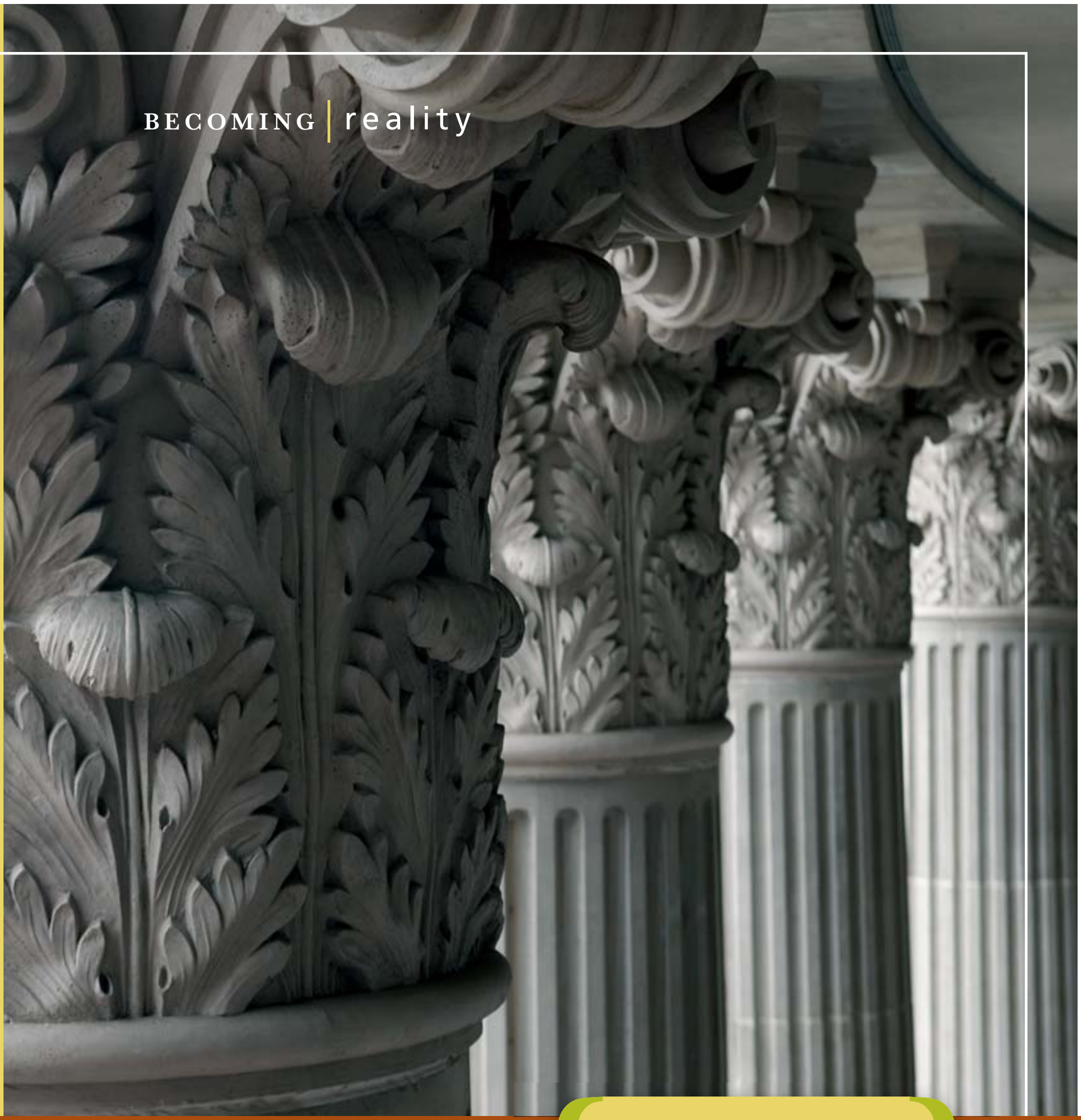
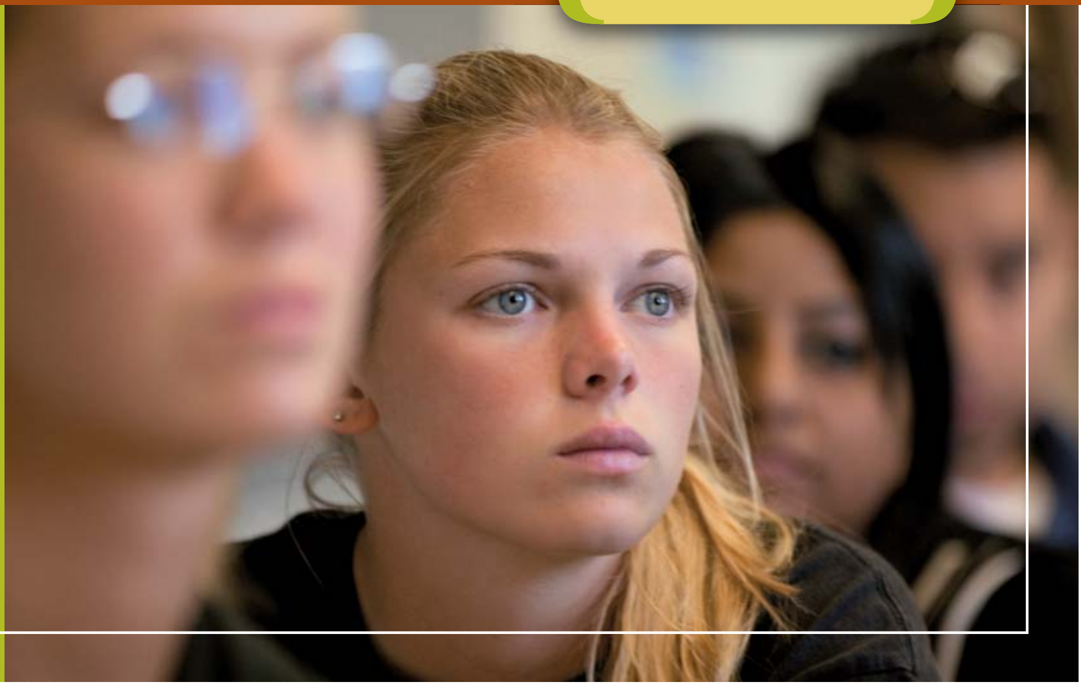
BECOMING | reality



BAYLOR UNIVERSITY | annual report

2004
2005



BAYLOR
UNIVERSITY

# BECOMING | reality

Fiscal year 2004-05 began with the dedication of two beautiful new buildings on the Baylor campus — integral milestones in assuring the University meets and exceeds the higher education needs of the future. The year ended with Robert B. Sloan, Jr. transitioning to chancellor from president, concluding a decade of leadership that challenged the University in unprecedented ways. ¶ In this, the third year of the University's 10-year vision statement, Baylor 2012, much of what has been in process now is becoming reality. From the buildings that have revolutionized both living and learning environments to the excellence being realized in classrooms and in athletic venues, Baylor is becoming what it aspired to be — an institution recognized nationally for its academic excellence *and* an institution firmly committed to Christ and its Baptist heritage. It is an aspiration that dates not just from the endorsement of Baylor 2012 in fall 2001, but from Baylor's charter in 1845. ¶ Better yet, witness the reality from the students who are experiencing it — here and now. They, too, are in the process of "becoming."

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# PRESIDENT'S perspective

The close of fiscal year 2004-05 marked the conclusion of my 10th year as president of Baylor University. As I transition to the role of chancellor of the University, I do so with optimism and enthusiasm about what the future holds.

This past year we celebrated significant milestones in the realization of Baylor 2012. The beautiful 600-bed North Village Residential Community opened in fall 2004, filled to capacity. It is Baylor's first Living and Learning Center (LLC), partnering with the School of Engineering and Computer Science. Also in the fall, the Honors College LLC opened in Alexander and Memorial Residence Halls, another opportunity to provide students close interaction with faculty and to social and intellectual activities within a community. A third LLC focused on leadership also began this year, with students living in Allen and Dawson Residence Halls.

The Baylor Sciences Building was dedicated and opened for fall classes with about 6,000 students a day benefiting from its cutting-edge classroom and laboratory design. Lauded for its architectural beauty and for its utility, the Sciences Building now has become the model for other universities to emulate.

*"Nothing — and no one — must cloud our united focus on progressing with the aspirations of Baylor 2012."*

Our Athletics Department achieved unparalleled success this past year, garnering four national championships (one team and three individual), a school-record six Big 12 team titles (four regular season, two tournament) and sending a record 12 teams to postseason play. Baylor was the only Big 12 program and one of six NCAA Division I-A institutions nationally to rank in both the top 10 of the most recent NCAA Graduation Rates report for overall student-athlete graduation success and the Directors' Cup top 25 joining Stanford, Duke, Virginia, Notre Dame and Penn State.

