

*MACALESTER  
COLLEGE*

*ANNUAL FINANCIAL STATEMENTS  
WITH AUDITORS OPINION  
FOR YEAR ENDED MAY 31, 2005*



**KPMG LLP**  
4200 Wells Fargo Center  
90 South Seventh Street  
Minneapolis, MN 55402

The Board of Trustees  
Macalester College:

We have audited the accompanying statements of financial position of Macalester College (the College), as of May 31, 2005 and 2004, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the College as of May 31, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 14, 2005, on our consideration of the College'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

**KPMG LLP**

Minneapolis, Minnesota  
September 14, 2005

**Macalester College**  
**Statements of Financial Position**  
**May 31, 2005 and 2004**  
(in thousands of dollars)

|   | Operations       | Investments    | Plant          | 2005<br>Total  | 2004<br>Total     |
|---|------------------|----------------|----------------|----------------|-------------------|
| <b>ASSETS</b>   |                  |                |                |                |                   |
| Cash and cash equivalents   | \$ 7,894         | 5,471          | 5,887          | 19,252         | \$ 13,758         |
| Collateral on loaned securities   | -                | 82,508         | -              | 82,508         | 81,046            |
| Accrued investment income   | 1,251            | 22             | -              | 1,273          | 1,491             |
| Prepaid expenses  | 426              | -              | 814            | 1,240          | 1,338             |
| Notes and accounts receivable, net of allowance for doubtful receivables of \$939 (and \$720 in 2004) | 1,936            | 4,892          | -              | 6,828          | 6,960             |
| Contributions receivable, net   | 1,081            | 747            | 2,460          | 4,288          | 2,085             |
| Interest rate swap agreement  | -                | -              | -              | -              | 295               |
| Long term investments   | 9,965            | 503,632        | -              | 513,597        | 481,339           |
| Real estate   | -                | 7,098          | -              | 7,098          | 7,098             |
| Land, buildings and equipment, net of accumulated depreciation  | -                | -              | 121,917        | 121,917        | 122,246           |
| Beneficial interest in perpetual trust  | -                | 27,696         | -              | 27,696         | 26,795            |
| <b>Total assets</b>   | <b>\$ 22,553</b> | <b>632,066</b> | <b>131,078</b> | <b>785,697</b> | <b>\$ 744,451</b> |
| <b>LIABILITIES AND NET ASSETS</b>   |                  |                |                |                |                   |
| Liabilities:  |                  |                |                |                |                   |
| Accounts payable and accrued expenses   | \$ 9,207         | -              | 964            | 10,171         | \$ 9,174          |
| Collateral on loaned securities   | -                | 82,508         | -              | 82,508         | 81,046            |
| Deferred revenue  | 374              | -              | -              | 374            | 1,343             |
| Deposits  | 255              | 15             | -              | 270            | 254               |
| Interest rate swap agreement  | -                | -              | 447            | 447            | -                 |
| Liabilities under planned giving agreements   | -                | 5,692          | -              | 5,692          | 5,864             |
| Government grants refundable  | -                | 4,449          | -              | 4,449          | 4,332             |
| Bonds and mortgages payable   | -                | -              | 56,752         | 56,752         | 57,981            |
| <b>Total liabilities</b>  | <b>9,836</b>     | <b>92,664</b>  | <b>58,163</b>  | <b>160,663</b> | <b>159,994</b>    |
| Net assets:   |                  |                |                |                |                   |
| Unrestricted:   |                  |                |                |                |                   |
| For operations  | 4,823            | -              | -              | 4,823          | 6,064             |
| For investment in plant   | -                | -              | 1,336          | 1,336          | 307               |
| For long term investments   | -                | 42,031         | -              | 42,031         | 36,549            |
| For endowment payout  | -                | 41,896         | -              | 41,896         | 36,300            |
| For debt service  | -                | -              | (249)          | (249)          | 510               |
| Net investment in plant   | -                | -              | 67,309         | 67,309         | 69,322            |
| <b>Total unrestricted</b>   | <b>4,823</b>     | <b>83,927</b>  | <b>68,396</b>  | <b>157,146</b> | <b>149,052</b>    |
| Temporarily restricted:   |                  |                |                |                |                   |
| For operations  | 7,894            | -              | -              | 7,894          | 6,749             |
| For investment in plant   | -                | -              | 4,519          | 4,519          | 684               |
| For long term investments   | -                | 113,739        | -              | 113,739        | 85,707            |
| <b>Total temporarily restricted</b>   | <b>7,894</b>     | <b>113,739</b> | <b>4,519</b>   | <b>126,152</b> | <b>93,140</b>     |
| Permanently restricted:   |                  |                |                |                |                   |
| For long term investments   | -                | 341,736        | -              | 341,736        | 342,265           |
| <b>Total net assets</b>   | <b>12,717</b>    | <b>539,402</b> | <b>72,915</b>  | <b>625,034</b> | <b>584,457</b>    |
| <b>Total liabilities and net assets</b>   | <b>\$ 22,553</b> | <b>632,066</b> | <b>131,078</b> | <b>785,697</b> | <b>\$ 744,451</b> |

See accompanying notes to financial statements.

