Princeton University
Notes to Consolidated Financial Statements

Year ended June 30, 1998

Nature of operations

Princeton University (the "University") is a privately endowed, nonsectarian institution of higher learning. When the University was chartered in 1746 as the College of New Jersey, it became the fourth college in British North America. It was renamed Princeton University in 1896. Originally located in Elizabeth, New Jersey, and later located in Newark, New Jersey, the school was moved to Princeton, New Jersey, in 1756.

The student body numbers approximately 4,600 undergraduates and 1,800 graduate students in more than 60 departments and programs. The University offers instruction in the liberal arts and sciences and in professional programs of the School of Architecture, the School of Engineering and Applied Science, and the Woodrow Wilson School of Public and International Affairs. The faculty numbers more than 1,100, including visitors and part-time appointments.

Summary of significant accounting policies

The financial statements of the University are prepared on the accrual basis and include the accounts of its wholly owned subsidiaries and three foundations controlled by the University. Financial information conforms to the statements of accounting principles of the Financial Accounting Standards Board (FASB) and to the American Institute of Certified Public Accountants *Audit and Accounting Guide for Not-for-Profit Organizations.* Recent pronouncements of the FASB include Statements of Financial Accounting Standards ("SFAS") No. 116, "Accounting for Contributions Received and Contributions Made," and SFAS No. 117, "Financial Statements of Not-for-Profit Organizations," issued by the Financial Accounting Standards Board.

Under SFAS No. 116, unconditional promises to give are recognized as revenues in the year made, not in the year in which the cash is received. The amounts are present-valued based on expected collections. Amounts received from donors to planned giving programs are shown in part as a liability for the present value of annuity payments to the donor and the balance as a gift of either temporarily or permanently restricted net assets.

SFAS No. 117 prescribes the standards for external financial statements and requires not-for-profit organizations to prepare a statement of financial position (balance sheet), statement of activities, and statement of cash flows. It requires the classification of the organization's net assets and its revenues and expenses into three categories according to the existence or absence of donor-imposed restrictions—permanently restricted, temporarily restricted, or unrestricted. Changes in each category are reflected in the statement of activities, certain of which are further categorized as nonoperating. Such activities primarily reflect transactions of a long-term investment or capital nature, including contributions receivable in future periods, contributions subject to donor-imposed restrictions, and gains and losses on investments in excess of the University's spending rule. Other significant accounting policies are described elsewhere in these notes.

The preparation of the University's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated statements of financial position and the reported amounts of revenue and expense included in the consolidated statement of activities. Actual results could differ from such estimates.

Investments

All investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair values. In addition, the University utilizes fair values for reporting other investments, primarily limited partnerships and derivatives.

The fair value of marketable equity, debt, and certain derivative securities (which includes both domestic and foreign issues) is generally based upon a combination of published current market prices and exchange rates. The fair value of restricted securities and other investments, where published market prices are not available, is based on estimated values when practicable, or at a nominal value. The fair values of limited partnerships have been based on estimates and assumptions determined by the respective general partners or a valuation committee in the absence of readily ascertainable market values. A summary of investments at fair value at June 30, 1998 and 1997 is as follows (in millions):

	1998	1997
Managed portfolio:		
Equity accounts	$3,204.7	$2,861.1
Fixed income accounts	928.3	888.9
Limited partnerships	1,282.2	989.0
Educational loans and mortgages	210.0	200.5
Miscellaneous assets	204.4	186.2
Gross investments	5,829.6	5,125.7
Separately managed investments of consolidated entity	(15.1)	(13.3)
Government funding for student loans	(13.7)	(12.7)
Net University investment portfolio	$5,800.8	$5,099.7

The composition of net investment return for the year ended June 30, 1998 was as follows (in thousands):

Realized and unrealized gains	$630,832
Interest, dividends, and other income	118,008
Total	$748,840

The University follows a spending rule for its endowment funds, including funds functioning as endowment, that provides for regular increases in spending while preserving the long-term purchasing power of the endowment. Earnings available for spending are shown in the Consolidated Statement of Activities as operating income, and the balance as nonoperating income.

As of June 30, 1998 and 1997 the University had loaned certain securities, returnable on demand, with a market value of $206 and $217 million, to several financial institutions that have deposited collateral with respect to such securities of $214 and $221 million, respectively. The University receives income on the invested collateral, and also continues to receive interest and dividends from the securities on loan. The collateral received in connection with the securities lending program is reduced by the liability to borrowers for financial statement purposes.

