



Report of Independent Auditors and
Consolidated Financial Statements

**The Corporation of
Gonzaga University**

May 31, 2012 and 2011

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

President and Board of Trustees
The Corporation of Gonzaga University

We have audited the accompanying consolidated statements of financial position of The Corporation of Gonzaga University (a Washington nonprofit corporation) (University) as of May 31, 2012 and 2011, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University as of May 31, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

REPORT OF INDEPENDENT AUDITORS
(continued)

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information on page 38 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management and is derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounts and the other records used to prepare the financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

Moss Adams LLP

Spokane, Washington
August 31, 2012

THE CORPORATION OF GONZAGA UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

ASSETS

	(in thousands)	
	May 31,	
	2012	2011
Cash and cash equivalents	\$ 59,160	\$ 43,096
Accounts and interest receivable, net	11,022	10,845
Inventories and prepaid expenses	4,631	6,034
Contributions receivable, net	10,567	12,555
Notes receivable, net	15,344	15,437
Deposits with bond trustees	13,391	14,068
Investments	149,861	153,836
Property, plant, and equipment, net	218,114	220,873
	<u>\$ 482,090</u>	<u>\$ 476,744</u>

LIABILITIES AND NET ASSETS

LIABILITIES

Accounts and other payables	\$ 12,096	\$ 11,037
Accrued salaries, taxes, and benefits	14,912	11,667
Deferred revenues	12,784	15,388
Annuity and life income obligations	3,337	3,339
Federal student loan program	11,074	11,099
Obligation under interest rate swaps	7,820	3,317
Notes and bonds payable	132,101	136,764
	<u>194,124</u>	<u>192,611</u>

NET ASSETS

Unrestricted		
Available for operations	37,539	28,567
Invested in or designated for campus facilities	84,039	87,767
Long-term investment	10,901	12,163
	<u>132,479</u>	<u>128,497</u>
Temporarily restricted	73,333	80,405
Permanently restricted	82,154	75,231
	<u>287,966</u>	<u>284,133</u>
Total net assets	<u>\$ 482,090</u>	<u>\$ 476,744</u>
Total liabilities and net assets	<u>\$ 482,090</u>	<u>\$ 476,744</u>

THE CORPORATION OF GONZAGA UNIVERSITY
CONSOLIDATED STATEMENTS OF ACTIVITIES

	(in thousands)			
	Year Ended May 31, 2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating Revenues				
Student tuition and fees, net	\$ 205,490	\$ -	\$ -	\$ 205,490
Less institutional financial aid	(65,860)	-	-	(65,860)
	139,630	-	-	139,630
Contributions	3,411	3,846	-	7,257
Government grants and contracts	2,466	-	-	2,466
Investment gain used for operations	95	4,119	-	4,214
Investment income used for operations	232	245	-	477
Auxiliary enterprises	27,420	-	-	27,420
Organized activities	3,417	-	-	3,417
Other sources	6,073	92	-	6,165
	182,744	8,302	-	191,046
Net assets released from restrictions	8,210	(8,210)	-	-
Total operating revenues	190,954	92	-	191,046
Operating Expenses				
Instruction	73,340	-	-	73,340
Libraries	5,848	-	-	5,848
Student services	10,100	-	-	10,100
Organized activities	18,584	-	-	18,584
General administrative and institutional	27,675	-	-	27,675
Operation and maintenance of plant	10,305	-	-	10,305
Scholarships and student aid	9,564	-	-	9,564
Auxiliary enterprises	25,731	-	-	25,731
Total operating expenses	181,147	-	-	181,147
Increase in net assets from operations	9,807	92	-	9,899
Nonoperating Activities				
Contributions for acquisition of capital assets	-	660	-	660
Contributions to endowment funds	-	50	6,425	6,475
Loss on disposal of equipment	(13)	-	-	(13)
Investment (loss) gain, net of amounts used for operations	(1,768)	(9,499)	137	(11,130)
Investment income, net of amounts used for operations	292	2,065	39	2,396
Change in value of interest rate swap	(4,503)	-	-	(4,503)
Change in value of split interest agreements	-	269	(220)	49
Net assets released from restrictions	1,092	(1,092)	-	-
Transfers	(925)	383	542	-
Total nonoperating activities	(5,825)	(7,164)	6,923	(6,066)
Increase (decrease) in net assets	3,982	(7,072)	6,923	3,833
Net assets at beginning of year	128,497	80,405	75,231	284,133
Net assets at end of year	\$ 132,479	\$ 73,333	\$ 82,154	\$ 287,966

THE CORPORATION OF GONZAGA UNIVERSITY
CONSOLIDATED STATEMENTS OF ACTIVITIES

	(in thousands)			
	Year Ended May 31, 2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating Revenues				
Student tuition and fees, net	\$ 191,257	\$ -	\$ -	\$ 191,257
Less institutional financial aid	(60,009)	-	-	(60,009)
	131,248	-	-	131,248
Contributions	2,958	4,733	-	7,691
Government grants and contracts	2,464	-	-	2,464
Investment gain used for operations	186	6,061	-	6,247
Investment income used for operations	518	204	-	722
Auxiliary enterprises	27,557	-	-	27,557
Organized activities	3,064	-	-	3,064
Other sources	7,007	-	-	7,007
	175,002	10,998	-	186,000
Net assets released from restrictions	9,730	(9,730)	-	-
Total operating revenues	184,732	1,268	-	186,000
Operating Expenses				
Instruction	68,876	-	-	68,876
Libraries	5,860	-	-	5,860
Student services	9,627	-	-	9,627
Organized activities	17,166	-	-	17,166
General administrative and institutional	25,714	-	-	25,714
Operation and maintenance of plant	10,360	-	-	10,360
Scholarships and student aid	9,950	-	-	9,950
Auxiliary enterprises	25,321	-	-	25,321
Total operating expenses	172,874	-	-	172,874
Increase in net assets from operations	11,858	1,268	-	13,126
Nonoperating Activities				
Contributions for acquisition of capital assets	-	667	-	667
Contributions to endowment funds	-	63	3,588	3,651
Gain on disposal of equipment	9	-	-	9
Investment gain, net of amounts used for operations	3,580	13,321	230	17,131
Investment income, net of amounts used for operations	257	1,816	52	2,125
Change in value of interest rate swap	(587)	-	-	(587)
Change in value of split interest agreements	-	508	232	740
Net assets released from restrictions	2,990	(2,990)	-	-
Transfers	(533)	1,048	(515)	-
Total nonoperating activities	5,716	14,433	3,587	23,736
Increase in net assets	17,574	15,701	3,587	36,862
Net assets at beginning of year	110,923	64,704	71,644	247,271
Net assets at end of year	\$ 128,497	\$ 80,405	\$ 75,231	\$ 284,133

THE CORPORATION OF GONZAGA UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	(in thousands)	
	Years Ended May 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in net assets	\$ 3,833	\$ 36,862
Adjustments to reconcile increase in net assets to net cash from operating activities		
Depreciation	8,769	8,870
Amortization of bond issue costs	176	195
Forgiveness and write-offs of notes receivable	175	270
Recovery of uncollectible receivables	(83)	(141)
Loss (gain) on disposal of fixed assets	13	(9)
Contributions restricted for long-term investments	(6,475)	(3,651)
Gifts of equipment and art	(49)	(122)
Gifts of investments	(1,948)	(207)
Interest and dividends restricted for long-term investment	(2,873)	(2,847)
Net realized and unrealized loss (gain) on long-term investments	6,916	(23,378)
Change in unrealized gain on foreign exchange contracts	-	(310)
Change in unrealized loss on interest rate swaps	4,503	587
Change in value of split interest agreements	497	(1,228)
Change in value of paid-up insurance at cash surrender value	(6)	(13)
Change in present value of contributions receivable	(264)	(304)
Change in assets and liabilities		
Receivables	2,021	1,085
Inventories and prepaid expenses	1,227	(531)
Accounts payable and other obligations	922	727
Accrued salaries, taxes, and benefits	3,245	1,520
Deferred revenues	(2,604)	(1,255)
Net cash from operating activities	<u>17,995</u>	<u>16,120</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property, plant, and equipment	(5,851)	(5,346)
Proceeds from sale of property and equipment	12	-
Proceeds from sale of investments	21,344	17,032
Purchase of investments	(22,828)	(19,662)
Issuance of notes receivable	(1,807)	(1,667)
Repayment of notes receivable	1,862	1,823
Reduction in deposits with bond trustees	677	991
Net cash used by investing activities	<u>(6,591)</u>	<u>(6,829)</u>