**Macalester College**  
**Statements of Activities**  
**Years ended May 31, 2005 and 2004**  
(in thousands of dollars)

|   | <u>Operations</u> | <u>Investments</u> | <u>Plant</u>   | <u>2005<br/>Total</u> | <u>2004<br/>Total</u> |
|---|-------------------|--------------------|----------------|-----------------------|-----------------------|
| Changes in unrestricted net assets:                         |                   |                    |                |                       |                       |
| Revenues and other additions:                               |                   |                    |                |                       |                       |
| Tuition and fees  | \$ 48,835         | -                  | -              | 48,835                | \$ 45,598             |
| Less: Student aid and scholarships                          | (21,650)          | -                  | -              | (21,650)              | (19,916)              |
| Net tuition and fees  | 27,185            | -                  | -              | 27,185                | 25,682                |
| Federal grants and contracts                                | 1,380             | -                  | -              | 1,380                 | 1,390                 |
| State grants and contracts                                  | 57                | -                  | -              | 57                    | 67                    |
| Private gifts and grants                                    | 4,365             | -                  | -              | 4,365                 | 4,929                 |
| Sales and service of auxiliary enterprises                  | 10,480            | -                  | -              | 10,480                | 10,060                |
| Sale of fixed assets/other sources                          | 582               | -                  | -              | 582                   | 1,094                 |
| Investment income   | 590               | -                  | 138            | 728                   | 416                   |
| Endowment payout  | 2,043             | -                  | -              | 2,043                 | 1,910                 |
| Realized and unrealized gains on:                           |                   |                    |                |                       |                       |
| Investments, net of gains used in endowment payout          | 174               | 8,926              | -              | 9,100                 | 9,557                 |
| Change in value of planned giving agreements                | -                 | (3)                | -              | (3)                   | -                     |
| Change in value of interest rate swap                       | -                 | -                  | (742)          | (742)                 | 1,258                 |
| Change in donor restrictions                                | 66                | 1,227              | -              | 1,293                 | -                     |
| Net assets released from restrictions                       | 22,867            | -                  | 86             | 22,953                | 24,512                |
| Total revenues and other additions                          | <u>69,789</u>     | <u>10,150</u>      | <u>(518)</u>   | <u>79,421</u>         | <u>80,875</u>         |
| Expenses:   |                   |                    |                |                       |                       |
| Instruction   | 24,824            | -                  | 1,601          | 26,425                | 25,331                |
| Research  | 977               | -                  | -              | 977                   | 1,094                 |
| Public service  | 345               | -                  | 36             | 381                   | 480                   |
| Academic support  | 6,007             | -                  | 348            | 6,355                 | 6,289                 |
| Student services  | 10,956            | -                  | 2,129          | 13,085                | 12,603                |
| Institutional support                                       | 11,826            | -                  | 949            | 12,775                | 12,059                |
| Auxiliary enterprises                                       | 8,639             | -                  | 2,108          | 10,747                | 9,866                 |
| Administration and other expenses                           | -                 | 165                | -              | 165                   | 189                   |
| Total expenses  | <u>63,574</u>     | <u>165</u>         | <u>7,171</u>   | <u>70,910</u>         | <u>67,911</u>         |
| Transfers among reporting categories:                       |                   |                    |                |                       |                       |
| Principal and interest                                      | (4,562)           | -                  | 4,562          | -                     | -                     |
| Capital improvements  | (2,042)           | (45)               | 2,087          | -                     | -                     |
| Long term investments                                       | (852)             | 1,138              | (286)          | -                     | -                     |
| Total transfers   | <u>(7,456)</u>    | <u>1,093</u>       | <u>6,363</u>   | <u>-</u>              | <u>-</u>              |
| Change in unrestricted net assets before extraordinary loss |                   |                    |                |                       |                       |
| extraordinary loss  | (1,241)           | 11,078             | (1,326)        | 8,511                 | 12,964                |
| Extraordinary loss on extinguishment of debt                | -                 | -                  | (417)          | (417)                 | -                     |
| Change in unrestricted net assets                           | <u>(1,241)</u>    | <u>11,078</u>      | <u>(1,743)</u> | <u>8,094</u>          | <u>12,964</u>         |
| Unrestricted net assets beginning of year                   |                   |                    |                |                       |                       |
| Unrestricted net assets at end of year                      | \$ <u>6,064</u>   | <u>72,849</u>      | <u>70,139</u>  | <u>149,052</u>        | <u>136,088</u>        |
|   | \$ <u>4,823</u>   | <u>83,927</u>      | <u>68,396</u>  | <u>157,146</u>        | \$ <u>149,052</u>     |

(continued)

See accompanying notes to financial statements.