As part of its investment strategy, the University enters into a variety of financial instruments and strategies, including futures, swaps, options, short sales, and forward foreign currency exchange contracts. In all cases except forward foreign currency exchange and swap contracts, these transactions are traded through securities and commodities exchanges. The forward foreign currency exchange and swap contracts are executed with creditworthy banks and brokerage firms.

At June 30, 1998 and 1997 approximately $40.5 and $42.5 million, respectively, of a controlled foundation's equity holdings have been hedged through a series of put-and-call options.

During 1998 and 1997 the University used swap and futures contracts to modify its investment portfolio exposures. In concert, the contracts convert domestic equity and domestic fixed income exposure into international equity and international fixed income exposure. At June 30, 1998 and 1997 the following contracts were outstanding (notional amounts in millions):

	1998	1997
Swaps	$185	$150
Futures:		
Commitments to buy	145	325
Commitments to sell	175	175

The contracts outstanding, which generally mature in less than three months, are included in the year-end managed portfolio at their fair values.

Subsequent to June 30, 1998, the University entered into new contracts, at approximately the same amount for the swaps and at lesser amounts for the futures, that were structured to achieve a similar objective.

Property

Land additions subsequent to June 30, 1973 are reported at estimated market value at the date of gift, in the case of gifts, and at cost in all other cases. Land acquired through June 30, 1973 is carried at estimated value at that date, computed using municipal tax assessments because it was not practicable to determine historical cost or the market value at the date of gift.

Buildings and improvements are stated at cost. Expenditures for operation and maintenance of physical plant are expensed as incurred.

Items classified as other property at June 30, 1998 and 1997 consist of the following (in thousands):

	1998	1997
Equipment	$202,551	$197,052
Rare books	34,480	31,048
Library books, periodicals, and bindings	119,989	111,103
Fine arts objects	65,292	63,928
Total	$422,312	$403,131

Equipment, rare books, and library books, periodicals, and bindings are stated at cost. Equipment includes items purchased with federal government funds; an indeterminate portion of those items are expected to be transferred to the University at the termination of the respective grant or contract. In addition to purchases with University funds, the University, since its inception, has received a substantial number of fine arts objects from individual gifts and bequests. Art objects acquired through June 30, 1973 are carried at insurable values at that date because it is not practicable to determine the historical cost or market value at the date of gift. Art objects acquired subsequent to June 30, 1973 are recorded at cost or fair value at the date of gift.

Annual depreciation is calculated on the straight-line method over a 40-year life for buildings and improvements, 30 years for library books, and 10 years for equipment.

Funds held in trust by others

The University is the income beneficiary of various trusts that are held and controlled by independent trustees. In addition, the University is the income beneficiary of entities that qualify as supporting organizations under Section 509(a)(3) of the U.S. Internal Revenue Code. Funds held in trust by others are recognized at the estimated fair value of the assets or the present value of the future cash flows when the irrevocable trust is established or the University is notified of its existence. Funds held in trust by others, stated at fair value, amounted to $84.7 million in 1998 and $74.6 million in 1997.

Deferred revenues

Deferred revenues represent advance receipts relating to the University's real estate leasing activities. Such amounts are amortized over the term of the related leases.

Indebtedness to third parties

The debt consists of loans through the New Jersey Educational Facilities Authority (NJEFA), taxable revenue bonds, commercial paper, various loans with the Student Loan Marketing Association (Sallie Mae), a capital lease, and various mortgages as follows (in thousands):

