



WAKE FOREST UNIVERSITY

Consolidated Financial Statements

June 30, 2014

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The Board of Trustees
Wake Forest University:

We have audited the accompanying consolidated financial statements of Wake Forest University (the University), which comprise the consolidated balance sheet as of June 30, 2014, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Wake Forest University as of June 30, 2014, and the changes in its net assets and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.



Report on Summarized Comparative Information

We have previously audited the 2013 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 17, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2013 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Other Matter

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

KPMG LLP

Greensboro, North Carolina
October 28, 2014

WAKE FOREST UNIVERSITY

Consolidated Balance Sheet

June 30, 2014

(with summarized comparative financial information as of June 30, 2013)

(Dollars in thousands)

Assets	Supplementary information			
	Reynolda Campus	WFUHS	2014	2013
Cash and cash equivalents	\$ 42,138	9,301	51,439	48,001
Accounts receivable, net	8,677	352,095	360,772	168,398
Patient receivables, net	—	49,294	49,294	77,974
Contributions receivable, net	102,528	5,051	107,579	90,545
Notes receivable, net	22,124	2,100	24,224	26,120
Investments	908,811	684,436	1,593,247	1,439,236
Investments in real estate	23,731	—	23,731	27,730
Other assets	9,380	14,334	23,714	25,647
Deposits with bond trustee	25	—	25	71,184
Land, buildings, and equipment, net	440,921	315,518	756,439	749,491
Total assets	\$ 1,558,335	1,432,129	2,990,464	2,724,326
Liabilities and Net Assets				
Liabilities:				
Accounts payable and accruals	\$ 24,631	256,030	280,661	167,751
Other liabilities and deferrals	73,604	281,717	355,321	287,617
Annuities payable	22,765	3,422	26,187	27,303
Notes payable and capital leases	5,905	19,107	25,012	54,685
Bonds payable	277,677	181,352	459,029	470,418
Postretirement benefits	15,258	43,964	59,222	13,022
Government grants refundable	9,688	—	9,688	9,827
Total liabilities	429,528	785,592	1,215,120	1,030,623
Net assets:				
Unrestricted	500,687	440,754	941,441	921,975
Temporarily restricted	364,550	57,850	422,400	390,112
Permanently restricted	263,570	147,933	411,503	381,616
Total net assets	1,128,807	646,537	1,775,344	1,693,703
Total liabilities and net assets	\$ 1,558,335	1,432,129	2,990,464	2,724,326

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Consolidated Statement of Activities

Year ended June 30, 2014

(with summarized comparative financial information for the year ended June 30, 2013)

(Dollars in thousands)

	2014			Total	2013 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Operating revenues:					
Student tuition and fees	\$ 317,607	—	—	317,607	298,715
Less student aid	(92,867)	—	—	(92,867)	(87,834)
Net student tuition and fees	224,740	—	—	224,740	210,881
Government grants and contracts	180,075	—	—	180,075	186,463
Private grants and contracts	4,570	13,352	—	17,922	21,667
Contributions	28,011	12,531	—	40,542	52,481
Investment return designated for current operations	37,470	25,633	—	63,103	61,046
Patient revenue, net	367,451	—	—	367,451	368,993
Other	242,826	—	—	242,826	132,203
Sales and services of auxiliary enterprises	80,284	—	—	80,284	77,564
Net assets released from restrictions	43,814	(43,814)	—	—	—
Total operating revenues	1,209,241	7,702	—	1,216,943	1,111,298
Operating expenses:					
Salaries and wages	581,163	—	—	581,163	594,942
Employee benefits	111,109	—	—	111,109	124,210
Student aid	9,083	—	—	9,083	8,969
Services	210,051	—	—	210,051	172,947
Clinical and laboratory supplies	50,050	—	—	50,050	43,565
Other operating expenses	204,176	—	—	204,176	96,704
Integration and restructuring costs	6,149	—	—	6,149	6,127
Depreciation and amortization	62,233	—	—	62,233	55,313
Interest on debt	17,813	—	—	17,813	15,947
Total operating expenses	1,251,827	—	—	1,251,827	1,118,724
Operating (deficit) excess	(42,586)	7,702	—	(34,884)	(7,426)
Nonoperating activities:					
Restricted contributions	—	33,858	26,508	60,366	53,378
Net assets released from restriction	36,259	(36,259)	—	—	—
Investment return in excess of (less than) amounts designated for current operations	34,856	28,836	7,021	70,713	25,607
Actuarial (loss) gain on annuity obligations	—	—	(821)	(821)	349
Unrealized gain (loss) on interest rate swaps	18	—	—	18	12,561
Postretirement related changes other than net periodic cost	(11,286)	—	—	(11,286)	7,529
Gain from affiliates, equity method	3,167	—	—	3,167	3,304
Donor designation changes	(594)	(158)	25	(727)	—
Other, net	(368)	(1,691)	(2,846)	(4,905)	90
Change from nonoperating activities	62,052	24,586	29,887	116,525	102,818
Change in net assets	19,466	32,288	29,887	81,641	95,392
Net assets at beginning of year	921,975	390,112	381,616	1,693,703	1,598,311
Net assets at end of year	\$ 941,441	422,400	411,503	1,775,344	1,693,703

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Statement of Activities

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

Year ended June 30, 2014

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating revenues:				
Student tuition and fees	\$ 280,636	—	—	280,636
Less student aid	(81,786)	—	—	(81,786)
Net student tuition and fees	198,850	—	—	198,850
Government grants and contracts	9,038	—	—	9,038
Private grants and contracts	2,364	—	—	2,364
Contributions	20,001	10,858	—	30,859
Investment return designated for current operations	17,848	19,420	—	37,268
Patient revenue, net	—	—	—	—
Other	7,078	—	—	7,078
Sales and services of auxiliary enterprises	80,284	—	—	80,284
Net assets released from restrictions	22,955	(22,955)	—	—
Total operating revenues	358,418	7,323	—	365,741
Operating expenses:				
Salaries and wages	173,795	—	—	173,795
Employee benefits	45,094	—	—	45,094
Student aid	3,415	—	—	3,415
Services	40,502	—	—	40,502
Clinical and laboratory supplies	—	—	—	—
Other operating expenses	51,674	—	—	51,674
Integration and restructuring costs	—	—	—	—
Depreciation and amortization	32,236	—	—	32,236
Interest on debt	11,952	—	—	11,952
Total operating expenses	358,668	—	—	358,668
Operating (deficit) excess	(250)	7,323	—	7,073
Nonoperating activities:				
Restricted contributions	—	33,858	20,767	54,625
Net assets released from restriction	36,259	(36,259)	—	—
Investment return in excess of (less than) amounts designated for current operations	16,296	22,228	5,118	43,642
Actuarial (loss) gain on annuity obligations	—	—	(1,297)	(1,297)
Unrealized gain (loss) on interest rate swaps	20	—	—	20
Postretirement related changes other than net periodic cost	(1,506)	—	—	(1,506)
Gain from affiliates, equity method	—	—	—	—
Donor designation changes	(594)	(158)	25	(727)
Other, net	(1,243)	(816)	(1,975)	(4,034)
Change from nonoperating activities	49,232	18,853	22,638	90,723
Change in net assets	48,982	26,176	22,638	97,796
Net assets at beginning of year	451,705	338,374	240,932	1,031,011
Net assets at end of year	\$ 500,687	364,550	263,570	1,128,807

