Baylor University

Financial Statements

Years Ended May 31, 2013 and 2012,
and Report of Independent Certified Public Accountants

BAYLOR UNIVERSITY

FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

TABLE OF CONTENTS

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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The Board of Regents
Baylor University

Report on the financial statements
We have audited the accompanying financial statements of Baylor University (the "University"), which comprise the balance sheet as of May 31, 2013, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements. The financial statements of the University as of May 31, 2012, were audited by other auditors. Those auditors expressed an unqualified opinion on those financial statements in their report dated September 26, 2012.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Baylor University as of May 31, 2013, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

GRANT THORNTON LLP

Dallas, Texas
September 25, 2013

BAYLOR UNIVERSITY
Balance Sheets

May 31, 2013 and 2012
(in thousands of dollars)

	2013	2012
ASSETS		
Cash & cash equivalents	$ 103,424	$ 49,205
Short-term investments	82,000	35,758
Bond proceeds held by trustees	125,966	104,469
Student accounts receivable, net	16,176	14,781
Contributions receivable, net	120,669	58,277
Grants & other receivables, net	29,471	23,606
Prepaid expenses & other	9,669	7,893
Student loans receivable, net	10,257	10,348
Long-term investments, at fair value	1,129,659	1,029,862
Property, plant & equipment, net	811,794	671,840
Total assets	**$ 2,439,085**	**$ 2,006,039**
LIABILITIES & NET ASSETS		
Liabilities		
Accounts payable	$ 53,463	$ 36,257
Personnel related current liabilities	19,704	18,034
Deposits & deferred revenue	74,642	61,627
Accrued postretirement benefits	59,605	52,849
Notes & bonds payable	631,789	438,051
Other liabilities	21,642	25,822
Total liabilities	**860,845**	**632,640**
Net Assets		
Unrestricted	483,639	450,127
Temporarily restricted	434,036	298,583
Permanently restricted	660,565	624,689
Total net assets	**1,578,240**	**1,373,399**
Total liabilities & net assets	**$ 2,439,085**	**$ 2,006,039**

See accompanying notes to financial statements.

BAYLOR UNIVERSITY
Statements of Activities

For the Years Ended May 31, 2013 and 2012
(in thousands of dollars)

	Year Ended May 31, 2013			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUES				
Tuition & fees	$ 502,326	$ --	$ --	**$ 502,326**
Less scholarships	(204,235)	--	--	**(204,235)**
Net tuition & fees	298,091	--	--	**298,091**
Endowment distributions & investment income	50,507	6,868	--	**57,375**
Gifts & private grants	17,693	5,851	--	**23,544**
Grants & contracts	21,717	699	--	**22,416**
Other sources - educational & general	21,859	73	--	**21,932**
Other sources - intercollegiate athletics	39,235	--	--	**39,235**
Sales & services of auxiliary enterprises	50,829	--	--	**50,829**
Net assets released from restrictions	9,851	(9,851)	--	**--**
Total operating revenues	509,782	3,640	--	**513,422**
OPERATING EXPENSES				
Program expenses				
Instruction	219,335			**219,335**
Academic support	50,618			**50,618**
Research & public service	20,051			**20,051**
Student services & activities	106,017			**106,017**
Auxiliary enterprises	39,347			**39,347**
Support expenses				
Institutional support	64,791			**64,791**
Total operating expenses	500,159	--	--	**500,159**
Increase in net assets from operating activities	9,623	3,640	--	**13,263**
NON-OPERATING ACTIVITIES				
Return on long-term investments	31,427	87,333	6,449	**125,209**
Distributions from long-term investments	(12,171)	(46,501)	--	**(58,672)**
Endowment earnings & distributions re-invested	--	--	2,101	**2,101**
Gifts for endowment & plant improvements	--	85,273	23,457	**108,730**
Grants for plant improvements	--	8,006	--	**8,006**
Net assets released from restrictions for plant improvements	4,465	(4,465)	--	**--**
Gain (loss) on interest rate swap	3,572	--	--	**3,572**
Change in postretirement benefits obligation other than net periodic benefit cost	(2,425)	--	--	**(2,425)**
Change in value of split interest agreements	86	1,931	3,047	**5,064**
Other increases (decreases)	(1,065)	236	822	**(7)**
Total non-operating activities	23,889	131,813	35,876	**191,578**
Change in net assets	33,512	135,453	35,876	**204,841**
Net assets at beginning of year	450,127	298,583	624,689	**1,373,399**
Net assets at end of year	$ 483,639	$ 434,036	$ 660,565	**$ 1,578,240**

See accompanying notes to financial statements.