THE CORPORATION OF GONZAGA UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	(in thousands)	
	Years Ended May 31,	
	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from contributions restricted for long-term investments	\$ 6,475	\$ 3,651
Payments on notes and bonds	(4,663)	(4,381)
Interest and dividends restricted for long-term investment	2,873	2,847
Net change in student loan liability	<u>(25)</u>	<u>(33)</u>
Net cash from financing activities	<u>4,660</u>	<u>2,084</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	16,064	11,375
CASH AND CASH EQUIVALENTS, beginning of year	<u>43,096</u>	<u>31,721</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 59,160</u>	<u>\$ 43,096</u>
SUPPLEMENTAL DISCLOSURES		
Interest paid (net of \$-0- and \$36 for 2012 and 2011, respectively, of capitalized interest)	<u>\$ 6,674</u>	<u>\$ 6,752</u>
Noncash acquisition of property, plant, and equipment	<u>\$ 135</u>	<u>\$ 556</u>

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 1 – Organization

Gonzaga University (University) is an independent, coeducational higher education institution founded in 1887 by the Society of Jesus. The University was incorporated in the state of Washington in 1894 as a tax-exempt charitable organization located in Spokane, Washington. The primary source of revenue is generated from tuition from the undergraduate, graduate (including online programs), and law programs through the schools of Arts & Sciences, Business, Engineering, Education, Professional Studies, and Law. Other sources of revenue include room and board, gifts, investment earnings, fees, and bookstore sales.

Note 2 – Summary of Significant Accounting Policies

The accounting policies of the University reflect practices common to universities and colleges and conform to accounting principles generally accepted in the United States of America (GAAP). The more significant policies are summarized below.

Basis of presentation – The accompanying consolidated financial statements have been prepared in accordance with GAAP with net assets, revenues, expenses, gains, and losses classified into three categories based on the existence or absence of externally (donor) imposed restrictions. The net assets of the University are classified and defined as follows:

Unrestricted net assets – Net assets are not subject to donor-imposed restrictions. Unrestricted net assets may be designated for specific purposes by action of the Board. All revenues, expenses, gains, and losses that are not changes in temporarily or permanently restricted net assets are considered unrestricted.

Temporarily restricted net assets – Net assets are subject to donor-imposed restrictions that will be met by actions of the University or the passage of time. This includes gifts as well as income and net gains and losses accruing on those gifts, whose use by the University is subject to donor imposed stipulations.

Permanently restricted net assets – Net assets are subject to donor-imposed restrictions that are permanently maintained by the University. Generally, the donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes. This includes gifts, trusts, and contributions that by donor restriction require the corpus be invested in perpetuity.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 2 – Summary of Significant Accounting Policies (continued)

Consolidation – The consolidated financial statements include the accounts of Gonzaga University, the Law School Foundation (Foundation), and Immobiliare Gonzaga Srl. The purpose of the Foundation is to provide additional revenue, endowment, and related income to the University’s Law School. Immobiliare Gonzaga Srl. is an Italian corporation formed to purchase and remodel a classroom/administration building used in the University’s Florence, Italy, program. All significant inter-entity transactions and balances have been eliminated. The summarized statements of financial position for these entities are as follows:

	For the Year ended May 31, 2012				
	Gonzaga University	Law School Foundation	Immobiliare Gonzaga Srl.	Inter-entity Elimination	Consolidated Total
Assets	\$ 465,457	\$ 15,237	\$ 5,908	\$ (4,512)	\$ 482,090
Liabilities	\$ 193,622	\$ 4	\$ 5,010	\$ (4,512)	\$ 194,124
NET ASSETS					
Unrestricted	128,741	2,840	898	-	132,479
Temporarily restricted	67,562	5,771	-	-	73,333
Permanently restricted	75,532	6,622	-	-	82,154
Total net assets	271,835	15,233	898	-	287,966
Total liabilities and net assets	\$ 465,457	\$ 15,237	\$ 5,908	\$ (4,512)	\$ 482,090

	For the Year ended May 31, 2011				
	Gonzaga University	Law School Foundation	Immobiliare Gonzaga Srl.	Inter-entity Elimination	Consolidated Total
Assets	\$ 459,993	\$ 16,000	\$ 5,483	\$ (4,732)	\$ 476,744
Liabilities	\$ 192,607	\$ 232	\$ 4,504	\$ (4,732)	\$ 192,611
NET ASSETS					
Unrestricted	124,555	2,963	979	-	128,497
Temporarily restricted	73,755	6,650	-	-	80,405
Permanently restricted	69,076	6,155	-	-	75,231
Total net assets	267,386	15,768	979	-	284,133
Total liabilities and net assets	\$ 459,993	\$ 16,000	\$ 5,483	\$ (4,732)	\$ 476,744

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 2 – Summary of Significant Accounting Policies (continued)

Cash and cash equivalents – Cash and cash equivalents consist of all cash balances and short-term, highly liquid investments with original maturities at the date of purchase of 90 days or less. Amounts also include money market mutual funds, all of which comply with Rule 2a-7 of the Investment Company Act of 1940, which seeks to limit the risk of money market funds. The University holds cash and cash equivalents at several major financial institutions, which during the course of the year may exceed the amounts insured by the Federal Depository Insurance Corporation. Cash and cash equivalents amounts related to donor-restricted funds are reported as investments.

Deposits with Bond Trustees – Amounts consist of debt service and debt service reserve funds held in investments as permitted under the Washington Higher Education Facilities Authority (WHEFA) documents. The funds are restricted to the purpose designated in the bond documents. These investment securities are exposed to various interest rate, market, and credit risks, and changes in risks could possibly materially affect the consolidated financial statements.

Investments – The University manages its investments by using external investment managers. These investment managers invest the University’s funds in various financial instruments in accordance with the Board approved investment policy.

The University’s investments are recorded in the consolidated financial statements at fair value. Net appreciation (depreciation) in investments, including realized gains or losses and unrealized appreciation or depreciation on investments, as well as all dividends, interest, and other investment income, is shown in the consolidated statements of activities. Investment income is reported as an increase in unrestricted, temporarily restricted, or permanently restricted net assets, depending on donor-imposed restrictions on the use of the income. Investments gifted to the University are recorded at the fair value at the date of gift.

Investments are exposed to various risks, such as interest rate, market, and credit and regulatory risk. Due to the level of risk associated with certain investments, it is at least reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect total net assets and the amounts reported in the consolidated statement of financial position.

Split-interest agreements – The University has split-interest agreements consisting of charitable gift annuities and irrevocable charitable remainder trusts. Assets are invested and payments are made to donors and/or other beneficiaries in accordance with respective agreements.

For those agreements in which the University is a trustee, contribution revenue is recognized at the date the agreement is established, net of the liability recorded at the present value of the estimated future payments to be made to the respective donors and/or other beneficiaries. The liability for charitable gift annuities issued by the Corporation of Gonzaga University was \$1,250 and \$994 for the years ended May 31, 2012 and 2011, respectively.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 2 – Summary of Significant Accounting Policies (continued)

Split-interest agreements (continued) – For those agreements in which the University does not serve as trustee, restricted contributions receivable and the related revenue are recognized for the present value of the estimated future benefits to be received when the trust is distributed.