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY
Statement of Activities
Wake Forest University Health Sciences
(Supplementary Information)
Year ended June 30, 2014
(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating revenues:				
Student tuition and fees	\$ 36,971			36,971
Less student aid	(11,081)			(11,081)
Net student tuition and fees	25,890	—	—	25,890
Government grants and contracts	171,037	—	—	171,037
Private grants and contracts	2,206	13,352	—	15,558
Contributions	8,010	1,673	—	9,683
Investment return designated for current operations	19,622	6,213	—	25,835
Patient revenue, net	367,451	—	—	367,451
Other	235,748	—	—	235,748
Sales and services of auxiliary enterprises	—	—	—	—
Net assets released from restrictions	20,859	(20,859)	—	—
Total operating revenues	<u>850,823</u>	<u>379</u>	<u>—</u>	<u>851,202</u>
Operating expenses:				
Salaries and wages	407,368	—	—	407,368
Employee benefits	66,015	—	—	66,015
Student aid	5,668	—	—	5,668
Services	169,549	—	—	169,549
Clinical and laboratory supplies	50,050	—	—	50,050
Other operating expenses	152,502	—	—	152,502
Integration and restructuring costs	6,149	—	—	6,149
Depreciation and amortization	29,997	—	—	29,997
Interest on debt	5,861	—	—	5,861
Total operating expenses	<u>893,159</u>	<u>—</u>	<u>—</u>	<u>893,159</u>
Operating (deficit) excess	<u>(42,336)</u>	<u>379</u>	<u>—</u>	<u>(41,957)</u>
Nonoperating activities:				
Restricted contributions	—	—	5,741	5,741
Net assets released from restriction	—	—	—	—
Investment return in excess of (less than) amounts designated for current operations	18,560	6,608	1,903	27,071
Actuarial (loss) gain on annuity obligations	—	—	476	476
Unrealized gain (loss) on interest rate swaps	(2)	—	—	(2)
Postretirement related changes other than net periodic cost	(9,780)	—	—	(9,780)
Gain from affiliates, equity method	3,167	—	—	3,167
Donor designation changes	—	—	—	—
Other, net	875	(875)	(871)	(871)
Change from nonoperating activities	<u>12,820</u>	<u>5,733</u>	<u>7,249</u>	<u>25,802</u>
Change in net assets	<u>(29,516)</u>	<u>6,112</u>	<u>7,249</u>	<u>(16,155)</u>
Net assets at beginning of year	470,270	51,738	140,684	662,692
Net assets at end of year	<u>\$ 440,754</u>	<u>57,850</u>	<u>147,933</u>	<u>646,537</u>

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Consolidated Statement of Cash Flows

Year ended June 30, 2014

(with summarized comparative financial information for the year ended June 30, 2013)

(Dollars in thousands)

	Supplementary information			
	Reynolda Campus	WFUHS	2014	2013
Cash flows from operating activities:				
Change in net assets	\$ 97,796	(16,155)	81,641	95,392
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Depreciation and amortization	32,236	29,997	62,233	55,313
Net appreciation on investments	(58,975)	(27,044)	(86,019)	(37,390)
Noncash gifts	(294)	(1,668)	(1,962)	(3,885)
Private gifts restricted for capital and long-term investment	(54,373)	(7,291)	(61,664)	(53,378)
Other revenue restricted for long-term investment	16	(27)	(11)	(433)
Loss on disposals of property and equipment	611	1,181	1,792	1,736
Gain from equity method affiliates	—	(3,167)	(3,167)	(3,304)
Unrealized (gain) loss on interest rate swaps	(20)	2	(18)	(12,561)
Bad debt expense	(30)	52,291	52,261	33,220
Write-off of bond issuance costs and original discount	—	—	—	576
Changes in operating assets and liabilities:				
Accounts and patient receivables	3,336	(217,738)	(214,402)	(22,020)
Contributions receivable	(4,893)	1,349	(3,544)	(20,318)
Notes receivable	(8)	—	(8)	(5)
Other assets and other liabilities and deferrals	(542)	69,488	68,946	98
Accounts payable and accruals	(5,759)	130,374	124,615	6,348
Postretirement benefits	2,236	9,152	11,388	(5,352)
Annuities payable	(640)	476	(164)	(1,185)
Net cash provided by operating activities	<u>10,697</u>	<u>21,220</u>	<u>31,917</u>	<u>32,852</u>
Cash flows from investing activities:				
Purchases of land, buildings, and equipment	(53,653)	(25,769)	(79,422)	(98,457)
Proceeds from sale of land, buildings, and equipment	1,323	—	1,323	5,930
Repayments of notes receivable	—	1,132	1,132	981
Disbursements of loans to students and other	(2,526)	(51)	(2,577)	(3,545)
Repayments of loans to students and other	3,203	64	3,267	4,261
Purchases of investments	(483,070)	(59,750)	(542,820)	(857,124)
Net proceeds from sales and maturities of investments	454,455	58,389	512,844	812,810
Decrease (increase) in deposits with bond trustee	71,159	—	71,159	(65,837)
Net cash used in investing activities	<u>(9,109)</u>	<u>(25,985)</u>	<u>(35,094)</u>	<u>(200,981)</u>
Cash flows from financing activities:				
Change in government grants refundable	(139)	—	(139)	(118)
Proceeds from notes payable	3,857	—	3,857	24,632
Payments on notes payable	(29,556)	(3,974)	(33,530)	(145,009)
Proceeds from issuance of bonds payable	—	—	—	313,065
Proceeds from borrowings from affiliates	—	(2,158)	(2,158)	37,450
Payments on bonds payable	(5,045)	(5,475)	(10,520)	(93,990)
Payments of bond issuance costs	—	—	—	(1,052)
Payments to terminate interest rate swaps	—	—	—	(36,258)
Proceeds from private gifts restricted for capital and long-term investment	41,079	7,291	48,370	40,645
Net realized gains restricted for long-term investment	251	473	724	732
Other revenue restricted for long-term investment	(16)	27	11	433
Net cash provided by (used in) financing activities	<u>10,431</u>	<u>(3,816)</u>	<u>6,615</u>	<u>140,530</u>
Net increase (decrease) in cash and cash equivalents	12,019	(8,581)	3,438	(27,599)
Cash and cash equivalents at beginning of year	<u>30,119</u>	<u>17,882</u>	<u>48,001</u>	<u>75,600</u>
Cash and cash equivalents at end of year	\$ <u>42,138</u>	<u>9,301</u>	<u>51,439</u>	<u>48,001</u>
Supplemental disclosures of cash flow information:				
Cash paid for interest	\$ 12,101	6,732	18,833	14,925
Assets acquired under capital leases	1,729	—	1,729	4,633
Transfer of plan assets to restricted investments	—	34,812	34,812	—

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(1) Organization and Summary of Significant Accounting Policies

(a) *Description of Wake Forest University*

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

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

The Integration Agreement created an integrated academic medical center that combines clinical care, education and research under a single management and debt structure referred to as Wake Forest Baptist (WFB), which is governed by WFUBMC. One of the nation's preeminent academic medical centers, WFB is an integrated healthcare system that operates over 40 subsidiaries. It provides a continuum of care that includes primary care centers, outpatient rehabilitation, and dialysis centers.

To ensure alignment across the organization, WFUHS and NCBH unrestricted operating income (deficit) are shared equally between the entities. Although the entities will be operated to maximize the value at the total WFB level, revenues, expenses, existing and new assets and debt will continue to be accounted for generally at the individual entity levels.

Effective March 26, 2011, NCBH, WFUHS, and WFUBMC formed a single obligated group (Obligated Group) under the existing NCBH master trust indenture (MTI). The separate WFUHS MTI was discharged and new obligations were issued to WFUHS obligation holders under the MTI. In addition, substantially all of the subsidiaries of NCBH, WFUHS, and WFUBMC were included in the single credit group (Combined Group) as Designated Members. The effect of the new credit structure is that each member of the Obligated Group becomes jointly and severally liable for all debt and other obligations that are to be evidenced and secured under the MTI.

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(b) Basis of Presentation

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

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

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

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

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

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

Revenues earned, expenses incurred, and returns made available for the University's operating purposes of teaching, research, patient care, and other programs and services are components of the operating excess or deficit presented in the consolidated statement of activities. The University considers the following items to be nonoperating activities: restricted contributions for capital and long-term investment and the related net assets released from restriction, investment return in excess of or less than amounts designated for current operations, actuarial gain or loss on annuity obligations, unrealized gain or loss on interest rate swaps, postretirement related changes other than net periodic cost, gain or loss from affiliates (equity method), donor designation changes, and other, net.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(c) **Cash Equivalents**

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

(d) **Revenue Recognition**

The University's revenue recognition policies are as follows:

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

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

Patient revenue, net – WFUHS records patient revenue at the estimated net realizable amounts due from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers and contractual adjustments. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and will be adjusted in future periods as interim or final settlements are determined.

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

WFUHS maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its charity care policy and equivalent service statistics. Costs incurred are estimated based on the ratio of total operating expenses to gross charges applied to charity care charges. The amounts of direct and indirect costs incurred for services and supplies furnished under WFUHS' charity care policy totaled approximately \$14,918 and \$13,585 in 2014 and 2013, respectively.

HITECH Incentive Funding for Meaningful Use of Electronic Health Records (EHR) – The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments under the Medicare and Medicaid programs for certain healthcare providers that use certified EHR

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

technology. The program is commonly referred to as the Health Information Technology for Economic and Clinical Health (HITECH) Act. To qualify for incentives under the HITECH Act, healthcare providers must meet designated EHR meaningful use criteria as defined by the Centers for Medicare and Medicaid Services (CMS). Incentive payments are awarded to healthcare providers who have attested to CMS that applicable meaningful use criteria have been met. Compliance with meaningful use criteria is subject to audit by the federal government or its designee and incentive payments are subject to adjustment in a future period. WFUHS recognizes revenue for EHR incentive payments in the period in which it has obtained reasonable assurance that it is in compliance with the applicable EHR meaningful use requirements. Accordingly, for the fiscal year ended June 30, 2014, WFUHS recognized EHR incentives of approximately \$4,988, which are included in other sources of revenue (separate from net patient service revenue) in the consolidated statement of activities.