Year Ended May 31, 2012			
Unrestricted	Temporarily Restricted	Permanently Restricted	**Total**
$ 463,484	$ --	$ --	**$ 463,484**
(184,763)	--	--	**(184,763)**
278,721	--	--	**278,721**
48,070	6,732	--	**54,802**
16,532	2,200	--	**18,732**
24,165	535	--	**24,700**
19,748	168	--	**19,916**
31,294	--	--	**31,294**
47,108	--	--	**47,108**
8,928	(8,928)	--	**--**
474,566	707	--	**475,273**
210,477			**210,477**
48,775			**48,775**
14,599			**14,599**
96,842			**96,842**
38,238			**38,238**
65,313			**65,313**
474,244	--	--	**474,244**
322	707	--	**1,029**
(11,973)	(6,232)	(7,281)	**(25,486)**
(11,580)	(44,802)	--	**(56,382)**
--	--	2,051	**2,051**
--	54,400	29,155	**83,555**
--	--	--	**--**
3,602	(3,602)	--	**--**
(7,375)	--	--	**(7,375)**
4,325	--	--	**4,325**
3,266	(4,570)	(1,721)	**(3,025)**
257	235	(974)	**(482)**
(19,478)	(4,571)	21,230	**(2,819)**
(19,156)	(3,864)	21,230	**(1,790)**
469,283	302,447	603,459	**1,375,189**
$ 450,127	$ 298,583	$ 624,689	**$ 1,373,399**

BAYLOR UNIVERSITY
Statements of Cash Flows

For the Years Ended May 31, 2013 and 2012
(in thousands of dollars)

	Year Ended May 31, 2013	Year Ended May 31, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	**$ 204,841**	**$ (1,790)**
Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities:		
Depreciation	31,046	30,937
Return on long-term investments	(125,209)	25,486
Distributions from long-term investments	58,672	56,382
Amortization of bond premium	(953)	(950)
Losses on disposal of property & equipment	4,563	1,649
Fixed assets gifts-in-kind	(164)	(286)
Contributions for endowment & plant improvements	(108,730)	(83,555)
Provision for bad debts	2,087	1,432
Changes in assets & liabilities:		
Short-term investments	(46,242)	6,331
Student accounts receivable	(1,817)	(776)
Contributions receivable	(64,062)	(41,958)
Grants & other receivables	(5,759)	(2,131)
Prepaid expenses & other	(1,776)	(940)
Accounts payable	17,206	15,237
Personnel related current liabilities	1,670	1,256
Deposits & deferred revenue	13,015	6,013
Accrued postretirement benefits	6,756	688
Other liabilities	(4,194)	7,818
Net cash provided by (used for) operating activities	**(19,050)**	**20,843**
CASH FLOWS FROM INVESTING ACTIVITIES		
Student loans made	(855)	(1,520)
Proceeds from collections of student loans	845	1,506
Proceeds from sales of long-term investments	39,826	20,970
Purchases of long-term investments	(73,086)	(53,247)
Unexpended bond proceeds increase	(21,497)	(104,592)
Purchases of property, plant & equipment	(175,399)	(69,807)
Net cash used for investing activities	**(230,166)**	**(206,690)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions for endowment & plant improvements:		
Endowment	24,922	30,121
Plant	83,808	53,434
Proceeds from long-term debt	200,652	132,027
Repayment of long-term debt	(5,961)	(21,376)
Increase in federal student loan funds refundable	14	--
Net cash provided by financing activities	**303,435**	**194,206**
Net increase in cash & cash equivalents	**54,219**	**8,359**
Cash & cash equivalents at beginning of year	**49,205**	**40,846**
Cash & cash equivalents at end of year	**$ 103,424**	**$ 49,205**

See accompanying notes to financial statements.

OVERVIEW OF BAYLOR UNIVERSITY

The mission of Baylor University (the "University") is to educate men and women for worldwide leadership and service by integrating academic excellence and Christian commitment within a caring community.

Chartered in 1845 by the Republic of Texas and affiliated with the Baptist General Convention of Texas, the University is the oldest continuously operating institution of higher learning in the State of Texas. Established to be a servant of the church and of society, the University seeks to fulfill its calling through excellence in teaching and research, in scholarship and publication, and in service to the community, both local and global. The approximately 1,000-acre campus is located on the banks of the Brazos River in Waco, Texas.