With these celebrations, Baylor nonetheless continued to be challenged by areas of dissension. In January 2005, Regents Chair Will Davis and I jointly announced that I would complete my tenure as president at the end of this fiscal year. My decision is based on my conviction that nothing – and no one – must cloud our united focus on progressing with the aspirations of Baylor 2012. It has been my privilege to be associated with this 10-year vision, and while another will carry the administration of it forward, I will continue to support it through public speaking and fundraising.

Much is still to be accomplished: continued renovation and construction of facilities, more Living and Learning Centers, continued recruitment of academically superior students and superb faculty. These are the challenges before Baylor as, united in focus and commitment, we continue to see Baylor 2012 become reality.

**Robert B. Sloan, Jr.**
**President**

# BECOMING | champions

## ACADEMIC:

» Baylor Law School students won annual Student Trial Advocacy Competition sponsored by the Association of Trial Lawyers of America, April 2005

» Michael Coons, master's student in mathematics, named a Fulbright scholar for 2005-06, will study at the Alfred Renyi Institute of the Hungarian Academy of the Sciences in Budapest

» Russell Browder, MDiv student in theology, named a Fulbright scholar for 2005-06, will study at the Instituto de Empresa in Madrid, Spain

» Baylor Model United Nations team took Best Small Delegation award for the second year in a row at the University of Pennsylvania Model UN Conference, November 2004; the team took second place Small Delegation award at the University of California, Berkeley, Model UN Conference, March, 2005

» Undergraduate Mock Trial Team won all four rounds at the regional competition of the American Mock Trial Association to advance to the nationals, February 2005

» Eric Green selected as one of the top five senior engineering students in the United States by the national electrical and computer engineering honor society, Eta Kappa Nu, October 2004

» Baylor's Phi Xi chapter of Mu Phi Epsilon, the international music fraternity, was recognized with three of MPE's most prestigious honors for 2004

## ATHLETIC:

» Women's Basketball NCAA Champions, Big 12 Champions

» Women's Tennis Singles NCAA Champion, Team Big 12 Champions

» Men's Tennis Singles NCAA Champion, National team runner-ups, Team Big 12 Champions

» Baseball reaches semifinals in College World Series, Big 12 Co-Champions

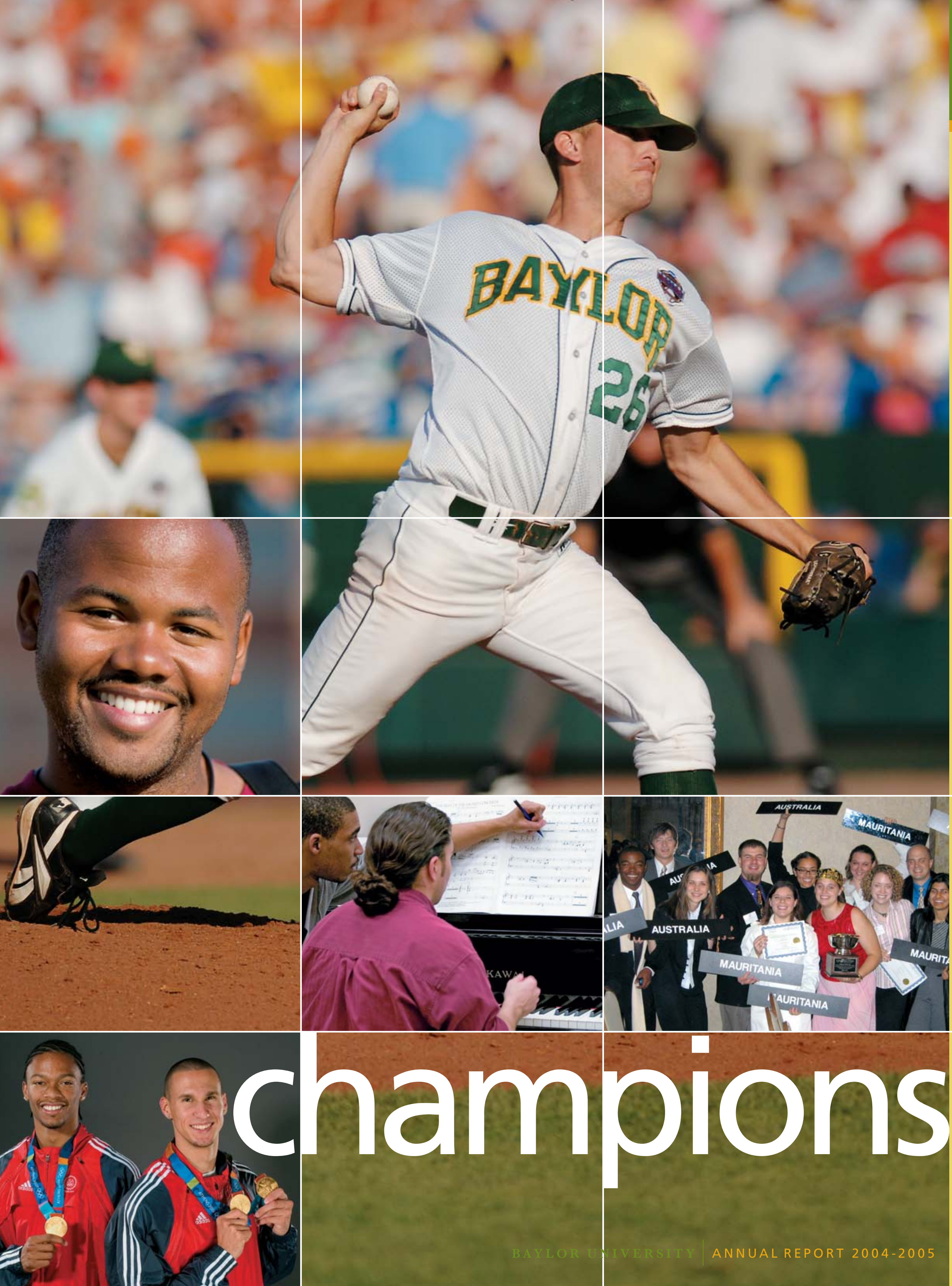
» Softball  advances to NCAA Super Regional for first time

» Men's Track, 400-meter NCAA Champion, 400-meter & 4x400-meter relay Big 12 Indoor and Outdoor Champions; women's 200-meter Big 12 Indoor Champion

» Track student-athletes Jeremy Wariner and Darold Williamson bring home three gold medals from Summer Olympic Games


*"This one was for Baylor University who needed a shining light and then it beamed across an entire nation."*

**– Head Coach Kim Mulkey-Robertson**




# champions

# transformed

*"Every professor I've had has been incredibly interesting. I love that about Baylor … professors are so student oriented. And, they are fascinated about their subjects."*

– Michael Stewart, BA '04, biochemistry

- » Baylor Sciences Building, 500,000-square-foot interdisciplinary complex, dedicated Sept. 24. Nominated for *R&D Magazine*'s 2005 Laboratory of the Year Award.
- » Southwest Securities Financial Markets Center in Baylor Hankamer School of Business dedicated Jan. 12. Awarded Grand Prize for classrooms and training facilities in May 2005 issue of *Presentations* magazine.
- » Groundbreaking Feb. 4 on Bill and Eva Williams Bear Habitat Complex
- » Groundbreaking April 29 for Ed Crenshaw Student Foundation Center on South Fifth Street between Speight and Bagby avenues

*It is life-preparing, not only career-preparing. There is something here for every student, regardless of your religious background or your economic or social status. You really step off this campus prepared for life.”*

— Allison Backus, BA ’04, philosophy, biology and chemistry minors

# community

## LIVING & LEARNING CENTERS

» North Village Residential Community dedicated Oct. 22. The first residential center to be built in 40 years, it is Baylor’s first announced Living and Learning Center, this one with the School of Engineering and Computer Science.

» Honors College Living and Learning Center in Alexander and Memorial Residence Halls dedicated Sept. 23 as Baylor’s second LLC

» A third LLC, this one focused on leadership, began in 2004 with students living in Allen and Dawson Residence Halls

## CAMPUS BEAUTIFICATION

» Wilson-Jones Memorial Garden, adjacent to Marrs McLean Gymnasium on Fifth Street, 2005 Senior Class Gift to honor Dr. F. Ray Wilson and Professor Robert B. Jones

» Sadie Jo Black Gardens in Founders Mall. Black taught for 35 years in the Department of Family and Consumer Sciences.