**Macalester College**  
**Statements of Activities**  
(in thousands of dollars)  
(Continued)

|   | Operations | Investments | Plant  | 2005<br>Total | 2004<br>Total |
|---|------------|-------------|--------|---------------|---------------|
| Changes in temporarily restricted net assets:                                       |            |             |        |               |               |
| Private gifts   | \$ 2,678   | 1,276       | 3,772  | 7,726         | \$ 1,244      |
| Other sources   | 37         | -           | -      | 37            | 17            |
| Investment income   | 26         | -           | -      | 26            | 20            |
| Endowment payout  | 22,199     | -           | 24     | 22,223        | 23,663        |
| Realized and unrealized gains on investments, net of gains used in endowment payout | -          | 24,178      | -      | 24,178        | 29,030        |
| Change in value of planned giving agreements  | -          | 39          | -      | 39            | (76)          |
| Net assets released from restrictions   | (22,867)   | -           | (86)   | (22,953)      | (24,512)      |
| Transfers among reporting categories  | (1,011)    | 886         | 125    | -             | -             |
| Change in donor restrictions  | 83         | 1,653       | -      | 1,736         | 5,132         |
| Change in temporarily restricted net assets   | 1,145      | 28,032      | 3,835  | 33,012        | 34,518        |
| Temporarily restricted net assets beginning of year                                 | 6,749      | 85,707      | 684    | 93,140        | 58,622        |
| Temporarily restricted net assets at end of year                                    | \$ 7,894   | 113,739     | 4,519  | 126,152       | \$ 93,140     |
| Changes in permanently restricted net assets:                                       |            |             |        |               |               |
| Private gifts   | \$ -       | 310         | -      | 310           | \$ 268        |
| Realized and unrealized gains on investments, net of gains used in endowment payout | -          | 725         | -      | 725           | 2,798         |
| Change in value of beneficial interest in perpetual trust                           | -          | 901         | -      | 901           | 750           |
| Change in value of planned giving agreements  | -          | 564         | -      | 564           | 955           |
| Change in donor restrictions  | -          | (3,029)     | -      | (3,029)       | (5,132)       |
| Net change in permanently restricted net assets                                     | -          | (529)       | -      | (529)         | (361)         |
| Permanently restricted net assets at beginning of year                              | -          | 342,265     | -      | 342,265       | 342,626       |
| Permanently restricted net assets at end of year                                    | \$ -       | 341,736     | -      | 341,736       | \$ 342,265    |
| Total net assets beginning of year  | \$ 12,813  | 500,821     | 70,823 | 584,457       | \$ 537,336    |
| Change in total net assets  | (96)       | 38,581      | 2,092  | 40,577        | 47,121        |
| Total net assets end of year  | \$ 12,717  | 539,402     | 72,915 | 625,034       | \$ 584,457    |

See accompanying notes to financial statements.

**Macalester College**  
**Statements of Cash Flows**  
**Years ended May 31, 2005 and 2004**  
(in thousands of dollars)

|   | <u>2005</u>      | <u>2004</u>    |
|---|------------------|----------------|
| Cash flows from operating activities:   |                  |                |
| Change in total net assets  | \$ 40,577        | 47,121         |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: |                  |                |
| Depreciation and amortization   | 4,305            | 4,053          |
| Realized and unrealized (gain) loss on investments  | (33,870)         | (40,951)       |
| Extraordinary loss on extinguishment of debt  | 417              | -              |
| Unrealized (gain) loss on interest rate swap  | 742              | (1,258)        |
| Private gifts and other income restricted for long term investments                         | (310)            | (268)          |
| Adjustment of actuarial liabilities for planned giving agreements                           | 449              | 234            |
| Change in assets and liabilities  |                  |                |
| Accrued investment income   | 218              | (105)          |
| Prepaid expenses  | 98               | (48)           |
| Notes and accounts receivable   | 132              | (1,035)        |
| Contributions receivable  | (2,203)          | 1,311          |
| Accounts payable and accrued expenses   | 997              | 537            |
| Deferred revenue  | (969)            | (798)          |
| Deposits  | 16               | 22             |
| Net cash provided by operating activities   | <u>10,599</u>    | <u>8,815</u>   |
| Cash flows from investing activities:   |                  |                |
| Proceeds from sale of investments   | 152,469          | 290,458        |
| Purchase of investments   | (150,857)        | (288,300)      |
| Purchase of land, building and equipment  | (3,976)          | (9,755)        |
| Net cash used in investing activities   | <u>(2,364)</u>   | <u>(7,597)</u> |
| Cash flows from financing activities:   |                  |                |
| Proceeds from issuance of bond payable, net   | 14,995           | -              |
| Principal payments on bonds payable including extinguishment of debt                        | (16,641)         | (1,627)        |
| Payments made to beneficiaries of planned giving agreements                                 | (621)            | (731)          |
| Increase in government grant refundable   | 117              | 93             |
| (Increase) decrease in funds for investment in land, buildings, and equipment               | -                | 11,714         |
| Change in value of beneficial interest in perpetual trust                                   | (901)            | (750)          |
| Private gifts, grants and other income restricted for long term investment                  | 310              | 268            |
| Net cash (used in) provided by financing activities   | <u>(2,741)</u>   | <u>8,967</u>   |
| Increase (decrease) in cash and cash equivalents  | 5,494            | 10,185         |
| Cash and cash equivalents at beginning of the year  | 13,758           | 3,573          |
| Cash and cash equivalents at end of the year  | <u>\$ 19,252</u> | <u>13,758</u>  |
| Supplemental disclosure - cash paid for interest  | <u>\$ 2,473</u>  | <u>2,474</u>   |