While remaining true to its Christian heritage, the University has grown to over 15,000 students, and its nationally recognized academic units offer 147 undergraduate, 74 masters, and 33 doctoral degree programs. In addition, two education specialist degrees are offered by the School of Education, and the Juris Doctor degree is offered by the School of Law.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting & Reporting

The financial statements of Baylor University include the accounts of the University, Brazos Valley Public Broadcasting Foundation (KWBU) and Central Texas Technology & Research Park, legally separate entities, over which the University has control as a sole member or for which the board of directors are chosen by the University's Board of Regents. The University's financial statements do not include the accounts of the Baylor Bear Foundation, Baylor "B" Association 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 in conformity with accounting principles generally accepted in the United States of America (US GAAP). The University's net assets, revenues, 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 or legal restrictions. Unrestricted net assets may be designated for specific purposes by the University's Board of Regents (the "Board").

Temporarily restricted -- net assets subject to donor-imposed or legal restrictions that must 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 earnings 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 that are not anticipated to be met in the year of receipt. Expenses are reported as decreases in unrestricted net assets. Income and net gains and losses on investments in donor restricted endowments are reported as increases or decreases in temporarily restricted net assets until appropriated for expenditure by the University. All other 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 restrictions among applicable net asset classes. Changes or clarifications in donor stipulations may cause certain net assets to be reclassified between permanently restricted, temporarily restricted or unrestricted net assets. These reclassifications are reported as net assets released from restrictions among applicable net assets classes.

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.

Cash & Cash Equivalents

Cash on deposit and all highly liquid financial instruments with original maturities of three months or less are classified as cash and cash equivalents, except those amounts assigned to investment managers, which are classified as investments, and unexpended bond proceeds which are classified as bond proceeds held by trustees.

Short-Term Investments

Short-term investments consist of operational funds invested in bank time deposits, short-term U.S. government securities, having maturities longer than three months but less than one year, and highly liquid money market funds.

Student Accounts & Loans Receivable

Student accounts receivable are stated net of allowance for doubtful accounts of $866,000 and $795,000 as of May 31, 2013 and 2012, respectively.

Student loans receivable are stated net of allowance for doubtful accounts of $852,000 and $935,000 as of May 31, 2013 and 2012, respectively. The University considered the allowance recorded at May 31, 2013 and 2012 to be reasonable and adequate to absorb potential credit losses inherent in the student loan portfolio.

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 loans is included in other liabilities in the accompanying balance sheets.

Split Interest Agreements

Split interest agreements consist primarily of gift annuities, charitable remainder trusts, life income funds and perpetual trusts. Assets held under these agreements are included primarily in long-term investments (see Note 4). The agreements administered by the Baptist Foundation of Texas (“BFT”) and others as temporary trustees, in which the assets will be distributed to the University upon termination, are reflected at their net present value as contributions receivable (see Note 5). Annuities payable are recorded at the present value of future payments, based on the Internal Revenue Service (“IRS”) discount rate at the time of the original gift, and are included in other liabilities in the accompanying balance sheets.

Property, Plant & Equipment

Property, plant and equipment valued at $5,000 or more are recorded at cost at the date of acquisition or, if acquired by gift, at estimated fair value at the 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 three to fifty years. Land and art/collections are considered non-depreciable given the nature of the assets. Equipment is removed from the records at the time of disposal.

The University recognizes asset retirement obligations (AROs) that are conditional on a future event, such as the legal obligation to safely dispose of asbestos when a building is remodeled or demolished. The University measures conditional AROs at estimated fair value using site specific surveys and a probability-weighted, discounted cash flow model with multiple scenarios, if applicable.

The University reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment charge is recognized when the fair value of the asset is less than the carrying value.

Deposits & Deferred Revenue

Deposits and deferred revenue consist of amounts contracted, billed or received for educational, research, intercollegiate athletics or auxiliary goods and services, or rental space, that have not yet been earned.

Other Liabilities

Other liabilities consist of annuities payable, interest rate swap liability, liability for conditional asset retirement obligations and federal student loan funds refundable.

Tuition & Fees

Tuition and fees revenues are recognized in the fiscal year during which the related semester concludes. Scholarships provided by the University for tuition and fees are reflected as a reduction of tuition and fees revenues. Scholarships are awarded to students by the University from unrestricted revenues, restricted endowment earnings, restricted gifts or government grants. Scholarships do not include payments to students for services rendered to the University.

Contributions

Contributions are recorded as revenues in the appropriate net asset class based on donor-imposed restrictions. Expiration of temporary restrictions on donor contributions are reported as net assets released from restrictions. Contributions received with donor-imposed restrictions that are anticipated to be 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. Donor contributions for the construction of a new football stadium and Business School facility totaled $74,209,000 and $46,614,000 for the years ended May 31, 2013 and 2012, respectively.