## PROGRAMMING

» The Place 2BU, evening and weekend free events to promote on-campus fellowship and fun

» Bear Growls, held at the beginning of new athletic seasons for faculty, staff, students and family members

# BECOMING | leaders


*"Baylor professors challenge us to seek after truth and the answers to life's toughest questions. They have equipped us with the intellectual and moral tools to effect positive change in our communities and the broader world."*

**– Jeff Leach, BA '05, political science, Student Body President**

# leaders

» Christian Leadership Institute

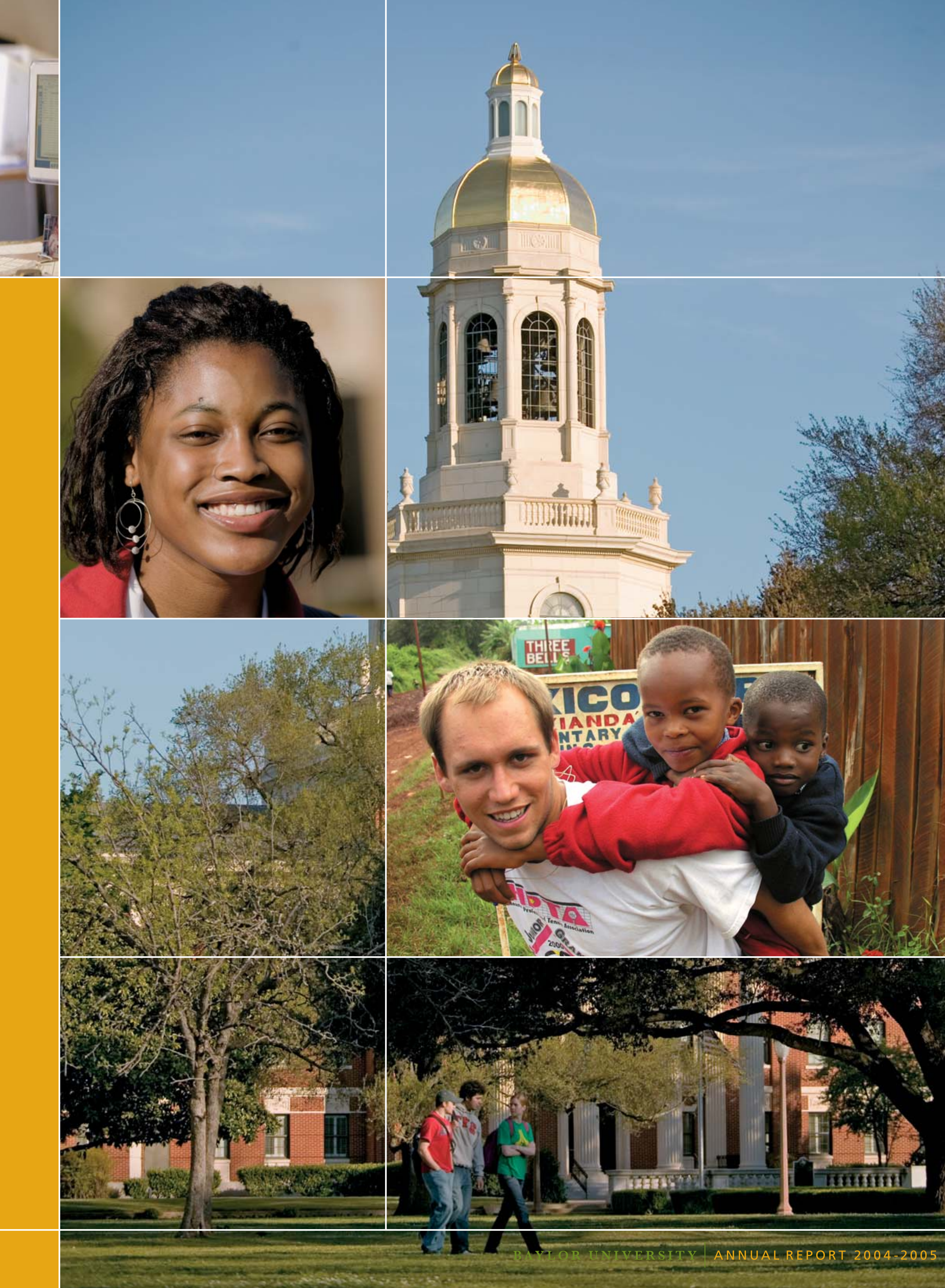
This four-day course offered in June is for incoming high school seniors who want to lead a life of influence, discover their potential for effecting the world, identify ways to leverage their strengths for success, and listen for God's calling in their lives.

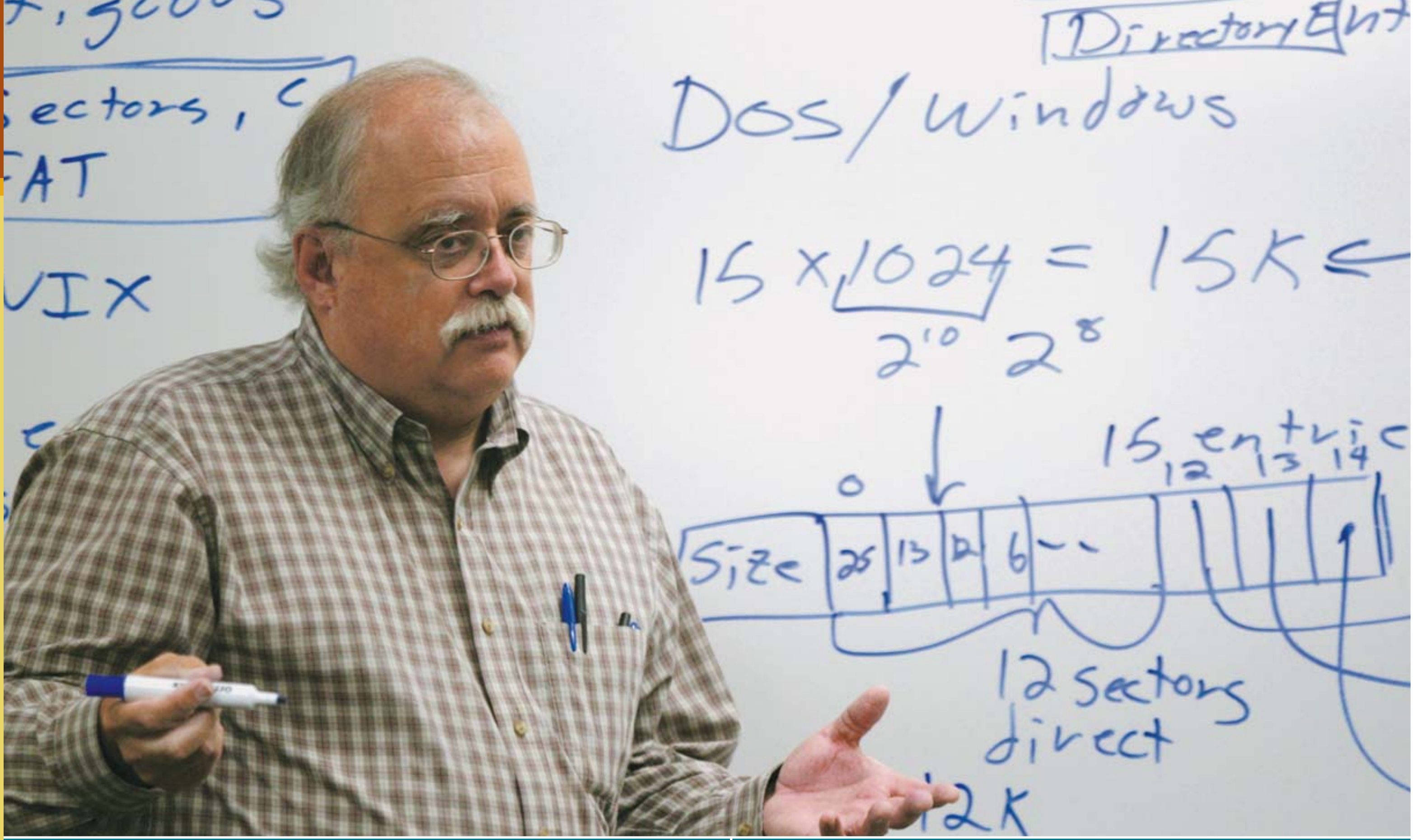
» Academy for Leader Development and Civic Engagement

Established in 2004 as the third Living and Learning Center, the LEAD-LLC gathers "leadership thinkers" by providing a forum for talented students to develop their strengths in preparation for answering a call to sustained leadership in their chosen vocation. The students live in Allen and Dawson residence halls, take required leadership courses, participate in mentoring groups and practice servant-leadership by giving 15 hours per semester in their first year to community service.