NJEFA Revenue Bonds	
Dated July 1, 1989, Series A, 6.36%, due in installments through July 1999, net of unamortized discount of $13	$ 1,992
Dated July 1, 1990, Series A, 6.46%, due in installments through July 2000, net of unamortized discount of $19	3,371
Dated July 1, 1991, Series A, 5.86%, due in installments through July 2001, net of unamortized discount of $34	5,431
Dated July 1, 1992, Series F, 5.08%, due in installments through July 2002, net of unamortized discount of $28	7,912
Dated August 1, 1993, Series B, 4.17%, due in installments through July 2003, net of unamortized discount of $53	9,472
Dated July 1, 1994, Series A, 5.84%, due in installments through July 2024, net of unamortized discount of $394	37,791
Dated July 1, 1995, Series C, 5.08%, due in installments through July 2025, net of unamortized discount of $346	23,179
Dated July 1, 1996, Series C, 4.86% due in installments through July 2006, net of unamortized discount of $58	20,432
Dated July 1, 1997, Series E, 4.42%, due in installments through July 2007, net of unamortized discount of $58	20,397
Taxable Revenue Bonds	
Dated March 15, 1994, Series 1994A, 6.02%, due in installments through July 2000, net of unamortized discount of $22	16,753
Dated March 15, 1994, Series 1994B, 6.41%, due in installments through July 2002, net of unamortized discount of $114	21,816
Dated March 15, 1994, Series 1994C, 6.48%, due in installments through July 2003, net of unamortized discount of $45	7,715
Commercial Paper	46,550
Student Loan Marketing Association (Sallie Mae)	
Various loans	35,956
Capital lease	1,887
Mortgages	1,159
Total	$261,813

The proceeds of NJEFA loans were used primarily for renovation and rehabilitation of University facilities and purchases of capital equipment. The proceeds of the Taxable Revenue Bonds were used to advance refund certain NJEFA loans and to reimburse the University for the cost of renovation and rehabilitation of University facilities and purchases of capital equipment in recent years that, due to statutory limitation, could not be financed with tax-exempt debt.

Subsequent to June 30, 1998, the University issued bonds of $40.0 million through the NJEFA. In addition to renovation and rehabilitation of University facilities and purchases of capital equipment, a portion of this issue is intended for a number of large utilities-related projects. Another issue for $19.0 million through the NJEFA was sold to effect an advance refunding of a portion of the 1994 Series A tax-exempt bonds. The University intends to issue additional bonds in the future.

The NJEFA loan agreements contain certain restrictive covenants with which the University must comply. Specifically, the ratio of available assets to general liabilities, as defined in the loan agreements, shall be equal to at least two to one. Also, the University pledges tuition and fees received from all students up to an amount equal to one and one half times the maximum annual debt service on all outstanding NJEFA bonds, in addition to the full faith and credit of the University. The University was in compliance with these covenants at June 30, 1998.

Loans with the Student Loan Marketing Association (Sallie Mae) are to be used for a parental loan program. As of June 30, 1998, the amount outstanding was $36 million, at rates ranging from 3.6 percent to 9.9 percent. As collateral, the University pledges these parent loans and additional student loans for which Sallie Mae provides a second market. Subsequent to June 30, 1998, the University entered into a $20 million loan facility with a local bank to provide funding on a prospective basis for the parental loan program.

During the year a commercial paper program was initiated as an initial step of a financing proposal to provide construction funds for several approved capital projects. The proceeds have permitted construction to proceed until permanent financing from gifts or other sources has been made available. The program has been authorized to a maximum level of $120 million for a period of up to five years. At June 30, 1998, $9.1 million of taxable debt was outstanding; the balance of $37.45 million was issued through the NJEFA on a tax-exempt basis to the investors. Maturities of the debt ranged from 43 to 60 days for taxable paper, and from 14 to 171 days for the tax-exempt obligations. Nominal interest rates were 5.555 percent and 3.554 percent, respectively.

Principal payments for each of the next five years and thereafter on debt outstanding at June 30, 1998, excluding commercial paper, are as follows (in thousands):

	Principal payments
1999	$ 34,592
2000	33,457
2001	25,692
2002	23,064
2003	21,871
Thereafter	77,771
Subtotal	216,447
Unamortized discount	(1,184)
Net long-term debt	$215,263

The fair value of the University's long-term debt is estimated based on current notes offered for the same or similar issues with similar security, terms, and maturities. At June 30, 1998, the carrying value and the estimated fair value of the University's long-term debt were $261.8 million and $269.9 million, respectively.

Commitments and contingencies

At June 30, 1998, the estimated completion costs of capital projects that have been approved were approximately $127.2 million. Major projects include a new campus center ($46.0 million), a social science building ($23.3 million), and major dormitory renovations ($23.8 million). Also, the University is obligated under certain limited partnership agreements to advance additional funding periodically up to specified levels. At June 30, 1998, the University had unfunded commitments of $554.4 million that are likely to be called through 2003.