Contributions receivable are recorded at the present value of estimated future cash flows using a discount rate appropriate to the effective date of the gift agreement.

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, interest expense and operation and maintenance of plant have been allocated directly or based on square footage among the functional categories.

Fundraising expenses of $13,067,000 and $12,450,000 incurred by the University in 2013 and 2012, respectively, are included primarily in the institutional support category in the statements of activities.

Use of Estimates & Assumptions

The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues and expenses during the reporting period, as well as the disclosure of contingent assets and liabilities. Significant items subject to such estimates and assumptions include valuations of certain investments which do not have readily determinable fair values, contributions receivable, allowances for uncollectible accounts and contingency reserves, calculations of asset retirement obligations, interest rate swap liability and actuarially determined liabilities related to postretirement benefit plans. Actual results ultimately could differ from management's estimates and assumptions.

Reclassifications to Prior Year Financial Statements

As of May 31, 2013, the University changed the reporting of the statements of activities to provide a measure of operations by separating operating and non-operating activities. Certain prior year amounts have been reclassified for comparative purposes to conform to the current year's presentation.

2. FAIR VALUE MEASUREMENTS

The estimated fair values of financial instruments that differ from the carrying amounts have been determined by the University using available market information. The estimates are not necessarily indicative of the amounts the University could realize in a current market exchange.

The carrying amounts of cash and cash equivalents, short-term investments, student accounts receivable, accounts payable, personnel related liabilities and deposits and deferred revenue approximate fair value because of their short maturity.

The carrying value of loans receivable from students under government loan programs is a reasonable estimate of fair value since the loans receivable cannot be sold and can only be assigned to the U.S. government or its designees. The fair value of loans receivable from students under University loan programs approximates carrying value.

The University records long-term investments and interest rate swaps at fair value. The estimated fair value of investments is based on quoted market prices except for certain investments for which quoted market prices are not available. US GAAP provides guidance for estimating the fair value of investments in investment companies that calculate net asset value. Accordingly, investments for which observable market prices in active markets do not exist are reported at fair value, as determined by the University, using net asset value as a practical expedient of fair value and other available information. The amount determined to be fair value may incorporate the University's own assumptions (including appropriate risk adjustments for nonperformance and lack of marketability).

The estimated fair value of alternative assets managed and held in limited partnership or other private investment fund structures is based upon the practical expedient of the reported net asset values provided by the respective external investment fund managers, adjusted for cash flows through May 31. The University reviewed and evaluated the net asset values provided by the managers and agreed with the valuation methods and assumptions used to determine those values except in a few immaterial instances. In those limited instances, the University applied additional valuation procedures furnished by qualified third parties or incorporated additional related financial data provided by fund managers to arrive at a fair value different than manager provided values. When the University determines a different value, the investment is carried at the more conservative of the two values. Therefore, the University believes the carrying amount of these financial instruments is a reasonable estimate of the fair value. Because alternative assets are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed.

The fair value of direct real estate holdings is determined from the most recent information available to the University (i.e., appraisals and/or property tax statements).

The fair value of mineral interests is estimated based on the expected net revenues generated by those assets. With certain holdings, geological reserve analysis can provide additional information for estimating fair value. For the fiscal years ended May 31, 2013 and 2012, the University utilized an engineering report and geological study of its largest mineral interest holding to obtain a more informed estimate of fair value and incorporated the results of the study into its estimate of expected net revenues and fair value for this holding.

The fair value of income interests/perpetual trusts is estimated based on the underlying assets contributed to the trusts.

Fair value is reflected in a hierarchy which prioritizes and ranks the level of market price observability. Market price observability is impacted by a number of factors, including the type of investment, the characteristics specific to the investment, and the state of the marketplace (including the existence and transparency of transactions between market participants). Investments with readily-available actively quoted prices or for which fair value can be measured from actively-quoted prices in an orderly market will generally have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Investments measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

Level 1 – Quoted prices (unadjusted) are available in active markets for identical investments that the University has the ability to access as of the reporting date. The type of investments generally included in Level 1 are listed securities traded on public exchanges and open-end mutual funds and other publicly traded listed securities held indirectly through separately managed accounts.

Level 2 – Pricing inputs are observable for the investments, either directly or indirectly, as of the reporting date, but are not the same as those used in Level 1. Fair value is determined through the use of models or other valuation methodologies. The types of investments generally included in this category are hedge funds primarily holding publicly-traded securities with significant fund level liquidity within ninety days.