(e) Contributions

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

(f) Investments

Investments in readily marketable debt and equity securities are stated at their fair values, which are determined based on quoted market prices. Investments in private equity and absolute return funds are reported at estimated fair value, utilizing their net asset values. Those net asset values are determined by the investment managers and are reviewed and evaluated by the University's or WFUHS' investment offices. These estimated fair values may differ from the values that would have been used had a ready market existed for these investments. Investments in equity method affiliates are accounted for using the equity method.

(g) Investments in Real Estate

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(h) *Split-Interest Agreements*

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

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

(i) *Fair Value Measurements*

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

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

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

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

The carrying amounts of cash and cash equivalents (Level 1), patient receivables (Level 2), and accounts receivable (Level 2) approximate fair value because of the terms and relatively short maturity of these financial instruments. The carrying amounts of contributions receivable represent the present value of estimated future cash flows, which approximates fair value (Level 3). Investments (Levels 1–3, see note 8) and deposits with bond trustee (Level 1) are reported at fair value as of the date of the consolidated financial statements. A reasonable estimate of the fair value of notes receivable from students under government loan programs cannot be made because such loans are not sellable and can only be assigned to the U.S. government or its designees. The fair value of receivables from students under University loan programs (Level 2) approximates carrying value.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

The carrying amounts of accounts payable and other accruals (Level 2) approximate fair value because of the relatively short maturity of these financial instruments. Annuities payable (Level 2) are recorded at fair value using a single discount rate equivalent to the University's nonexempt borrowing rate. The carrying amounts of notes and bonds payable (Level 2) with variable interest rates approximate their fair value because substantially all of these financial instruments bear interest at rates that approximate current market rates for borrowings with similar maturities and credit quality. The disclosure of fair value of fixed-rate debt maturities is determined using a relative price approach, by discounting future principal and interest payments at the market yield to maturity, and at the market yield to each call date. The fair value of Reynolda Campus Series 2009 fixed-rate tax-exempt bonds (Level 2) was \$116,956 and \$114,020 at June 30, 2014 and 2013, respectively. The fair value of WFUHS Series 2012B and Series 2012C fixed-rate bonds (Level 2) was \$119,181 and \$56,955, at June 30, 2014, respectively, and \$119,434 and \$59,045, at June 30, 2013, respectively.

(j) Bond Issuance Costs

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

(k) Deposits with Bond Trustee

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

(l) Land, Buildings, and Equipment

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

(m) Integration and Restructuring Costs

As a result of the Integration Agreement and management's continued efforts toward the creation of an integrated academic medical center, WFUHS has recognized \$6,149 and \$6,127 for the years ended June 30, 2014 and 2013, respectively, in associated integration and restructuring costs, which include payments to third parties for assistance with the integration agreement and establishment of an integrated clinical documentation and billing system as well as the recognition of termination benefits related to a reduction in force. Given the nature of these costs and in accordance with management's policy for the recognition of revenue and expense related to continuing operations, the integration and restructuring costs have been reported as an expense in the consolidated statement of activities.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(n) *Impairment of Long-Lived Assets*

The University periodically assesses the realizability of its long-lived assets and evaluates such assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. For assets to be held, impairment is determined to exist if estimated future cash flows, undiscounted and without interest charges, are less than the carrying amount. There were no impairment losses recorded in the consolidated statement of activities.

(o) *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.

(p) *Government Grants Refundable*

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

(q) *Derivative Instruments*

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

(r) *Postretirement Plans*

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

On June 2, 2011, WFUHS' Board of Directors approved that effective January 1, 2012, the postretirement medical and dental plan would be discontinued for most future retirees and was communicated to all employees on September 30, 2011. The minimum age required for postretirement benefits increased from 60 to 62. However, the additional requirement of the rule of 75 (age and service) remained unchanged. All current retirees and currently eligible employees previously grandfathered continued to be eligible for benefits under this plan. Any WFUHS employee who is within five years of meeting the new retirement eligibility of age 62 with combined age and years of service equal to at least 75 as of January 1, 2012 was grandfathered into this benefit plan.

During fiscal year 2014, WFUHS signed a declaration to terminate the voluntary employees' beneficiary association (VEBA) and amended the terms of the trust to allow the assets to be drawn down to pay eligible plan participants' health and dental claims. As a result of the amendment, the assets are no longer considered restricted as plan assets and are included in investments in the consolidated balance sheet. Upon complete liquidation of the VEBA, future health and dental claims will be paid from WFUHS' general assets.

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

(s) ***Use of Estimates***

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

(t) ***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. If applicable, unrelated business income is reported by all member and subsidiary organizations on IRS Form 990-T. Fiscal years ending on or after June 30, 2011 remain subject to examination by federal and state tax authorities. The University has evaluated uncertain tax positions for its fiscal years ended June 30, 2014 and 2013, including a quantification of tax risks in areas such as unrelated business income and taxation of its for-profit subsidiaries. This evaluation did not identify any material items that effect the consolidated financial statements for the years ended June 30, 2014 and 2013.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(u) Reclassifications

Certain amounts previously reported in the 2013 consolidated financial statements have been reclassified to conform to the 2014 presentation. Such reclassifications have no effect on total assets, liabilities or net assets as previously reported.

(v) Comparative Financial Information

The consolidated financial statements include certain prior year information for comparative purposes, which does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the University's consolidated financial statements for the year ended June 30, 2013 from which this information was derived.

(2) Accounts Receivable

The following is an analysis of accounts receivable at June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Accounts receivable	\$ 6,219	43,305	49,524	62,477
Grants receivable	2,932	34,063	36,995	41,276
Royalties receivable	—	275,465	275,465	65,919
Total accounts receivable	9,151	352,833	361,984	169,672
Less allowance for bad debts	(474)	(738)	(1,212)	(1,274)
Accounts receivable, net	<u>\$ 8,677</u>	<u>352,095</u>	<u>360,772</u>	<u>168,398</u>

In fiscal year 2014, WFUHS reached a settlement agreement with Kinetic Concepts, Inc. (KCI) that resolves a patent dispute between the two organizations over the Negative Pressure Wound Therapy technology. Under the terms of the settlement, KCI agrees to pay retrospective U.S. patent royalties over a four year period of \$280,000 to WFUHS to resolve all disputes between WFUHS and KCI. This settlement amount is included in accounts receivable net of the estimated present value of future cash flows, and in other operating revenue in the consolidated statement of activities. The receivable balance includes the inventors' share which represents 50% of the settlement amount. The corresponding liability for amounts due to the inventors is included in other liabilities in the consolidated balance sheet and in other operating expenses in the consolidated statement of activities.

(3) Patient Revenue and Patient Receivables

Net patient service revenue is recorded when patient services are performed at the estimated net realizable amounts from patients, third-party payers, and others for services rendered. WFUHS recognizes patient

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

service revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, WFUHS recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of WFUHS' uninsured patients will be unable or unwilling to pay for the services provided. Thus, WFUHS records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payer sources, and the related provision for bad debts are as follows:

	WFUHS	
	<u>2014</u>	<u>2013</u>
Third-party payers	\$ 348,977	327,640
Self-pay	70,694	73,290
Provision for bad debts	<u>(52,220)</u>	<u>(31,937)</u>
Patient revenue, net	<u>\$ 367,451</u>	<u>368,993</u>

WFUHS has agreements with third-party payers that provide for payments to WFUHS at amounts different from its established rates. Payment arrangements with nongovernmental payers are a negotiated percentage increase to the Medicare fee schedule allowable. Under the Medicare and Medicaid programs, WFUHS is entitled to reimbursement for billed current procedural terminology (CPT) codes at fee schedule rates determined by federal and state governments. Differences between established billing rates and reimbursements from these programs are recorded as contractual adjustments to arrive at net patient service revenue.

Patient receivables are reduced by an allowance for doubtful accounts. In evaluating the collectibility of patient receivables, WFUHS analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, WFUHS analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (e.g., for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), WFUHS records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

Subsequent to the implementation of a new patient accounting system, WFUHS has identified, through extensive analysis, revenue cycle and billing disruptions that have led to growing patient receivable balances along with corresponding cash collections not being realized. As a result of this comprehensive review, WFUHS recognized an unfavorable \$21,000 change in estimate to accurately reflect the realization of the outstanding patient receivables. This change in estimate is reflected as a reduction to patient service revenue in the consolidated statement of activities for the year ended June 30, 2014.

