



WAKE FOREST UNIVERSITY

OMB Circular A-133 Reports

June 30, 2013

(With Independent Auditors' Report Thereon)

WAKE FOREST UNIVERSITY

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

Independent Auditors' Report

The Board of Trustees
Wake Forest University:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Wake Forest University (the University), which comprise the consolidated balance sheet as of June 30, 2013, 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 control 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free 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 auditor considers internal control relevant to the entity'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 entity'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 consolidated financial position of the University as of June 30, 2013, 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 University's 2012 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated October 25, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 17, 2013 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control over financial reporting and compliance.

KPMG LLP

Greensboro, North Carolina
October 17, 2013

WAKE FOREST UNIVERSITY

Consolidated Balance Sheet

June 30, 2013

(with summarized comparative financial information as of June 30, 2012)

(Dollars in thousands)

Assets	Supplementary information			
	Reynolda Campus	WFUHS	2013	2012
Cash and cash equivalents	\$ 30,119	17,882	48,001	75,600
Accounts receivable, net	12,098	156,300	168,398	181,191
Patient receivables, net	—	77,974	77,974	68,898
Contributions receivable, net	84,145	6,400	90,545	58,687
Notes receivable, net	22,875	3,245	26,120	27,801
Investments	820,711	618,525	1,439,236	1,353,115
Investments in real estate	27,730	—	27,730	27,199
Other assets	6,734	18,913	25,647	16,480
Deposits with bond trustee	71,184	—	71,184	5,347
Land, buildings, and equipment, net	428,564	320,927	749,491	703,151
Total assets	\$ 1,504,160	1,220,166	2,724,326	2,517,469
Liabilities and Net Assets				
Liabilities:				
Accounts payable and accruals	\$ 42,096	125,655	167,751	153,146
Other liabilities and deferrals	70,386	217,231	287,617	282,257
Annuities payable	23,405	3,898	27,303	28,488
Notes payable and capital leases	31,604	23,081	54,685	175,062
Bonds payable	282,809	187,609	470,418	251,886
Postretirement benefits	13,022	—	13,022	18,374
Government grants refundable	9,827	—	9,827	9,945
Total liabilities	473,149	557,474	1,030,623	919,158
Net assets:				
Unrestricted	451,705	470,270	921,975	954,518
Temporarily restricted	338,374	51,738	390,112	294,737
Permanently restricted	240,932	140,684	381,616	349,056
Total net assets	1,031,011	662,692	1,693,703	1,598,311
Total liabilities and net assets	\$ 1,504,160	1,220,166	2,724,326	2,517,469

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Consolidated Statement of Activities

Year ended June 30, 2013

(with summarized comparative financial information for the year ended June 30, 2012)

(Dollars in thousands)

	2013			2012 Total
	Unrestricted	Temporarily restricted	Permanently restricted	
Operating revenues:				
Student tuition and fees	\$ 298,715	—	—	298,715
Less student aid	(87,834)	—	—	(87,834)
Net student tuition and fees	210,881	—	—	210,881
Government grants and contracts	186,463	—	—	186,463
Private grants and contracts	4,706	16,961	—	21,667
Contributions	22,071	30,410	—	52,481
Investment return designated for current operations	37,808	23,238	—	61,046
Patient revenue, net	368,993	—	—	368,993
Other	132,203	—	—	132,203
Sales and services of auxiliary enterprises	77,564	—	—	77,564
Net assets released from restrictions	46,132	(46,132)	—	—
Total operating revenues	1,086,821	24,477	—	1,111,298
Operating expenses:				
Salaries and wages	594,942	—	—	594,942
Employee benefits	124,210	—	—	124,210
Student aid	8,969	—	—	8,969
Services	172,947	—	—	172,947
Clinical and laboratory supplies	43,565	—	—	43,565
Other operating expenses	96,704	—	—	96,704
Integration and restructuring costs	6,127	—	—	6,127
Depreciation and amortization	55,313	—	—	55,313
Interest on debt	15,947	—	—	15,947
Total operating expenses	1,118,724	—	—	1,118,724
Operating (deficit) excess	(31,903)	24,477	—	(7,426)
Nonoperating activities:				
Restricted contributions	—	23,830	29,548	53,378
Net assets released from restriction	5,460	(5,460)	—	—
Investment return in excess of (less than) amounts designated for current operations	11,450	10,172	3,985	25,607
Actuarial gain (loss) on annuity obligations	—	—	349	349
Unrealized gain (loss) on interest rate swaps	12,561	—	—	12,561
Postretirement related changes other than net periodic cost	7,529	—	—	7,529
Gain from affiliates, equity method	3,304	—	—	3,304
Donor designation changes	(42,687)	43,658	(971)	—
Other, net	1,743	(1,302)	(351)	90
Change from nonoperating activities	(640)	70,898	32,560	102,818
Change in net assets	(32,543)	95,375	32,560	95,392
Net assets at beginning of year	954,518	294,737	349,056	1,598,311
Net assets at end of year	\$ 921,975	390,112	381,616	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, 2013

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating revenues:				
Student tuition and fees	\$ 264,055	—	—	264,055
Less student aid	(76,867)	—	—	(76,867)
Net student tuition and fees	187,188	—	—	187,188
Government grants and contracts	8,725	—	—	8,725
Private grants and contracts	2,229	194	—	2,423
Contributions	16,159	29,355	—	45,514
Investment return designated for current operations	17,961	17,585	—	35,546
Patient revenue, net	—	—	—	—
Other	7,737	—	—	7,737
Sales and services of auxiliary enterprises	77,564	—	—	77,564
Net assets released from restrictions	24,020	(24,020)	—	—
Total operating revenues	341,583	23,114	—	364,697
Operating expenses:				
Salaries and wages	167,398	—	—	167,398
Employee benefits	43,480	—	—	43,480
Student aid	3,480	—	—	3,480
Services	35,468	—	—	35,468
Clinical and laboratory supplies	—	—	—	—
Other operating expenses	56,039	—	—	56,039
Integration and restructuring costs	—	—	—	—
Depreciation and amortization	26,506	—	—	26,506
Interest on debt	9,048	—	—	9,048
Total operating expenses	341,419	—	—	341,419
Operating (deficit) excess	164	23,114	—	23,278
Nonoperating activities:				
Restricted contributions	—	23,830	21,588	45,418
Net assets released from restriction	5,460	(5,460)	—	—
Investment return in excess of (less than) amounts designated for current operations	5,849	7,627	2,498	15,974
Actuarial gain (loss) on annuity obligations	—	—	1,124	1,124
Unrealized gain (loss) on interest rate swaps	8,314	—	—	8,314
Postretirement related changes other than net periodic cost	2,880	—	—	2,880
Gain from affiliates, equity method	—	—	—	—
Donor designation changes	(42,687)	43,658	(971)	—
Other, net	880	(439)	(230)	211
Change from nonoperating activities	(19,304)	69,216	24,009	73,921
Change in net assets	(19,140)	92,330	24,009	97,199
Net assets at beginning of year	470,845	246,044	216,923	933,812
Net assets at end of year	\$ 451,705	338,374	240,932	1,031,011

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY
Statement of Activities
Wake Forest University Health Sciences
(Supplementary Information)
Year ended June 30, 2013
(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating revenues:				
Student tuition and fees	\$ 34,660	—	—	34,660
Less student aid	(10,967)	—	—	(10,967)
Net student tuition and fees	23,693	—	—	23,693
Government grants and contracts	177,738	—	—	177,738
Private grants and contracts	2,477	16,767	—	19,244
Contributions	5,912	1,055	—	6,967
Investment return designated for current operations	19,847	5,653	—	25,500
Patient revenue, net	368,993	—	—	368,993
Other	124,466	—	—	124,466
Sales and services of auxiliary enterprises	—	—	—	—
Net assets released from restrictions	22,112	(22,112)	—	—
Total operating revenues	<u>745,238</u>	<u>1,363</u>	<u>—</u>	<u>746,601</u>
Operating expenses:				
Salaries and wages	427,544	—	—	427,544
Employee benefits	80,730	—	—	80,730
Student aid	5,489	—	—	5,489
Services	137,479	—	—	137,479
Clinical and laboratory supplies	43,565	—	—	43,565
Other operating expenses	40,665	—	—	40,665
Integration and restructuring costs	6,127	—	—	6,127
Depreciation and amortization	28,807	—	—	28,807
Interest on debt	6,899	—	—	6,899
Total operating expenses	<u>777,305</u>	<u>—</u>	<u>—</u>	<u>777,305</u>
Operating (deficit) excess	<u>(32,067)</u>	<u>1,363</u>	<u>—</u>	<u>(30,704)</u>
Nonoperating activities:				
Restricted contributions	—	—	7,960	7,960
Net assets released from restriction	—	—	—	—
Investment return in excess of (less than) amounts designated for current operations	5,601	2,545	1,487	9,633
Actuarial gain (loss) on annuity obligations	—	—	(775)	(775)
Unrealized gain (loss) on interest rate swaps	4,247	—	—	4,247
Postretirement related changes other than net periodic cost	4,649	—	—	4,649
Gain from affiliates, equity method	3,304	—	—	3,304
Donor designation changes	—	—	—	—
Other, net	863	(863)	(121)	(121)
Change from nonoperating activities	<u>18,664</u>	<u>1,682</u>	<u>8,551</u>	<u>28,897</u>
Change in net assets	<u>(13,403)</u>	<u>3,045</u>	<u>8,551</u>	<u>(1,807)</u>
Net assets at beginning of year	483,673	48,693	132,133	664,499
Net assets at end of year	<u>\$ 470,270</u>	<u>51,738</u>	<u>140,684</u>	<u>662,692</u>