» Africa '05 Mission Trip

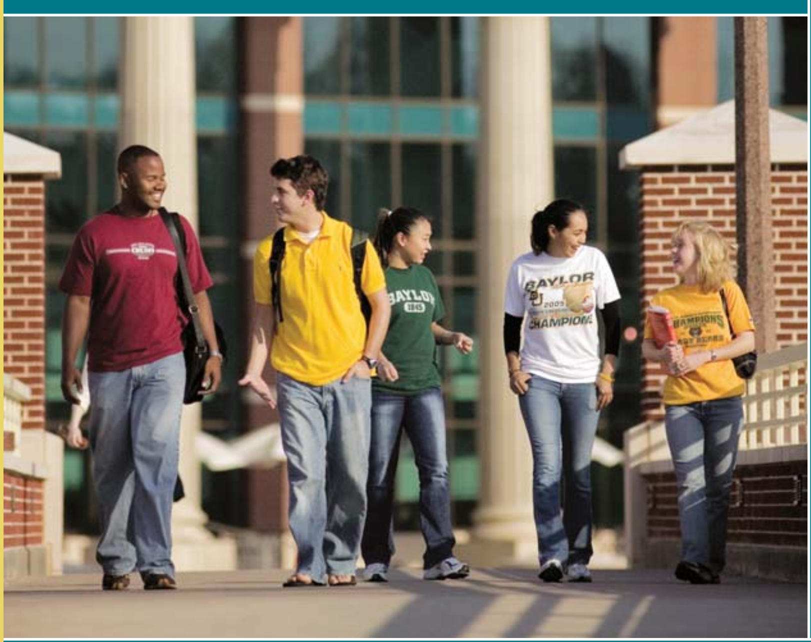
Some 150 students, faculty and administrators spent two weeks in May in Nairobi, Kenya. Eleven faculty-led specialty teams utilized skills in journalism, engineering, deaf communication, medicine, music and other academic fields.


THREE
BELLS




*"Whatever you do here at Baylor, be an expert at it. Dive into an organization and really participate. Don't just be adequate. Be extraordinary."*

**– Dustin Perkins, BA '04, psychology and neuroscience**



## FACULTY

- Martin Medhurst, Distinguished Professor of Rhetoric and Communication, awarded 2004 Paul Boase Prize for Scholarship from Ohio University's School of Communication
- Jane Abbott-Kirk, associate professor of piano, named 2004 Collegiate Teacher of the Year by the Texas Music Teachers Association
- Matthew C. Cordon, associate professor of law and reference librarian at the Baylor Law School, named one of two recipients of the 2004 Outstanding Article Award presented by the Academic Law Libraries Special Interest Section of the American Association of Law Libraries
- James M. Bennighof, vice provost of academic administration, and Scott McAllister, assistant professor of composition, received 2004-05 awards for excellence in music composition by the American Society of Composers, Authors and Publishers
- Charles Tolbert II, professor and chair of sociology and anthropology, had an article he co-authored in 1980 selected as one of the 10 most influential articles ever in this area of sociology by the American Sociological Association's Section on Organizations, Occupations and Work

» Christopher J. Hansen, assistant professor of communications studies, won a platinum award for best original screenplay for a drama at Worldfest 2005

» William H. Brackney, professor of religion, was named the 2004 recipient of the Norman W. Cox award, presented annually by the Baptist History and Heritge Society

## STUDENTS

» Incoming fall 2004 freshman class average SAT score 1190, a record high

» 45 National Merit Scholars

» Fall 2004 class reached 25 percent diversity

» Named among the nation's top 100 institutions to Hispanics in The Hispanic Outline in Higher Education, 2004

» Kristin Kan, Truman Scholarship, 2004

» Joe Barnard, National Security Education Program, 2004

» Angela Sager, National Security Education Program, 2004

## ACADEMICS

» Baylor was the only one of 50 Big 12, Big Ten, Ivy League and other schools to receive an "A" for its core curriculum by the American Council of Trustees and Alumni in Washington, D.C., 2004

» Achieved national rankings in 2005 edition of America's Best Colleges, compiled by *U.S.News & World Report:*

- Undergraduate engineering program without a doctoral program ranked 14th
- Hankamer School of Business' Entrepreneurship program ranked 10th
- U.S. Army-Baylor master's in physical therapy ranked fifth; master's in health services administration ranked 20th, "Best Graduate Schools"
- Law School's advocacy program ranked seventh, "Best Graduate Schools"

excellent

# FISCAL perspective

With fiscal year 2004-05, Baylor University completed the third year of Baylor 2012, the long-range vision for the University. As part of the vision's capital plan, several new buildings were completed and occupied. The first year of operations of these new facilities, along with the University's continuing student financial aid commitment and a slight decrease in enrollment, put pressure on the operating budget and necessitated a call to all faculty and staff to underspend the operating expenses and capital expenditures components of the budget. Baylor's faculty and staff are to be highly commended for their sacrifices that assured that the University operated within its resources.

During fiscal year 2004-05, the total assets of the University increased from $1.367 billion to $1.426 billion. Baylor's net assets increased $66 million during the year to $1.060 billion. The continued rebound in the market, along with insightful investment policies and practices, resulted in an increase in total endowment from $672 million at May 31, 2004, to $746 million at May 31, 2005.

The Fall 2004 enrollment of 13,799 students, compared to 13,937 students in Fall 2003, generated tuition and fees during 2004-05 of $254 million, which, when reduced by $74 million of scholarships, resulted in net tuition and fees of $180 million, an increase of $11 million over 2003-04. Gifts to the University totaled $32 million and endowment and investment income totaled $44 million for 2004-05, up $5 million from the prior year. Sales and services of auxiliary enterprises provided another $41 million of revenues.

During 2004-05, the University expended $186 million for instruction, research and academic support, and $23 million was spent on student activities and services. Also during the year, the auxiliary enterprise units expended $51 million. Approximately 60 percent of Baylor's operating budget is personnel costs. With no salary increases for the year and only spending for essential operating and capital needs, the University generated an operating surplus of approximately $4.4 million for the year after accrual of a year-end bonus for faculty and staff.

The University's balance sheet remained strong with total investments of $796 million at fiscal year end. Baylor's net investment in property, plant and equipment totaled $522 million at May 31, 2005, and during 2004-05, the University's long-term debt was reduced by $9 million to $247 million.

Prior to the Fall 2004 semester, construction was completed on the $103 million Baylor Sciences building, a 500,000 square-foot science education center that represented by far the largest single construction project in Baylor's history. The $33 million North Village residential complex, home to almost 600 students, along with the $10 million, 1,170 car, East Campus Parking Facility, also were completed and placed into service early in 2004-05.

Over the last three years, the University has endured less than projected enrollment, increased tuition discounting and the resulting budget and salary constraints. Throughout this period, the perseverance and dedication of the Baylor family has been evident time and time again. Now, with increased demand and a record freshman class for the Fall 2005 semester, the benefits of some of the early Baylor 2012 initiatives are beginning to be realized. This new level of demand coupled with conservative forecasts of net revenue and equally guarded expenditures will provide the funding to further Baylor 2012.

**Reagan Ramsower**
**Acting Vice President for Finance and Administration**

## FINANCIAL STATEMENTS

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# INDEPENDENT AUDITORS' REPORT

## BOARD OF REGENTS
## BAYLOR UNIVERSITY

We have audited the accompanying balance sheets of Baylor University (the "University") as of May 31, 2005 and 2004 (restated), and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the University'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. 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 University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 above financial statements present fairly, in all material respects, the financial position of the University as of May 31, 2005 and 2004 (restated), and the changes in its net assets and its cash flows for the years then ended in conformity with accoutnting principles generally accepted in the United States of America.

As discussed in Note 1, the accompanying 2004 financial statements have been restated.

Deloitte & Touche LLP

August 24, 2005

# BALANCE SHEETS

**MAY 31, 2005 AND 2004** *(Restated)*
*(in thousands of dollars)*

| | MAY 31, 2005 | | | |
|---|---|---|---|---|
| **ASSETS** | UNRESTRICTED | TEMPORARILY RESTRICTED | PERMANENTLY RESTRICTED | TOTAL |
| Cash & cash equivalents | $ 42,629 | $ — | $ — | $ **42,629** |
| Student accounts receivable, net | 7,180 | — | — | **7,180** |
| Contributions, grants & other receivables | 19,141 | 10,123 | 6,921 | **36,185** |
| Prepaid expenses & other | 7,369 | 13 | — | **7,382** |
| Student loans receivable, net | 9,928 | — | 4,547 | **14,475** |
| Investments, at fair value | 272,593 | 61,953 | 461,646 | **796,192** |
| Property, plant & equipment, net of accumulated depreciation of $215,934 & $197,718 at May 31, 2005 & 2004, respectively | 522,252 | — | — | **522,252** |
| **TOTAL ASSETS** | **$ 881,092** | **$ 72,089** | **$ 473,114** | **$ 1,426,295** |
| **LIABILITIES & NET ASSETS** | | | | |
| **LIABILITIES** | | | | |
| Accounts payable | $ 12,366 | $ 325 | $ 101 | $ **12,792** |
| Salaries & payroll taxes payable | 29,021 | — | — | **29,021** |
| Deposits & deferred income | 26,484 | — | — | **26,484** |
| Annuities payable | — | 1,448 | 4,474 | **5,922** |
| Notes & bonds payable | 247,459 | — | — | **247,459** |
| Liability for interest rate swap | 37,384 | — | — | **37,384** |
| Federal student loan funds refundable | 7,329 | — | — | **7,329** |
| **TOTAL LIABILITIES** | **360,043** | **1,773** | **4,575** | **366,391** |
| **NET ASSETS** | | | | |
| Unrestricted | 1,608 | — | — | **1,608** |
| Designated for operations | 19,574 | — | — | **19,574** |
| Restricted | — | 6,790 | 6,005 | **12,795** |
| Annuity & living trusts | — | 12,545 | 21,126 | **33,671** |
| Endowment | 148,658 | 38,437 | 441,408 | **628,503** |
| Board-designated endowment | 109,912 | 7,722 | — | **117,634** |
| Net invested in plant | 241,297 | 4,822 | — | **246,119** |
| **TOTAL NET ASSETS** | **521,049** | **70,316** | **468,539** | **1,059,904** |
| **TOTAL LIABILITIES & NET ASSETS** | **$ 881,092** | **$ 72,089** | **$ 473,114** | **$ 1,426,295** |