The present value of payments to beneficiaries of charitable gift annuities and charitable remainder trusts is calculated using discount rates ranging from 4% to 6%. These discount rates represent rates commensurate with the risks involved, which were in existence at the date of the gift. Gains or losses resulting from changes in actuarial assumptions and accretion of the applicable discounts are recorded as changes in the respective net asset class in the consolidated statements of activities as incurred.

Inventories – Student bookstore and supply inventories are stated at the lower of cost, using the first-in first-out method, or market.

Accounts and contributions receivable – Accounts receivable from students included in accounts and interest receivable, net, in the consolidated statement of financial position are reported net of an allowance for doubtful accounts, which was \$100 and \$350 for the years ended May 31, 2012 and 2011, respectively. Accounts receivable are written off only when they are deemed to be permanently uncollectible.

Contributions, including unconditional promises to give, are recognized as revenue when the donor's commitment is made. Unconditional promises are recognized at the estimated present value of the future cash flows using discount rates, net of allowances for uncollectibles. The discounts are computed using a rate that is commensurate with the risks involved and applicable to the years in which the promises are received. Based upon historical pledge payments, history, and current information, an allowance for uncollectible accounts is included. Account balances are charged off against the allowance after all means of collection have been exhausted and potential recovery is considered remote. Promises made that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted revenue.

Notes receivable – Notes receivable primarily consist of amounts due from students under the University's repayable financial aid programs and are stated net of allowance for doubtful accounts. The allowance was \$306 and \$446 for the years ended May 31, 2012 and 2011, respectively. The notes receivable bear interest ranging from 5% to 6% and are generally repayable to the University over a period not to exceed 10 years.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 2 – Summary of Significant Accounting Policies (continued)

Property, plant, and equipment – Property, plant, and equipment are stated at cost at the date of acquisition or fair value at the date of donation. The cost of major improvements in excess of \$100 and purchases of depreciable items in excess of \$5 are capitalized. Normal repair and maintenance expenses and minor equipment costs are expensed as incurred. Depreciation, except for land and artwork, is provided for on a straight-line basis over the estimated useful lives of the respective assets as follows:

Building and improvements	25 - 50 years
Equipment and furniture	3 - 7 years
Library books	10 years

Revenue recognition – Student tuition, fees, and room and board are recognized in the period in which the services are provided. Grant revenue is recognized either when the services are provided or when the funds are expended. Interest income on student loans is recognized when charged.

Student tuition and fees are reflected net of student marketing and recruiting costs of \$5,444 and \$5,282 for the years ended May 31, 2012 and 2011, respectively, which represent the amount paid to an unrelated third party for certain of the University’s graduate distance learning programs where, from a revenue recognition standpoint, the University is considered an agent in the transaction.

Deferred revenues include amounts received for tuition, fees, and certain auxiliary activities, which have not yet been earned, and student deposits. Deferred revenues also include amounts received from grants and contracts that have not yet been earned.

Foreign operations – The University has a number of both graduate and undergraduate programs in foreign countries, primarily Canada and Italy. Gross revenues and expenses of these programs are as follows:

	<u>2012</u>	<u>2011</u>
Canadian program		
Gross revenue	\$ 2,607	\$ 2,987
Gross expenses	680	784
Florence and other European programs		
Gross revenue	9,121	7,464
Gross expenses	7,093	6,282

Advertising – Costs expensed for the years ended May 31, 2012 and 2011, were \$584 and \$563, respectively.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 2 – Summary of Significant Accounting Policies (continued)

Fund-raising expenses – Costs related to development and fund-raising are expensed as incurred for years ended May 31, 2012 and 2011, and were \$4,646 and \$4,613, respectively.

Derivative financial instruments – GAAP establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. All derivatives, whether designated in hedging relationships or not, are reflected on the consolidated statement of financial position at estimated fair value.

Taxes – The Internal Revenue Service has recognized the University as exempt from tax under the provisions of Section 501(c)(3) of the Internal Revenue Code except to the extent of unrelated business income under Sections 511 through 515. Unrelated business income tax, if any, is immaterial and, therefore, the consolidated financial statements do not include a provision for federal income tax. The University adheres to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, relating to accounting for uncertain tax positions. ASC 740-10 prescribes a recognition threshold and measurement process for accounting for uncertain tax positions and also provides guidance on various related matters such as derecognition, interest, penalties, and disclosure requirements. As of May 31, 2012 and 2011, the University had no uncertain tax positions requiring accrual. In addition, the University presently is exempt from Washington State real and personal property taxes pursuant to WAC 458-16-270 on the majority of its educational and other noncommercial properties of the University.

Operating and nonoperating activities – The University’s measure of operating activities, presented in the consolidated statements of activities, includes all transactions that are incurred in the course of the normal business operations of the University. Operating expenses are reported by functional categories, after allocating costs for interest on long term indebtedness and depreciation.

Nonoperating activities presented in the consolidated statements of activities include transactions that result from something other than the on-going day-to-day activity of the University.

Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Reclassifications – Certain reclassifications were made to the 2011 consolidated financial statements to conform to the 2012 presentation. The reclassifications have no effect on the change in net assets or net asset balances as previously reported.

Subsequent events – The University has evaluated subsequent events through August 31, 2012, which is the date the consolidated financial statements were available to be issued.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 2 – Summary of Significant Accounting Policies (continued)

Adoption of new accounting pronouncements – In July 2010, the FASB issued an accounting standards update that provides for new and enhanced disclosure requirements related to the credit quality of financing receivables and the allowance for credit losses. The requirements, which the University adopted effective June 1, 2011, include disclosures about the nature of the credit risk in an entity’s financing receivables, how risk is incorporated into the allowance for credit losses, and the reasons for any changes in the allowance. The guidance impacts disclosures only.

Note 3 – Accounts and Interest Receivable

Accounts and interest receivable consisted of the following as of May 31:

	2012	2011
Student receivables	\$ 1,207	\$ 1,289
Government grants	6,351	5,674
Accrued interest receivable	76	117
Short-term receivables	1,046	1,561
Other receivables	2,442	2,554
	11,122	11,195
Less allowance for doubtful accounts	(100)	(350)
	\$ 11,022	\$ 10,845

Note 4 – Contributions Receivable, Net

Contributions receivable, net at May 31 are expected to be realized in the following periods:

	2012	2011
In one year or less	\$ 7,858	\$ 8,385
Between one year and five years	7,274	9,202
More than five years	1,869	1,612
Less present value discounts	(703)	(967)
	16,298	18,232
Less allowance for uncollectibles	(5,731)	(5,677)
	\$ 10,567	\$ 12,555

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 4 – Contributions Receivable, Net (continued)

Contributions receivable, net, at May 31 are designated as follows:

	<u>2012</u>	<u>2011</u>
Unrestricted	\$ 41	\$ 50
Temporarily restricted scholarships/other	3,117	3,657
Endowment for scholarships and endowed chairs	2,614	2,310
Construction/debt service on building projects	<u>4,795</u>	<u>6,538</u>
	<u>\$ 10,567</u>	<u>\$ 12,555</u>

The University received a pledge from a charitable foundation to make annual future distributions to the University. The net present value of these future distributions is \$4,558 at May 31, 2012 and 2011. Because there are conditions associated with these future payments, this pledge of future annual payments is not recognized as revenue or as a related pledge receivable.

Note 5 – Notes Receivable

Student loans – The University makes uncollateralized loans to students based on financial need. Student loans are funded through federal government loan programs and institutional resources. At May 31, 2012 and 2011, student loans represented 3.18% and 3.24% of total assets, respectively.