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Consolidated Statement of Cash Flows

Year ended June 30, 2013

(with summarized comparative financial information for the year ended June 30, 2012)

(Dollars in thousands)

	Supplementary information			
	Reynolda Campus	WFUHS	2013	2012
Cash flows from operating activities:				
Change in net assets	\$ 97,199	(1,807)	95,392	(15,964)
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Depreciation and amortization	26,506	28,807	55,313	51,224
Net (appreciation) depreciation on investments	(28,100)	(9,290)	(37,390)	30,738
Noncash gifts	(2,198)	(1,687)	(3,885)	(129)
Private gifts restricted for capital and long-term investment	(45,418)	(7,960)	(53,378)	(31,799)
Other revenue restricted for long-term investment	(90)	(343)	(433)	(465)
Loss on disposals of property and equipment	70	1,666	1,736	1,976
Gain from equity method affiliates	—	(3,304)	(3,304)	(1,591)
Unrealized (gain) loss on interest rate swaps	(8,314)	(4,247)	(12,561)	34,664
Bad debt expense	1,283	31,937	33,220	33,428
Postretirement curtailment gain	—	—	—	(8,122)
Write-off of bond issuance costs and original discount	—	576	576	1,016
Changes in operating assets and liabilities:				
Accounts and patient receivables	(2,348)	(19,672)	(22,020)	(58,759)
Contributions receivable	(18,409)	(1,909)	(20,318)	(4,110)
Notes receivable	(5)	—	(5)	17
Other assets and other liabilities and deferrals	9,825	(9,727)	98	3,989
Accounts payable and accruals	4,776	1,572	6,348	7,675
Postretirement benefits	(1,678)	(3,674)	(5,352)	(7,390)
Annuities payable	(894)	(291)	(1,185)	2,271
Net cash provided by operating activities	<u>32,205</u>	<u>647</u>	<u>32,852</u>	<u>38,669</u>
Cash flows from investing activities:				
Purchases of land, buildings, and equipment	(82,935)	(15,522)	(98,457)	(101,344)
Proceeds from sale of land, buildings, and equipment	251	5,679	5,930	1,755
Repayments of notes receivable	—	981	981	730
Disbursements of loans to students and other	(3,249)	(296)	(3,545)	(2,509)
Repayments of loans to students and other	4,118	143	4,261	3,520
Purchases of investments	(782,520)	(74,604)	(857,124)	(640,832)
Net proceeds from sales and maturities of investments	733,432	79,378	812,810	599,250
(Increase) decrease in deposits with bond trustee	(65,837)	—	(65,837)	8,435
Net cash used in investing activities	<u>(196,740)</u>	<u>(4,241)</u>	<u>(200,981)</u>	<u>(130,995)</u>
Cash flows from financing activities:				
Change in government grants refundable	(118)	—	(118)	(158)
Proceeds from notes payable	2,984	21,648	24,632	109,070
Payments on notes payable	(3,667)	(141,342)	(145,009)	(19,655)
Proceeds from issuance of bonds payable	125,000	188,065	313,065	—
Proceeds from borrowings from affiliates	—	37,450	37,450	—
Payments on bonds payable	(4,880)	(89,110)	(93,990)	(97,966)
Payments of bond issuance costs	(1,052)	—	(1,052)	—
Payments to terminate interest rate swaps	—	(36,258)	(36,258)	—
Proceeds from private gifts restricted for capital and long-term investment	32,685	7,960	40,645	30,715
Net realized gains restricted for long-term investment	212	520	732	351
Other revenue restricted for long-term investment	90	343	433	465
Net cash provided by (used in) financing activities	<u>151,254</u>	<u>(10,724)</u>	<u>140,530</u>	<u>22,822</u>
Net decrease in cash and cash equivalents	(13,281)	(14,318)	(27,599)	(69,504)
Cash and cash equivalents at beginning of year	43,400	32,200	75,600	145,104
Cash and cash equivalents at end of year	\$ <u>30,119</u>	<u>17,882</u>	<u>48,001</u>	<u>75,600</u>
Supplemental disclosures of cash flow information:				
Cash paid for interest	\$ 7,072	7,853	14,925	13,489
Assets acquired under capital leases	2,984	1,649	4,633	65

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2013

(Dollars in thousands)

(1) Organization and Summary of Significant Accounting Policies

(a) *Description of Wake Forest University*

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

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

The Integration Agreement created an integrated academic medical center that combines clinical care, education and research under a single management and debt structure referred to as Wake Forest Baptist (WFB). One of the nation's preeminent academic medical centers, WFB is an integrated health care system that operates over 50 subsidiaries. It provides a continuum of care that includes primary care centers, outpatient rehabilitation, dialysis centers and home health care.

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

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

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2013

(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, 2013

(Dollars in thousands)

(c) **Cash Equivalents**

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

(d) **Revenue Recognition**

The University's revenue recognition policies are as follows:

Student tuition and fees – Student tuition and fees are recorded as revenue during the year that the related services are rendered. Student tuition and fees received in advance of services to be rendered are recorded as deferred revenue. Student aid provided by the University is reflected as a reduction of 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 net of contractual adjustments. WFUHS has agreements with third-party payors that provide for payments to WFUHS at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Patient revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

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 \$13,585 and \$15,040 in 2013 and 2012, respectively.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2013

(Dollars in thousands)

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 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, 2013, WFUHS recognized EHR incentives of approximately \$6,589, 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.

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(g) *Investments in Real Estate*

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

(h) *Split-Interest Agreements*

The University's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts and charitable gift annuities for which the University serves as trustee. Assets held in these trusts are stated at fair value and are included in investments. 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.

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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.

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 the Series 2009 fixed-rate tax-exempt bonds (Level 2) was \$114,020 and \$119,701 at June 30, 2013 and 2012, 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.

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(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 \$6,127 and \$1,922 for the years ended June 30, 2013 and 2012, 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.

(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 for Reynolda Campus and WFUHS for the years ended June 30, 2013 and 2012.

(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.

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(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.

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

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.

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(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. Unrelated business income of the University is reported on Form 990-T. The University recognizes the effect of income tax positions only if those positions are more likely than not of being sustained.

(u) *Reclassifications*

Certain amounts previously reported in the 2012 consolidated financial statements have been reclassified to conform to the 2013 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, 2012 from which this information was derived.

(w) *Recently Adopted Accounting Standards*

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, in 2011. This ASU requires the reason for the fair value measurement to be disclosed, a description of the valuation techniques, and descriptions of the inputs used for all Level 2 and Level 3 fair value measurements. The University implemented this standard in fiscal year 2013 and it had no effect on the change in net assets in the consolidated financial statements.

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(2) Accounts Receivable

The following is an analysis of accounts receivable at June 30, 2013 and 2012 (see note 19 for additional information):

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Accounts receivable	\$ 10,032	118,364	128,396	146,993
Grants receivable	2,502	38,774	41,276	35,365
Total accounts receivable	12,534	157,138	169,672	182,358
Less allowance for bad debts	(436)	(838)	(1,274)	(1,167)
Accounts receivable, net	\$ <u>12,098</u>	<u>156,300</u>	<u>168,398</u>	<u>181,191</u>

(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 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	
	2013	2012
Third-party payers	\$ 327,640	316,071
Self-pay	73,290	77,025
Provision for bad debts	(31,937)	(32,238)
Patient revenue, net	\$ <u>368,993</u>	<u>360,858</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 CPT codes at fee schedule rates determined by federal and state

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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.

