Offered Rate) and makes payments at 3.67% and settles with the counterparty on a monthly basis. LIBOR is the interest rate index used as a basis for repricing the Series 2002B variable rate bonds, however, the rate may vary from LIBOR in any rate period. WFUHS selected the combination of a variable rate bond issue and long-term interest rate swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The net settlement amount incurred on the swap is included in interest expense. The fair value of the interest rate swap is the estimated amount WFUHS would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

In the normal course of its business, WFUHS entered into a long-term interest rate swap agreement in 2007 having a notional amount of $104,040, which effectively fixed the interest rate on the remaining unhedged portion of the Series 2002 variable rate bond issue at 3.52% through July 1, 2034. WFUHS receives 67% of LIBOR (London InterBank Offered Rate) and makes payments at 3.52% and settles with the counterparty on a monthly basis. LIBOR is the interest rate index used as a basis for repricing the remaining unhedged Series 2002 variable rate bonds, however, the rate may vary from LIBOR in any rate period. WFUHS elected the long-term swap agreement to effectively lock-in the lowest available cost at the time of the transaction, and reduce cash flow volatility associated with rising interest rates. The net settlement amount incurred on the swap is included in interest expense. The fair value of the interest rate swap is the estimated amount WFUHS would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

At June 30, 2007, the fair value of the interest rate swaps for WFUHS was an asset of $4,029 and is included in other assets in the consolidated statements of financial position. The change in fair value of the interest rates swaps for the year ended June 30, 2007 was a gain of $2,490 and is excluded from the education and general expenses on the consolidated statement of activities.

In November 2004, the Reynolda Campus executed a floating-to-fixed rate swap with two banks on two separate, identical swap agreements, effective December 21, 2004 to effectively fix the variable cost of the Series 2004B bonds. The Reynolda Campus receives 68% of the one-month LIBOR index and makes payments at a fixed rate of 3.02%, settling with both counterparties on a monthly basis. The swap's original notional amount of $30,160, split evenly between the two counterparties, amortizes to coincide with the amortization of the Series 2004B bonds and expires on January 1, 2018. At June 30, 2007, the swap had a fair value of $1,120, which is included in other assets in the consolidated statements of financial position. The change in fair value of the interest rate swaps for the year ended June 30, 2007 was a loss of $288 and is excluded from the education and general expenses of the consolidated statements of activities.

In November 2006, the Reynolda Campus executed a floating-to-fixed rate swap with a bank, effective November 6, 2006 to effectively fix the variable cost of the Series 2004A bonds. The Reynolda Campus receives 67% of the one-month LIBOR index and makes payments at a fixed rate of 3.38%, settling monthly. The swap had an original notional amount of $36,605 and amortizes to coincide with the amortization of the Series 2004A bonds. The swap expires January 1, 2020. At June 30, 2007, the swap had a fair value of $770, which is included in other assets in the consolidated statements of financial position. The change in fair value of the interest rate swaps for the year ended June 30, 2007 was a gain of $770 and is excluded from the education and general expenses of the consolidated statements of activities.

In April 2007, the University executed a forward-starting floating-to-fixed rate swap agreement to protect against the risk of interest rate changes, based on a notional amount of $50,000, effective October 1, 2008 and maturing January 1, 2038. Under the terms of the agreement, the University will receive 67% of the one-month LIBOR index and will make payments at a fixed rate of 3.61%, settling monthly. Since the effective date of the swap is in the future, the University does not exchange any payments with the counterparty until the effective date, but the agreement carries with it a market fair value based on swap market conditions. The University anticipates that changes in the cost of issuing traditional fixed-rate debt will be offset by the change in the fair value of the swap, and additionally, that interest on variable rate bonds will correlate highly with 67% of the one-month LIBOR index, such that the University has the option to (1) issue variable rate bonds in October 2008, thereby effectively creating synthetic fixed-rate debt, or (2) unwind the swap, capturing the value of the movement of interest rates from the swap issuance date through an upfront payment or receipt, and issuing traditional fixed rate bonds. At June 30, 2007, the swap had a fair value of $1,395, which is included in the consolidated statements of financial position and is recorded as a gain that was excluded from the education and general expenses on the consolidated statements of activities.