Patient receivables are recorded net of allowance for contractual adjustments and uncollectible accounts of \$123,761 and \$49,294, respectively, at June 30, 2014 and \$78,419 and \$44,093, respectively, at June 30, 2013.

WFUHS' allowance for doubtful accounts for self-pay patients decreased from 90% of self-pay accounts receivable at June 30, 2013 to 86% of self-pay accounts receivable at June 30, 2014. In addition, WFUHS' self-pay allowances and expenses (which include charity care charges foregone and bad debt expense) increased \$32,117 from \$63,679 for fiscal year 2013 to \$95,796 for fiscal year 2014. Both increases were the result of negative trends experienced in the collection of amounts from self-pay patients in fiscal year 2014. WFUHS does not maintain a material allowance for doubtful accounts from third-party payers, nor did it have significant write-offs from third-party payers.

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

	<u>2014</u>	<u>2013</u>
Medicare	11%	23%
Medicaid	20	19
Self-pay	38	30
Other	31	28
	<u>100%</u>	<u>100%</u>

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(4) Contributions Receivable

The following is an analysis of the maturities of the University's contributions receivable at June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
One year or less	\$ 24,393	2,291	26,684	21,892
Between one and five years	47,927	3,118	51,045	37,326
More than five years	95,674	433	96,107	96,484
Gross contributions receivable	167,994	5,842	173,836	155,702
Less estimated uncollectible amounts	(5,680)	(491)	(6,171)	(6,303)
Less discount to present value	(59,786)	(300)	(60,086)	(58,854)
Contributions receivable, net	\$ <u>102,528</u>	<u>5,051</u>	<u>107,579</u>	<u>90,545</u>

Contributions receivable, net for Reynolda Campus included perpetual commitments from a foundation with a long-standing history of support to the University. These long-term unconditional promises to give represented 34% of Reynolda Campus' net contributions receivable as of June 30, 2014.

(5) Notes Receivable

The following is an analysis of notes receivable at June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Student loans receivable	\$ 19,326	888	20,214	20,956
Other notes receivable	3,196	2,810	6,006	7,299
Total notes receivable	22,522	3,698	26,220	28,255
Less estimated uncollectible amounts	(398)	(1,598)	(1,996)	(2,135)
Notes receivable, net	\$ <u>22,124</u>	<u>2,100</u>	<u>24,224</u>	<u>26,120</u>

The University makes uncollateralized loans to students based on financial need. Student loans are funded through Federal government loan programs or institutional resources. At June 30, 2014 and 2013, student loans receivable consisted of Federal loan programs of \$18,467 and \$19,140, respectively, and institutional loan programs of \$1,747 and \$1,816, respectively. The University participates in the Perkins federal revolving loan program. The availability of funds for loans under the program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the Federal government of \$9,688 and \$9,827 at June 30, 2014 and 2013, respectively, are ultimately refundable to the

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

federal government and are reported as government grants refundable on the consolidated balance sheet. Outstanding loans canceled under the program result in a reduction of the funds available for loan and a decrease in the liability to the federal government. Amounts due under the Perkins loan program are guaranteed by the federal government and, therefore, no allowance for uncollectible amounts is reported under the program. Allowances for uncollectible institutional student loans are based on prior collection experience and current economic factors, which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. Institutional student loan balances are written off only when they are deemed to be permanently uncollectible. At June 30, 2014 and 2013, the allowance for uncollectible institutional student loan amounts was \$423 and \$387, respectively.

(6) Investments

Investments at June 30, 2014 and 2013 consist of the following:

	2014	2013
Short-term investments ^(a)	\$ 57,983	84,547
Absolute return ^(b)	300,657	286,822
Commodities: ^(c)		
Timberland	24,474	22,768
Energy	51,354	28,993
Other	14,206	17,840
Fixed income: ^(d)		
Domestic	381,155	346,079
International	80,531	82,277
Private equity ^(e)	106,233	108,707
Public equity: ^(f)		
Domestic	190,591	133,324
International	164,883	132,400
Real estate: ^(g)		
Commercial	39,779	38,313
Residential	19,962	19,887
Other	48,867	41,154
Beneficial interest in perpetual trusts and assets held by others ^(h)	27,269	24,258
Other	85,303	71,867
Total investments	\$ 1,593,247	1,439,236

(a) Includes short duration U.S. Treasury debt securities and other short-term, higher quality debt securities, cash and money market mutual funds.

(b) Includes investments in hedge funds and hedge fund-of-funds that invest both long and short on a global basis primarily in: equity securities (common stocks), credit securities (both investment grade

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

and noninvestment grade), commodities, and currencies. In aggregate, the expectation is that the returns of this segment should not be highly correlated to the broad equity market.

- (c) Includes primarily illiquid investments in timberland, oil and gas properties, and water rights and entitlements held through limited partnership interests. While many of the investments are U.S. focused, some are more global. The category also includes more liquid allocations made to commodity (precious metals, industrial materials, and energy) mutual funds.
- (d) Includes long only, hedge strategies, and illiquid investments in various fixed income strategies (both U.S. and non-U.S.) including: investment grade securities, noninvestment grade securities, mortgage backed securities, asset backed securities, Treasury Inflation Protected Securities (TIPS), distressed debt, senior loans, and bank loans. The long only position also includes mutual funds that have daily liquidity in U.S. and non-U.S. fixed income markets.
- (e) Includes illiquid investments primarily in buyout, growth equity, and venture capital (both U.S. and non-U.S.) held through limited partnership interests.
- (f) Includes investments primarily in U.S. and non-U.S. common stocks (including emerging markets) as well as funds that invest in U.S. and non-U.S. common stocks (including emerging markets), mutual funds, and exchange traded funds. While most of the assets are invested long only, some assets are invested on a hedged basis (both long and short).
- (g) Includes illiquid investments in commercial real estate, residential real estate, and farmland held through limited partnership interests. While many of the investments are U.S. focused, some are more global.
- (h) Includes trusts and certain other assets held and administered by others which the University has an unconditional right to receive all or a portion of the specified cash flows.

The University invests a substantial portion of these assets into an internal long-term pool on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of each quarter within which the transaction took place. At June 30, 2014, a total of 23,249,587 units existed in the long-term pool with a fair value of \$51.11 per unit. At June 30, 2013, a total of 22,435,685 units existed in the long-term pool with a fair value of \$48.56 per unit.

On October 18, 2013, the Board of Trustees approved the creation of Verger Capital Management LLC (VCM), of which the University is the controlling and majority member, to provide investment management services for the long-term pool. As of June 30, 2014, approximately 39.4% of the related investments had transferred to VCM. The remaining long-term pool investments are scheduled to transfer during fiscal year 2015, unless lock-up provisions exist. Verger Capital Fund LLC and Verger Fund I LLC were also created to support the investment of the long-term pool, and the University is the sole member of both organizations as of June 30, 2014. As of June 30, 2014, VCM, Verger Capital Fund LLC and Verger Fund I LLC are consolidated entities.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

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

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

	<u>2014</u>	<u>2013</u>
Investment income, net	\$ 37,426	29,880
Realized gains, net	33,705	47,517
Changes in unrealized appreciation (depreciation)	<u>62,685</u>	<u>9,256</u>
Total investment return	133,816	86,653
Investment return designated for current operations	<u>(63,103)</u>	<u>(61,046)</u>
Investment return in excess of (less than) amounts designated for current operations	<u>\$ 70,713</u>	<u>25,607</u>

Investment income has been reduced by investment fees of \$12,846 and \$11,047 in 2014 and 2013, respectively.

(7) Endowment

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

The Board of Trustees has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as allowing the University to appropriate for expenditure or accumulate so much of an endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. As a result of this interpretation, the University's policy is to report as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

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

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

The University has adopted investment and spending policies for endowment assets that support the objectives of optimizing long-term returns and providing a sustainable level of endowment income distribution to support the University's activities through the annual operating budget while preserving the real (inflation adjusted) purchasing power of the endowment. The University's primary investment objective is to maximize total return within reasonable and prudent levels of risk while maintaining sufficient liquidity to meet disbursement needs. The endowment spending rate for the years ended June 30, 2014 and 2013 was 5.3%, calculated as a percentage of the average of the previous three-year semiannual moving market value per unit and subject to a 10% maximum annual growth or decline in per-unit spending.