At May 31, student loans consisted of the following:

	<u>2012</u>	<u>2011</u>
Federal government programs	\$ 14,618	\$ 14,882
Institutional programs	<u>1,032</u>	<u>1,001</u>
	15,650	15,883
Less allowance for doubtful accounts	<u>(306)</u>	<u>(446)</u>
Student loans receivable, net	<u>\$ 15,344</u>	<u>\$ 15,437</u>

The University participates in the Perkins and Nursing federal revolving loan programs. The availability of funds for loans under the programs is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the federal government of \$12,716 at May 31, 2012 and 2011, are ultimately refundable to the government, and are classified as liabilities in the statements of financial position. Outstanding loans cancelled under the programs result in a reduction of the funds available for loans and a decrease in the liability to the government.

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Note 5 – Notes Receivable (continued)

At May 31, 2012 and 2011, the following amounts were past due under all student loan programs:

May 31,	60-89 Days Past Due	90-119 Days Past Due	120-179 Days Past Due	180-729 Days Past Due	730+ Days Past Due	Total Past Due
2012	\$ 228	\$ 42	\$ 90	\$ 327	\$ 459	\$ 1,146
2011	164	73	43	318	413	1,011

Allowances for doubtful accounts are established based on prior collection experience and current economic factors, which in management’s judgment could influence the ability of loan recipients to repay the amounts per the loan terms. Institutional loan balances are written off only when they are deemed to be permanently uncollectible. Accounts due under the Perkins loan program are guaranteed by the federal government, and therefore, no reserves are placed on any past due balances under the program.

Note 6 – Investments

Investments at May 31 are as follows:

	2012	2011
At market		
Cash and cash equivalents	\$ 11,990	\$ 471
Certificates of deposit	-	387
Equity securities	58,731	71,365
Fixed income securities	22,005	20,188
Balanced fund securities	1,279	11,159
Alternatives	39,568	35,522
Split-interest agreements	15,072	13,089
Real property	741	754
Life insurance cash surrender value	367	509
Other	108	392
	<u>\$ 149,861</u>	<u>\$ 153,836</u>

Within cash and cash equivalents reported as investments as of May 31, 2012, approximately \$10,700 represents Law School Foundation endowment amounts held temporarily as cash until long term investment opportunities were identified. Shortly after May 31, 2012, this amount was invested as follows: 33% domestic equity mutual funds, 37% domestic and international publically traded equity securities, and 30% in corporate and US government bonds.

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Note 6 - Investments (continued)

For the years ended May 31 the University's total return on investments and cash and cash equivalents includes:

	<u>2012</u>	<u>2011</u>
Net unrealized and realized (loss) gain on investments held at market	\$ (6,916)	\$ 23,378
Interest income and dividends	<u>2,873</u>	<u>2,847</u>
Total return on investments and cash and cash equivalents	<u>\$ (4,043)</u>	<u>\$ 26,225</u>
Amounts withdrawn under spending policy	<u>\$ 4,398</u>	<u>\$ 5,023</u>

See Note 14 for unfunded cash commitments associated with alternative investments.

Note 7 - Endowment

The University's endowment consists of approximately 690 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Endowment net asset composition by type of fund is summarized as follows:

	<u>As of May 31, 2012</u>			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (1,159)	\$ 50,080	\$ 82,154	\$ 131,075
Board-designated funds	<u>12,060</u>	<u>-</u>	<u>-</u>	<u>12,060</u>
	<u>\$ 10,901</u>	<u>\$ 50,080</u>	<u>\$ 82,154</u>	<u>\$ 143,135</u>

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Note 7 – Endowment (continued)

	As of May 31, 2011			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment funds	\$ (526)	\$ 57,384	\$ 75,231	\$ 132,089
Board-designated funds	12,689	-	-	12,689
	\$ 12,163	\$ 57,384	\$ 75,231	\$ 144,778

Interpretation of relevant law – Under the Washington Uniform Prudent Management of Institutional Funds Act (WUPMIFA), the Board has adopted as policy for donor-restricted endowment funds the requirement to preserve the original fair value of the initial gift and any subsequent gifts (as of the respective gift date), along with any accumulations to the permanent endowment made at the direction of the donor, absent explicit donor stipulations to the contrary. Together, these amounts become the permanently restricted value of the funds.

In accordance with WUPMIFA, the University considers the following factors in making a determination to appropriate or accumulate income from donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the University and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the University
- The investment policies of the University

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Note 7 – Endowment (continued)

Return objectives and risk parameters – The University has adopted an investment and spending policy for endowment assets that attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds the University must hold in perpetuity or for a donor-specified period(s) as well as Board-designated funds. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce an acceptable level of return while assuming a moderate level of investment risk on a total portfolio basis. The University's goal for its endowment funds, over time, is to provide an average annualized return of approximately 5% in excess of inflation, as measured by the Higher Education Price Index (HEPI) over a market cycle of three to five years. To satisfy its long-term rate of return, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends), and maintains a diversified asset allocation that places a greater emphasis on equity-based and alternative investments to achieve its long-term return objectives within prudent risk constraints.

Spending policy – The spending policy and how the investment objectives relate to the spending policy are as follows:

The University has a policy of appropriating for distribution each year based upon a hybrid rate that is the sum of two components:

- a) 70% based upon the HEPI for the Pacific Region applied to the prior year endowment spending amount.
- b) 30% based upon a rate of 4% to 5% of a three-year rolling average of the fund's total market value, measured quarterly.

Absent donor stipulations to the contrary, the University will not appropriate for distribution from an endowment fund if such expenditure will result in the fair value of the fund falling below the permanently restricted value of the fund, measured as of May 31 of the fiscal year of appropriation.

Funds with deficiencies – From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level the University is required to retain as a fund of perpetual duration. Deficiencies of this nature reported in unrestricted net assets were \$1,159 and \$526 as of May 31, 2012 and 2011, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred as a result of the investment of permanently restricted contributions and amounts appropriated for spending.

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Note 7 – Endowment (continued)

Changes in endowment net assets are summarized as follows:

	For the Year Ended May 31, 2012			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Net assets, beginning of year	\$ 12,163	\$ 57,384	\$ 75,231	\$ 144,778
Investment return				
Investment income	292	2,065	39	2,396
Net loss (realized and unrealized)	(1,388)	(5,213)	(83)	(6,684)
Total investment return	(1,096)	(3,148)	(44)	(4,288)
Contributions	-	50	6,425	6,475
Amount distributed for operating activities	(4,398)	-	-	(4,398)
Transfers	214	(188)	542	568
Released from restriction	4,018	(4,018)	-	-
Net assets, end of year	<u>\$ 10,901</u>	<u>\$ 50,080</u>	<u>\$ 82,154</u>	<u>\$ 143,135</u>

	For the Year Ended May 31, 2011			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Net assets, beginning of year	\$ 6,460	\$ 40,561	\$ 71,644	\$ 118,665
Investment return				
Investment income	257	1,816	52	2,125
Net gain (realized and unrealized)	5,082	18,452	462	23,996
Total investment return	5,339	20,268	514	26,121
Contributions	-	63	3,588	3,651
Amount distributed for operating activities	(5,023)	-	-	(5,023)
Transfers	814	1,065	(515)	1,364
Released from restriction	4,573	(4,573)	-	-
Net assets, end of year	<u>\$ 12,163</u>	<u>\$ 57,384</u>	<u>\$ 75,231</u>	<u>\$ 144,778</u>

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Note 8 – Property, Plant, and Equipment, Net

Components of property, plant, and equipment, net, at May 31 are as follows:

	<u>2012</u>	<u>2011</u>
Land	\$ 6,827	\$ 6,827
Buildings and improvements	265,661	263,096
Equipment and furniture	24,471	24,363
Artwork	2,986	2,971
Library books	4,807	4,689
Construction in progress	<u>2,009</u>	<u>1,117</u>
	306,761	303,063
Less accumulated depreciation	<u>(88,647)</u>	<u>(82,190)</u>
	<u><u>\$ 218,114</u></u>	<u><u>\$ 220,873</u></u>