See accompanying notes to financial statements.

## MACALESTER COLLEGE

Notes to Financial Statements

May 31, 2005 and 2004

(in thousands of dollars)

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### 1) Background and Organization

Macalester College (the College) is a highly selective, four year, coeducational, private liberal arts college. Founded in 1874, the College is located in the urban setting of Saint Paul, Minnesota, and is affiliated with the Presbyterian Church (USA). The College offers a liberal arts program leading to a Bachelor of Arts degree and is accredited by the North Central Association of Colleges and Secondary Schools.

### 2) Summary of Significant Accounting Policies

#### ***Basis of Presentation***

The accompanying financial statements are presented on the accrual basis of accounting. To ensure the observance of limitations and restrictions placed on the use of available resources, the College maintains its accounts in accordance with the principles and practices of fund accounting. Fund accounting is the procedure by which resources for various purposes are classified for accounting purposes into funds that are maintained in accordance with activities or objectives of the College. For external reporting purposes, however, the College's financial statements have been prepared to focus on the organization as a whole and to present balances and transactions classified in accordance with the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified as follows:

*Permanently restricted net assets*--Net assets subject to donor imposed stipulations that they be maintained permanently by the College. Generally the donor of these assets permits the College to use all or part of the income earned and capital gains, if any, on related investments for general or specific purposes.

*Temporarily restricted net assets*--Net assets subject to donor imposed stipulations that restrict their use to a specific purpose and/or the passage of time.

*Unrestricted net assets*--Net assets not subject to donor imposed stipulations. Certain of these amounts have been designated by the board for investment purposes as indicated in the presentation.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor imposed restrictions. Donor restricted contributions whose restrictions are met in the same year as the gift is made are reported as temporarily restricted contributions in the current year. Expirations of temporary restrictions on net assets, that is, the donor imposed stipulated purpose has been accomplished and/or the stipulated time period has elapsed, are reported as net assets released from 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.

(Continued)

## **MACALESTER COLLEGE**

Notes to Financial Statements

May 31, 2005 and 2004

(in thousands of dollars)

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Contributions, including unconditional promises to give, are recognized as revenue in the period received and reported in their appropriate net asset group, subject to the existence or absence of donor imposed stipulations. Conditional promises to give are not recognized until 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 are discounted at an appropriate discount rate commensurate with the risks involved. Amortization of discount is recorded as additional contribution revenue in accordance with donor imposed restrictions, if any, on the contributions.

Dividends, interest, and net gains or losses, both realized and unrealized, on investments are reported as follows:

- as increases or decreases in permanently restricted net assets if the terms of the gift or the College's interpretation of relevant state law require that they be added to the principal of a permanent endowment asset;
- as increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income; and
- as increases in unrestricted net assets in all other cases.

### ***Cash and Cash Equivalents***

Cash and cash equivalents include interest bearing money market accounts and short-term investments with an original maturity of less than three months, except those held for investment purposes.

### ***Land, Buildings and Equipment***

Constructed and purchased property and equipment are carried at cost. Land, buildings and equipment donated to the College are stated at fair value at date of donation. Long-lived assets, with the exception of land and artwork, are depreciated using the straight-line method over their estimated useful lives.

### ***Bond Issue Costs***

Bond issue costs are amortized using the straight-line method over the life of the associated bond issue. Bond issue costs are reported as prepaids on the Statement of Financial Position.

### ***Tax Status***

The College has received a determination letter from the Internal Revenue Service indicating it is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code and is subject to federal income tax only on net unrelated business income. No provision has been made for income taxes in the accompanying financial statements as the College has had no significant unrelated business income.