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

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the original gift. Deficiencies of this nature are reported in unrestricted net assets as follows: Reynolda Campus and WFUHS, respectively, were \$5,394 and \$756 as of June 30, 2014; and \$7,499 and \$1,631 as of June 30, 2013.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

Endowment net assets consist of the following at June 30, 2014 and 2013:

	2014			Total	2013 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Reynolda Campus:					
Donor-restricted endowment funds	\$ (5,394)	245,140	229,378	469,124	424,569
Board-designated endowment funds	244,610	—	—	244,610	235,794
Endowment net assets	<u>239,216</u>	<u>245,140</u>	<u>229,378</u>	<u>713,734</u>	<u>660,363</u>
WFUHS:					
Donor-restricted endowment funds	(756)	53,241	123,193	175,678	159,262
Board-designated endowment funds	258,614	—	—	258,614	242,013
Endowment net assets	<u>257,858</u>	<u>53,241</u>	<u>123,193</u>	<u>434,292</u>	<u>401,275</u>
Total endowment net assets	<u>\$ 497,074</u>	<u>298,381</u>	<u>352,571</u>	<u>1,148,026</u>	<u>1,061,638</u>

Changes in endowment net assets for the years ended June 30, 2014 and 2013 are as follows:

	2014			Total	2013 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Reynolda Campus:					
Beginning balance	\$ 228,295	220,429	211,639	660,363	615,648
Investment return:					
Investment income net of fees	1,519	3,035	35	4,589	8,648
Net appreciation	18,053	40,071	193	58,317	31,988
Total investment return	19,572	43,106	228	62,906	40,636
Contributions	46	1,065	17,643	18,754	12,487
Appropriation for expenditure	(8,606)	(19,460)	(132)	(28,198)	(30,143)
Transfers due to donor redesignations	—	—	—	—	20,598
Transfers to (from) Board-designated funds	(91)	—	—	(91)	1,137
Ending balance	<u>\$ 239,216</u>	<u>245,140</u>	<u>229,378</u>	<u>713,734</u>	<u>660,363</u>

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

	2014			Total	2013 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
WFUHS:					
Beginning balance	\$ 240,382	45,481	115,412	401,275	384,485
Investment return:					
Investment income net of fees	5,199	8,354	275	13,828	9,566
Net appreciation (depreciation)	20,337	1,278	1,068	22,683	17,731
Total investment return	25,536	9,632	1,343	36,511	27,297
Contributions	634	—	7,538	8,172	6,615
Appropriation for expenditure	(11,194)	(1,872)	(1,100)	(14,166)	(17,122)
Transfers due to donor redesignations	—	—	—	—	—
Transfers to (from) Board -designated funds	2,500	—	—	2,500	—
Ending balance	\$ 257,858	53,241	123,193	434,292	401,275

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(8) Fair Values of Assets and Liabilities

The following table summarizes the valuation of the University's assets and liabilities within the fair value hierarchy levels as of June 30, 2014:

	2014				2013
	Level 1	Level 2	Level 3	Total	Total
Financial assets:					
Cash and cash equivalents	\$ 51,439	—	—	51,439	48,001
Investments:					
Short-term investments	57,983	—	—	57,983	84,547
Absolute return	—	137,163	163,494	300,657	286,822
Commodities:					
Timberland	—	—	24,474	24,474	22,768
Energy	11,497	—	39,857	51,354	28,993
Other	7,549	—	6,657	14,206	17,840
Fixed income:					
Domestic	337,473	314	43,368	381,155	346,079
International	19,125	31,052	30,354	80,531	82,277
Private equity	—	—	106,233	106,233	108,707
Public equity:					
Domestic	96,563	29,818	64,210	190,591	133,324
International	101,733	29,427	33,723	164,883	132,400
Real estate:					
Commercial	—	—	39,779	39,779	38,313
Residential	—	—	19,962	19,962	19,887
Other	12,980	—	35,887	48,867	41,154
Beneficial interest in perpetual trusts and assets held by others					
Other	—	—	27,269	27,269	24,258
Other	2,759	40,752	41,792	85,303	71,867
Deposits with bond trustee	25	—	—	25	71,184
Total assets	\$ 699,126	268,526	677,059	1,644,711	1,558,421
Financial liabilities:					
Other liabilities and deferrals:					
Interest rate swap agreements	\$ —	20,012	—	20,012	20,030
Other employee benefits	—	40,752	—	40,752	32,583
Annuities payable	—	26,187	—	26,187	27,303
Total liabilities	\$ —	86,951	—	86,951	79,916

Most investments classified in Levels 2 and 3 consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. These shares or units are generally reported at the net asset value reported by the fund managers. Because the net asset value reported by each fund is used as a practical expedient to estimate fair value of the University's interest therein, its classification in Level 2 or 3 is based on the University's ability to redeem its interest at or near June 30. The classification of investments in the fair value hierarchy is not necessarily an indication of the

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

risks or liquidity of each investment's underlying assets and liabilities. In general, for Level 2 and Level 3 investments, the University utilizes the investment manager to provide a valuation estimate based on disclosed techniques and processes, which have been reviewed for propriety and consistency with consideration given to type and investment strategy.

The University's policy is to recognize transfers into and out of Levels 1, 2, and 3 as of the end of the year or when a change in level becomes known. There were no significant transfers between Level 1 and Level 2 securities during the year ended June 30, 2014.

Fair value for LIBOR-based interest rate swaps is determined using a relative price approach, by discounting the future expected cash flows at the market discount rate. For the variable leg of a swap, the expected cash flows are based on implied market forward rates for the appropriate underlying index. A credit value adjustment is applied to the total market value of the swap and quantifies the default risk of a counterparty using a default probability assumption based on the counterparty's credit default swap pricing at June 30, 2014.

Obligations under split-interest agreements reported in annuities payable were discounted at a rate that is equivalent to the University's nonexempt borrowing rate of 3.87%, and 3.96% at June 30, 2014, and 2013, respectively.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

The following table presents the reconciliation of Level 3 assets measured at fair value for the year ended June 30, 2014. Both observable and unobservable inputs may be used to determine the fair value of positions that the University has classified as Level 3.

	<u>Balance as of June 30, 2013</u>	<u>Total realized and unrealized gains (losses)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Net transfers out of Level 3</u>	<u>Balance as of June 30, 2014</u>
Investments:						
Absolute return	\$ 179,092	29,976	37,647	(50,876)	(32,345)	163,494
Commodities:						
Timberland	22,768	1,631	193	(118)	—	24,474
Energy	19,028	6,727	23,954	(9,852)	—	39,857
Other	6,526	132	497	(498)	—	6,657
Fixed income:						
Domestic	65,303	(403)	11,938	(33,470)	—	43,368
International	12,097	215	21,523	(3,481)	—	30,354
Private equity	108,707	16,312	23,360	(42,146)	—	106,233
Public equity:						
Domestic	48,553	9,212	22,953	(16,508)	—	64,210
International	27,473	5,106	1,849	(705)	—	33,723
Real estate:						
Commercial	38,313	3,326	8,891	(10,751)	—	39,779
Residential	19,887	1,132	5,752	(6,809)	—	19,962
Other	33,172	1,728	4,771	(3,784)	—	35,887
Interests in perpetual trusts and assets held by others	24,258	5,569	2,045	(4,603)	—	27,269
Other	37,843	3,949	—	—	—	41,792
Total assets	<u>\$ 643,020</u>	<u>84,612</u>	<u>165,373</u>	<u>(183,601)</u>	<u>(32,345)</u>	<u>677,059</u>

For the year ended June 30, 2014, a change in the University's ability to redeem investments in the near term at net asset value represents almost all of the net transfers from Level 3 to Level 2.

The University's aggregate unfunded private capital commitments are approximately \$116,738, or 7.3%, of total investments at June 30, 2014. Of these commitments, \$31,641 relates to private equity, \$12,509 relates to real estate, \$16,916 relates to commodities, \$31,834 relates to absolute return, and \$23,838 relates to fixed income. These commitments are expected to be called over a multi-year time frame. The University believes it has adequate liquidity and funding sources to meet these obligations.

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

inherently uncertain, the University takes these factors into consideration when allocating to private investments and believes that it has adequate liquidity to meet its obligations.

Investment liquidity as of June 30, 2014 is aggregated below based on redemption or sale period:

Daily, with 1 – 5 days notice	\$	648,535
Monthly, with 5 – 15 days notice		156,522
Quarterly, with 5 – 95 days notice		98,418
Semi-annually, with 45 – 95 days notice		71,788
Yearly, with 60 – 180 days notice		132,984
Liquidity within 2 years, with 60 – 95 days notice		81,203
Illiquid		403,797
Total as of June 30, 2014	\$	1,593,247

(9) Land, Buildings, and Equipment

Land, buildings, and equipment are summarized as follows at June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Land and improvements	\$ 25,197	97,404	122,601	119,321
Buildings and other improvements	614,726	390,838	1,005,564	873,070
Equipment and furnishings	98,032	181,587	279,619	257,634
Construction in progress	13,554	9,457	23,011	125,669
	751,509	679,286	1,430,795	1,375,694
Less accumulated depreciation	(310,588)	(363,768)	(674,356)	(626,203)
	\$ 440,921	315,518	756,439	749,491

Total depreciation expense on buildings, improvements, equipment, and furnishings was \$61,187 and \$54,315 for the years ended June 30, 2014 and 2013, respectively.