Although the University anticipates that the interest rate payments made on its variable rate debt will correlate highly with the percent of LIBOR swaps in place, the University is exposed to basis risk since the tax-exempt variable rate may vary from the percent of LIBOR swap rate in any rate period. 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 percent of LIBOR payments being received from the counterparties.

The University is exposed to credit loss in the event of nonperformance by the counterparty to its long-term interest rate swaps.

## (16) 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.

**WAKE FOREST UNIVERSITY**

Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2007

| Federal and state grantors/pass-through grantors/agencies, or cluster title | Federal CFDA Number | Expenditures |
|---|---|---|
| Federal Award Expenditures: | | |
| Research and Development Cluster: | | |
| Wake Forest University Health Sciences: | | |
| Department of Health and Human Services: | | |
| National Institutes of Health | 93.RD | $ 113,664,661 |
| Agency for Healthcare Research and Quality | 93.RD | 168,070 |
| Center for Disease Control & Prevention | 93.RD | 1,771,047 |
| Health Resources and Services Administration | 93.RD | 705,055 |
| Office of The Secretary | 93.RD | 22,410 |
| DHHS Pass-through programs from: | | |
| Albert Einstein College of Medicine | 93.RD | 478,359 |
| Association of Teachers of Preventive Medicine | 93.RD | 128,980 |
| Baylor College of Medicine | 93.RD | 135,392 |
| Booz Allen Hamilton | 93.RD | 109,426 |
| Brown University | 93.RD | 18,773 |
| Cancer & Leukemia Group B Foundation | 93.RD | 181,315 |
| Case Western Reserve University | 93.RD | 132,625 |
| Cedars-Sinai Medical Center | 93.RD | 248,061 |
| Children’s Hospital, Boston | 93.RD | 213,809 |
| Children’s Hospital, Cincinnati | 93.RD | 116,333 |
| Children's Oncology Group | 93.RD | 98,453 |
| Columbia University | 93.RD | 36,886 |
| Constella Health Sciences | 93.RD | 43 |
| Duke University Clinical Research Institute | 93.RD | 67,207 |
| Duke University | 93.RD | 1,192,956 |
| EMMES Corporation | 93.RD | 67 |
| Fred Hutchinson Cancer Research Center | 93.RD | 7,706 |
| Gentest Corporation | 93.RD | 112 |
| George Washington University | 93.RD | 86,117 |
| Georgetown University | 93.RD | 39,589 |
| Gynecologic Oncology Group | 93.RD | 112,444 |
| Harvard University | 93.RD | 360,532 |
| Intermountain Healthcare | 93.RD | 8,661 |
| Ixion Biotechnology, Inc. | 93.RD | 11,405 |
| Jackson State University | 93.RD | 59,790 |
| Jaeb Center for Health Research | 93.RD | 41,068 |
| Jivan Biologics, Inc, | 93.RD | 1,822 |
| John Wayne Cancer Institute | 93.RD | 1,416 |
| Johns Hopkins University | 93.RD | 345,651 |
| Joslin Diabetes Center | 93.RD | (35) |
| Louisiana State University | 93.RD | (1,201) |
| Massachusetts General Hospital | 93.RD | 5,425 |
| Mayo Clinic | 93.RD | 289,091 |
| Millar Instruments, Inc. | 93.RD | 7,066 |
| NanoSonic | 93.RD | (2,241) |
| National Jewish Medical and Research Center | 93.RD | 47,036 |
| National Marrow Donor Program | 93.RD | 46,163 |
| North Carolina Central University | 93.RD | 26,116 |
| Northwestern University | 93.RD | 3,901 |
| Oregon Health Sciences University | 93.RD | 83,799 |
| Pacific Health Research Institute | 93.RD | (5) |
| Pennsylvania State University | 93.RD | 102,190 |
| Plureon Corporation | 93.RD | 660,301 |
| Renal Research Institute | 93.RD | 21,489 |
| Southwest Oncology Group | 93.RD | 343 |
| State University of New York | 93.RD | 92,161 |
| Stovall Life Sciences, Inc. | 93.RD | 19,420 |
| Strang Cancer Research Center | 93.RD | 57 |
| Susan G. Koman Breast Cancer Foundation | 93.RD | 1,526 |
| Temple University School of Medicine | 93.RD | 5,300 |
| Thomas Jefferson University | 93.RD | 62,152 |
| Transonic Systems, Inc. | 93.RD | 2,569 |



(Continued)