Patient receivables are recorded net of allowance for contractual adjustments and uncollectible accounts of \$78,419 and \$44,093, respectively, at June 30, 2013 and \$98,741 and \$35,499, respectively, at June 30, 2012.

WFUHS' allowance for doubtful accounts for self-pay patients increased from 82% of self-pay accounts receivable at June 30, 2012 to 90% of self-pay accounts receivable at June 30, 2013. In addition, WFUHS' self-pay allowances and expenses (which include charity care charges foregone and bad debt expense) decreased \$1,679 from \$65,358 for fiscal year 2012 to \$63,679 for fiscal year 2013. Both increases were the result of negative trends experienced in the collection of amounts from self-pay patients in fiscal year 2013. 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:

	2013	2012
Medicare	23%	26%
Medicaid	19	16
Self-pay	30	25
Other	28	33
	100%	100%

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(4) Contributions Receivable

The following is an analysis of the maturities of the University's contributions receivable at June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
One year or less	\$ 21,377	515	21,892	21,887
Between one and five years	33,450	3,876	37,326	26,213
More than five years	93,198	3,286	96,484	57,346
Gross contributions receivable	148,025	7,677	155,702	105,446
Less estimated uncollectible amounts	(5,831)	(472)	(6,303)	(4,954)
Less discount to present value	(58,049)	(805)	(58,854)	(41,805)
Contributions receivable, net	\$ <u>84,145</u>	<u>6,400</u>	<u>90,545</u>	<u>58,687</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 42% of Reynolda Campus' net contributions receivable as of June 30, 2013.

(5) Notes Receivable

The following is an analysis of notes receivable at June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Student loans receivable	\$ 20,040	916	20,956	21,604
Other notes receivable	3,164	4,135	7,299	8,568
Total notes receivable	23,204	5,051	28,255	30,172
Less estimated uncollectible amounts	(329)	(1,806)	(2,135)	(2,371)
Notes receivable, net	\$ <u>22,875</u>	<u>3,245</u>	<u>26,120</u>	<u>27,801</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, 2013 and 2012, student loans receivable consisted of Federal loan programs of \$19,140 and \$19,791, respectively, and institutional loan programs of \$1,816 and \$1,813, 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 \$9,827 and \$9,945 at June 30, 2013 and 2012, respectively, are ultimately refundable to the

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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, 2013 and 2012, the allowance for uncollectible institutional student loan amounts was \$387 and \$420, respectively.

(6) Investments

Investments at June 30, 2013 and 2012 consist of the following:

	2013	2012
Short-term investments ^(a)	\$ 84,547	134,593
Absolute return ^(b)	286,822	221,348
Commodities: ^(c)		
Timberland	22,768	23,191
Energy	28,993	18,340
Other	17,840	16,085
Fixed income: ^(d)		
Domestic	346,079	381,356
International	82,277	82,750
Private equity ^(e)	108,707	108,655
Public equity: ^(f)		
Domestic	133,324	126,298
International	132,400	99,563
Real estate: ^(g)		
Commercial	38,313	35,721
Residential	19,887	22,142
Other	41,154	28,040
Beneficial interest in perpetual trusts and assets held by others ^(h)	24,258	24,936
Other	71,867	30,097
Total investments	\$ 1,439,236	1,353,115

(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

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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, 2013, a total of 22,435,685 units existed in the long-term pool with a fair value of \$48.56 per unit. At June 30, 2012, a total of 21,482,088 units existed in the long-term pool with a fair value of \$47.60 per unit.

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

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

	<u>2013</u>	<u>2012</u>
Investment income, net	\$ 29,880	21,877
Realized gains, net	47,517	27,560
Changes in unrealized appreciation (depreciation)	<u>9,256</u>	<u>(35,927)</u>
Total investment return	86,653	13,510
Investment return designated for current operations	<u>(61,046)</u>	<u>(60,658)</u>
Investment return in excess of (less than) amounts designated for current operations	<u>\$ 25,607</u>	<u>(47,148)</u>

Investment income has been reduced by investment fees of \$11,047 and \$9,414 in 2013 and 2012, 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.

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

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3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the University
7. The investment policies of the University

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

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

The endowment spending rate for the years ended June 30, 2013 and 2012 was 5.3%, calculated as a percentage of the average of the previous three-year semiannual moving market value per unit and subject to a 10% maximum annual growth or decline in per-unit spending.

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Endowment net assets consist of the following at June 30, 2013 and 2012:

	2013			2012 Total	
	Unrestricted	Temporarily restricted	Permanently restricted		Total
Reynolda Campus:					
Donor-restricted endowment funds	\$ (7,499)	220,429	211,639	424,569	361,147
Board-designated endowment funds	235,794	—	—	235,794	254,501
Endowment net assets	228,295	220,429	211,639	660,363	615,648
WFUHS:					
Donor-restricted endowment funds	(1,631)	45,481	115,412	159,262	148,558
Board-designated endowment funds	242,013	—	—	242,013	235,927
Endowment net assets	240,382	45,481	115,412	401,275	384,485
Total endowment net assets	\$ 468,677	265,910	327,051	1,061,638	1,000,133

Changes in endowment net assets for the years ended June 30, 2013 and 2012 are as follows:

	2013			2012 Total	
	Unrestricted	Temporarily restricted	Permanently restricted		Total
Reynolda Campus:					
Beginning balance	\$ 246,388	169,295	199,965	615,648	640,002
Investment return:					
Investment income net of fees	3,138	5,475	35	8,648	3,937
Net appreciation	10,776	20,991	221	31,988	587
Total investment return	13,914	26,466	256	40,636	4,524
Contributions	11	(14)	12,490	12,487	29,333
Appropriation for expenditure	(11,066)	(18,976)	(101)	(30,143)	(29,607)
Transfers due to donor redesignations	(22,089)	43,658	(971)	20,598	(3,677)
Transfers to (from) Board-designated funds	1,137	—	—	1,137	(24,927)
Ending balance	\$ 228,295	220,429	211,639	660,363	615,648

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Transfers due to donor redesignations in fiscal year 2013 include \$43,658 related to a donor designating an unrestricted contribution received during the fiscal year ended June 30, 2011 to a term endowment fund. This redesignation is reflected in the accompanying consolidated statement of activities in nonoperating activities.

	2013			Total	2012 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
WFUHS:					
Beginning balance	\$ 234,296	41,707	108,482	384,485	392,450
Investment return:					
Investment income net of fees	6,008	3,233	325	9,566	6,124
Net appreciation (depreciation)	11,212	5,961	558	17,731	(4,003)
Total investment return	17,220	9,194	883	27,297	2,121
Contributions	(11)	—	6,626	6,615	7,419
Appropriation for expenditure	(11,123)	(5,420)	(579)	(17,122)	(17,505)
Transfers due to donor redesignations	—	—	—	—	—
Transfers to (from) Board -designated funds	—	—	—	—	—
Ending balance	\$ 240,382	45,481	115,412	401,275	384,485

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 \$7,499 and \$1,631 as of June 30, 2013; and \$8,113 and \$1,631 as of June 30, 2012.

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(8) Fair Values of Assets and Liabilities

The following table summarizes the valuation of the University's assets and liabilities within the fair value hierarchy levels as of June 30, 2013:

	2013				2012
	Level 1	Level 2	Level 3	Total	Total
Financial assets:					
Cash and cash equivalents	\$ 48,001	—	—	48,001	75,600
Investments:					
Short-term investments	84,547	—	—	84,547	134,593
Absolute return	—	107,730	179,092	286,822	221,348
Commodities:					
Timberland	—	—	22,768	22,768	23,191
Energy	9,965	—	19,028	28,993	18,340
Other	11,314	—	6,526	17,840	16,085
Fixed income:					
Domestic	280,776	—	65,303	346,079	381,356
International	70,180	—	12,097	82,277	82,750
Private equity	—	—	108,707	108,707	108,655
Public equity:					
Domestic	49,611	35,160	48,553	133,324	126,298
International	80,885	24,042	27,473	132,400	99,563
Real estate:					
Commercial	—	—	38,313	38,313	35,721
Residential	—	—	19,887	19,887	22,142
Other	7,982	—	33,172	41,154	28,040
Beneficial interest in perpetual trusts and assets held by others					
Other	—	—	24,258	24,258	24,936
Other	1,441	32,583	37,843	71,867	30,097
Deposits with bond trustee	71,184	—	—	71,184	5,347
Total assets	\$ 715,886	199,515	643,020	1,558,421	1,434,062
Financial liabilities:					
Other liabilities and deferrals:					
Interest rate swap agreements	\$ —	20,030	—	20,030	68,849
Other employee benefits	—	32,583	—	32,583	25,738
Annuities payable	—	27,303	—	27,303	28,488
Total liabilities	\$ —	79,916	—	79,916	123,075

Most investments classified in Levels 2 and 3 consist of shares or units in investment funds as opposed to direct interests in the University underlying holdings, which may be marketable. 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. If the interest can be redeemed in the near term, the investment is classified as Level 2. The

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classification of investments in the fair value hierarchy is not necessarily an indication of the 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 change in circumstances that caused the transfer. There were no significant transfers between Level 1 and Level 2 securities during the year ended June 30, 2013.