The University's policy is to capitalize interest cost incurred on debt during the construction of major projects exceeding one year. Interest cost of \$1,350 and \$4,055 was capitalized in the years ended June 30, 2014 and 2013, respectively.

The liabilities associated with AROs for the years ended June 30, 2014 and 2013, respectively, were \$14,643 and \$13,845 for Reynolda Campus, and \$3,254 and \$3,289 for WFUHS. These liabilities are reported in other liabilities and deferrals on the consolidated balance sheet.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(10) Notes, Capital Leases, and Bonds Payable

Notes, capital leases, and bonds payable at June 30, 2014 and 2013 consist of the following:

<u>Reynolda Campus</u>	<u>Years to nominal maturity</u>	<u>Interest rate at June 30, 2014</u>		<u>2014</u>	<u>2013</u>
Notes payable and capital leases:					
2007 Construction loan	—	—%		\$ —	27,361
2013 Construction loan	3	0.60	variable	2,127	—
1994 Construction loan	—	—		—	930
Promissory note	5	4.00	fixed	725	950
Capital leases	5	1.32 to 14.45	fixed	<u>3,053</u>	<u>2,363</u>
Total notes payable and capital leases				<u>5,905</u>	<u>31,604</u>
Bonds payable:					
2004 Series A tax-exempt	<1 to 6	0.06%	variable	26,290	28,065
2004 Series B tax-exempt	<1 to 6	0.04	variable	14,210	17,480
2009 Series serial tax-exempt	26	4.00 to 5.00	fixed	49,430	49,430
2009 Series term tax-exempt	25	5.00	fixed	60,570	60,570
2012 Series serial taxable	30	2.60 to 3.10	fixed	20,425	20,425
2012 Series term taxable	30	3.45 to 3.70	fixed	104,575	104,575
Unamortized bond premium				<u>2,177</u>	<u>2,264</u>
Total bonds payable				<u>277,677</u>	<u>282,809</u>
Total notes payable, capital leases, and bonds payable				<u>\$ 283,582</u>	<u>314,413</u>

Reynolda Campus has a three-year construction loan financing agreement with Branch Banking and Trust Company that permits the University to borrow up to \$100,000, bearing interest at LIBOR plus 0.45% to 0.60%. The loan agreement requires annual reviews on the December 31 anniversary date with interest payable quarterly.

Reynolda Campus has outstanding \$40,500 of tax-exempt North Carolina Facilities Finance Agency Revenue Bonds, Series 2004A and Series 2004B. The obligations of the University are evidenced by a loan agreement dated December 1, 2004, by and between the University and Branch Banking and Trust Company, as trustee. The Series 2004 tax-exempt bonds are due annually through 2020 in varying amounts from \$6,195 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 North Carolina Facilities Finance Agency Revenue Bonds, Series 2009, are evidenced by a loan agreement dated May 1, 2009, by and between the University and Branch Banking and Trust Company, as

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

trustee. The Series 2009 tax-exempt bonds have final maturities of January 1, 2039 for the serial bonds and January 1, 2038 for the term bonds. The 2009 bonds maturing on January 1, 2038 are subject to mandatory redemption through 2038 in increasing annual amounts of \$7,410 to \$10,005. Interest is payable each January 1 and July 1. The University's obligation under the loan agreement is an unsecured, unconditional obligation.

The Series 2012 taxable bonds are evidenced by a loan agreement dated August 2, 2012, by and between the University and Branch Banking and Trust Company, as trustee. The Series 2012 taxable bonds have final maturities of January 15, 2027 for the serial bonds and January 15, 2042 for the term bonds. The 2012 bonds maturing on January 15, 2032 and 2042 are subject to mandatory sinking fund redemptions through 2032 and 2042 in increasing annual amounts of \$5,445 to \$6,205 and \$6,405 to \$8,830, respectively. Interest is payable each January 15 and July 15. The University's obligation under the loan agreement is an unsecured, unconditional obligation.

WFUHS	Years to nominal maturity	Interest rate at June 30, 2014		2014	2013
Notes payable and capital leases:					
Loan agreement	<1 to 10	0.84%	variable	\$ 17,679	19,680
Equipment loan	<1	6.05	fixed	—	261
Promissory note	3	noninterest bearing		240	320
Promissory note	7	8.00	fixed	1,081	1,192
Capital leases	3	4.07 to 5.42	fixed	107	1,628
Total notes payable and capital leases				<u>19,107</u>	<u>23,081</u>
Bonds payable:					
Series 2012 B	<1 to 20	2.00 to 5.00%	fixed	109,220	112,605
Series 2012 C	<1 to 20	0.87	variable	56,955	59,045
Unamortized bond premium				<u>15,177</u>	<u>15,959</u>
Total bonds payable				<u>181,352</u>	<u>187,609</u>
Total notes payable, capital leases, and bonds payable				<u>\$ 200,459</u>	<u>210,690</u>

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

Bonds issued under the MTI are payable solely from the Obligated Group's revenues (as defined by the MTI). Additionally, the Combined Group must remain compliant with certain covenants and restrictions required by the MTI and loan agreements underlying the bonds. The Combined Group is subject to covenants under the MTI containing restrictions or limitations with respect to indebtedness, property encumbrance, consolidation or merger or transfer of assets. In addition, the Combined Group has agreed that it will not create any lien upon its property, accounts, or revenue now owned or hereafter acquired other than "permitted liens" as described in the MTI. WFUHS believes it is in compliance with such covenants and restrictions as of June 30, 2014. As of June 30, 2014, WFUHS is jointly and severally liable for \$499,980 of bonds payable borrowed by the other members of the Obligated Group and for \$89,000 under WFUBMC's line of credit. Because WFUHS does not expect to fund repayment of any of the amounts attributed to the other members of the Obligated Group under the MTI, no portion of these amounts meets the criteria for liability recognition in the accompanying consolidated financial statements.

The Series 2012 Revenue Bonds represent bonds issued by Wake Forest Baptist Obligated Group, representing funds borrowed by the entities pursuant to loan agreements with the North Carolina Medical Care Commission (NCMCC). As a conduit issuer, the NCMCC loans the debt proceeds to the borrower and the bonds are issued by the NCMCC under a MTI structure. The MTI provides the flexibility for multiple parties to participate in the debt issuances as part of an obligated group.

The Series 2012B bonds mature in full in fiscal year 2034. The fixed rate instruments bear interest at fixed coupon rates ranging from 2.00% to 5.00%. Per the bond agreements, the principal and sinking fund payments on the bonds are due on December 1 of each year beginning in 2014 and in increasing annual amounts of \$3,385 to \$7,000.

The Series 2012C bonds mature in full in fiscal year 2034. The bonds were issued in the Index Floating Rate Mode and bear interest at an Index Floating Rate based on the SIFMA Index plus a spread of 0.74%. At the option of WFUHS, the bonds may be converted to various interest rate modes. Per the bond agreements, the principal and sinking fund payments on the bonds are due on December 1 of each year beginning in 2014 and in increasing annual amounts of \$2,090 to \$4,825.