**WAKE FOREST UNIVERSITY**

Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2007

| Federal and state grantors/pass-through grantors/agencies, or cluster title | Federal CFDA Number | | Expenditures |
|---|---|---|---|
| Tufts University | 93.RD | $ | 7,185 |
| Tulane University | 93.RD | | (11,782) |
| University of Alabama | 93.RD | | 99,187 |
| University of Arkansas | 93.RD | | (1,289) |
| University of California at Irvine | 93.RD | | 22,604 |
| University of California at Los Angeles | 93.RD | | 12,109 |
| University of California at San Diego | 93.RD | | 265,313 |
| University of California at San Francisco | 93.RD | | 151,238 |
| University of Chicago | 93.RD | | 47,041 |
| University of Colorado | 93.RD | | 284,487 |
| University of Florida | 93.RD | | 705,716 |
| University of Hawaii | 93.RD | | 36,320 |
| University of Iowa | 93.RD | | 25,423 |
| University of Maryland | 93.RD | | 151,359 |
| University of Medicine and Dentistry of New Jersey | 93.RD | | 4,736 |
| University of Miami | 93.RD | | 44,419 |
| University of Michigan | 93.RD | | 15,105 |
| University of Minnesota | 93.RD | | 211,242 |
| University of Mississippi | 93.RD | | 22,929 |
| University of North Carolina at Chapel Hill | 93.RD | | 971,071 |
| University of Pennsylvania | 93.RD | | 165,544 |
| University of Pittsburgh | 93.RD | | 1,366,364 |
| University of Rochester | 93.RD | | 32,341 |
| University of South Carolina | 93.RD | | 49,702 |
| University of Texas - SA | 93.RD | | 39,514 |
| University of Utah | 93.RD | | 14,549 |
| University of Vermont | 93.RD | | 1,121 |
| University of Virginia | 93.RD | | 2,740,491 |
| University of Washington | 93.RD | | 599,461 |
| University of Wisconsin-Madison | 93.RD | | 4,240 |
| Vanderbilt University | 93.RD | | 237,135 |
| Virginia Polytechnic Institute and State University | 93.RD | | 22,757 |
| Washington University, St. Louis | 93.RD | | 3,883 |
| Winston-Salem State University | 93.RD | | 72,182 |
| Wright State University | 93.RD | | 28,334 |
| Total Department of Health and Human Services | | | 130,480,895 |
| Department of Defense: | | | |
| Defense Advance Research Project | 12.RD | | 1,705,610 |
| Office of Naval Research | 12.RD | | 91,153 |
| U.S. Army | 12.RD | | 1,351,552 |
| Total Department of Defense | | | 3,148,315 |
| Department of Justice: | | | |
| Department of Justice | 16.RD | | 145,927 |
| National Institute of Justice | 16.RD | | 32,524 |
| Office of Juvenile Justice and Delinquency Prevention | 16.RD | | 1,049,911 |
| Total Department of Justice | | | 1,228,362 |
| Department of Agriculture | 10.RD | | 190,980 |
| Department of Energy | 81.RD | | 482,010 |
| Department of State | 19.RD | | 8,853 |
| Department of Transportation | 20.RD | | 27,677 |
| Department of Veterans Affairs | 64.RD | | 49,678 |
| Environmental Protection Agency | 66.RD | | 117,706 |
| National Aeronautics and Space Administration | 43.RD | | 90,080 |
| National Science Foundation | 47.RD | | 147,650 |
| Subtotal – Wake Forest University Health Sciences | | | 135,972,206 |



(Continued)