Employee benefit plans

Effective January 1, 1994, all faculty and staff who meet specific employment requirements participate in a defined contribution plan, which participates in the Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF). Prior to this date, the University participated in a TIAA and CREF defined contribution plan for faculty and certain administrative employees, while all other employees participated in a noncontributory defined benefit plan. The University's contributions were $21.7 million for the year ended June 30, 1998. The defined contribution plan permits employee contributions.

Until December 31, 1993, the University had a noncontributory defined benefit plan. The plan is fully funded for all past service costs. The amount of net periodic pension cost for the defined benefit plan for 1997 is composed of (in thousands):

Service cost	$ 383
Interest cost	5,572
Return on assets	(7,671)
Net amortization and deferral	(278)
Net periodic pension cost/(income)	$ (1,994)

The funded status of the defined benefit plan at July 1, 1997, the latest valuation date, is as follows (in thousands):

Accumulated benefit obligation (all participants' benefits are fully vested)	$ 71,849
Fair value of plan assets	$ 98,137
Projected benefit obligation	71,901
Plan assets in excess of projected benefit obligation	26,236
Unrecognized net transition obligation	839
Unrecognized net (gain)/loss	(16,621)
Unrecognized prior service cost	941
Prepaid pension cost	$ 11,395

The expected long-term rate of return on plan assets was 8 percent. The discount rate used to measure the projected benefit obligation was 8 percent. The initial transition obligation and prior service cost are being amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan, which approximates 14 years.

Postretirement benefits other than pensions

Effective July 1, 1993, the University adopted the provisions of SFAS No. 106, "Accounting for Postretirement Benefits Other Than Pensions." SFAS 106 requires employers to recognize the cost of providing postretirement benefits for employees over the period of their working years. The University has calculated its Accumulated Postretirement Benefits Obligation ("APBO") and elected to amortize it over 20 years.

The University provides single coverage health insurance to its retirees who meet certain eligibility requirements. Participants may purchase additional dependent or premium coverage. The accounting for the plan anticipates future cost-sharing changes to the written plan that are consistent with the University's expressed intent to increase retiree contributions in line with medical costs.

The benefits cost for the year consists of the following (in thousands):

Service cost	$ 3,680
Interest cost	9,052
Net amortization of transition amount	6,361
Other	(1,711)
Total	$ 17,382

The APBO at June 30, 1998 consisted of actuarially determined obligations to the following categories of employees (in thousands):

Retirees	$ 51,489
Fully eligible active employees	26,368
Other active participants	32,825
Total	$110,682

Reconciliation of funded status (in thousands):

Accumulated postretirement benefit obligation and funded status	$110,682
Unrecognized transition obligation existing at June 30, 1998	(95,420)
Unrecognized net gain	59,554
Accrued expense at June 30, 1998	$ 74,816

An assumed discount rate of 7 percent was used to calculate the APBO. The assumed health care cost trend rate to be used to calculate the University's cost of benefits for fiscal 1999 is an increase of 11.5 percent over the costs for fiscal 1998. The cost trend used to calculate the APBO ranges downward to 5.25 percent in the year 2006 and thereafter. An increase of 1 percent in the cost trend rate would raise the APBO to $128.3 million and cause the service and interest cost components of the net periodic cost to be increased by $2.5 million.

Promises to give

At June 30, 1998 and 1997 the University had received from donors unconditional promises to give contributions of amounts receivable in the following periods (in thousands):

	1998	1997
Less than one year	$ 32,375	$ 52,204
One to five years	123,686	95,262
More than five years	9,090	6,038
Total	165,151	153,504
Less unamortized discount	22,673	20,364
Net amount	$142,478	$133,140

The amounts promised have been discounted at a rate for intermediate-term funds to take into account the time value of money. Current year promises are included in revenue as additions to temporarily or permanently restricted net assets, as determined by the donors.

In addition, the University has received from donors promises to give $29.8 million, which are conditioned upon the raising of matching gifts from other sources. These amounts will be recognized as income in the periods in which the conditions have been fulfilled.

Net assets

Net assets are categorized as *unrestricted, temporarily restricted, and permanently restricted.* The unrestricted category contains, in addition to expendable funds, amounts dedicated to special programs, invested in plant and equipment, and designated for other related purposes. Temporarily restricted net assets are those that may be spent after the occurrence of an event or time certain, and permanently restricted net assets cannot be spent.

Fair value of financial instruments

Except as set forth elsewhere in these notes, the University's other financial instruments are carried in the balance sheet at amounts that approximate their fair values.