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, 2013.

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 3.96% at June 30, 2013, and 3.02% at June 30, 2012.

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The following table presents the reconciliation of Level 3 assets measured at fair value for the year ended June 30, 2013. 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, 2012</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, 2013</u>
Investments:						
Absolute return	\$ 145,692	26,041	32,725	(25,366)	—	179,092
Commodities:						
Timberland	23,191	17	706	(1,146)	—	22,768
Energy	14,903	(283)	6,096	(1,688)	—	19,028
Other	4,856	(330)	2,000	—	—	6,526
Fixed income:						
Domestic	145,558	732	14,640	(68,677)	(26,950)	65,303
International	21,916	480	9,892	(17,882)	(2,309)	12,097
Private equity	108,655	3,909	20,127	(23,984)	—	108,707
Public equity:						
Domestic	35,804	5,610	20,656	(13,517)	—	48,553
International	17,976	2,126	20,369	(12,998)	—	27,473
Real estate:						
Commercial	35,721	1,541	9,872	(8,821)	—	38,313
Residential	22,142	995	5,231	(8,481)	—	19,887
Other	21,833	1,920	10,907	(1,488)	—	33,172
Interests in perpetual trusts and assets held by others	24,936	2,164	478	(3,320)	—	24,258
Other	30,097	2,255	39,125	(1,051)	(32,583)	37,843
Total assets	<u>\$ 653,280</u>	<u>47,177</u>	<u>192,824</u>	<u>(188,419)</u>	<u>(61,842)</u>	<u>643,020</u>

For the year ended June 30, 2013, 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 \$121,382 or 8.4% of total investments at June 30, 2013. Of these commitments, \$44,909 relates to private equity, \$20,010 relates to real estate, \$10,816 relates to commodities, \$16,417 relates to absolute return, and \$29,230 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 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.

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Investment liquidity as of June 30, 2013 is aggregated below based on redemption or sale period:

Daily, with 1 – 5 days notice	\$	574,573
Monthly, with 5 – 15 days notice		159,130
Quarterly, with 5 – 95 days notice		68,258
Semi-annually, with 45 – 95 days notice		54,113
Yearly, with 60 – 180 days notice		140,693
Liquidity within 2 years, with 60 – 95 days notice		86,580
Illiquid		355,889
Total as of June 30, 2013	\$	<u>1,439,236</u>

(9) Land, Buildings, and Equipment

Land, buildings, and equipment are summarized as follows at June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Land and improvements	\$ 21,945	97,376	119,321	119,724
Buildings and other improvements	493,676	379,394	873,070	869,193
Equipment and furnishings	80,353	177,281	257,634	232,022
Construction in progress	110,563	15,106	125,669	71,668
	<u>706,537</u>	<u>669,157</u>	<u>1,375,694</u>	<u>1,292,607</u>
Less accumulated depreciation	<u>(277,973)</u>	<u>(348,230)</u>	<u>(626,203)</u>	<u>(589,456)</u>
	<u>\$ 428,564</u>	<u>320,927</u>	<u>749,491</u>	<u>703,151</u>

Total depreciation expense on buildings, improvements, equipment, and furnishings was \$54,315 and \$50,184 for the years ended June 30, 2013 and 2012, 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 \$4,055 and \$2,446 was capitalized in the years ended June 30, 2013 and 2012, respectively.

The liabilities associated with AROs for the years ended June 30, 2013 and 2012, respectively, were \$13,845 and \$13,142 for Reynolda Campus, and \$3,785 and \$3,659 for WFUHS. These liabilities are reported in other liabilities and deferrals on the consolidated balance sheet.

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(10) Notes, Capital Leases, and Bonds Payable

Notes, capital leases, and bonds payable at June 30, 2013 and 2012 consist of the following:

<u>Reynolda Campus</u>	<u>Years to nominal maturity</u>	<u>Interest rate at June 30, 2013</u>		<u>2013</u>	<u>2012</u>
Notes payable and capital leases:					
Construction loan	<1	0.54%	variable	\$ 27,361	28,747
1994 Construction loan	2	4.19	fixed	930	1,823
Promissory note	6	4.00	fixed	950	1,175
Capital leases	3	1.32 to 14.45	fixed	<u>2,363</u>	<u>542</u>
Total notes payable and capital leases				<u>31,604</u>	<u>32,287</u>
Bonds payable:					
2004 Series A tax-exempt	<1 to 7	0.05%	variable	28,065	29,785
2004 Series B tax-exempt	<1 to 7	0.05	variable	17,480	20,640
2009 Series serial tax-exempt	27	4.00 to 5.00	fixed	49,430	49,430
2009 Series term tax-exempt	26	5.00	fixed	60,570	60,570
2012 Series serial taxable	14	2.60 to 3.10	fixed	20,425	—
2012 Series term taxable	29	3.45 to 3.70	fixed	104,575	—
Unamortized bond premium				<u>2,264</u>	<u>2,351</u>
Total bonds payable				<u>282,809</u>	<u>162,776</u>
Total notes payable, capital leases, and bonds payable				<u>\$ 314,413</u>	<u>195,063</u>

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Reynolda Campus has a construction loan financing agreement with a bank that permits the University to borrow up to \$50,000, bearing interest at one-month LIBOR plus 0.35%. The loan agreement requires annual reviews on the March 31 anniversary date with interest payable quarterly. The Reynolda Campus intends to maintain a similar agreement with a bank in 2014 eliminating the required principal and interest balloon payment due on March 31, 2014.

Reynolda Campus has outstanding \$45,545 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 \$5,045 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 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.

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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 January 15, 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, 2013		2013	2012
Notes payable and capital leases:					
Loan agreement				\$ —	89,115
Commercial loan				—	29,340
Loan agreement				—	9,241
Loan agreement	<1 to 10	0.84%	variable	19,680	—
Equipment loan	<1	6.05%	fixed	261	1,304
Loan agreement				—	11,962
Promissory note	4	noninterest bearing		320	400
Promissory note	8	8.00%	fixed	1,192	1,354
Capital leases	4	4.07% to 5.42%	fixed	1,628	59
Total notes payable and capital leases				<u>23,081</u>	<u>142,775</u>
Bonds payable:					
Series 2012 B	<1 to 21	2.00% to 5.00%	fixed	112,605	—
Series 2012 C	<1 to 21	0.87%	variable	59,045	—
2008 Series A tax-exempt				—	59,500
2008 Series B tax-exempt				—	29,610
Unamortized bond premium				15,959	—
Total bonds payable ^(a)				<u>187,609</u>	<u>89,110</u>
Total notes payable, capital leases, and bonds payable				<u>\$ 210,690</u>	<u>231,885</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.

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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, 2013. As of June 30, 2013, WFUHS is jointly and severally liable for \$494,399 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 2013 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 2013 and in increasing annual amounts of \$2,090 to \$4,825.

The Series 2008 Revenue Bonds represent funds borrowed by the entities pursuant to loan agreements with the North Carolina Medical Care Commission (NCMCC). As a conduit issuer, the NCMCC loans the debt proceeds to the borrower and the bonds are issued by the NCMCC under a MTI structure. The MTI provides the flexibility for multiple parties to participate in debt issuances as part of an obligated group. The Series 2008 bonds were refunded in full with the proceeds from the issuance of the Series 2012 bonds during fiscal year 2013.

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 \$20,014 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.

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Aggregate annual maturities of notes, capital leases, and bonds payable for each of the five fiscal years subsequent to June 30, 2013 and thereafter are as follows:

	<u>Reynolda Campus</u>	<u>WFUHS</u>	<u>Total</u>
2014	\$ 34,435	9,531	43,966
2015	6,918	7,772	14,690
2016	7,126	8,039	15,165
2017	7,345	8,191	15,536
2018	6,900	8,326	15,226
In total thereafter	<u>249,425</u>	<u>152,872</u>	<u>402,297</u>
	<u>\$ 312,149</u>	<u>194,731</u>	<u>506,880</u>

The 2014 maturities include a construction loan for \$27,361 for Reynolda Campus that management intends to renew in 2014 with a maturity date beyond 2014.