WFUHS entered a loan agreement during fiscal year 2013, with a variable interest rate based upon the one-month LIBOR plus a premium of 0.65% for \$20,214 to refinance two previously outstanding fixed rate notes. Fixed principal payments and accrued interest are due monthly with a final maturity date of April 1, 2023. This taxable loan is guaranteed by both NCBH and WFUBMC.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

Aggregate annual maturities of notes, capital leases, and bonds payable for each of the five fiscal years subsequent to June 30, 2014 and thereafter are as follows:

	Reynolda Campus	WFUHS	Total
2015	\$ 9,379	7,940	17,319
2016	7,464	8,037	15,501
2017	7,687	8,217	15,904
2018	7,247	8,415	15,662
2019	7,288	8,575	15,863
In total thereafter	242,340	144,098	386,438
	\$ 281,405	185,282	466,687

(11) Interest Rate Swap Agreements

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

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

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

	Reynolda Campus		WFUHS
	November 2006 interest rate swap	October 2008 interest rate swap	August 2002 interest rate swap
Notional amount	\$ 26,290	50,000	24,697
Effective date	November 6, 2006	October 1, 2008	August 20, 2002
Maturity date	January 1, 2020	January 1, 2038	July 1, 2034
Rate received	67% of one-month LIBOR	67% of one-month LIBOR	67% of one-month LIBOR
Rate paid	3.38%	3.61%	3.67%
Collateral provisions	None	100% liability if > \$20,000	100% asset/liability – \$250 min
Settlement frequency	Monthly	Monthly	Weekly

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

The University records all interest rate swap agreements in other liabilities and deferrals on the consolidated balance sheet at their respective fair values. The fair value of the interest rate swap agreements is the estimated amount the University would pay to terminate the swap agreements at the reporting date, taking into account current forward interest rates and the current forward creditworthiness of the swap counterparties. All changes in fair value are reflected as a gain or loss in nonoperating activities in the consolidated statement of activities. Periodic net cash settlement amounts with counterparties are accounted for as adjustments to interest expense on the related debt and collateral to support the swaps is included in investments on the consolidated balance sheet. Collateral held by counterparties at June 30, 2014 and 2013, respectively, was \$0 and \$0 for Reynolda Campus, and \$4,340 and \$4,600 for WFUHS.

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

	2014		2013	
	Fair value	Gain (Loss)	Fair value	Gain
Reynolda Campus:				
November 2006 interest rate swap	\$ (2,338)	545	(2,883)	1,116
October 2008 interest rate swap	<u>(13,120)</u>	<u>(525)</u>	<u>(12,595)</u>	<u>7,198</u>
Total	<u>(15,458)</u>	<u>20</u>	<u>(15,478)</u>	<u>8,314</u>
WFUHS:				
August 2002 interest rate swap	<u>(4,554)</u>	<u>(2)</u>	<u>(4,552)</u>	<u>4,247</u>
Total	<u>(4,554)</u>	<u>(2)</u>	<u>(4,552)</u>	<u>4,247</u>
Grand total	<u><u>\$ (20,012)</u></u>	<u><u>18</u></u>	<u><u>(20,030)</u></u>	<u><u>12,561</u></u>

As of June 30, 2014, the University's adjusted debt portfolio, after taking into account the aforementioned swap agreements, was 100% fixed rate for Reynolda Campus, and approximately 73% fixed rate for WFUHS.

(12) Net Assets

Temporarily restricted net assets are composed of the following at June 30, 2014 and 2013:

	2014			2013
	Reynolda Campus	WFUHS	Total	Total
Gifts and pledges	\$ 119,410	4,609	124,019	124,199
Grants and contracts	—	—	—	3
Donor-restricted endowments	<u>245,140</u>	<u>53,241</u>	<u>298,381</u>	<u>265,910</u>
	<u><u>\$ 364,550</u></u>	<u><u>57,850</u></u>	<u><u>422,400</u></u>	<u><u>390,112</u></u>

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

Such temporarily restricted net assets are available for the following purposes as of June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Student scholarships	\$ 166,338	6,005	172,343	152,766
Instruction and research	75,432	43,441	118,873	107,026
Academic support	51,144	8,404	59,548	58,163
Subsequent period operations, capital, and other	71,636	—	71,636	72,157
	<u>\$ 364,550</u>	<u>57,850</u>	<u>422,400</u>	<u>390,112</u>

Permanently restricted net assets are composed of the following at June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Donor-restricted endowments	\$ 229,378	123,193	352,571	327,051
Gifts and pledges	16,779	2,392	19,171	18,999
Student loan funds	1,175	4,813	5,988	5,914
Interests in perpetual trusts and assets held by others	5,143	14,921	20,064	16,974
Annuity and other split-interest agreements	11,095	2,614	13,709	12,678
	<u>\$ 263,570</u>	<u>147,933</u>	<u>411,503</u>	<u>381,616</u>

The future return on the following donor-restricted endowments is restricted for the following purposes as of June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Student scholarships	\$ 153,030	27,372	180,402	164,762
Instruction and research	49,331	78,380	127,711	123,324
Academic support	20,207	17,441	37,648	32,777
Subsequent period operations and other	6,810	—	6,810	6,188
	<u>\$ 229,378</u>	<u>123,193</u>	<u>352,571</u>	<u>327,051</u>

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(13) Functional Expenses

Expenses are reported in the consolidated statement of activities in natural categories. Functional expenses for the years ended June 30, 2014 and 2013 are categorized as follows:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Instruction and departmental research	\$ 117,417	185,436	302,853	183,424
Patient services	—	482,191	482,191	487,812
Sponsored research, training, and other programs	9,358	182,202	191,560	194,328
Organized activities	2,094	—	2,094	1,981
Academic support	28,348	12,156	40,504	35,463
Libraries	12,266	3,414	15,680	16,547
Student services	29,394	2,228	31,622	30,343
Institutional support	76,716	25,532	102,248	92,347
Auxiliary enterprises	83,075	—	83,075	76,479
Total operating expenses	\$ 358,668	893,159	1,251,827	1,118,724

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

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(14) Contingencies and Other Commitments

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

	<u>Reynolda Campus</u>	<u>WFUHS</u>	<u>Total</u>
Year ending June 30:			
2015	\$ 10,233	1,166	11,399
2016	9,986	693	10,679
2017	10,187	487	10,674
2018	10,297	466	10,763
2019	10,503	471	10,974
	<u>\$ 51,206</u>	<u>3,283</u>	<u>54,489</u>

Total income from real estate was \$10,123 and \$10,197 for Reynolda Campus and \$1,913 and \$2,340 for WFUHS for the years ended June 30, 2014 and 2013, respectively.

The estimated cost to complete construction in progress at June 30, 2014 and 2013, respectively, were \$21,035 and \$32,844 for Reynolda Campus, and \$2,146 and \$7,002 for WFUHS.

Grant awards not yet funded and for which services have not yet been performed are not recorded until services have been performed. At June 30, 2014, such grant awards amounted to \$9,987 and \$210,022 for Reynolda Campus and WFUHS, respectively.

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

The University is involved in legal actions arising in the normal course of activities and is subject to periodic audits and inquiries by regulatory agencies. Although the ultimate outcome of such matters is not determinable at this time, management, after taking into consideration advice of legal counsel, believes that the resolutions of pending matters will not have a materially adverse effect, individually or in the aggregate, upon the University's consolidated financial statements.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(15) Sale-Leaseback Agreement

In 2006, WFUHS entered into a sale-leaseback agreement to sell and lease back certain assets. The initial lease term is 20 years with four renewal options of five years each and the lease is classified as an operating lease. Operating lease payments in each year from 2015 to 2019 are \$7,516, \$7,591, \$7,667, \$7,744, and \$7,821 respectively, and \$64,210 thereafter.

In 2010, WFUHS entered into another sale-leaseback agreement to sell and lease back certain assets. The initial lease term is 16 years with three 5-year renewal options. The lease is classified as an operating lease. Operating lease payments are due monthly and expected payments each year from 2015 to 2019 are \$5,236, \$5,366, \$5,501, \$5,638, and \$5,779, respectively, and \$51,749 thereafter.

WFUHS has a deferred gain related to the sale and leaseback of certain assets. The deferred gain was \$25,019 and \$26,965 for 2014 and 2013, respectively, and is included in other liabilities and deferrals on the consolidated balance sheet.

(16) Retirement Plans

Substantially all employees of the University are eligible to participate in defined contribution benefit plans. The University contributes a specified percentage of each employee's salary to the plans. Contributions for the year ended June 30, 2014 and 2013, respectively, were \$11,496 and \$11,027 for Reynolda Campus and \$7,756 and \$24,075 for WFUHS.

Reynolda Campus and WFUHS have accrued \$2,493 and \$5,341 at June 30, 2014, respectively, for a liability associated with a defined benefit supplemental executive retirement plan. These liabilities are included in other liabilities and deferrals on the consolidated balance sheet.