*See accompanying notes to financial statements.*

## MAY 31, 2004

*(as Restated, see Note 1)*

| UNRESTRICTED | TEMPORARILY RESTRICTED | PERMANENTLY RESTRICTED | TOTAL |
|---|---|---|---|
| $ 33,344 | $ — | $ — | $ **33,344** |
| 11,575 | — | — | **11,575** |
| 18,649 | 11,511 | 6,473 | **36,633** |
| 7,615 | 27 | 4 | **7,646** |
| 9,670 | — | 3,116 | **12,786** |
| 245,273 | 53,726 | 442,878 | **741,877** |
| 523,098 | — | — | **523,098** |
| **$ 849,224** | **$ 65,264** | **$ 452,471** | **$ 1,366,959** |

| | | | |
|---|---|---|---|
| $ 26,289 | $ 365 | $ 98 | $ **26,752** |
| 23,629 | — | — | **23,629** |
| 28,430 | 120 | — | **28,550** |
| — | 1,402 | 4,358 | **5,760** |
| 256,438 | — | — | **256,438** |
| 24,790 | — | — | **24,790** |
| 7,254 | — | — | **7,254** |
| **366,830** | **1,887** | **4,456** | **373,173** |
| 1,724 | — | — | **1,724** |
| 17,907 | — | — | **17,907** |
| — | 8,021 | 5,824 | **13,845** |
| — | 12,768 | 18,951 | **31,719** |
| 111,442 | 31,973 | 423,240 | **566,655** |
| 100,041 | 5,645 | — | **105,686** |
| 251,280 | 4,970 | — | **256,250** |
| 482,394 | 63,377 | 448,015 | **993,786** |
| **$ 849,224** | **$ 65,264** | **$ 452,471** | **$ 1,366,959** |

# STATEMENTS OF ACTIVITIES

**FOR THE YEARS ENDED MAY 31, 2005 AND 2004** *(Restated)*
*(in thousands of dollars)*

| | YEAR ENDED MAY 31, 2005 | | | |
|---|---|---|---|---|
| **» REVENUES** | UNRESTRICTED | TEMPORARILY RESTRICTED | PERMANENTLY RESTRICTED | TOTAL |
| Tuition & fees | $ 253,948 | $ — | $ — | $ **253,948** |
| Less scholarships | (73,845) | — | — | **(73,845)** |
| Net tuition & fees | 180,103 | — | — | **180,103** |
| Gifts, private grants & Baptist General Convention of Texas appropriation | 11,994 | 5,830 | 13,880 | **31,704** |
| Endowment & investment income | 36,581 | 4,990 | 2,014 | **43,585** |
| Realized gains (losses) on investments | 106 | 91 | 1,426 | **1,623** |
| Other sources | 18,875 | 10,526 | — | **29,401** |
| Auxiliary enterprises | 41,114 | — | — | **41,114** |
| **TOTAL REVENUES** | 288,773 | 21,437 | 17,320 | **327,530** |
| Net assets released from restrictions | 21,920 | (21,787) | (133) | — |
| **TOTAL NET REVENUES** | 310,693 | (350) | 17,187 | **327,530** |
| **» EXPENSES** | | | | |
| Program expenses | | | | |
| Instruction | 143,969 | | | **143,969** |
| Academic support, research & public service | 42,169 | | | **42,169** |
| Student activities & services | 23,220 | | | **23,220** |
| Auxiliary enterprises | 51,222 | | | **51,222** |
| Support expenses | | | | |
| Institutional support | 43,548 | | | **43,548** |
| **TOTAL EXPENSES** | 304,128 | | | **304,128** |
| **INCREASE (DECREASE) IN NET ASSETS BEFORE OTHER CHANGES** | 6,565 | (350) | 17,187 | **23,402** |
| **» OTHER CHANGES** | | | | |
| Unrealized gains on investments | 44,882 | 6,948 | 2,211 | **54,041** |
| Unrealized gain (loss) on interest rate swap | (12,594) | — | — | **(12,594)** |
| Loss on disposal of fixed assets | (198) | — | — | **(198)** |
| Change in value of split interest agreements - Present value adjustments | — | 341 | 1,126 | **1,467** |
| **TOTAL OTHER CHANGES** | 32,090 | 7,289 | 3,337 | **42,716** |
| **INCREASE IN NET ASSETS** | 38,655 | 6,939 | 20,524 | **66,118** |
| **NET ASSETS AT BEGINNING OF YEAR** | 482,394 | 63,377 | 448,015 | **993,786** |
| **NET ASSETS AT END OF YEAR** | $ 521,049 | $ 70,316 | $ 468,539 | $ **1,059,904** |

*See accompanying notes to financial statements.*

## YEAR ENDED MAY 31, 2004

*(as Restated, see Note 1)*

| UNRESTRICTED | TEMPORARILY RESTRICTED | PERMANENTLY RESTRICTED | TOTAL |
|---|---|---|---|
| $ 228,725 | $ — | $ — | **$ 228,725** |
| (59,433) | — | — | **(59,433)** |
| 169,292 | — | — | **169,292** |
| | | | |
| 12,342 | 6,227 | 16,533 | **35,102** |
| 33,141 | 4,621 | 1,200 | **38,962** |
| 4,272 | (30) | 1,362 | **5,604** |
| 19,022 | 8,926 | — | **27,948** |
| 35,941 | — | — | **35,941** |
| 274,010 | 19,744 | 19,095 | **312,849** |
| 24,360 | (24,231) | (129) | **—** |
| 298,370 | (4,487) | 18,966 | **312,849** |
| | | | |
| 133,330 | | | **133,330** |
| 39,121 | | | **39,121** |
| 24,085 | | | **24,085** |
| 46,312 | | | **46,312** |
| | | | |
| 43,610 | | | **43,610** |
| 286,458 | | | **286,458** |
| 11,912 | (4,487) | 18,966 | **26,391** |
| | | | |
| 76,108 | 13,108 | 4,936 | **94,152** |
| 16,921 | — | — | **16,921** |
| (3,327) | — | — | **(3,327)** |
| | | | |
| — | 2,108 | 2,764 | **4,872** |
| 89,702 | 15,216 | 7,700 | **112,618** |
| 101,614 | 10,729 | 26,666 | **139,009** |
| 380,780 | 52,648 | 421,349 | **854,777** |
| $ 482,394 | $ 63,377 | $ 448,015 | **$ 993,786** |

# STATEMENTS OF CASH FLOWS

**FOR THE YEARS ENDED MAY 31, 2005 AND 2004** *(Restated)*
*(in thousands of dollars)*

| | YEAR ENDED MAY 31, 2005 | YEAR ENDED MAY 31, 2004 *(as Restated, see Note 1)* |
|---|---|---|
| **» CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| **INCREASE IN NET ASSETS** | **$ 66,118** | **$ 139,009** |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Depreciation | 26,958 | 24,890 |
| Loss on disposal of property & equipment | 198 | 3,327 |
| Fixed assets gifts-in-kind | (54) | (53) |
| Net realized & unrealized gains on investments | (55,664) | (99,756) |
| Contributions restricted for permanent investments | (13,880) | (13,394) |
| Unrealized loss (gain) on interest rate swap | 12,594 | (16,921) |
| Decrease (increase) in: | | |
| Student accounts receivable | 4,395 | (7,375) |
| Contributions, grants & other receivables | 448 | (1,737) |
| Prepaid expenses & other | 264 | 99 |
| Increase (decrease) in: | | |
| Accounts payable | (13,960) | 4,582 |
| Salaries & payroll taxes payable | 5,392 | 4,047 |
| Deposits & deferred income | (2,066) | 7,843 |
| Annuities payable | 162 | (1,487) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | **30,905** | **43,074** |
| **» CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Loans to students, net change | (1,689) | (1,193) |
| Proceeds from sales of investments | 45,400 | 137,887 |
| Purchases of investments | (44,051) | (45,851) |
| Proceeds from sale of property & equipment | 400 | 2,312 |
| Purchases of property, plant & equipment | (26,656) | (129,511) |
| **NET CASH USED IN INVESTING ACTIVITIES** | **(26,596)** | **(36,356)** |
| **» CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Contributions restricted for permanent investments: | | |
| Endowment | 11,619 | 13,055 |
| Annuities & living trusts | 2,261 | 339 |
| Proceeds from long-term debt | — | 2,370 |
| Repayment of long-term debt | (8,979) | (7,141) |
| Increase in federal student loan funds refundable | 75 | 64 |
| **NET CASH PROVIDED BY FINANCING ACTIVITIES** | **4,976** | **8,687** |
| **NET INCREASE IN CASH & CASH EQUIVALENTS** | **9,285** | **15,405** |
| **CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR** | **33,344** | **17,939** |
| **CASH & CASH EQUIVALENTS AT END OF YEAR** | **$ 42,629** | **$ 33,344** |

*See accompanying notes to financial statements.*

*May 31, 2005 and 2004 (Restated)*

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF ACCOUNTING & REPORTING

The financial statements of Baylor University (the "University") include the accounts of the University, Waco Arbors Holding Corporation and Brazos Valley Public Broadcasting Foundation (KWBU), legally separate entities, the board of directors of which are chosen by the University's Board of Regents. The University's financial statements do not include the accounts of the Baylor Foundation, Baylor Stadium Corporation, Baylor Bear Foundation, Baylor-Waco Foundation or Baylor Alumni Association. These entities are excluded due to the nature of their relationship to the University or due to their aggregate assets, revenues, expenses and net assets not being significant in relation to the University.