**WAKE FOREST UNIVERSITY**

Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2007

| Federal and state grantors/pass-through grantors/agencies, or cluster title | Federal CFDA Number | Expenditures |
|---|---|---|
| College of Arts and Sciences, Schools of Law, Management, and Divinity: | | |
| Department of Health and Human Services: | | |
| National Institutes of Health | 93.RD | $ 3,294,895 |
| Total Department of Health and Human Services | | 3,294,895 |
| Department of Defense: | | |
| U.S. Army | 12.RD | 253,653 |
| U.S. Air Force | 12.RD | 531,000 |
| Total Department of Defense | | 784,653 |
| National Science Foundation | 47.RD | 1,242,843 |
| Department of Agriculture | 10.RD | 24,876 |
| Department of State | 19.RD | 210,441 |
| Subtotal – College of Arts and Sciences, Schools of Law, Management, and Divinity | | 5,557,708 |
| Total Research and Development Cluster | | 141,529,914 |
| Student Financial Aid Cluster: | | |
| Wake Forest University Health Sciences: | | |
| Department of Education: | | |
| Federal Family Education Loan Program | 84.032 | 16,646,725 |
| Subtotal – Wake Forest University Health Sciences | | 16,646,725 |
| College of Arts and Sciences, Schools of Law, Management, and Divinity: | | |
| Department of Education: | | |
| Federal Supplemental Educational Opportunity Grant | 84.007 | 278,409 |
| Federal Family Education Loan Program | 84.032 | 35,041,197 |
| Federal Work Study Program | 84.033 | 1,312,538 |
| Academic Competitiveness Grants and National Science and Mathematics Access to Retain Talent Grants | 84.376 | 89,650 |
| Jacob K. Javits Fellowships Program | 84.170 | 28,809 |
| Federal Perkins Loan Program | 84.038 | 3,544,007 |
| Federal Pell Grant Program | 84.063 | 718,088 |
| Subtotal – College of Arts and Sciences, Schools of Law, Management, and Divinity | | 41,012,698 |
| Total Student Financial Aid Cluster | | 57,659,423 |
| Other Programs: | | |
| College of Arts and Sciences, Schools of Law, Management, and Divinity: | | |
| Department of Commerce | 11.550 | 5,940 |
| National Endowment for the Humanities | 45.000 | 4,275 |
| Institute of Museum and Library Sciences | 45.301 | 53,214 |
| Subtotal – Colleges of Arts and Sciences, Schools of Law, Management, and Divinity | | 63,429 |
| Wake Forest University Health Sciences: | | |
| Department of Education | 84.116 | 75,546 |
| Department of Education | 84.902 | 22,784 |
| Total Other Programs | | 161,759 |
| Total Federal Award Expenditures | | 199,351,096 |



(Continued)

**WAKE FOREST UNIVERSITY**

Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2007

| Federal and state grantors/pass-through grantors/agencies, or cluster title | Federal CFDA Number | Expenditures |
|---|---|---|
| State Award Expenditures: | | |
| Wake Forest University Health Sciences: | | |
| NC Department of Health and Human Services | | $ 5,996,129 |
| NC Department of Agriculture | | 15,574 |
| North Carolina Aid to Medical Education | | 1,328,000 |
| Board of Governors | | 742,100 |
| State of NC Pass-through funds from: | | |
| University of North Carolina at Chapel Hill | | 5,622,012 |
| North Carolina Biotechnology Center | | 269,980 |
| NC Health & Wellness Trust Fund | | 217,037 |
| Other | | 31,942 |
| Subtotal – Wake Forest University Health Sciences | | 14,222,774 |
| College of Arts and Sciences, Schools of Law, Management, and Divinity: | | |
| North Carolina Legislative Tuition Grant | | 1,856,300 |
| North Carolina State Contractual Scholarship Fund | | 1,285,625 |
| North Carolina Student Incentive Grant | | 4,900 |
| Other | | 24,000 |
| Subtotal – College of Arts and Sciences, Schools of Law, Management, Divinity | | 3,170,825 |
| Total State Award Expenditures | | 17,393,599 |
| Total Federal and State Award Expenditures | | $ 216,744,695 |

See accompanying notes to schedule of expenditures of federal and state awards.

## (1) Basis of Presentation

The accompanying schedule of expenditures of federal and state awards includes all grants, contracts, and similar agreements entered into directly between Wake Forest University (the University) and agencies and departments of the federal and state governments and all subawards to the University by nonfederal organizations pursuant to federal and state grants, contracts and similar agreements and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

## (2) Summary of Significant Accounting Policies for Federal and State Award Expenditures

Expenditures for certain federal student financial aid programs are recognized as incurred and include the federal share of students' Federal Supplemental Educational Opportunity Grant program grants and Federal Work Study program earnings, certain other federal financial assistance grants for students and administrative cost allowances, where applicable. Federal Pell grant awards are recognized as agency transactions and are not recorded as expenditures in the financial statements.

Expenditures for other federal awards of the University's academic and other divisions are determined using the cost accounting principles and procedures set forth in OMB Circular A-21, *Cost Principles for Educational Institutions*. Under these cost principles, certain expenditures are not allowable or are limited as to reimbursement.