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## MACALESTER COLLEGE

Notes to Financial Statements

May 31, 2005 and 2004

(in thousands of dollars)

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### ***Fair Value of Financial Instruments***

The carrying amounts of cash and cash equivalents, notes and accounts receivable, accounts payable and accrued expenses, deposits, and deferred revenue approximate fair value because of the short maturity of these financial instruments. Contributions receivable and planned giving agreement liabilities are recorded at fair value using appropriate discount rates.

Long term investments and funds for investment, buildings and equipment in securities traded on national or international securities exchanges are carried at fair value, based upon values provided by external investment managers or quoted market values. The collateral on loaned securities is reported at fair value based on quoted market prices of the underlying investments. Fair values for certain investments held in alternative structures including limited partnerships, commingled funds, and limited liability corporations are estimated by the respective investment managers as market values are not readily determinable. These valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments and other pertinent information. The estimated values as determined by the general partners and investment managers may differ from the values that would have been used had ready markets for the investments existed and the differences could be significantly higher or lower for any specific holding. The beneficial interest in perpetual trust is reported at fair value of the trust assets.

A reasonable estimate of the fair value of the receivables from students under government loan programs and grants refundable to government for student loans could not be made because the notes receivable are not saleable and can only be assigned to the U. S. government or its designees. The fair value of receivables from students under College loan programs approximates carrying value.

The estimated fair value of the College's revenue bonds was calculated by discounting future cash flows through estimated maturity using the borrowing rate currently available to the College for debt of similar original maturity. The carrying value of the College bonds is \$55,420 and \$57,510 at May 31, 2005 and 2004, respectively, and the fair value was approximately \$56,789 and \$58,309. The carrying value approximates the fair value of the Series 1994 and 2003 bonds as the interest rate varies weekly.

### ***Derivative Financial Instruments***

In accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, Macalester accounts for derivative instruments, including derivative instruments embedded in other contracts. SFAS No. 133 requires that derivative instruments be measured at fair value and reported as assets or liabilities in the statement of financial position. Changes in the fair value of derivatives during the year are reported in the statement of activities. Macalester's interest rate swap agreement

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## MACALESTER COLLEGE

Notes to Financial Statements

May 31, 2005 and 2004

(in thousands of dollars)

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is considered a derivative financial instrument and has been reported in the statement of financial position at fair value. The change in the fair value of the agreement during the year is reported in the statement of activities. The net cash received or paid under the terms of the interest rate swap agreement over its term is reported as a component of interest expense.

### ***Planned Giving Agreements***

The College's planned giving agreements consist primarily of charitable gift annuities, charitable remainder unitrust contracts and pooled life income funds. For those trusts for which the College is the trustee, the assets are reported as long-term investments at their fair value. Contribution revenue is recognized at the dates the trusts are established after recording a liability for the present value of the estimated future payments to be made to the beneficiaries using discount rates and assumptions established upon initial recognition of the liability and the use of the appropriate mortality tables. The obligation is adjusted during the term of the agreement for changes in the value of the assets, amortization of the discount and other changes in the estimates of future benefits.

For those irrevocable trusts for which the College does not serve as trustee, contribution revenue and a receivable are recognized at the date the trust is established for the present value of the estimated future payments to be received.

The College is also the beneficiary of a perpetual trust held and administered by others. The estimated fair value of the assets were recognized as assets and revenue at the date the College was notified of the establishment of the trust. Distributions from the trust are recorded as investment income.

### ***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

### ***Reclassification***

Certain 2004 amounts have been reclassified to conform to the 2005 presentation.

(Continued)

## MACALESTER COLLEGE

Notes to Financial Statements

May 31, 2005 and 2004

(in thousands of dollars)

### 3) Long Term Investments

The long term investments include funds traditionally considered the endowment of the College as well as assets of funds for planned giving agreements and loan funds totaling \$15,585 and \$15,368 as of May 31, 2005 and 2004, respectively. The allocations shown at fair value are as follows:

|  | <u>2005</u>       | <u>2004</u>       |
|--|-------------------|-------------------|
| Long term investments of Macalester College:   |                   |                   |
| Publicly Traded Securities:                    |                   |                   |
| Domestic Equity                                | \$ 131,545        | \$ 182,505        |
| Foreign Equity                                 | 120,160           | 102,952           |
| Fixed Income                                   | 93,232            | 97,961            |
| Alternative strategies in illiquid structures: |                   |                   |
| Domestic Equities                              | 59,177            | 14,469            |
| Private Equities                               | 29,461            | 25,982            |
| Absolute Return                                | 42,937            | 21,577            |
| Real Estate                                    | 20,687            | 20,436            |
| Natural Resources                              | 10,362            | 9,878             |
| Other  | <u>6,036</u>      | <u>5,579</u>      |
| Total fair value                               | <u>\$ 513,597</u> | <u>\$ 481,339</u> |
| Total cost                                     | <u>\$ 450,437</u> | <u>\$ 439,005</u> |