The financial statements of the University are prepared on the accrual basis. The University's net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified as follows:

**UNRESTRICTED** – net assets that are not subject to donor-imposed restrictions.

**TEMPORARILY RESTRICTED** – net assets subject to donor-imposed or legal restrictions that may meet or will be met either by actions of the University and/or the passage of time.

**PERMANENTLY RESTRICTED** – net assets subject to donor-imposed restrictions that the assets be maintained permanently. Generally, the donors of these assets permit the University to use all or part of the income earned on the related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless the use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets are reported as net assets released from temporary restrictions among applicable net asset classes.

Income and realized net gains and losses on investments are reported as follows:

- As changes in permanently restricted net assets if so restricted by the donor;
- As changes in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income or gains and losses; and
- As changes in unrestricted net assets in all other cases.

### FUND ACCOUNTING

To ensure observance of limitations and restrictions placed on the use of resources available to the University, the internal accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes are classified into funds that are in accordance with specified activities or objectives. These financial statements, however, are prepared to focus on the entity as a whole and to present transactions according to the existence or absence of donor-imposed restrictions.

### FUNCTIONAL ALLOCATION OF EXPENSES

The expenses of providing various programs and support services have been categorized on a functional basis in the statements of activities. Accordingly, expenses such as depreciation and operation and maintenance of plant have been allocated directly or based on square footage among the functional categories.

Fundraising expenses of approximately $6,450,000 and $6,370,000 incurred by the University in 2005 and 2004, respectively, are included in the institutional support category in the statements of activities.

### CONTRIBUTIONS

Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class.

Donor contributions to fund construction projects are classified as temporarily restricted net assets until the facility is placed in service. At that time, the temporarily restricted net assets are released from restriction and replenish unrestricted net asset balances designated for plant projects. The University follows the policy of recording contributions of long-lived assets directly as invested in plant assets instead of recognizing the gift over the useful life of the asset.

### CASH & CASH EQUIVALENTS

Cash on deposit for operations and all highly liquid financial instruments with maturities of 90 days or less are classified as cash equivalents, except those amounts assigned to investment managers, which are classified as investments. The fair value of cash equivalents is estimated to be the same as book value due to the short maturity of these instruments.

### ENDOWMENT

Endowment net assets classified as unrestricted include realized gains and losses and net unrealized appreciation (depreciation) on endowment assets, the earnings of which are unrestricted by the donor. Endowment net assets classified as temporarily restricted include realized gains and losses and net unrealized appreciation (depreciation) on endowment assets that are restricted by the donor for a specific purpose. Permanently restricted endowment net assets are those assets that must be invested in perpetuity to provide a permanent source of income.

Board-designated endowment net assets include gifts and funds that have been designated by the Board of Regents (the "Board") to function as endowment. These funds may be expended at the discretion of the Board. Also included are certain temporarily restricted net assets that have not been expended for their restricted purpose but are being invested and the earnings expended for the restricted purpose.

The Baylor University Fund ("BUF") is a unitized fund consisting of equities, fixed income and alternative assets and serves as the primary investment vehicle for the University's endowment and other long-term investments. The University has adopted a spending policy for the BUF whereby the Board authorizes a dividend to be paid for endowments participating in the BUF for the purposes intended by the donors. This policy attempts to meet three objectives: (1) provide a predictable, stable stream of earnings to participating accounts; (2) ensure that the purchasing power of this revenue stream does not decline over time; and (3) ensure that the purchasing power of the endowment assets do not decline over time. Under this policy, actual earnings, as well as a prudent portion of realized and unrealized gains, may be expended for operational purposes. For the years ended May 31, 2005 and 2004, this dividend was based on 5% of the previous 48 months' average market value per unit of the BUF.

### SPLIT INTEREST AGREEMENTS

Split interest agreements consist primarily of gift annuities, charitable remainder unitrusts and annuity trusts, life income funds and perpetual trusts. Assets held under these agreements are included in investments (see Note 2), except for agreements administered by the Baptist Foundation of Texas ("BFT") and others as temporary trustees. The net present values of these agreements administered by the BFT and others as temporary trustees are reflected as unconditional promises to give (see Note 10). Annuities payable are recorded at the present value of future payments. Beginning in the year ended May 31, 2004, the method of calculating the present value was changed to use the Internal Revenue Service ("IRS") discount rate at the time of the original gift rather than the current IRS discount rate.

### STUDENT LOANS

The assets and liabilities of student loans financed primarily by the federal government and administered by the University, primarily the Federal Perkins Loan Program, are included with those of the University. The total of the federal government portion of these net assets is shown as federal student loan funds refundable in the accompanying balance sheets.

### PROPERTY, PLANT & EQUIPMENT

Property, plant & equipment valued at $5,000 or more are recorded at cost at date of acquisition or, if acquired by gift, at estimated fair value at date of gift. Additions to plant assets are capitalized, while maintenance and minor renovations are charged to operations. Plant assets are reflected net of accumulated depreciation calculated on a straight-line basis over the estimated useful lives ranging from 3 to 50 years.

### DEPOSITS & DEFERRED INCOME

Deposits & deferred income consist of amounts billed or received for educational, research and auxiliary goods and services that have not yet been earned.

### 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 amounts reported in the statements and accompanying notes. Actual results could differ from these estimates.

### RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS

Subsequent to the issuance of the University's 2004 financial statements, management determined that an error had occurred in the recording of certain split interest agreements, which related to the treatment of two charitable lead annuity trusts, where the University is a beneficiary. As a result of this error, contributions receivable and annuity & living trusts on the balance sheet as of May 31, 2004, and gift revenue and change in value of split interest agreements, present value adjustments for the year ended May 31, 2004 on the statement of activities have been restated from amounts previously reported. The effects of this restatement by major financial statement line items are as follows:

*(in thousands of dollars)*

| | TEMPORARILY RESTRICTED | | TOTAL | |
|---|---|---|---|---|
| **BALANCE SHEET** – May 31, 2004: | AS PREVIOUSLY REPORTED | AS RESTATED | AS PREVIOUSLY REPORTED | AS RESTATED |
| Contributions, grants & other receivables | $ 7,641 | $ 11,511 | $ 32,763 | $ 36,633 |
| Total assets | 61,394 | 65,264 | 1,363,089 | 1,366,959 |
| Annuity & living trusts | 8,898 | 12,768 | 27,849 | 31,719 |
| Total net assets | 59,507 | 63,377 | 989,916 | 993,786 |
| **STATEMENT OF ACTIVITIES** for the year ended May 31, 2004: | | | | |
| Gifts, private grants & Baptist General Convention of Texas appropriation | 6,347 | 6,227 | 35,722 | 35,102 |
| Total net revenues | (3,867) | (4,487) | 313,469 | 312,849 |
| Change in value of split interest agreements – Present value adjustments | 1,660 | 2,108 | 4,424 | 4,872 |
| Total other changes | 14,768 | 15,216 | 112,170 | 112,618 |
| Increase in net assets | 10,901 | 10,729 | 139,181 | 139,009 |
| Total net assets at beginning of year | 48,606 | 52,648 | 850,735 | 854,777 |
| Total net assets at end of year | 59,507 | 63,377 | 989,916 | 993,786 |

### OTHER

Certain reclassifications have been made to the 2004 financial statements to conform to the 2005 presentation.

## 2. INVESTMENTS

The University's investments are recorded at fair value. The estimated fair value of investments is based on quoted market prices, except for certain alternative investments for which quoted market prices are not available. The estimated fair value of these alternative investments is based on valuations provided by the external investment managers.