Note 9 – Bonds and Notes Payable

As of May 31, notes and bonds payable consisted of the following:

	<u>2012</u>	<u>2011</u>
Tax Exempt Bonds payable to the Washington Higher Education Facilities Authority (Authority or WHEFA)		
Series 2010 A, original issuance of \$42,420, interest at fixed rates ranging from 2.500% to 5.000%, maturing 2029	\$ 36,590	\$ 39,515
Series 2009 B, original issuance of \$53,460, interest at fixed rates ranging from 3.000% to 5.000%, maturing 2029	53,210	53,460
Series 2009 A, original issuance of \$39,845, interest at fixed rates ranging from 4.000% to 6.250%, maturing 2029	37,845	38,520
Other unsecured notes due in various installments through 2015. Interest rates range from 1.39% to 7.75%	<u>1,613</u>	<u>2,258</u>
	129,258	133,753
Unamortized premium	<u>2,843</u>	<u>3,011</u>
	<u><u>\$ 132,101</u></u>	<u><u>\$ 136,764</u></u>

THE CORPORATION OF GONZAGA UNIVERSITY
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Note 9 - Bonds and Notes Payable (continued)

The WHEFA bonds are secured on a parity basis by a pledge of, and lien on, all unrestricted current fund revenues, as defined in the loan agreement, by a deed of trust on substantially all property and equipment of the University, and the University's interest in certain funds and reserves held by the Bond Trustee.

In relation to the WHEFA bonds, the University has agreed to certain covenants, including covenants to maintain its accredited status, limit its ability to incur additional indebtedness, limit encumbrances on parts of its campus, and maintain certain financial ratios as defined in the related agreements.

The WHEFA bonds require a debt service reserve fund, which is funded and included in the University's deposit with the bond trustee.

As a result of the bond offerings, the University held \$13,391 and \$14,068 in deposits with bond trustees at May 31, 2012 and 2011, respectively. These funds are held in investments and consist of the following:

	<u>2012</u>	<u>2011</u>
Debt service reserve funds	\$ 13,303	\$ 13,419
Project funds	-	59
Rebate holdback funds	-	500
Debt service funds	<u>88</u>	<u>90</u>
	<u>\$ 13,391</u>	<u>\$ 14,068</u>

THE CORPORATION OF GONZAGA UNIVERSITY
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Note 9 - Bonds and Notes Payable (continued)

Principal payments on notes and bonds payable are as follows:

Years Ending May 31,	<u>Principal</u>
2013	\$ 5,108
2014	5,740
2015	5,654
2016	5,745
2017	6,020
Thereafter	<u>100,991</u>
	129,258
Premium	<u>2,843</u>
	<u><u>\$ 132,101</u></u>

The University also has a \$10,000 revolving line of credit agreement with Bank of America that bears interest equal to a prime rate established by Bank of America, which was 3.25% as of May 31, 2012. The revolving line of credit is secured by a parity lien on unrestricted gross revenues and certain deposit and security accounts with Bank of America and U.S. Bank. There were no outstanding advances against the line of credit as of May 31, 2012 and 2011. The line of credit agreement matures on January 31, 2013, and may be extended if agreed to by both parties.

Note 10 - Derivative Instruments and Hedging Activities

In connection with previously refunded WHEFA bonds, the University entered in the following interest rate swap agreements:

Notional Amount on Effective Date	Effective Date	Term	Gonzaga Pays	<u>Gonzaga Receives</u>
\$ 35,550	10/1/2014	4/1/2034	4.1195%	67% of one month LIBOR if LIBOR is 3.5% or greater or 77% of one month LIBOR if LIBOR is less than 3.5%
7,325	10/1/2012	4/1/2022	4.1680%	70% of one month LIBOR

THE CORPORATION OF GONZAGA UNIVERSITY
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Note 10 – Derivative Instruments and Hedging Activities (continued)

In prior years, the University used variable-rate debt to finance the construction and acquisition of property, plant, and equipment. The University entered into interest rate swap (swap) agreements in order to obtain a synthetic fixed rate and to hedge the risk of changes in interest payments on the bonds caused by changes in the market rates. The swaps are secured on a parity basis with the WHEFA bonds. All of the University's variable-rate WHEFA bonds have been refunded with proceeds of fixed rate WHEFA bonds. The above swaps can be terminated at market rates at any time during the term of the swap.

The University does not enter into derivative instruments for any purpose other than cash flow hedging purposes and does not speculate for investment purposes using derivative instruments. The transactions involve both credit and market risk. The notional amounts do not represent direct credit exposure. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid. If the University's bond rating falls below BBB+ by S&P or Baa1 by Moody's, the swap counterparty has the ability to require the University to post collateral. The University's current credit rating, as provided by Moody's Investors Service, is A3 with a stable outlook. This rating was affirmed on May 31, 2012.

The swaps were issued at market terms so they had no fair value at inception. The carrying amount of the swaps has been adjusted to the fair value at the end of the fiscal year. A derivative liability of \$7,820 and \$3,317 for the years ended May 31, 2012 and 2011, respectively, are shown as an obligation under interest rate swaps on the consolidated statements of financial position. Accordingly, all of the adjustments of the swaps' carrying amounts are reported as an increase or decrease in nonoperating activities.

The effect of derivative instruments on the consolidated statements of activities for the years ended May 31, 2012 and 2011:

Derivatives in Fair Value Hedging Relationships	Location of Loss Recognized in Income on Derivative	Amount of Loss Recognized in Income on Derivatives	
		2012	2011
Interest rate swap agreements	Change in value of interest rate swap	\$ (4,503)	\$ (587)

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Note 11 - Retirement Plans

Retirement benefits are provided to all employees working a minimum of 1,000 hours per year under a 403(b) defined contribution plan (Plans). Beginning the first day of the month following one year of service, eligible employees are required to contribute 5% of their salary and the University contributes 8.5%. Investment choices are offered through two providers: TIAA-CREF and Fidelity Investments. The Plans provide individually-owned retirement accounts, which are 100% vested immediately. The University's expense for these Plans was \$5,509 and \$5,192 for the years ended May 31, 2012 and 2011, respectively.

Included in accounts and interest receivable and accrued benefits payable is an accrual for \$1,289 and \$1,301 for the years ended May 31, 2012 and 2011, respectively, which represents voluntary employee contributions to the 457(b) plan. By IRS regulations, these funds are considered to be assets of the University until distributed to participants.

Note 12 - Net Assets

The University's net assets were available for the following purposes at May 31:

	<u>2012</u>	<u>2011</u>
Board-Designated, included in Unrestricted Net Assets		
Debt service	\$ 1,234	\$ 560
Operating reserves	6,605	6,605
Arena reserves	7,188	5,773
Remodeling of University facilities	2,905	2,560
Technology projects	242	1,455
Law School initiatives	1,612	1,595
Academic enhancements	3,587	2,251
Medical claims reserve fund	2,612	2,376
Quasi-endowment fund	12,060	12,689
All other	<u>836</u>	<u>298</u>
Total Board-designated, included in unrestricted net assets	<u>\$ 38,881</u>	<u>\$ 36,162</u>

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Note 12 - Net Assets (continued)

	2012	2011
Temporarily Restricted		
Scholarships	\$ 31,685	\$ 35,515
Plant facilities	2,961	3,382
Charitable Remainder Trust	2,983	2,852
Endowed chairs	9,140	10,008
All other	26,564	28,648
Total temporarily restricted	\$ 73,333	\$ 80,405
Permanently Restricted		
General purpose endowments	\$ 10,166	\$ 8,913
Library endowments	728	720
Scholarship endowments	54,383	50,519
Academic chair endowments	12,510	12,420
Annuity and life income endowments	3,326	1,629
Student loan program	1,041	1,030
Total permanently restricted	\$ 82,154	\$ 75,231

Note 13 - Commitments and Contingencies

Commitments -

Operating leases - The University leases certain educational facilities under noncancelable operating leases. Future minimum lease payments are as follows:

Years Ending May 31,	
2013	\$ 196
2014	64
2015	63
2016	63
2017	63
Thereafter	914
	\$ 1,363

Rental expense for the facilities operating leases amounted to \$196 for the years ended May 31, 2012 and 2011.