(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. The University has entered into interest rate swap agreements to manage interest cost and risks associated with its variable rate debt portfolios.

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

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

	<u>Reynolda Campus</u>		<u>WFUHS</u>	
	<u>November 2006</u> <u>interest rate swap</u>	<u>October 2008</u> <u>interest rate swap</u>	<u>August 2002</u> <u>interest rate swap</u>	<u>February 2007</u> <u>interest rate swap</u>
Notional amount	\$ 28,065	50,000	25,314	—
Effective date	November 6, 2006	October 1, 2008	August 20, 2002	February 26, 2007
Maturity date	January 1, 2020	January 1, 2038	July 1, 2034	July 1, 2034
Rate received	67% of one-month LIBOR	67% of one-month LIBOR	67% of one-month LIBOR	67% of one-month LIBOR
Rate paid	3.38%	3.61%	3.67%	3.52%
Collateral provisions	None	100% liability if > \$20,000	100% asset/liability – \$250 min	100% asset/liability – \$250 min
Settlement frequency	Monthly	Monthly	Weekly	Weekly

The University records all interest rate swap agreements in other liabilities and deferrals on the consolidated balance sheet at their respective fair values. The fair value of the interest rate swap agreements is the estimated amount the University would pay to terminate the swap agreements at the reporting date, taking into account current forward interest rates and the current forward creditworthiness of the swap counterparties. All changes in fair value are reflected as a gain or loss in nonoperating activities in the consolidated statement of activities. Periodic net cash settlement amounts with counterparties are accounted for as adjustments to interest expense on the related debt and collateral to support the swaps is included in investments on the consolidated balance sheet. During the year ended June 30, 2013, WFUHS made payments totaling \$36,258 to terminate the 2007 agreement and to reduce the notional amount of the 2002 agreement. Collateral held by counterparties at June 30, 2013 and 2012, respectively, was \$0 and \$300 for Reynolda Campus, and \$4,600 and \$45,580 for WFUHS.

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

	<u>2013</u>		<u>2012</u>	
	<u>Fair value</u>	<u>Gain</u>	<u>Fair value</u>	<u>Loss</u>
Reynolda Campus:				
November 2006 interest rate swap	\$ (2,883)	1,116	(3,999)	(987)
October 2008 interest rate swap	(12,595)	7,198	(19,793)	(12,064)
Total	(15,478)	8,314	(23,792)	(13,051)
WFUHS:				
August 2002 interest rate swap	(4,552)	4,247	(21,098)	(9,867)
February 2007 interest rate swap	—	—	(23,959)	(11,746)
Total	(4,552)	4,247	(45,057)	(21,613)
Grand total	\$ (20,030)	12,561	(68,849)	(34,664)

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As of June 30, 2013, the University's adjusted debt portfolio, after taking into account the aforementioned swap agreements, was 100% fixed rate for Reynolda Campus, and approximately 84% fixed rate for WFUHS.

(12) Net Assets

Temporarily restricted net assets are composed of the following at June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Gifts and pledges	\$ 117,945	6,254	124,199	81,400
Grants and contracts	—	3	3	2,335
Donor-restricted endowments	220,429	45,481	265,910	211,002
	\$ 338,374	51,738	390,112	294,737

Such temporarily restricted net assets are available for the following purposes as of June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Student scholarships	\$ 147,190	5,576	152,766	91,685
Instruction and research	70,416	36,610	107,026	100,695
Academic support	48,611	9,552	58,163	50,294
Subsequent period operations, capital, and other	72,157	—	72,157	52,063
	\$ 338,374	51,738	390,112	294,737

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Permanently restricted net assets are composed of the following at June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Donor-restricted endowments	\$ 211,639	115,412	327,051	308,447
Gifts and pledges	14,647	4,352	18,999	9,568
Student loan funds	1,128	4,786	5,914	5,866
Interests in perpetual trusts and assets held by others	3,469	13,505	16,974	16,464
Annuity and other split-interest agreements	10,049	2,629	12,678	8,711
	<u>\$ 240,932</u>	<u>140,684</u>	<u>381,616</u>	<u>349,056</u>

The future return from donor-restricted endowments is available for the following purposes as of June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Student scholarships	\$ 143,410	21,352	164,762	157,931
Instruction and research	46,025	77,299	123,324	113,080
Academic support	16,016	16,761	32,777	31,361
Subsequent period operations and other	6,188	—	6,188	6,075
	<u>\$ 211,639</u>	<u>115,412</u>	<u>327,051</u>	<u>308,447</u>

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(13) Functional Expenses

Expenses are reported in the consolidated statement of activities in natural categories. Functional expenses for the years ended June 30, 2013 and 2012 are categorized as follows:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Instruction and departmental research	\$ 114,709	68,715	183,424	170,095
Patient services	—	487,812	487,812	448,883
Sponsored research, training, and other programs	10,832	183,496	194,328	201,941
Organized activities	1,981	—	1,981	2,006
Academic support	22,586	12,877	35,463	32,209
Libraries	12,997	3,550	16,547	15,934
Student services	28,150	2,193	30,343	28,081
Institutional support	73,685	18,662	92,347	118,429
Auxiliary enterprises	76,479	—	76,479	75,378
Total operating expenses	\$ 341,419	777,305	1,118,724	1,092,956

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

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(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:			
2014	\$ 10,034	243	10,277
2015	10,236	149	10,385
2016	10,441	89	10,530
2017	10,564	50	10,614
2018	10,775	24	10,799
	<u>\$ 52,050</u>	<u>555</u>	<u>52,605</u>

Total income from real estate was \$10,197 and \$9,756 for Reynolda Campus and \$2,340 and \$3,531 for WFUHS for the years ended June 30, 2013 and 2012, respectively.

The estimated cost to complete construction in progress at June 30, 2013 and 2012, respectively, were \$32,844 and \$84,119 for Reynolda Campus, and \$7,002 and \$9,560 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, 2013, such grant awards amounted to \$9,191 and \$185,776 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.

(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 2014 to 2018 are \$7,441, \$7,516, \$7,591, \$7,667, and \$7,744, respectively.

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.

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Operating lease payments are due monthly and expected payments each year from 2014 to 2018 are \$5,107, \$5,236, \$5,366, \$5,501, and \$5,638 respectively.

WFUHS has a deferred gain related to the sale and lease back of certain assets. The deferred gain was \$26,965 and \$28,911 for 2013 and 2012, 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, 2013 and 2012, respectively, were \$11,027 and \$10,408 for Reynolda Campus and \$24,075 and \$27,219 for WFUHS.

Reynolda Campus and WFUHS have accrued \$2,093 and \$3,683 at June 30, 2013, 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.

The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at June 30, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Benefit obligations at June 30	\$ (13,022)	(37,767)	(50,789)	(57,304)
Fair value of plan assets at June 30	—	41,203	41,203	38,930
Total (liability) asset at June 30	\$ (13,022)	3,436	(9,586)	(18,374)

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Notes to Consolidated Financial Statements

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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, 2013 and 2012:

	2013			2012 Total
	Reynolda Campus	WFUHS	Total	
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 14,700	42,604	57,304	72,812
Service cost	747	517	1,264	2,084
Interest cost	658	1,865	2,523	2,914
Plan amendments	—	—	—	(26,847)
Participants' contributions	678	1,675	2,353	2,174
Actuarial (gain) loss	(2,730)	(5,494)	(8,224)	8,379
Benefits paid	<u>(1,031)</u>	<u>(3,400)</u>	<u>(4,431)</u>	<u>(4,212)</u>
Benefit obligation at end of year	<u>13,022</u>	<u>37,767</u>	<u>50,789</u>	<u>57,304</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	—	38,930	38,930	38,926
Actual return on plan assets	—	2,273	2,273	4
Employer contributions	353	1,725	2,078	2,038
Participants' contributions	678	1,675	2,353	2,174
Benefits paid	<u>(1,031)</u>	<u>(3,400)</u>	<u>(4,431)</u>	<u>(4,212)</u>
Fair value of plan assets at end of year	<u>—</u>	<u>41,203</u>	<u>41,203</u>	<u>38,930</u>
Total (liability) asset	\$ <u><u>(13,022)</u></u>	\$ <u><u>3,436</u></u>	\$ <u><u>(9,586)</u></u>	\$ <u><u>(18,374)</u></u>
Amounts recognized in unrestricted net assets:				
Prior service credit	\$ —	11,320	11,320	17,374
Net actuarial gain (loss)	<u>3,255</u>	<u>(16,358)</u>	<u>(13,103)</u>	<u>(24,814)</u>
Total increase (decrease)	\$ <u><u>3,255</u></u>	\$ <u><u>(5,038)</u></u>	\$ <u><u>(1,783)</u></u>	\$ <u><u>(7,440)</u></u>

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Notes to Consolidated Financial Statements

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The following table provides the components of net periodic benefit cost for the years ended June 30, 2013 and 2012:

	2013			2012
	Reynolda Campus	WFUHS	Total	Total
Service cost	\$ 747	517	1,264	2,084
Interest cost	658	1,865	2,523	2,914
Expected return on plan assets	—	(2,725)	(2,725)	(2,547)
Amortization of prior service cost (credit)	5	(6,059)	(6,054)	(4,623)
Amortization of net actuarial loss	—	3,940	3,940	5,616
Curtailement gain	—	—	—	(8,097)
Net periodic benefit cost	<u>\$ 1,410</u>	<u>(2,462)</u>	<u>(1,052)</u>	<u>(4,653)</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 \$(145) and \$(3,576), respectively.