Included in the fair value of preferred stocks is \$5,892 and \$5,579 at May 31, 2005 and 2004, respectively, relating to 90,710 shares of the Reader's Digest Association, Inc. preferred stock which is not publicly traded. Additionally, the College has agreed not to sell such shares of stock without first offering the shares to the Reader's Digest Association, Inc. As of May 31, 2005 and 2004, the fair value of endowments funded in part or fully by DeWitt Wallace is \$383,725 and \$358,297.

Certain of the College's external investment managers are authorized to use derivative contracts in managing the assets under their control. From time to time, managers may enter into forward currency contracts to hedge currency risk on investments in foreign securities and other future contracts to adjust asset allocation efficiently. Changes in the fair value of the derivative contracts are included in endowment gains and losses. As of May 31, 2005 and 2004, investments totaling \$222,274 and \$102,952, respectively, included limited use of forward currency contracts, and investments totaling \$120,160 and \$29,804, respectively, included other derivative instruments.

The College participates in a securities lending program, whereby securities owned by the College and included and reported on the accompanying Statement of Financial Position in the College's investments are loaned to other institutions. As of May 31, 2005 and 2004, the

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## **MACALESTER COLLEGE**

Notes to Financial Statements

May 31, 2005 and 2004

(in thousands of dollars)

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College had loaned certain securities, returnable on demand, with a fair value of \$80,912 and \$79,194, respectively, to several financial institutions that have deposited collateral with respect to such securities of \$82,508 and \$81,046, respectively. The College receives income on the invested collateral and also continues to receive interest and dividends from securities on loan. This transaction has been accounted for as a non-cash investing activity for purposes of the accompanying Statement of Cash Flow.

### **4) Funds Held in Trust by Others**

The College's beneficial interest in the fair value of assets in a perpetual trust is \$27,696 and \$26,795 as of May 31, 2005 and 2004, respectively. For the years ended May 31, 2005 and 2004, the College received \$1,057 and \$1,120 from this trust, respectively.

The College is the income beneficiary of a revocable trust with an estimated value of \$13,054 and \$12,257 as of May 31, 2005 and 2004, respectively, which is controlled by independent trustees. For the year ended May 31, 2005 and 2004, the College received \$304 and \$422 from this trust, respectively. These assets are not recorded on the financial statements of the College.

### **5) Valuation and Performance of Long Term Investment Funds**

The majority of the assets of the endowment funds have been placed in an investment pool, on a fair value basis, with each individual fund within the pool subscribing to or disposing of units on the basis of the market value per unit at the beginning of the month within which the transaction takes place.

Endowment investment and spending for the pooled investments is based on a total return policy. The Board of Trustees sets a spending rate which is used to establish the endowment payout. A spending rate for 2005 and 2004 of 5.0% and 5.1%, respectively, is applied to a sixteen-quarter average of investment fair value. The payout is supplemented by an amount equivalent to the investment expenses. If yield (interest and dividend income) is not sufficient to support the calculated payout, the balance is allocated from gains of the endowment assets. As of May 31, 2005 certain individual endowed funds had gain deficiencies totaling \$160 and did not have gains available to supplement yield. The gain deficiencies have been offset by an allocation from unrestricted net assets within the investment pool. As the market value of endowed funds with gain deficiencies increases, the allocation will reverse.

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**MACALESTER COLLEGE**

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(in thousands of dollars)

The College's endowment payout on pooled and non-pooled assets as reported in the financial statements is as follows:

| Year ended May 31, 2005                                 | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Permanently<br/>Restricted</u> | <u>Total</u>     |
|---|---------------------|-----------------------------------|-----------------------------------|------------------|
| Endowment yield (net of investment expenses of \$1,659) | \$ 1,045            | \$ 10,016                         | \$ 46                             | \$ 11,107        |
| Gains used in endowment payout                          | <u>998</u>          | <u>12,207</u>                     | <u>62</u>                         | <u>13,267</u>    |
| Endowment payout  | <u>\$ 2,043</u>     | <u>\$ 22,223</u>                  | <u>\$ 108</u>                     | <u>\$ 24,374</u> |
| Year ended May 31, 2004                                 | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Permanently<br/>Restricted</u> | <u>Total</u>     |
| Endowment yield (net of investment expenses of \$1,653) | \$ 1,002            | \$ 9,874                          | \$ 45                             | \$ 10,921        |
| Gains used in endowment payout                          | <u>908</u>          | <u>13,789</u>                     | <u>71</u>                         | <u>14,768</u>    |
| Endowment payout  | <u>\$ 1,910</u>     | <u>\$ 23,663</u>                  | <u>\$ 116</u>                     | <u>\$ 25,689</u> |