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Note 13 – Commitments and Contingencies (continued)

Contingencies – The University is subject to legal proceedings and claims that arise in the ordinary course of its business. In the opinion of management, the results of these matters will not have a significant impact on the consolidated financial statements.

The University receives and expends monies under federal grant programs and is subject to audits by governmental agencies. The University believes that any liabilities resulting from such audits would not have a material impact on the consolidated financial statements of the University.

Note 14 – Fair Value of Financial Instruments

Fair value measurements – The University has determined the fair value of certain assets and liabilities in accordance with the provisions of the *Fair Value Measurements and Disclosures Topic of FASB ASC*, which provides a framework for measuring fair value under GAAP.

FASB ASC 820-10-30-2 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. Observable inputs are developed based on market data obtained from sources independent of the University. Unobservable inputs reflect the University's own assumptions about market inputs based on its own data.

A fair value hierarchy has also been established by the *Fair Value Measurements and Disclosures Topic of FASB ASC*, which prioritizes the valuation inputs into three broad levels. Level 1 inputs consist of quoted market prices in active markets for identical assets or liabilities the University has the ability to access at the measurement date. Level 2 inputs consist of valuations other than quoted prices included in Level 1 that are observable by the University for the related asset or liability. Level 3 inputs consist of unobservable valuations related to the asset or liability. Transfers between the levels are recognized on the actual date of the event or circumstance that caused the transfer.

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Note 14 – Fair Value of Financial Instruments (continued)

The following tables present assets and liabilities that are measured at fair value on a recurring basis at May 31, 2012 and 2011.

	May 31, 2012			
	Fair Value	Level 1 ⁽⁹⁾	Level 2	Level 3
Cash and cash equivalents	\$ 71,150	\$ 71,150	\$ -	\$ -
Equity securities				
Managed mutual funds				
Domestic large cap	12,534	12,534	-	-
Domestic small/mid cap	5,642	2,844	2,798	-
International developed markets	12,393	12,393	-	-
International emerging markets	7,338	7,338	-	-
International small/mid cap	2,756	2,756	-	-
Exchange traded funds				
S&P 500 Index	6,803	6,803	-	-
Russell 1000 Growth Index	3,920	3,920	-	-
MSCI EAFA (Europe, Asia, Australia, Far East) Index	2,591	2,591	-	-
Direct ownership				
Publicly traded	2,950	2,950	-	-
Privately held stock ⁽²⁾	1,804		876	928
Fixed income securities				
Managed domestic mutual funds ⁽³⁾	12,555	12,555	-	-
Managed high yield mutual fund	4,297	4,297	-	-
Managed international mutual fund	4,813	4,813	-	-
Corporate bonds	340	340	-	-
Balanced fund securities				
Managed mutual funds ⁽⁴⁾	1,279	1,279	-	-
Alternatives ⁽¹⁰⁾				
Managed diversified global multi-asset partnership ⁽⁵⁾	14,811	-	-	14,811
Private equity limited partnership investments				
Leveraged buy-out and distressed funds	3,682	-	-	3,682
Venture capital fund	1,635	-	-	1,635
Diversified funds of funds	6,899	-	-	6,899
Direct investment fund	290	-	-	290
Real estate funds	10,563	-	-	10,563
Healthcare fund	565	-	-	565
Mezzanine debt fund	1,123	-	-	1,123
Split interest agreements				
Equity/fixed income ⁽⁶⁾	15,072	8,345	-	6,727
Deposits with bond trustees				
Money market	227	227	-	-
U.S. government agency obligations	13,164	13,164	-	-
Real property ⁽⁷⁾	741	-	741	-
Life insurance cash surrender value	367	367	-	-
Other	108	43	65	-
Total assets	<u>\$ 222,412</u>	<u>\$ 170,709</u>	<u>\$ 4,480</u>	<u>\$ 47,223</u>
Obligation under interest rate swaps ⁽⁸⁾	<u>\$ (7,820)</u>	<u>\$ -</u>	<u>\$ (7,820)</u>	<u>\$ -</u>
Total liabilities	<u>\$ (7,820)</u>	<u>\$ -</u>	<u>\$ (7,820)</u>	<u>\$ -</u>

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Note 14 – Fair Value of Financial Instruments (continued)

	May 31, 2011			
	Fair Value	Level 1 ⁽⁹⁾	Level 2	Level 3
Cash and cash equivalents	\$ 43,567	\$ 43,567	\$ -	\$ -
Certificates of deposit	387	387	-	-
Equity securities				
Managed mutual funds				
Domestic large cap	10,032	10,032	-	-
Domestic small/mid cap ⁽¹⁾	6,293	3,072	3,221	-
International developed markets	15,589	15,589	-	-
International emerging markets	10,236	10,236	-	-
International small/mid cap	5,196	5,196	-	-
Exchange traded funds				
S&P 500 Index	8,389	8,389	-	-
Russell 1000 Growth Index	11,016	11,016	-	-
Russell 2000 Value Index	1,974	1,974	-	-
Direct ownership				
Publicly traded	976	976	-	-
Privately held stock ⁽²⁾	1,664	-	714	950
Fixed income securities				
Managed domestic mutual funds ⁽³⁾	19,791	19,791	-	-
Corporate bonds	397	397	-	-
Balanced fund securities				
Managed mutual funds ⁽⁴⁾	11,159	11,159	-	-
Alternatives ⁽¹⁰⁾				
Managed diversified global multi-asset partnership ⁽⁵⁾	15,180	-	-	15,180
Private equity limited partnership investments				
Leveraged buy-out fund	2,339	-	-	2,339
Venture capital fund	1,500	-	-	1,500
Diversified funds of funds	6,425	-	-	6,425
Direct investment fund	388	-	-	388
Real estate funds	8,366	-	-	8,366
Healthcare fund	614	-	-	614
Mezzanine debt fund	710	-	-	710
Split interest agreements				
Equity/fixed income ⁽⁶⁾	13,089	8,372	-	4,717
Deposits with bond trustees				
Money market	726	726	-	-
U.S. government agency obligations	13,342	13,342	-	-
Real property ⁽⁷⁾	754	-	754	-
Life insurance cash surrender value	509	509	-	-
Other	392	44	348	-
	<u>\$ 211,000</u>	<u>\$ 164,774</u>	<u>\$ 5,037</u>	<u>\$ 41,189</u>
Obligation under interest rate swaps ⁽⁸⁾	<u>\$ (3,317)</u>	<u>\$ -</u>	<u>\$ (3,317)</u>	<u>\$ -</u>
	<u>\$ (3,317)</u>	<u>\$ -</u>	<u>\$ (3,317)</u>	<u>\$ -</u>

THE CORPORATION OF GONZAGA UNIVERSITY
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Note 14 – Fair Value of Financial Instruments (continued)