The weighted average discount rate used to determine the accumulated postretirement benefit obligation at June 30, 2013 for Reynolda Campus and WFUHS, respectively, was 5.01% and 4.87%, and at June 30, 2012 was 4.56% and 4.47%, respectively. The discount rate reflects the current yield curve results as of June 30, 2013 and 2012. For management purposes, Reynolda Campus used 9.00% and 9.50%, and WFUHS used 8.50% and 9.00% for 2013 and 2012, 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 2013 and 2012. The expected return assumed on plan assets for WFUHS was 7.00% for 2013 and 7.00% for 2012. The rate is reviewed annually and adjusted as appropriate to reflect changes in the expected market performance of the investments.

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

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

		<u>One percentage increase</u>	<u>One percentage decrease</u>
Reynolda Campus:			
Effect on total service and interest cost components of net periodic benefit cost	\$	31	(27)
Effect on postretirement benefit obligation		181	(160)
WFUHS:			
Effect on total service and interest cost components of net periodic benefit cost	\$	14	(12)
Effect on postretirement benefit obligation		255	(221)

Aggregate benefits expected to be paid by the University in each of the next five fiscal years subsequent to June 30, 2013 and thereafter are as follows:

	<u>Reynolda Campus</u>	<u>WFUHS</u>	<u>Total</u>
2014	\$ 571	1,814	2,385
2015	631	2,037	2,668
2016	688	2,222	2,910
2017	757	2,433	3,190
2018	804	2,537	3,341
Five years thereafter	4,851	12,675	17,526
	\$ <u>8,302</u>	<u>23,718</u>	<u>32,020</u>

The expected benefits to be paid are based on the same assumptions used to measure the University's benefit obligation at June 30, 2013 and include estimated future employee service.

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Recent federal health care legislation includes several provisions that may affect the University's benefit plans, including imposing an excise tax on high cost coverage, eliminating lifetime and annual coverage limits, and imposing inflation-adjusted fees for each person covered by a health insurance policy for each policy plan year ending after September 30, 2012, through September 30, 2019. For the postretirement benefit plan, the changes due to recent federal health care legislation increase the postretirement benefit obligation by approximately \$0 and \$57 for Reynolda Campus, and \$0 and \$130 for WFUHS, respectively, for June 30, 2013 and 2012. This change has been reflected as an actuarial loss.

(18) Related-Party Transactions

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

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

	<u>2013</u>	<u>2012</u>
Revenue from MCIA	\$ 36,156	63,218
Other revenue from NCBH	68,979	67,395
Total revenue from NCBH	<u>\$ 105,135</u>	<u>130,613</u>
Accounts receivable from NCBH, net	<u>\$ 4,761</u>	<u>4,671</u>

In addition to the aforementioned transactions, WFUHS and NCBH each incur expenses in the course of managing WFB as an integrated academic medical center. Beginning in 2013, 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. In the year ended June 30, 2013, this resulted in a net transfer of \$34,483 in expenses from WFUHS to NCBH, which was recorded by WFUHS as a reduction in expense.

In October 2012, WFUBMC entered into an unsecured line of credit in the amount of \$200,000 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 \$126,450 as of June 30, 2013. A liability of \$37,450 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.

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(19) Royalties Receivable

Management has recorded revenue and a related receivable for licensing fees for “VAC System” technologies. On October 6, 1993, WFU (later WFUHS) and Kinetic Concepts, Inc. (KCI) entered into a license agreement that grants the licensee the exclusive worldwide right and license to make, sell and sublicense products and services related to the patented technologies. WFUHS and KCI jointly brought various suits for patent infringement against a number of entities. One such suit was brought against Smith & Nephew, Inc. (S&N) for infringement of certain asserted claims of certain patents based on a wound healing device made and sold by S&N. Following a jury trial in the Western District of Texas, the jury held that the asserted claims of the patents were valid and infringed by S&N. Subsequently, the district court granted S&N’s motion for judgment as a matter of law and overturned the jury verdict, concluding that the asserted claims of the patents were invalid for obviousness. WFUHS and KCI appealed that decision to the United States Court of Appeals for the Federal Circuit. The Court of Appeals reversed the District Court’s judgment as a matter of law, finding the asserted claims of the patents valid and remanding back to the Texas District Court to address certain outstanding motions and to determine damages. WFUHS and S&N subsequently settled the litigation and entered into a license agreement providing for S&N to pay WFUHS royalties of 10% of S&N’s net revenues.

In February 2011, KCI failed to pay royalties under its license and brought a declaratory judgment suit in the United States District Court, Western District of Texas against WFUHS seeking a judgment that the patents are invalid and not infringed and that KCI owes no royalties on them. WFUHS subsequently terminated KCI’s license on March 18, 2011 and sued KCI for patent infringement in the Middle District of North Carolina, as well as for breach of contract, among other causes of action. The cases were consolidated and transferred to the Western District of Texas. These unpaid royalties for the period July 1, 2010 through March 18, 2011 are accrued under accounts receivable in the consolidated balance sheet and amount to \$65,919 at June 30, 2013 and 2012. The receivable balance includes the inventors’ share, which represents 50% of the amount after expenses or a gross amount of \$30,315. A matching liability for amounts due to the inventors is included in other liabilities and deferrals in 2013 and 2012. WFUHS believes the KCI suit is without merit and is vigorously defending its rights under the license agreement and is vigorously prosecuting its claims for infringement by KCI. The parties have been in active litigation for a year and the trial is set for April 7, 2014. To date, there have been no meaningful settlement discussions between the parties and discovery and motions practice continue.

(20) Professional Liability Insurance

WFB maintains professional liability coverage, which included a \$4,000 per occurrence and a \$16,000 annual aggregate self-insurance retention for the year ended June 30, 2013. WFUHS estimates its professional liability on an actuarial basis. WFUHS’ accrued professional liability costs, including estimated claims incurred but not reported, amounted to approximately \$40,086 and \$38,538 at June 30, 2013 and 2012, 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.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2013

(Dollars in thousands)

(21) Subsequent Events

The University has evaluated events occurring after June 30, 2013 through October 17, 2013, 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.

WAKE FOREST UNIVERSITY
Schedule of Expenditures of Federal and State Awards
Year ended June 30, 2013