(17) Postretirement Benefits

The University sponsors defined benefit postretirement medical and dental plans that cover all of its full-time employees who elect coverage and satisfy the plans' eligibility requirements when they retire. In addition, Reynolda Campus sponsors a death benefit plan which pays a \$2 benefit for each retiree. To be eligible, retired employees of Reynolda Campus must be at least 62 years of age with ten or more years of service or be at least 65 years of age with five or more years of service. Retired employees of WFUHS must satisfy the "Rule of 75", meaning that the employees' age and years of service must equal or exceed 75 at retirement with a minimum age of 60. Employees of Reynolda House, Inc. are not eligible for the plans. The plans are contributory with retiree contributions established based on the University contributions being fixed amounts. As discussed in note 1, the WFUHS plan was frozen on January 1, 2012. As discussed in note 1, WFUHS signed a declaration to terminate the VEBA. As a result of the declaration, the assets are no longer considered restricted as plan assets and are included in investments in the consolidated balance sheet. The impact of the declaration is reflected as a transfer of plan assets in the following tables.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

The following table sets forth the plan's benefit obligations, fair value of plan assets, funded status and balance sheet presentation at June 30, 2014 and 2013:

	2014			2013
	Reynolda Campus	WFUHS	Total	
Benefit obligations at June 30	\$ (15,258)	(43,964)	(59,222)	(50,789)
Fair value of plan assets at June 30	—	—	—	41,203
Total (liability) asset at June 30	\$ (15,258)	(43,964)	(59,222)	(9,586)
Balance sheet presentation:				
Assets	\$ —	—	—	3,436
Liabilities	(15,258)	(43,964)	(59,222)	(13,022)
Net	\$ (15,258)	(43,964)	(59,222)	(9,586)

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

The following table provides a reconciliation of the changes in each plan's benefit obligation, fair value of plan assets, and funded status for the years ended June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 13,022	37,767	50,789	57,304
Service cost	655	401	1,056	1,264
Interest cost	638	1,796	2,434	2,523
Participants' contributions	717	1,860	2,577	2,353
Actuarial loss (gain)	1,341	6,217	7,558	(8,224)
Benefits paid	(1,115)	(4,077)	(5,192)	(4,431)
Benefit obligation at end of year	15,258	43,964	59,222	50,789
Change in plan assets:				
Fair value of plan assets at beginning of year	—	41,203	41,203	38,930
Actual return on plan assets	—	5,087	5,087	2,273
Employer contributions	398	(9,261)	(8,863)	2,078
Participants' contributions	717	1,860	2,577	2,353
Benefits paid	(1,115)	(4,077)	(5,192)	(4,431)
Transfer of plan assets	—	(34,812)	(34,812)	—
Fair value of plan assets at end of year	—	—	—	41,203
Total (liability) asset	\$ (15,258)	(43,964)	(59,222)	(9,586)
Amounts recognized in unrestricted net assets:				
Prior service credit	\$ —	5,261	5,261	11,320
Net actuarial gain (loss)	1,769	(17,891)	(16,122)	(13,103)
Total increase (decrease)	\$ 1,769	(12,630)	(10,861)	(1,783)

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

The following table provides the components of net periodic benefit cost for the years ended June 30, 2014 and 2013:

	2014			2013 Total
	Reynolda Campus	WFUHS	Total	
Service cost	\$ 655	401	1,056	1,264
Interest cost	638	1,796	2,434	2,523
Expected return on plan assets	—	(2,884)	(2,884)	(2,725)
Amortization of prior service cost (credit)	—	(6,059)	(6,059)	(6,054)
Amortization of net actuarial (gain) loss	(145)	2,482	2,337	3,940
Net periodic benefit cost	\$ <u>1,148</u>	<u>(4,264)</u>	<u>(3,116)</u>	<u>(1,052)</u>

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

The actuarial net (gain) loss and prior service cost (credit) for the defined postretirement benefits plans that will be amortized from accumulated nonoperating income into net periodic benefit cost (credit) over the next fiscal year for Reynolda Campus and WFUHS are \$(18) and \$167, respectively.

The weighted average discount rate used to determine the accumulated postretirement benefit obligation at June 30, 2014 for Reynolda Campus and WFUHS, respectively, was 4.45% and 4.36%, and at June 30, 2013 was 5.01% and 4.87%, respectively. The discount rate reflects the current yield curve results as of June 30, 2014 and 2013. For management purposes, Reynolda Campus used 8.50% and 9.00%, and WFUHS used 8.00% and 8.50% for 2014 and 2013, respectively, for the annual rate of increase in the per capita cost of covered healthcare benefits for the first year, and a 4.50% rate was assumed in each year as the ultimate rate. The expected healthcare costs trend for the post-65 assumed an annual rate of 3.50% for 2014 and 2013. The expected return assumed on plan assets for WFUHS was 0.00% and 7.00% for 2014 and 2013. The rate is reviewed annually and adjusted as appropriate to reflect changes in the expected market performance of the investments.

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

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

	<u>One percentage increase</u>	<u>One percentage decrease</u>
Reynolda Campus:		
Effect on total service and interest cost components of net periodic benefit cost	\$ 44	(38)
Effect on postretirement benefit obligation	269	(236)
WFUHS:		
Effect on total service and interest cost components of net periodic benefit cost	\$ 15	(13)
Effect on postretirement benefit obligation	330	(275)

Aggregate benefits expected to be paid by the University in each of the next five fiscal years subsequent to June 30, 2014 and thereafter are as follows:

	<u>Reynolda Campus</u>	<u>WFUHS</u>	<u>Total</u>
2015	\$ 643	2,201	2,844
2016	620	2,365	2,985
2017	735	2,551	3,286
2018	780	2,657	3,437
2019	852	2,628	3,480
Five years thereafter	5,219	12,913	18,132
	<u>\$ 8,849</u>	<u>25,315</u>	<u>34,164</u>

The expected benefits to be paid are based on the same assumptions used to measure the University's benefit obligation at June 30, 2014 and include estimated future employee service.

Recent federal healthcare legislation includes several provisions that may affect the University's benefit plans, including imposing an excise tax on high cost coverage, eliminating lifetime and annual coverage limits, and imposing inflation-adjusted fees for each person covered by a health insurance policy for each policy plan year ending after September 30, 2012, through September 30, 2019. For the postretirement benefit plan, the changes due to recent federal healthcare legislation did not change the postretirement benefit obligation for Reynolda Campus and WFUHS.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(18) Related-Party Transactions

WFUHS and NCBH each incur expenses in the course of managing WFB as an integrated academic medical center. These expenses are aggregated and allocated between WFUHS and NCBH such that each individual entity bears a share of the expenses that is proportionate to the benefit received by each entity. Additionally, WFUHS and NCBH participate in various expansion projects, share certain facilities, provide various services, and incur certain expenses on behalf of each other. These transactions are recorded at fair value and the costs associated with operating and maintaining jointly occupied facilities are ultimately paid by the party having beneficial occupancy. For the year ended June 30, 2014, the settlement of these shared expenses resulted in a payable to NCBH of \$101,492, which is included in accounts payable on the consolidated balance sheet.

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

	<u>2014</u>	<u>2013</u>
(Expense) revenue from MCIA	\$ (20,906)	36,156
Corporate service allocation, net	50,923	34,483
Other professional fees, net	<u>42,005</u>	<u>68,979</u>
Total net revenue from NCBH	<u>\$ 72,022</u>	<u>139,618</u>

WFUBMC entered into an unsecured line of credit in the amount of \$160,000 to provide for the working capital needs of NCBH, WFUHS and their affiliates. This line of credit is guaranteed by both NCBH and WFUHS. The outstanding balance of this line of credit was \$124,367 and \$126,450 as of June 30, 2014 and 2013, respectively. A liability of \$35,367 and \$37,450 as of June 30, 2014 and 2013, respectively, due to WFUBMC has been recorded in other liabilities and deferrals for the proceeds of this line of credit that have been utilized by WFUHS.

(19) Professional Liability Insurance

WFB maintains professional liability coverage, which included a \$4,000 per occurrence and a \$16,000 annual aggregate self-insurance retention for the year ended June 30, 2014. WFUHS estimates its professional liability on an actuarial basis. WFUHS' accrued professional liability costs, including estimated claims incurred but not reported, amounted to approximately \$41,869 and \$40,086 at June 30, 2014 and 2013, respectively, and are included in other liabilities and deferrals on the consolidated balance sheet. In the opinion of management, adequate provision has been made for the related risk.

The estimated liability for self-insurance claims will be significantly affected if current and future claims differ from historical trends. While management monitors reported claims closely and considers potential outcomes as estimated by its actuaries when determining its self-insurance liability accruals, the complexity of the claims, the extended period of time to settle the claims and the wide range of potential outcomes complicate the estimation. In the opinion of management, adequate provision has been made for this related risk.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2014

(Dollars in thousands)

(20) HIPPA Compliance

Under the Health Insurance Portability and Accountability Act of 1996 (HIPPA), the federal government has authority to complete fraud and abuse investigations. HIPPA has established substantial fines and penalties for offenders. WFUHS maintains policies, procedures and requires regular training sessions to employers to monitor compliance with HIPPA, as well as other applicable local, state and federal statutes and regulations.

(21) Subsequent Events

The University has evaluated events occurring after June 30, 2014 through October 28, 2014, which represents the date the consolidated financial statements were issued and determined that all significant events and disclosures are included in the consolidated financial statements.