- (1) In December 2010, \$3,310 invested with a private fund and previously categorized as Level 2 was transferred to Level 1, as a result of the fund converting to a publically traded mutual fund.
- (2) Privately held stock characterized as Level 2 is valued using the market approach based on recent sales transactions. Privately held stock characterized as Level 3 is valued based on the net asset value of the investment, which approximates market value.
- (3) As of May 31, 2012 and 2011, approximately 93% and 77% of the underlying mutual fund investments are in fixed income securities and 7% and 23% are in cash, respectively. As of May 31, 2012 and 2011, of the underlying fixed income investments, 40% and 55% are in high quality U.S. government and agency obligations, 40% and 38% are in domestic corporate obligations, and 20% and 7% are in other obligations, including domestic municipal, foreign corporate and sovereign obligations, respectively.
- (4) As of May 31, 2012 and 2011, approximately 70% and 73% of the underlying mutual fund investments are in domestic and international equities, and 26% and 22% are in domestic corporate and U.S. government and agency obligations, and 4% and 5% are in cash, respectively.
- (5) Amounts represent a limited partnership investment in a newer global multi-asset fund that is still raising limited partner capital and deploying investments against its long-term asset allocation strategy. The underlying investments, as of May 31, 2012 and 2011, are invested 19% and 50% in fixed income (corporate bonds, sovereign debt, U.S. government agency obligations), 31% and 28% in domestic and international public equities, 32% and 19% in absolute return (distressed debt and event driven strategies), 13% and 2% in real assets, and 5% and 1% in privates, respectively. The long-term asset allocation ranges, which should be reached within the next year, are fixed income (5 - 15%), public equities (20 - 40%), absolute return (20-45%), real assets (10 - 25%) and private equity (5 - 15%).
- (6) Level 1 amounts include assets of 50 and 41 charitable gift annuities and charitable remainder trusts, as of May 31, 2012 and 2011, respectively, where the University serves as trustee. Amounts are maintained with various custodial banks, and largely invested in domestic mutual funds following a 60% equities/40% fixed income allocation target. Level 3 amounts represent a beneficial interest in the future cash flows of seven and six different trusts as of May 31, 2012 and 2011, respectively, measured under the income approach, involving a discounted cash flow analysis based on the expected annuity payments to be made over the remaining life of each respective beneficial interest, utilizing a risk-free rate and adjusted for the inherent risk of the assets held in trust and the risk of nonperformance.
- (7) Real property is valued using tax assessed values, which approximate market values.
- (8) Interest rate swaps are valued using estimates of the related LIBOR rates and the BMA municipal swap index rates during the term of the swap agreements.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 14 – Fair Value of Financial Instruments (continued)

(9) Fair values are determined using active market exchanges valued at the last reported sales price.

(10) Alternative investments held through limited partnerships consist primarily of investments that are not readily marketable. Investments in these categories, which are managed externally, are valued utilizing the most current information provided by the investment managers.

Following is a reconciliation of activity for the years ended May 31, 2012 and 2011, of assets measured at fair value based upon significant unobservable (no market) - Level 3 information.

	Privately Held Stock	Managed Diversified Global Multi- Asset Partnership	Leveraged Buy-Out and Distressed Funds	Venture Capital Fund
Balance, May 31, 2010	\$ 950	\$ -	\$ 2,054	\$ 1,321
Realized gains (losses)	-	(47)	85	6
Unrealized gains	-	227	239	262
Return of capital/transfers to income	-	-	(39)	(89)
Purchases/capital calls	-	15,000	-	-
Settlements	-	-	-	-
Transfers out ⁽¹⁾	-	-	-	-
Balance, May 31, 2011	950	15,180	2,339	1,500
Realized gains (losses)	-	(289)	103	130
Unrealized gains (losses)	(22)	(80)	113	124
Return of capital/transfers to income	-	-	(306)	(119)
Purchases/capital calls	-	-	1,433	-
Settlements	-	-	-	-
Transfers out	-	-	-	-
Balance, May 31, 2012	\$ 928	\$ 14,811	\$ 3,682	\$ 1,635

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 14 – Fair Value of Financial Instruments (continued)

	Diversified Funds of Funds	Direct Investment Fund	Real Estate Funds	Healthcare Fund
Balance, May 31, 2010	\$ 4,794	\$ 253	\$ 6,180	\$ 593
Realized gains (losses)	324	67	358	88
Unrealized gains (losses)	985	119	1,828	123
Return of capital/transfers to income	(303)	(112)	-	(343)
Purchases/capital calls	625	61	-	153
Settlements	-	-	-	-
Transfers out ⁽¹⁾	-	-	-	-
Balance, May 31, 2011	6,425	388	8,366	614
Realized gains	82	322	533	158
Unrealized gains (losses)	410	(70)	1,664	(41)
Return of capital/transfers to income	(268)	(350)	-	(203)
Purchases/capital calls	250	-	-	37
Settlements	-	-	-	-
Transfers out	-	-	-	-
Balance, May 31, 2012	\$ 6,899	\$ 290	\$ 10,563	\$ 565

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 14 – Fair Value of Financial Instruments (continued)

	<u>Mezzanine Debt Fund</u>	<u>Hedge Fund</u>	<u>Split Interest Agreements</u>
Balance, May 31, 2010	\$ -	\$ 5,652	\$ 4,502
Realized gains (losses)	(43)	562	-
Unrealized gains	-	(170)	413
Return of capital/transfers to income	-	(45)	(198)
Purchases/capital calls	753	-	-
Settlements	-	(5,697)	-
Transfers out ⁽¹⁾	-	(302)	-
	<hr/>	<hr/>	<hr/>
Balance, May 31, 2011	710	-	4,717
Realized gains (losses)	63	-	-
Unrealized gains (losses)	(2)	-	470
Return of capital/transfers to income	(264)	-	(204)
Purchases/capital calls	616	-	1,744
Settlements	-	-	-
Transfers out	-	-	-
	<hr/>	<hr/>	<hr/>
Balance, May 31, 2012	<u>\$ 1,123</u>	<u>\$ -</u>	<u>\$ 6,727</u>

(1) Transfers out of Level 3 resulted from the redemption of a hedge fund investment on December 31, 2010, with a 5% portion retained by the fund manager until completion of the fund's audit. As of May 31, 2011, amounts are included in Other (Level 2), with such amounts paid to the University in July 2011.

Realized and unrealized net gains on Level 3 assets of \$3,895 and \$5,426 for the years ended May 31, 2012 and 2011, respectively, are reported in the consolidated statements of activities as a component of nonoperating realized/unrealized investment gain (loss). Net unrealized gains included in the consolidated statements of activities for Level 3 assets still held at May 31, 2012 are \$2,589.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 14 – Fair Value of Financial Instruments (continued)

Redemption, funding commitments, restrictions, and other information associated with the nature and valuation of applicable Level 2 and Level 3 investments is as follows. As of May 31, 2012, it is not probable that any of the investments listed below will be sold or transferred for amounts that differ from the recorded fair value.

	Fair Value at May 31, 2012	Unfunded Cash Commitments	Redemption Frequency (if Eligible)	Redemption Notice Period	Investment Strategies and Other Restrictions
Managed mutual funds (Level 2)					
Domestic small/mid cap	\$ 2,798	\$ -	Normally Monthly	10 days prior to month end	(a)
Managed diversified global multi- asset partnership (Level 3)	14,811	-	(b)	(b)	(b)
Private equity limited partnership investments (Level 3)					
Leveraged buy-out & distressed funds	3,682	579	(c)	n/a	(c), (f)
Venture capital fund	1,635	-	(c)	n/a	(c), (g)
Diversified fund of funds	6,899	1,575	(d)	n/a	(d), (h)
Direct investment fund	290	53	(c)	n/a	(c), (i)
Real estate funds	10,563	-	(e)	(e)	(e)
Healthcare fund	565	28	(d)	n/a	(d), (j)
Mezzanine debt fund	1,123	1,958	(d)	n/a	(d), (k)
	<u>\$ 42,366</u>	<u>\$ 4,193</u>			