Cost and estimated fair value of investments as of May 31, 2005 and 2004 are as follows:

*(in thousands of dollars)*

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | COST | ESTIMATED FAIR VALUE | COST | ESTIMATED FAIR VALUE |
| Short-term | $ 14,394 | $ 19,601 | $ 6,899 | $ 8,569 |
| Collateralized investment contract | 6,903 | 6,903 | 29,808 | 29,808 |
| Debt securities | 63,392 | 81,539 | 70,721 | 87,244 |
| Equity securities | 349,742 | 463,795 | 371,946 | 470,638 |
| Alternative assets | 132,390 | 180,422 | 82,401 | 104,884 |
| Real estate | 11,490 | 21,703 | 13,349 | 20,292 |
| Mineral rights | 8,060 | 21,873 | 12,395 | 20,064 |
| Other | 356 | 356 | 376 | 378 |
| **TOTAL INVESTMENTS** | $ 586,727 | $ 796,192 | $ 587,895 | $ 741,877 |

Net appreciation (depreciation) in the fair value of investments, which consists of the realized gains and losses and the unrealized appreciation (depreciation) on those investments, is shown in the statements of activities.

Short-term investments consist primarily of short-term U.S. government securities and money market funds and are not subject to significant market or credit risks. The collateralized investment contract is with Trinity Plus Funding Company, LLC and pays interest at a rate tied to the Bond Market Association Municipal Swap Index. Alternative assets consist of distressed securities, venture capital, hedge funds and private equities.

The fair value of real estate is determined from the most recent information available to the University (i.e., appraisals and/or property tax statements). The fair value of mineral rights is estimated based on the income stream generated by those assets.

Investments, at fair value, are managed by the following:

*(in thousands of dollars)*

| | 2005 | 2004 |
|---|---|---|
| The University | $ 624,285 | $ 583,690 |
| BFT | 138,691 | 125,197 |
| Others | 33,216 | 32,990 |
| **TOTAL INVESTMENTS** | $ 796,192 | $ 741,877 |

The BFT is an agency of the Baptist General Convention of Texas that was created to manage investment funds for Texas Baptist institutions. The investments managed by the BFT for the University represent approximately 7% of the BFT's total assets as of May 31, 2005 and 2004.

Investments include interests in split interest agreements. The fair values representing interests in split interest agreements are $138,276,000 and $129,000,000 as of May 31, 2005 and 2004, respectively.

Investment return for the years ended May 31, 2005 and 2004 consists of the following:

*(in thousands of dollars)*

| | 2005 | 2004 |
|---|---|---|
| Endowment & investment income | $ 43,585 | $ 38,588 |
| Realized gains on investments | 1,623 | 5,604 |
| Unrealized gains on investments | 54,041 | 94,152 |
| **TOTAL INVESTMENT RETURN** | $ 99,249 | $ 138,344 |

The endowment & investment income reflected is net of investment expenses of $5,473,000 and $5,024,000 for the years ended May 31, 2005 and 2004, respectively.

## 3. PROPERTY, PLANT & EQUIPMENT

At May 31, 2005 and 2004, plant assets consist of:

*(in thousands of dollars)*

| | 2005 | 2004 |
|---|---|---|
| Land | $ 28,218 | $ 28,218 |
| Buildings | 537,382 | 379,950 |
| Equipment | 77,960 | 79,434 |
| Other improvements | 91,464 | 73,042 |
| | 735,024 | 560,644 |
| Less accumulated depreciation | (215,934) | (197,718) |
| | 519,090 | 362,926 |
| Construction-in-progress | 3,162 | 160,172 |
| **PROPERTY, PLANT & EQUIPMENT, NET** | $ 522,252 | $ 523,098 |

Depreciation expense was $26,958,000 and $24,890,000 for the years ended May 31, 2005 and 2004, respectively. Real and personal property were insured for $1,000,000,000 at May 31, 2005 and $800,000,000 at May 31, 2004. The current year increase in buildings and other improvements categories was the result of placing in service the Sciences Facility, North Village Residential Community, East Campus Parking Garage, and various utility improvements. During the year, the University wrote off minor equipment (equipment fully depreciated with values under $5,000), as well as equipment from inventories. These actions resulted in a write off of $7,115,000 of equipment with the accompanying accumulated depreciation of $7,115,000 causing a decrease in equipment value from 2004 to 2005.

## 4. NOTES & BONDS PAYABLE

Notes & bonds payable consisting of both non-interest bearing unsecured notes and interest bearing unsecured and secured notes and bonds with varying terms and maturity dates to February 1, 2032 were $247,459,000 and $256,438,000 at May 31, 2005 and 2004, respectively. Interest payments on a cash basis totaled $11,396,000 and $9,212,000, and interest expense was $11,466,000 and $10,466,000 for the years ended May 31, 2005 and 2004, respectively. Interest expense totaling $2,583,000 and $8,686,000 was capitalized to projects for the years ended May 31, 2005 and 2004, respectively. Earnings on bond proceeds, which offset interest capitalized, were $280,000 and $1,052,000 for the years ended May 31, 2005 and 2004, respectively.

The University issued $247,500,000 in tax-exempt and taxable revenue bonds through the Waco Education Finance Corporation during the fiscal year ended May 31, 2002, of which $47,059,000 was used to refinance Series 1997, 1998, 1999, 2000 and 2001 bonds. The University capitalized and is amortizing on a straight-line basis bond issue costs related to the Series 2002A, 2002B and 2002C issues over the life of the bonds. As of May 31, 2005 and 2004, unamortized bond issue costs of $3,667,000 and $3,803,000, respectively, are included in prepaid expenses and other in the University's balance sheets. Amortization expense for issue costs was $162,000 and $163,000 for the years ended May 31, 2005 and 2004, respectively.

Notes & bonds payable at May 31, 2005 and 2004 consist of the following:

*(in thousands of dollars)*

| | 2005 | 2004 |
|---|---|---|
| Non-interest bearing unsecured note payable to a foundation, due in annual installments beginning June 30, 2004 to June 30, 2013 | $ 4,500 | $ 5,000 |
| Non-interest bearing unsecured note payable to a foundation, due in quarterly installments as repayments from loans to students are received | 1,736 | 2,230 |
| Unsecured note payable to a foundation, bearing interest at 5%, due in annual installments to May 15, 2006, interest only May 15, 2004 | 1,000 | 2,000 |
| Non-interest bearing unsecured notes payable to a corporation, due in monthly installments through September 1, 2008 | 834 | 1,084 |
| Secured note payable to a private entity (secured by land), bearing interest at 7.5%, due in annual installments of $747,314 to January 1, 2012 | 3,958 | 4,377 |
| Non-interest bearing unsecured note payable to a private entity, due in annual installments through June 30, 2008 | 280 | 350 |
| Secured note payable to a private entity (secured by property), bearing interest at 9.57%, due in monthly installments through July 1, 2006, with planned payment in full August 1, 2006 | 1,851 | 1,897 |
| Series 2002A Waco Education Finance Corporation Tax-Exempt Variable Rate Demand Bonds, swapped to a fixed rate of 4.91% (see Note 5), interest payable semiannually, principal payable annually to February 1, 2032 | 168,925 | 171,900 |
| Series 2002B Waco Education Finance Corporation Tax-Exempt Select Auction Variable Rate Securities ("SAVRS"), originally bearing interest at the SAVRS rate for each 35-day auction rate period; the variable rate swapped to a synthetic fixed rate of 3.83% (see Note 5) in 2005, interest payable semiannually, principal payable annually to February 1, 2032 | 53,200 | 56,250 |
| Series 2002C Waco Education Finance Corporation Taxable SAVRS, bearing interest at the SAVRS rate for each 35-day auction rate period (3.10% and 1.32% at May 31, 2005 and 2004, respectively), principal payable annually to February 1, 2032 | 11,175 | 11,350 |
| **TOTAL NOTES & BONDS PAYABLE** | $ 247,459 | $ 256,438 |

The fair values of notes and bonds payable were the same as the book values as of May 31, 2005 and 2004.

Principal and interest on notes and bonds for the periods subsequent to May 31, 2005 are as follows:

*(in thousands of dollars)*

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 & Thereafter | TOTAL |
|---|---|---|---|---|---|---|---|
| Principal | $ 9,245 | $ 10,256 | $ 6,591 | $ 6,688 | $ 6,487 | $ 208,192 | $ 247,459 |
| Interest | 11,405 | 10,843 | 10,492 | 10,222 | 9,940 | 125,403 | 178,305 |
| **TOTAL** | $ 20,650 | $ 21,099 | $ 17,083 | $ 16,910 | $ 16,427 | $ 333,595 | $ 425,764 |

## 5. DERIVATIVE FINANCIAL INSTRUMENTS

The University has limited involvement with derivative financial instruments and does not use them for trading purposes. The University has entered into long-term interest rate swap agreements with a financial institution counterparty. The purpose of these agreements is to swap the University's Series 2002A variable rate demand bonds having a notional amount of $174,800,000 for a fixed rate of 4.91% through February 1, 2032, and to swap the University's Series 2002B variable rate demand bonds having a notional amount of $58,900,000 for a synthetic fixed rate of 3.83% under a BMA-based structure through February 1, 2032. The University entered into the swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The value of the swap instrument represents the estimated cost to terminate the swap agreement at the reporting date, taking into account current and projected interest rates. The fair value of the interest rate swap included in the University's balance sheets as a liability at May 31, 2005 and 2004 was $37,384,000 and $24,790,000, respectively. To control credit risk, the University considered the credit rating and reputation of the counterparty before entering into the transaction and will monitor the credit standing of its counterparty during the life of the transaction.