Federal and state grantors/pass-through grantors/agencies, or cluster title	Federal CFDA number	Expenditures
Federal award expenditures:		
Research and Development Cluster:		
Wake Forest University Health Sciences:		
U.S. Department of Health and Human Services (DHHS):		
National Institutes of Health	93.RD	\$ 121,303,512
ARRA-National Institutes of Health	93.701	1,899,395
ARRA-SPRINT	93.3015M	260,391
ARRA-SPRINT	93.3020M	(13,172)
Center for Disease Control and Prevention	93.RD	2,365,943
Health Resources and Services Administration	93.RD	1,260,949
DHHS pass-through programs from:		
Albert Einstein College of Medicine	93.RD	110,562
ARRA-American College of Radiology Imaging	93.701	9,738
American College of Radiology Imaging	93.RD	9,854
American Heart Association	93.RD	59,981
Association of State and Territorial Chronic Disease Program	93.RD	115,698
Boston University	93.RD	291,270
Brigham & Women's Hospital	93.RD	403,206
Cancer and Leukemia Group B Foundation	93.RD	95,646
Centerpoint Human Services	93.RD	304,372
Children's Hospital Research Center	93.RD	11,844
Children's Oncology Group	93.RD	46,384
Cincinnati Children's Hospital	93.RD	89,014
City of Hope Comprehensive Cancer Center	93.RD	3,525
Columbia University	93.RD	40,836
Davidson College	93.RD	17,756
Duke University Clinical Research Institute	93.RD	15,490
ARRA - Duke University	93.701	50,209
Duke University	93.RD	1,796,482
East Tennessee State University	93.RD	7,420
ARRA - Emory University	93.701	30,699
Emory University	93.RD	28,254
Fred Hutchinson Cancer Research Center	93.RD	16,312
Fogarty International Center	93.RD	85,871
George Washington University	93.RD	181,604
George State University	93.RD	6,130
Georgia Health Sciences University	93.RD	78,881
ARRA-Georgia Institute of Technology	93.701	3,831
Gynecologic Oncology Group	93.RD	51,233
Hemophilia of Georgia, Inc.	93.RD	17,558
Jackson State University	93.RD	682,728
Jaeb Center for Health Research	93.RD	6,368
ARRA-John Wayne Cancer Institute	93.701	568
John Wayne Cancer Institute	93.RD	12,769
ARRA-John Hopkins University	93.701	18,869
Johns Hopkins University	93.RD	1,147,938
Marshfield Clinic Research Foundation	93.RD	2,780
Massachusetts General Hospital	93.RD	77,427
Mayo Clinic	93.RD	74,209
Medical College of Wisconsin	93.RD	255,063
Meharry Medical College	93.RD	71,132
Mercer University	93.RD	47,096
Miami University	93.RD	11,426
Mount Sinai School of Medicine	93.RD	123
Mountain Area Health Education Center	93.RD	86,879
National Jewish Medical and Research Center	93.RD	1,278
New Hanover Regional Medical Center	93.RD	2,049
North Carolina Central University	93.RD	44,992
North Carolina Department of Health and Human Services	93.RD	1,484,042
Northwestern University	93.RD	25,884
Ohio State University	93.RD	35,775
Oklahoma Medical Research Foundation	93.RD	282,390

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Schedule of Expenditures of Federal and State Awards
Year ended June 30, 2013

Federal and state grantors/pass-through grantors/agencies, or cluster title	Federal CFDA number	Expenditures
Oregon Health & Sciences University	93.RD	\$ 264,903
Pennsylvania State University	93.RD	19,942
Renal Research Institute	93.RD	24,851
Rensselaer Polytechnic	93.RD	73,824
ARRA - Seattle Institute for Biomedical and Clinical Research	93.RD	76,575
Seattle Institute for Biomedical and Clinical Research	93.RD	10,715
Southwest Oncology Group	93.RD	1
Southwest Research Institute	93.RD	67,137
Stanford University	93.RD	47,975
Temple University School of Medicine	93.RD	28,877
Texas Biomedical Research Institute	93.RD	17,773
ARRA - University of Alabama - Birmingham	93.701	19,397
University of Alabama - Birmingham	93.RD	279,059
University of Arkansas	93.RD	18,079
University of California at Los Angeles	93.RD	92,011
ARRA - University of California at San Diego	93.701	1,087
University of California at San Diego	93.RD	165,771
University of California at San Francisco	93.RD	87,128
University of Cincinnati	93.RD	151,317
University of Cincinnati Medical Center	93.RD	284,170
ARRA - University of Colorado	93.701	6,275
University of Colorado	93.RD	(1,203)
University of Colorado - Denver	93.RD	19,691
ARRA - University of Florida	93.701	57
University of Florida	93.RD	2,336,817
University of Health Network, Toronto	93.RD	15,062
University of Illinois at Chicago	93.RD	2,593
University of Illinois-Urbana	93.RD	202,123
University of Iowa	93.RD	9,554
University of Maryland	93.RD	74,930
University of Miami	93.RD	145,828
University of Medicine & Dentistry of New Jersey	93.RD	203
University of Michigan	93.RD	100,299
University of Minnesota	93.RD	499,996
University of Mississippi	93.RD	25,494
ARRA - University of North Carolina at Chapel Hill	93.701	196,828
University of North Carolina at Chapel Hill	93.RD	3,315,005
University of Nottingham, UK	93.RD	187,797
University of Pennsylvania	93.RD	226,040
ARRA - University of Pittsburgh	93.701	1,117
University of Pittsburgh	93.RD	545,009
University of Rochester	93.RD	3,095
University of South Alabama-Mobile	93.RD	(86)
University of Southern California	93.RD	48,024
University of Texas – SA	93.RD	35,896
University of Texas M.D. Anderson Cancer	93.RD	410,802
University of Toledo	93.RD	50
University of Utah	93.RD	16,302
University of Virginia	93.RD	33,104
University of Washington	93.RD	473,488
University of Wisconsin-Madison	93.RD	78,741
Vanderbilt University	93.RD	12,044
Virginia Commonwealth University	93.RD	82,428
Virginia Polytechnic Institute and State University	93.RD	610,320
Washington University, St. Louis	93.RD	119,363
ARRA - Wayne State University	93.701	25,970
Wayne State University	93.RD	54,430
Winston-Salem State University	93.RD	378
Yale University	93.RD	973
Total U.S. Department of Health and Human Services		147,073,892

WAKE FOREST UNIVERSITY
Schedule of Expenditures of Federal and State Awards
Year ended June 30, 2013

Federal and state grantors/pass-through grantors/agencies, or cluster title	Federal CFDA number	Expenditures
U.S. Department of Defense (DOD):		
Defense Advance Research Project	12.RD	\$ 1,878,807
U.S. Army	12.RD	3,758,645
DOD pass-through programs from:		
American Burn Association	12.RD	33,261
Department of the Navy	12.RD	161,533
Geneva Foundation	12.RD	41,542
John Hopkins University	12.RD	154,755
Southwest Research Institute	12.RD	6,746
University of California San Diego	12.RD	9,759
University of Wisconsin-Madison	12.RD	13,674
Virginia Polytechnic Institute and State University	12.RD	455,958
Total U.S. Department of Defense		6,514,680
U.S. Department of Justice (DOJ):		
National Institute of Justice	16.RD	136,177
ARRA - National Institute of Justice	16.804	55,930
DOJ pass-through program from University of North Carolina at Greensboro	16.RD	41,760
Total U.S. Department of Justice		233,867
U.S. Department of Transportation (DOT)	20.RD	1,151,597
DOT pass-through programs from:		
Community Voices	20.RD	52,564
Phoenix Center	20.RD	47,776
Virginia Tech	20.RD	13,009
Total U.S. Department of Transportation		1,264,946
U.S. Department of Veterans Affairs	64.RD	249,579
U.S. Environmental Protection Agency (EPA)	66.RD	93,691
EPA pass-through program from University of Washington	66.RD	20,147
Total U.S. Environmental Protection Agency		113,838
National Aeronautics and Space Administration	43.RD	108,277
National Science Foundation (NSF)	47.RD	196,640
NSF pass-through programs from:		
Ohio State University	47.RD	25,222
Virginia Technology	47.RD	35,053
University of Southern California	47.RD	130,767
Total National Science Foundation		387,682
Subtotal – Wake Forest University Health Sciences		155,946,761
College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.:		
U.S. Department of Health and Human Services (DHHS):		
National Institutes of Health	93.RD	2,469,548
DHHS pass-through programs from:		
Brigham & Women's Hospital	93.836	4,645
Duke University	93.RD	8,445
Loma Linda University	93.837	30,024
University of Illinois	93.859	33,716
University of Pittsburgh	93.839	163,066
University of Texas	93.273	12,440
Total U.S. Department of Health and Human Services		2,721,884

WAKE FOREST UNIVERSITY
Schedule of Expenditures of Federal and State Awards
Year ended June 30, 2013

Federal and state grantors/pass-through grantors/agencies, or cluster title	Federal CFDA number	Expenditures
U.S. Department of Defense (DOD):		
U.S. Army	12.RD	\$ 313,771
National Security Agency	12.RD	10,698
DOD pass-through programs from:		
Georgia Southern University	12.RD	20,583
University of New Mexico	12.800	61,185
University of Texas A&M	12.800	17,579
Total U.S. Department of Defense		423,816
National Science Foundation (NSF)	47.RD	1,813,171
ARRA - National Science Foundation	47.082	22,383
NSF pass-through programs from:		
Clemson University	47.049	43,430
Oregon State University	47.074	25,296
ARRA - University of Illinois	47.082	11,360
University of North Carolina at Chapel Hill	47.075	55,827
Total National Science Foundation		1,971,467
U.S. Department of Agriculture	10.RD	36,915
U.S. Department of Commerce	11.609	118,522
U.S. Department of Energy (DOE)	81.049	576
DOE pass-through programs from:		
Battelle Memorial Institute	81.RD	220,634
Fisk University	81.123	139,659
Lawrence Berkeley National Laboratory	81.RD	60,184
Lawrence Livermore National Labs	81.RD	10,516
University of Texas at Dallas	81.049	115,091
Total U.S. Department of Energy		546,660
U.S. Department of State	19.RD	258,382
National Aeronautics and Space Administration (NASA)	43.RD	95,031
NASA pass-through programs from California Institute of Technology	43.RD	45,899
Total National Aeronautics and Space Administration		140,930
U.S. Fish and Wildlife Service	10.RD	1,854
Subtotal – College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.		6,220,430
Total Research and Development Cluster		162,167,191
Student Financial Aid Cluster:		
Wake Forest University Health Sciences:		
U.S. Department of Education:		
Federal Direct Student Loans	84.268	21,237,243