- a) This category includes one fund, with the fair value estimated using active market exchanges valued at the last reported sales price. The investment in the fund can be redeemed given proper notice, unless any withdrawal would have an adverse effect on the fund. The fund's investment objective is to achieve long-term capital appreciation by investing in a portfolio of small and medium capitalization companies defined as companies whose market capitalizations fall within the range of the Russell 2500 Index at the time of purchase.
- b) This category includes one fund, with the fair value estimated using the net asset value of the University's ownership interest in partner's capital, which approximates market value. The University may receive up to 5% of its capital account balance as an automatic annual distribution. Currently, the University has elected to retain this 5% of its capital balance in the fund. The University may change this election annually, and the election must be made in the first quarter of the calendar year preceding the first calendar year to which the distribution applies, and amounts will be distributed within 90 days of the end of the calendar year, or within 10 business days after the fund's audited financial statements for the year are completed.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 14 – Fair Value of Financial Instruments (continued)

For distributions in excess of the automatic annual distribution, the University may request the withdrawal of all or a portion of its capital account on the last day of any calendar year by providing a withdrawal request at any time during the fourth quarter of the preceding calendar year. The amount must be at least \$1,000. The amount requested to be withdrawn will be apportioned between the liquid portion and limited liquidity portion of the University's capital account, as determined based on the liquidity attributes of the underlying fund investments. The fund will make a distribution within 30 days after the effective withdrawal date in an amount not less than 90% of the liquid portion, with the remaining liquid portion amount paid subsequent to the fund's financial statement audit. For withdrawal amounts attributable to the limited liquidity portion, distributions will be made within 45 days after the realization or deemed realization of assets held in that account. Distributions may be made in cash or in fund assets (or both). The fund general partner can also suspend the rights of the University and other limited partners to make withdrawals or receive distributions for all or part of any period of market disruption. The fund general partner may also limit withdrawals such that they do not exceed 15% of the liquid subaccount balance.

The fund's objective is to manage and grow long-term capital with equity-like annual returns of 10-12% over time, with lower than average risk.

- c) This category includes four private equity funds, with the fair values estimated using the net asset value per share of the investments, which approximates market value. Each fund is nonredeemable and can be sold only on the secondary market as long as the respective fund general partner receives an opinion from counsel that such a transfer is not in violation of certain sanctions of the Securities Act, Investment Company Act and/or federal tax laws. Distributions are received through the liquidation of the underlying assets of the funds. If these investments were held, it is estimated that the underlying assets of the funds would be liquidated by December 31, 2019.
- d) This category includes four private equity funds, with the fair values estimated using the net asset value per share of the investments, which approximates market value. The funds can only be redeemed through the liquidation of underlying assets, and as underlying assets are liquidated, distributions are received. It is estimated that the underlying assets of the illiquid funds will be liquidated between 2014 and 2024.
- e) This category includes two real estate funds that are primarily invested in U.S. commercial and residential real estate. The fair values of the investments in this category have been estimated using the net asset value of the University's ownership interest in partner's capital, which approximates market value. Investments representing approximately 50% of the investments in this category can be redeemed with at least 90 days notice, as liquid assets in the fund permits. The remaining portion of real estate funds can only be redeemed through liquidation of the underlying assets. It is estimated that the underlying assets of the illiquid funds will be liquidated by December 31, 2015.
- f) These funds include an investment in a diversified portfolio of private equity funds, primarily comprised of domestic leveraged buy-out funds, and an investment initiated in 2012 with a distressed debt fund.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 14 – Fair Value of Financial Instruments (continued)

- g) The fund invests in a diversified portfolio of private equity funds, primarily comprised of domestic venture capital funds.
- h) The funds invest 39% in domestic equity, 9% in international buy-out, 25% in U.S. buyout, 14% in U.S. venture capital, and 13% in international private equity, respectively. Each fund has the objective to generate capital appreciation at a rate in excess of that historically generated by investments in publically traded equity securities.
- i) The fund invests in privately-held entities, which have potential for significant growth in revenue and earnings.
- j) The fund invests in private equity and structured equity-related investments in healthcare companies.
- k) The fund makes mezzanine-level investments, which primarily consist of subordinated corporate debt and are typically coupled with an equity component in the form of common or preferred stock, options, or warrants.

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

Cash and cash equivalents – Due to the highly liquid nature, carrying value approximates fair value.

Notes receivable – The carrying value approximates fair value for notes receivable, which are primarily federally sponsored student loans with U.S. government mandated interest rates and repayment terms subject to significant restriction as to their transfer or disposition.

Contributions receivable – Fair value approximates carrying value based on the present value of expected future cash flows, less an allowance for collectability. The *Fair Value Measurements and Disclosures* Topic of FASB ASC requires a fair value measurement only at the time of initial recognition of a promise to give.

WHEFA bonds and notes payable – Fair values are determined using future cash flows discounted at a rate of interest currently offered for debt with similar remaining maturities. The fair value and carrying value of the WHEFA bonds payable at May 31, 2012, were approximately \$144,065 and \$130,488, respectively. The fair value and the carrying value of the WHEFA bonds payable at May 31, 2011, were approximately \$138,507 and \$134,506, respectively. The fair value of the WHEFA bonds payable has been provided by a third party. The fair value of notes payable to banks (including the line of credit agreement) approximates the carrying value.

THE CORPORATION OF GONZAGA UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS)

Note 14 – Fair Value of Financial Instruments (continued)

Valuation limitations – The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. In addition, while the University believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Note 15 – Related Parties

Contributions receivable includes amounts due from members of the Board as listed below:

	<u>2012</u>	<u>2011</u>
Contribution pledge receivable, net	\$ 2,087	\$ 3,500
Contributions revenue	311	533

The University has numerous banking relationships with a bank of which the chairman and CEO is a member of the Board.

Note 16 – Subsequent Events

On August 7, 2012, the WHEFA Revenue Bonds, Series 2012 A in the amount of \$7,305 and Series 2012 B in the amount of \$3,320, were issued to finance the construction of a mixed use parking and retail facility on the University campus (the Boone Avenue Retail Center). The Bonds are privately held by a national bank (the Bank) and bear interest at the rate of one month LIBOR plus 92 basis points, reset monthly. Interest is paid quarterly with principal paid annually beginning on April 1, 2014, based upon a thirty year amortization. The private placement with the Bank matures on July 31, 2022, and may be extended at the option of the Bank. The Bonds are secured on a parity basis with all other Bonds issued through the Authority (see Note 9). The covenants are substantially the same as those of the existing debt issued through the Authority. The variable interest rate exposure is expected to be hedged using existing interest rate swap agreements, as previously disclosed.

On July 31, 2012, the University made principal payments on other notes of \$674, of which \$500 and \$174 were otherwise scheduled for the years ended May 31, 2014 and 2015, respectively (see Note 9).

SUPPLEMENTARY INFORMATION

THE CORPORATION OF GONZAGA UNIVERSITY
UNRESTRICTED OPERATING EXPENSES COMBINED BY NATURAL EXPENDITURE
(IN THOUSANDS)

The University's classification on unrestricted operating expenses in the statements of activities are combined by natural expenditures as of May 31, 2012 and 2011, as follows.

	<u>2012</u>	<u>2011</u>
Salaries	\$ 82,010	\$ 78,258
Benefits	20,282	19,291
Meetings, travel, and memberships	10,087	9,151
Scholarships and student aid	9,564	9,950
Depreciation	8,769	8,870
Dining expenses	8,192	8,189
Occupancy, telephone, utilities, and insurance	8,189	8,076
Interest and fees on debt	7,081	7,214
Materials, supplies, printing, and postage	6,274	4,570
Professional fees and contracted services	4,884	4,694
Bookstore cost of goods sold	3,613	2,714
Maintenance and rentals	3,558	3,846
Library materials	2,184	2,230
Advertising, promotion, and recruitment	846	890
Other expenses	<u>5,614</u>	<u>4,931</u>
	<u>\$ 181,147</u>	<u>\$ 172,874</u>