**6) Contributions Receivable**

Contributions receivable consists of the following:

|   | <u>2005</u>     | <u>2004</u>     |
|---|-----------------|-----------------|
| Unconditional promises expected to be collected in: |                 |                 |
| Less than one year                                  | \$ 1,541        | \$ 1,113        |
| One year to five years                              | 2,886           | 854             |
| Greater than five years                             | 257             | 358             |
| Less: Discount to present value (5%)                | <u>(396)</u>    | <u>(240)</u>    |
|   | <u>\$ 4,288</u> | <u>\$ 2,085</u> |

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**MACALESTER COLLEGE**

Notes to Financial Statements

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(in thousands of dollars)

**7) Land, Building and Equipment**

The following is a summary of the College's property and equipment:

|                                | <u>2005</u>       | <u>2004</u>      |
|--------------------------------|-------------------|------------------|
| Land and land improvements     | \$ 1,414          | \$ 1,414         |
| Buildings                      | 163,938           | 156,034          |
| Equipment                      | 4,258             | 4,706            |
| Construction in progress       | <u>700</u>        | <u>4,911</u>     |
|                                | 170,310           | 167,065          |
| Less: Accumulated depreciation | <u>(48,393)</u>   | <u>(44,819)</u>  |
|                                | <u>\$ 121,917</u> | <u>\$122,246</u> |

**8) Bonds and Mortgages Payable**

Bonds and mortgages payable consist of the following:

|   | <u>2005</u> | <u>2004</u> |
|---|-------------|-------------|
| College Housing Program Mortgages at 3%, due in semi-annual installments through 2020 (original amount \$880)   | 446         | 471         |
| Minnesota Higher Education Facilities Authority (MHEFA) variable rate demand revenue bonds of 1994, weekly maturity and rate reset, 1.75% average for current fiscal year, total principal due 2024 (original amount \$6,660)               | 6,660       | 6,660       |
| Minnesota Higher Education Facilities Authority Revenue Bonds of 1995, 5.48% average, final series due 2016 (original amount \$11,245)  | 0           | 8,025       |
| Minnesota Higher Education Facilities Authority Revenue Bonds of 1997, 5.41% average, final series due 2017 (original amount \$11,000)  | 0           | 8,365       |
| Minnesota Higher Education Facilities Authority Revenue Bonds of 1998, 4.94% average, final series due 2022 (original amount \$22,345)  | 18,465      | 19,160      |
| Minnesota Higher Education Facilities Authority variable rate demand revenue bonds of 2003, weekly rate reset as well as a weekly tender option, 1.75% average for current fiscal year, total principal due 2033 (original amount \$15,300) | 15,300      | 15,300      |

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## Notes to Financial Statements

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|  | <u>2005</u>      | <u>2004</u>     |
|--|------------------|-----------------|
| Minnesota Higher Education Facilities Authority Revenue<br>Bonds of 2004, 4.73% average, final series due 2017<br>(original amount \$14,995) | <u>14,995</u>    | <u>0</u>        |
|  | 55,866           | 57,981          |
| Plus unamortized bond premium  | <u>886</u>       | <u>0</u>        |
|  | <u>\$ 56,752</u> | <u>\$57,981</u> |

The College is involved in the College Housing Program of the U. S. Department of Housing and Urban Development. The funds received under this program have been used to rehabilitate student dormitories and dining areas. The mortgages under this program are secured by a lien on the College's stadium carried at original acquisition cost and improvements of \$781 at May 31, 2005 and 2004, and by pledges of gross stadium and tuition revenues.

In September of 1994, \$6,660 of variable rate demand revenue bonds were issued on behalf of the College by MHEFA. The bonds were initially issued with a weekly maturity and rate reset, but longer maturities as well as a fixed rate are optional. Proceeds of the issue were used to finance various campus improvements and an athletic field expansion. Loan repayments associated with the bonds will be general obligations of the College, with interest payable monthly (semi-annual if converted to fixed), and principal payable at maturity, on March 1, 2024.

In November of 1995, \$11,245 of revenue bonds were issued on behalf of the College by MHEFA. The average maturity of the issued bonds was 12.4 years, at an average rate of 5.48%. The bonds were secured by a pledge by MHEFA. Proceeds of the issue were used to finance renovation and expansion of the Olin/Rice Halls Science Facility.

In May of 1997, \$11,000 of revenue bonds were issued on behalf of the College by MHEFA. The average maturity of the issued bonds was 12.05 years, at an average rate of 5.41%. Proceeds of this issue were used to finance campus improvements.

