
Princeton University

Notes to Consolidated Financial Statements

Year ended June 30, 1999

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.

The prior year financial statements of the University include certain reclassifications to conform to the current year presentation.

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, 1999 and 1998 is as follows (in millions):

	1999	1998
Managed portfolio:		
Equity accounts	\$3,570.7	\$3,204.7
Fixed income accounts	926.4	928.3
Limited partnerships	1,865.9	1,282.2
Educational loans and mortgages	216.2	210.0
Miscellaneous assets	177.4	204.4
Gross investments	6,756.6	5,829.6
Planned Giving investments	(189.0)	(162.9)
Separately managed investments of consolidated entity	0.0	(15.1)
Government funding for student loans	(14.1)	(13.7)
Working capital	(84.3)	(55.1)
Net University investment portfolio	<u>\$6,469.2</u>	<u>\$5,582.8</u>

The composition of net investment return for the years ended June 30, 1999 and 1998 were as follows (in thousands):

	1999	1998
Realized and unrealized gains	\$ 910,888	\$630,832
Interest, dividends, and other income	96,228	118,008
Total	<u>\$1,007,116</u>	<u>\$748,840</u>

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. Earn-

ings available for spending are shown in the Consolidated Statement of Activities as operating income, and the balance as nonoperating income.

As of June 30, 1999 and 1998 the University had loaned certain securities, returnable on demand, with a market value of \$183 and \$206 million, respectively, to several financial institutions that have deposited collateral with respect to such securities of \$187 and \$214 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, 1999 and 1998 approximately \$30.0 and \$40.5 million, respectively, of a controlled foundation's equity holdings have been hedged through a series of put-and-call options.

In fiscal 1999 the University terminated a program that used swap and futures contracts to modify its investment portfolio exposures. The contracts were utilized to convert domestic equity and domestic fixed income exposure into international equity and international fixed income exposure.

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, 1999 and 1998 consist of the following (in thousands):

	1999	1998
Equipment	\$203,245	\$202,551
Rare books	36,056	34,480
Library books, periodicals, and bindings	129,014	119,989
Fine arts objects	65,593	65,292
Total	<u>\$433,908</u>	<u>\$422,312</u>

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 \$88.6 million in 1999 and \$84.7 million in 1998.

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 parental loans with the Student Loan Marketing Association (Sallie Mae) and a local bank, a capital lease, and various mortgages as follows (in thousands):

NJEFA Revenue Bonds

Dated July 1, 1990, Series A, 6.46%, due in installments through July 2000, net of unamortized discount of \$10	\$ 1,740
Dated July 1, 1991, Series A, 5.86%, due in installments through July 2001, net of unamortized discount of \$23	3,727
Dated July 1, 1992, Series F, 5.08%, due in installments through July 2002, net of unamortized discount of \$21	6,089
Dated August 1, 1993, Series B, 4.17%, due in installments through July 2003, net of unamortized discount of \$42	7,738
Dated July 1, 1994, Series A, 5.84%, due in installments through July 2012, net of unamortized discount of \$197	17,953
Dated July 1, 1995, Series C, 5.08%, due in installments through July 2025, net of unamortized discount of \$317	21,308
Dated July 1, 1996, Series C, 4.86% due in installments through July 2006, net of unamortized discount of \$51	18,289
Dated July 1, 1997, Series E, 4.42%, due in installments through July 2007, net of unamortized discount of \$52	18,498
Dated July 1, 1998, Series E, 4.87%, due in installments through July 2024, net of unamortized discount of \$89	18,536

Dated July 1, 1998, Series F, 4.44%, due in installments through July 2018, net of unamortized discount of \$164	36,756
Dated February 15, 1999, Series A, 4.80%, due in installments through July 2029, net of unamortized discount of \$387	44,883
<i>Taxable Revenue Bonds</i>	
Dated March 15, 1994, Series 1994A, 6.02%, due in installments through July 2000, net of unamortized discount of \$11	9,444
Dated March 15, 1994, Series 1994B, 6.41%, due in installments through July 2002, net of unamortized discount of \$85	17,990
Dated March 15, 1994, Series 1994C, 6.48%, due in installments through July 2003, net of unamortized discount of \$36	6,624
<i>Commercial Paper</i>	38,400
<i>Parental Loans</i>	40,690
<i>Capital lease</i>	652
<i>Mortgages</i>	672
Total	<u><u>\$309,989</u></u>

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, 1999, the University issued bonds of \$50.0 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 and special renovations to several buildings to bring the buildings up to all current code requirements and functionality standards. The University intends to issue additional bonds in the future.