WAKE FOREST UNIVERSITY
Schedule of Expenditures of Federal and State Awards
Year ended June 30, 2013

Federal and state grantors/pass-through grantors/agencies, or cluster title	Federal CFDA number	Expenditures
College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.:		
U.S. Department of Education:		
Federal Supplemental Educational Opportunity Grant	84.007	\$ 438,869
Federal Direct Student Loans	84.268	47,437,175
Federal Work Study Program	84.033	936,534
Federal Perkins Loan Program	84.038	2,177,833
Federal Pell Grant Program	84.063	2,351,036
Subtotal – College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.		53,341,447
Total Student Financial Aid Cluster		74,578,690
Other Programs:		
Wake Forest University Health Sciences:		
U.S. Department of Education:		
Postsecondary Education Program	84.116	29,223
Higher Education & Institutional Aid Program	84.031	11
Subtotal – Wake Forest University Health Sciences		29,234
College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.:		
U.S. Department of Education (DOE):		
DOE pass-through program from North Carolina Independent Colleges and Universities: College Access Challenge Grant Program	84.378	19,118
Institute of Museum and Library Sciences (IMLS):		
Museums for America	45.301	95,905
IMLS pass-through program from Duke University: Grants to States	45.310	795
Total Institute of Museum and Library Sciences		96,700
National Endowment for the Arts:		
Promotion of the Arts: Grants to Organizations and Individuals	45.024	52,327
National Endowment for the Humanities (NEH):		
Promotion of the Humanities: Professional Development	45.163	319,353
National Science Foundation (NSF):		
NSF pass-through program from University of North Carolina at Greensboro: Mathematical and Physical Sciences	47.049	24,880
Subtotal – College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.		512,378
Total Other Programs		541,612
Total Federal Award Expenditures		\$ 237,287,493

WAKE FOREST UNIVERSITY
Schedule of Expenditures of Federal and State Awards
Year ended June 30, 2013

Federal and state grantors/pass-through grantors/agencies, or cluster title	Expenditures
State award expenditures:	
Wake Forest University Health Sciences:	
NC Department of Health and Human Services	\$ 5,659,802
NC Department of Commerce	4,521,764
Board of Governors	220,404
State of NC pass-through funds from:	
CenterPoint Human Services	51,610
North Carolina Biotechnology Center	350,704
NC Health and Wellness Trust Fund	(31)
University of North Carolina at Chapel Hill	4,368,842
Other	28,741
Subtotal – Wake Forest University Health Sciences	15,201,836
College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.:	
North Carolina Arts Council	15,000
North Carolina State Education Assistance Authority	(1,080)
Subtotal – College of Arts and Sciences, Schools of Law, Business, and Divinity, and Reynolda House, Inc.	13,920
Total state award expenditures	15,215,756
Total federal and state award expenditures	\$ 252,503,249

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

WAKE FOREST UNIVERSITY

Notes to Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2013

(1) Basis of Presentation

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

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

Expenditures for certain federal student financial aid programs are recognized as incurred and include the federal share of students' Federal Supplemental Educational Opportunity Grant (FSEOG) program grants and Federal Work Study (FWS) program earnings, Pell grants, loan disbursements, and administrative cost allowances, where applicable.

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

Expenditures for non-financial aid awards include indirect costs, related primarily to facilities operation and maintenance and general, divisional, and departmental administrative services, which are allocated to direct cost objectives (including federal awards) based on negotiated formulas commonly referred to as facilities and administrative cost rates. Facilities and administrative costs allocated to such awards for the year ended June 30, 2013 were based on predetermined rates negotiated with the University's cognizant federal agency, the U.S. Department of Health and Human Services.

Negative balances presented in the schedule represent programs with unfunded expenditures prior to normal close-out procedures, which were subsequently transferred to nonfederal cost centers.

Expenditures labeled as ARRA relate to the American Recovery and Reinvestment Act (Pub. L. No. 111- 5).

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

Facilities and administrative cost recoveries and administrative cost allowances for the University's academic and other divisions for the year ended June 30, 2013 are summarized as follows:

Federal:		
Research and development	\$	36,447,238
Student financial aid		178,549
Other		8,172
	\$	<u>36,633,959</u>

WAKE FOREST UNIVERSITY

Notes to Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2013

(4) Federal Student Financial Aid Loan Programs

The Federal Perkins Loan, Health Professions Student Loan (HPSL), and the Primary Care Loan (PCL) programs are administered directly by the University and balances and transactions relating to these programs are included in the University's basic financial statements. The balance of loans outstanding under the Federal Perkins Loan program was \$19,139,894 as of June 30, 2013. There were no loans outstanding for the HPSL and PCL programs as of June 30, 2013.

The University approved the following amounts of new loans under the Federal Direct Student Loan Program to students of the University during the year ended June 30, 2013:

Federal Direct Student Loan Program:	
Federal Stafford loans	\$ 7,230,143
Federal unsubsidized Stafford loans	35,116,796
Federal PLUS loans	<u>26,327,479</u>
Total	<u><u>\$ 68,674,418</u></u>

The University is responsible only for the performance of certain administrative duties with respect to the Federal Direct Student Loan Program and, accordingly, these loans are not included in its basic financial statements. It is not practicable to determine the balance of loans outstanding to students and former students of the University under these programs as of June 30, 2013.

(5) Matching

Under the FWS program, the University matched \$252,672 in compensation for the year ended June 30, 2013 in addition to the federal share of expenditures in the accompanying schedule.

Under the FSEOG program, the University matched \$146,290 in funds awarded to students for the year ended June 30, 2013 in addition to the federal share of expenditures in the accompanying schedule.

(6) Subrecipients

Of the federal expenditures presented in the schedule, the University provided federal awards to subrecipients during the year ended June 30, 2013 as follows:

Federal program	Amount provided to subrecipients
Research and development cluster	\$ 35,040,691



KPMG LLP
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300 North Greene Street
Greensboro, NC 27401

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

The Board of Trustees
Wake Forest University:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of Wake Forest University (the University), which comprise the consolidated balance sheet as of June 30, 2013, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated October 17, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the University's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we do not express an opinion on the effectiveness of University's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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



Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the University's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Greensboro, North Carolina
October 17, 2013



KPMG LLP
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300 North Greene Street
Greensboro, NC 27401

Independent Auditors' Report on Compliance for Each Major Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal and State Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

The Board of Trustees
Wake Forest University:

Report on Compliance for the Major Federal Program

We have audited Wake Forest University's (the University) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the University's major federal program for the year ended June 30, 2013. The University's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the University's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the University's compliance.

Opinion on the Major Federal Program

In our opinion, the University complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2013.



Report on Internal Control Over Compliance

Management of the University is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the University's internal control over compliance with the types of requirements that could have a direct and material effect on a major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for a major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal and State Awards by OMB Circular A-133

We have audited the consolidated financial statements of the University as of and for the year ended June 30, 2013, and have issued our report thereon dated October 17, 2013, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal and state awards is presented for purposes of additional analysis as required by OMB Circular A-133 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 schedule of expenditure of federal and state awards is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Greensboro, North Carolina
March 7, 2014

WAKE FOREST UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended June 30, 2013

(1) Summary of Auditors' Results

- (a) The type of report issued on the financial statements: **Unmodified opinion**
- (b) Significant deficiencies in internal control disclosed by the audit of the financial statements: **None reported** Material weaknesses: **None**
- (c) Noncompliance which is material to the financial statements: **None**
- (d) Significant deficiencies in internal control over major programs: **None reported**
Material weaknesses: **None**
- (e) The type of report issued on compliance for major programs: **Unmodified opinion**
- (f) Any audit findings which are required to be reported under Section 510(a) of OMB Circular A-133: **None**
- (g) Major program: **Research and Development Cluster**
- (h) Dollar threshold used to distinguish between Type A and Type B programs: **\$3,000,000**
- (i) Auditee qualified as a low-risk auditee under Section 530 of OMB Circular A-133: **Yes**

(2) Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*

None

(3) Findings and Questioned Costs Relating to Federal Awards

None