The net change in assets resulting from changes in the swaps' fair value resulted in a loss of $12,594,000 as of May 31, 2005, and a gain of $16,921,000 as of May 31, 2004.

## 6. RETIREMENT PLAN

The University has a noncontributory retirement plan covering all full-time faculty and staff. The plan is a defined contribution plan and is administered by outside agencies. Retirement benefits equal the amount accumulated to each individual employee's credit at the date of retirement. The University's contributions to the plan for the years ended May 31, 2005 and 2004 were $9,457,000 and $9,163,000, respectively.

## 7. POSTRETIREMENT BENEFITS

The University provides medical and life insurance benefits for eligible retired faculty and staff. Employees are eligible for such benefits if they retire after attaining specified age and service requirements while employed by the University. Through May 31, 2002, full-time faculty and staff became eligible for these benefits upon reaching age 55 and having 20 years of full-time service at retirement. The lifetime maximum on group medical benefits is $2,000,000, and the maximum benefit for life insurance is $20,000. The factors in the calculation of medical benefits include retiree premium contributions, deductibles and coinsurance provisions that are assumed to grow with the medical inflation rate.

Effective June 1, 2002, employees attaining the age of 55 with 20 years of continuous, full-time service at the University as of May 31, 2007, will continue under the postretirement medical and life insurance programs in effect before June 1, 2002. Those employees not meeting the above eligibility requirements may still participate in the postretirement medical program but will receive no postretirement life insurance benefits and will not be reimbursed for Medicare Part B premiums. Under the new plan, all full-time faculty and staff become eligible for postretirement benefits upon reaching age 55 and having 10 years of full-time service at retirement.

The University follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. This statement requires that the expected cost of postretirement benefits be charged to operations on an accrual basis during the years that the faculty and staff render service. SFAS No. 106 also requires that the accumulated obligation at the implementation date be recognized as a liability and that an offsetting amount be recognized as a reduction in net assets or amortized as an expenditure over 20 years. The University chose to amortize the accumulated postretirement benefits over 20 years.

The following tables set forth the unfunded status of postretirement benefits, as well as the components of net periodic benefit costs and the weighted-average assumptions as of the measurement date, May 31:

*(in thousands of dollars)*

| | 2005 | 2004 |
|---|---|---|
| **» CHANGE IN BENEFIT OBLIGATION:** | | |
| Accumulated postretirement benefit obligation ("APBO") at beginning of year | $ 28,566 | $ 23,895 |
| Service cost | 1,001 | 784 |
| Interest cost | 1,819 | 1,408 |
| Plan participants' contributions | 979 | 832 |
| Actuarial (gain) loss | (3,510) | 3,527 |
| Benefit payments | (2,032) | (1,880) |
| Accumulated postretirement benefit obligation at end of year | 26,823 | 28,566 |
| **» CHANGE IN PLAN ASSETS:** | | |
| Fair value of plan assets at beginning of year | — | — |
| Actual return on plan assets | — | — |
| Employer contributions | 1,053 | 1,048 |
| Plan participants' contributions | 979 | 832 |
| Benefit payments | (2,032) | (1,880) |
| Fair value of plan assets at end of year | — | — |
| Funded status | (26,823) | (28,566) |
| Unrecognized transition obligation | 2,190 | 2,464 |
| Unrecognized net loss | 10,883 | 15,355 |
| Accrued postretirement benefit cost | $ (13,750) | $ (10,747) |
| **» WEIGHTED-AVERAGE ASSUMPTIONS AT MEASUREMENT DATE:** | | |
| Discount rate | 5.50% | 6.50% |
| Salary scale | 4.00% | 4.00% |
| Health care cost trend rate (grading to 5% in 2011) | 9.50% | 10.25% |
| **» COMPONENTS OF NET PERIODIC POSTRETIREMENT BENEFIT COST:** | | |
| Service cost | $ 1,001 | $ 784 |
| Interest cost | 1,819 | 1,408 |
| Amortization of: | | |
| Transition obligation | 274 | 274 |
| Actuarial loss | 962 | 666 |
| Net postretirement benefit cost | $ 4,056 | $ 3,132 |
| **» WEIGHTED-AVERAGE ASSUMPTIONS FOR NET PERIODIC POSTRETIREMENT BENEFIT COST:** | | |
| Discount rate | 6.50% | 6.00% |
| Salary scale | 4.00% | 4.00% |
| Health care cost trend rate (grading to 5% in 2011) | 10.25% | 11.00% |

The benefit obligation at May 31, 2005 is determined using an assumed health care cost trend rate of 9.5%. The health care cost trend rates are assumed to decrease gradually to 5% over six years and remain at that level thereafter.

Health care cost trend rate assumptions have a significant impact on the amounts reported. A one-percentage-point increase in the assumed health care cost trend rate would have increased aggregate service and interest costs and the APBO by approximately $394,000 and $3,490,000, respectively. Likewise, a one-percentage-point decrease in the assumed health care cost trend rate would have decreased aggregate service and interest costs and the APBO by approximately $313,000 and $2,841,000, respectively.

Expected employer contributions for fiscal year 2006 are $1,101,000. The projected postretirement benefit payments for each of the five fiscal years subsequent to May 31, 2005 are as follows: $1,101,000 in 2006; $1,147,000 in 2007; $1,209,000 in 2008; $1,270,000 in 2009; and $1,322,000 in 2010. Projected aggregate postretirement benefit payments for the five-year period ended May 31, 2015 are $7,426,000.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"), which introduces a prescription drug benefit under Medicare was signed into law. The University is currently evaluating the options available under the Act and has yet to determine if the Baylor plan is actuarially equivalent to the standard Medicare Part D benefit. Therefore, any measures of APBO or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act on the plan.

## 8. OUTSTANDING LEGACIES

The University is the beneficiary under various wills and trust agreements, the realizable amounts of which are not presently determinable. The University's share of such bequests is recorded when the University has an irrevocable right to the bequest and the proceeds are measurable.

## 9. TAX STATUS

The University is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code. The University has been classified as an organization that is not a private foundation, and contributions to it qualify for deduction as charitable contributions. The University files unrelated business income tax and other information returns as required by government authorities.

## 10. UNCONDITIONAL PROMISES TO GIVE

As pledges are made to the University, the intent of the donor, the circumstances surrounding the pledge and any action taken by the University in response to the pledge are considered in determining whether the pledge is an "intent to give" or an "unconditional promise to give." An intent to give is not recorded as revenue until collected or when converted to an unconditional promise to give. An unconditional promise to give is recorded as a contribution receivable and as revenue at the present value of the estimated future cash flows.

Intents to give total $44,775,000 and $50,269,000 as of May 31, 2005 and 2004, respectively. Payments on these intents to give are due in varying periods.

As of May 31, 2005 and 2004, unconditional promises to give consist of the following:

*(in thousands of dollars)*

| | 2005 | 2004 |
|---|---|---|
| Endowment funds | $ 200 | $ 500 |
| Building projects | | |
| Due in 1 year | 774 | 620 |
| Due in 1 to 5 years | 1,431 | 1,646 |
| Split interest agreements | 22,167 | 17,516 |
| Less: Present value adjustment | (9,161) | (8,690) |
| **TOTAL CONTRIBUTIONS RECEIVABLE** | $ 15,411 | $ 11,592 |

The unconditional promises to give related to split interest agreements are discounted based on life expectancies of the annuity recipients.

## 11. COMMITMENTS AND CONTINGENCIES

### CAPITAL EXPENDITURES

The University is contractually obligated for amounts aggregating a maximum of approximately $6,175,000 and $14,266,000 at May 31, 2005 and 2004, respectively. Such obligations relate primarily to capital projects.

### INVESTMENTS

As part of the University's alternative investments program, the University is obligated under certain limited partnership agreements to advance additional funding up to specified levels upon the request of the general partner. The University had unfunded commitments of $103,070,000 and $51,309,000 at May 31, 2005 and 2004, respectively, which are expected to be called over the next five years.

### CONTINGENCIES

The University is a party to various legal proceedings and complaints arising in the ordinary course of operations, some of which are covered by insurance. The administration is not aware of any claims or contingencies, which are not covered by insurance, that would be material to the financial position of the University.

The University participates in several state and federal grant programs and must comply with requirements of the grantor agencies. The administration is of the opinion that the University is in compliance with these grantor requirements.

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