The NJEFA loan agreements entered into through 1998 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, 1999.

Loans with the Student Loan Marketing Association (Sallie Mae) are to be used for a parental loan program. As of June 30, 1999, the amount outstanding was \$32.4 million, at rates ranging from 5.3 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. In fiscal 1999 the University entered into a \$20 million loan facility with a local bank to provide funding for the parental loan program. Terms to the borrowers are similar to the Sallie Mae program in that fixed or variable rates may be selected on a pass-through basis; terms may be as long as 14 years. At June 30, 1999 the balance outstanding was \$8.3 million at rates ranging from 5.3 percent to 6.0 percent.

In fiscal year 1998 a commercial paper program was authorized 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, 1999, \$3.5 million of taxable debt was outstanding; the balance of \$34.9 million was issued through the NJEFA on a tax-exempt basis to the investors. Maturities of the debt were 60 days for taxable paper, and from 28 to 117 days for the tax-exempt obligations. Nominal interest rates were 4.860 percent and 3.081 percent, respectively.

Principal payments for each of the next five years and thereafter on debt outstanding at June 30, 1999, excluding commercial paper, are as follows (in thousands):

	<i>Principal payments</i>
2000	\$38,459
2001	30,864
2002	28,407
2003	27,398
2004	21,039
Thereafter	<u>126,907</u>
Subtotal	273,074
Unamortized discount	(1,485)
Net long-term debt	<u><u>\$271,589</u></u>

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, 1999, the carrying value and the estimated fair value of the University's long-term debt, excluding commercial paper, were \$271.6 million and \$269.8 million, respectively.

Commitments and contingencies

At June 30, 1999, the estimated completion costs of capital projects that have been approved were approximately \$144.6 million. Major projects include a new campus center (\$36.8 million), a social science building (\$21.6 million), and major dormitory renovations (\$15.8 million). Also, the University is obligated under certain limited partnership agreements to advance additional funding periodically up to specified levels. At June 30, 1999, the University had unfunded commitments of \$550.3 million that are likely to be called through 2004.

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 \$22.9 million for the year ended June 30, 1999. 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 1999 is composed of (in thousands):

Service cost	\$ 310
Interest cost	5,648
Return on assets	(8,720)
Net amortization and deferral	<u>(996)</u>
Net periodic pension cost/(income)	<u><u>\$ (3,758)</u></u>

The funded status of the defined benefit plan at July 1, 1998, the latest valuation date, is as follows (in thousands):

Accumulated benefit obligation (all participants' benefits are fully vested)	<u>\$ 73,065</u>
Fair value of plan assets	\$111,499
Projected benefit obligation	<u>73,097</u>
Plan assets in excess of projected benefit obligation	38,402
Unrecognized net transition obligation	672
Unrecognized net (gain)/loss	(26,548)
Unrecognized prior service cost	<u>863</u>
Prepaid pension cost	<u><u>\$ 13,389</u></u>

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	\$ 3,514
Interest cost	7,582
Net amortization of transition amount	6,361
Other	(3,028)
Total	<u>\$ 14,429</u>

The APBO at June 30, 1999 consisted of actuarially determined obligations to the following categories of employees (in thousands):

Retirees	\$ 49,368
Fully eligible active employees	29,450
Other active participants	35,960
Total	<u>\$ 114,778</u>

Reconciliation of funded status (in thousands):

Accumulated postretirement benefit obligation and funded status	\$ 114,778
Unrecognized transition obligation existing at June 30, 1999	(89,058)
Unrecognized net gain	59,701
Accrued expense at June 30, 1999	<u>\$ 85,421</u>

An assumed discount rate of 7.5 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 2000 is an increase of 11 percent over the costs for fiscal 1999. 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 \$132.6 million and cause the service and interest cost components of the net periodic cost to be increased by \$2.2 million.

Promises to give

At June 30, 1999 and 1998 the University had received from donors unconditional promises to give contributions of amounts receivable in the following periods (in thousands):

	1999	1998
Less than one year	\$ 49,069	\$ 32,375
One to five years	127,410	123,686
More than five years	36,917	9,090
Total	<u>213,396</u>	<u>165,151</u>
Less unamortized discount	38,350	22,673
Net amount	<u>\$ 175,046</u>	<u>\$ 142,478</u>

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 \$34.3 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.