In July of 1998, \$22,345 of revenue bonds were issued on behalf of the College by MHEFA. The average maturity of the issued bonds is 14.59 years at an average rate of 4.94%. A portion of the proceeds were used, together with other funds of the College, for construction of a new campus center. The remaining portion was used for refunding in advance the 1992 bond issue.

In February of 2003, \$15,300 of variable rate demand revenue bonds were issued on behalf of the College by MHEFA. The bonds were issued with a weekly rate reset, as well as a

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## MACALESTER COLLEGE

Notes to Financial Statements

May 31, 2005 and 2004

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weekly tender option. In the event of a tender and unsuccessful remarketing, self liquidity is provided through treasury securities held as long term investments. Proceeds of the issue are being used to finance various dormitory improvements. Loan repayments associated with the bonds will be general obligations of the College, with interest payable monthly and principal payable at maturity, on March 1, 2033.

In December of 2004, \$14,995 of revenue bonds were issued on behalf of the College by MHEFA. The average maturity of the issued bonds is 7.04 years, at an average rate of 4.73%. Proceeds of this issue were used to fund the March 1, 2005 redemption of the MHEFA Bonds of 1995, to secure the release of the obligation under the MHEFA Bonds of 1997, and to pay certain issuance costs.

In direct connection with the variable rate demand revenue bonds issued in 2003, the College entered into an interest rate swap agreement that obligates it to pay a fixed rate of 3.33% annually to the counterparty in exchange for the receipt of a floating payment equal to 67% of the 30 day London Interbank offered rate (LIBOR). The net difference between the amounts paid to and received from the counterparty is recorded as interest expense. Payments under the swap contract are based on a notional amount of \$15,000. The contract expires on May 31, 2016. As of May 31, 2005, the estimated market value of the swap contract was (\$447).

Annual debt commitments (principal) at May 31, 2005, are as follows:

| <u>Fiscal year ending May 31,</u> | <u>Amount</u>    |
|-----------------------------------|------------------|
| 2006                              | 1,660            |
| 2007                              | 1,886            |
| 2008                              | 1,956            |
| 2009                              | 2,017            |
| 2010                              | 2,118            |
| after 2010                        | 46,229           |
|                                   | <u>\$ 55,866</u> |

Total interest costs on debt aggregated \$2,716 and \$2,493 during the year ended May 31, 2005 and 2004, respectively.

### 9) High Winds Fund

Included in the permanently restricted net assets are resources related to the High Winds Fund. The Fund is subject to the provisions of an agreement between the College and a major benefactor which provides, among other things, for physical segregation and administration of such funds in accordance with the provisions of such agreement. The purpose of the High Winds Fund is to maintain and improve the beauty, serenity and security of the area surrounding the College campus. As of May 31, 2005, the High Winds Fund owned nine properties surrounding the College campus. The total value of the assets of the Fund as of May 31, 2005 and 2004 is \$10,010 and \$9,707, respectively.

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May 31, 2005 and 2004

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### 10) Retirement Plan

The College provides retirement benefits to substantially all employees. Certain academic and non academic personnel are covered under defined contribution plans with Teachers Insurance and Annuity Association and College Retirement Equities Fund, and Vanguard Fiduciary Trust Company. A plan covering union employees is funded by deposits with trustees based on a fixed rate of contribution per hour worked. The College has no liability for these pension plans once deposits are made to the administrators. The College has an unfunded pension plan which supplements retirement benefits of certain professional and staff employees not fully covered by other plans. The unfunded liability under the supplemental plan at May 31, 2005 and 2004 was approximately \$173 and \$181, respectively.

Total benefit expense for the year ended May 31, 2005, was \$2,465 including \$20 paid under the unfunded supplemental plan and for the year ended May 31, 2004, was \$2,408 including \$21 paid under the unfunded supplemental plan.

### 11) Functional Expenses

Expenses are reported in the College's financial statements in categories recommended by the National Association of College and University Business Officers and are classified among program and supporting services as follows:

|  | <u>2005</u>      | <u>2004</u>      |
|--|------------------|------------------|
| Program - Student instruction and services | \$ 60,808        | \$ 57,296        |
| Management and general                     | 6,753            | 7,231            |
| Fundraising                                | <u>3,349</u>     | <u>3,383</u>     |
|  | <u>\$ 70,910</u> | <u>\$ 67,911</u> |

### 12) Commitments

On May 26, 2005 the college entered into a contract to purchase and install administrative computing software with Sungard SCT Corporation. The contract calls for the College to purchase hardware, software licenses, and consulting, conversion, and training services over a three year period. The College evaluated the vendor's products and negotiated its contract in conjunction with three other local private colleges. The installation of the new software will be executed in collaboration with these three colleges.

The College is committed as of May 31, 2005 to invest approximately \$83,620 in certain limited partnerships for long term investment purposes.