Expenditures for non-financial aid awards include indirect costs, related primarily to facilities operation and maintenance and general, divisional and departmental administrative services, which are allocated to direct cost objectives (including federal awards) based on negotiated formulas commonly referred to as facilities and administrative cost rates. Facilities and administrative costs allocated to such awards for the year ended June 30, 2007 were based on Predetermined rates negotiated with the University's cognizant federal agency, the Department of Health and Human Services.

## (3) Summary of Facilities and Administrative Costs and Administrative Cost Allowances - Governmental Sources

Facilities and administrative cost recoveries and administrative cost allowances for the University's academic and other divisions for the year ended June 30, 2007 are summarized as follows:

| | |
|---|---|
| Federal | |
| Research and development | $ 32,231,698 |
| Student financial aid | 256,046 |
| Other | 35,127 |
| State | 52,621 |
| | $ 32,575,492 |

## (4) Federal Student Financial Aid Loan Programs

The Federal Perkins, Health Professions Student Loan (HPSL) and the Primary Care Loan (PCL) Programs are administered directly by the University and balances and transactions relating to these programs are included in the University's financial statements. The balances of loans outstanding under the Federal Perkins, HPSL, and PCL programs were $17,016,269, $46,179, and $280,386, respectively, as of June 30, 2007.

The University is responsible only for the performance of certain administrative duties with respect to the Federal Family Education Loan Programs and, accordingly, these loans are not included in its financial statements. It is not practicable to determine the balance of loans outstanding to students and former students of the University under these programs as of June 30, 2007.

## (5) Subrecipients

Of the federal expenditures presented in the schedule, the University provided federal awards to subrecipients as follows:

| Federal amount granting agency | | provided to subrecipients |
|---|---|---|
| National Institutes of Health | $ | 19,072,671 |
| Agency for Healthcare Research & Quality | | 157,902 |
| Center for Disease Control & Prevention | | 394,889 |
| Department of Defense | | 416,031 |
| Department of Justice | | 594,596 |
| Department of Transportation | | 4,971 |
| Department of Education | | 37,500 |
| | $ | 20,678,560 |

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**Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
Wake Forest University:

We have audited the consolidated financial statements of Wake Forest University as of and for the year ended June 30, 2007, and have issued our report thereon dated October 1, 2007. As discussed in note 1(s), Wake Forest University adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132 (R)*, during the year ended June 30, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Wake Forest University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Wake Forest University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Wake Forest University's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the University's financial statements that is more than inconsequential will not be prevented or detected by the University's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the University's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.


(Continued)

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Wake Forest University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Wake Forest University in a separate letter dated October 1, 2007.

This report is intended solely for the information and use of the audit committee of the board of trustees, management and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 1, 2007

KPMG

**KPMG LLP**
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# Report on Compliance with Requirements Applicable to the Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
Wake Forest University:

## Compliance

We have audited the compliance of Wake Forest University with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2007. Wake Forest University's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Wake Forest University's management. Our responsibility is to express an opinion on Wake Forest University's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Wake Forest University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Wake Forest University's compliance with those requirements.

In our opinion, Wake Forest University complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2007.

## Internal Control Over Compliance

The management of Wake Forest University is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Wake Forest University's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over compliance.



(Continued)

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the University's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the University's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the University's internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the audit committee of the board of trustees, management and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 5, 2007

**WAKE FOREST UNIVERSITY**

Schedule of Findings and Questioned Costs

Year ended June 30, 2007

**(1) Summary of Auditors' Results**

(a) The type of report issued on the financial statements: **Unqualified opinion**

(b) Reportable conditions in internal control were disclosed by the audit of the financial statements: **No**
Material weaknesses: **None**

(c) Noncompliance which is material to the financial statements: **None**

(d) Reportable conditions in internal control over major programs: **None reported**
Material weaknesses: **None**

(e) The type of report issued on compliance for major programs: **Unqualified opinion**

(f) Any audit findings which are required to be reported under Section 0.510(a) of OMB Circular A-133: **No**

(g) Major program: **Research and development**

(h) Dollar threshold used to distinguish between Type A and Type B programs: **$3,000,000**

(i) Auditee qualified as a low-risk auditee under Section 0.530 of OMB Circular A-133: **Yes**

**(2) Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*: None**

**(3) Finding and Questioned Costs Relating to Federal Awards: None**