Level 3 – Pricing inputs are unobservable for the investments and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant judgment or estimation by the fund manager. These types of investments generally include hedge funds with significant liquidity restrictions, private equities and real assets held in partnership format.

Whereas Level 1 investments are able to be liquidated as of the reporting date at published market values, Level 2 and 3 investments may contain restrictions on the ability to liquidate assets as of the reporting date. Investments that can be liquidated within ninety days of the reporting date at net asset value or its equivalent are classified as Level 2 investments. Investments classified as Level 3 have significant liquidity restrictions which would prevent redemption within ninety days of the reporting date, if at all.

US GAAP permits entities to choose to measure financial instruments and other items at fair value that are not currently required to be measured at fair value. The University has elected not to value any other financial assets or liabilities at fair value as provided for in accounting guidelines.

3. ENDOWMENT

The University's endowment totals $1,061,157,000 and $964,161,000 as of May 31, 2013 and 2012, respectively, and is a component of the University's long-term investment pool. The endowment consists of $882,090,000 and $799,902,000 of donor-restricted endowment net assets and $179,067,000 and $164,259,000 of board designated endowment net assets as of May 31, 2013 and 2012, respectively. The management of the endowment is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). The Board of the University has an established policy consistent with UPMIFA as adopted by the State of Texas. The University seeks to preserve the fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. Accordingly, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor agreement at the time the accumulation is added to the fund. The remaining portion of the donor restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

(1) The duration and preservation of the fund
(2) The purposes of the University and the donor restricted endowment fund
(3) General economic conditions
(4) The possible effect of inflation and deflation
(5) The expected total return from income and the appreciation of investments
(6) Other resources of the University
(7) The investment policies of the University

Board designated endowment net assets include gifts and other revenues that have been designated by 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.

Changes in endowment net assets for the year ended May 31, 2013 are as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2012	$ 137,805	$ 224,114	$ 602,242	$ 964,161
Investment earnings, net of expenses	2,725	13,064	571	16,360
Net realized & unrealized gains (losses) on investments	23,515	74,665	7,839	106,019
Contributions	--	408	23,093	23,501
Terminated annuities & other	--	--	2,651	2,651
Transfers to board designated	3,597	897	--	4,494
Distributions	(9,528)	(46,501)	--	(56,029)
Endowment net assets, May 31, 2013	$ 158,114	$ 266,647	$ 636,396	$ 1,061,157

Changes in endowment net assets for the year ended May 31, 2012 are as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2011	$ 150,455	$ 274,247	$ 579,227	$ 1,003,929
Investment earnings, net of expenses	2,938	14,651	649	18,238
Net realized & unrealized gains (losses) on investments	(13,481)	(20,837)	(5,847)	(40,165)
Contributions	--	--	27,777	27,777
Terminated annuities & other	--	--	436	436
Transfers to board designated	6,843	855	--	7,698
Distributions	(8,950)	(44,802)	--	(53,752)
Endowment net assets, May 31, 2012	$ 137,805	$ 224,114	$ 602,242	$ 964,161

Funds totaling $4,971,000 and $12,207,000, which market values are less than original values, are reported in unrestricted net assets in the accompanying balance sheets as of May 31, 2013 and 2012, respectively.

Return Objectives & Risk Parameters

The University has adopted investment and spending policies for endowment assets that attempt 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. To meet its long-term rate-of-return objectives, the University relies on a total return strategy utilizing both income and growth to maximize the risk adjusted return through diversification of the assets. Under this policy, actual earnings, as well as a prudent portion of realized and unrealized gains may be distributed for operational needs or in accordance with donor restrictions. Accordingly, the endowment assets are invested in a diversified manner that is intended to produce results that exceed its long-term performance benchmarks. The University expects its endowment funds, over time, to provide an average rate of return at least equal to the spending policy requirements plus the rate of inflation. Actual returns in any given year may vary from this amount.

Spending Policy & How the Investment Objectives Relate to Spending Policy

The Baylor University Fund (“BUF”) is a unitized fund consisting of publicly traded equity and fixed income securities, alternative assets and mineral rights; and serves as the primary investment vehicle for the University’s endowment and other long-term investments. As permitted under Texas law, the Board has adopted a spending policy for the BUF that authorizes a dividend to be paid for endowments participating in the BUF to be used for the purposes intended by donors. For the years ended May 31, 2013 and 2012, this dollar dividend per BUF unit was based on 5% of the previous 48-months’ rolling average net asset market value per unit of the BUF. The permitted change in this dividend amount from the previous year shall be no less than 0% and no more than 6%, and in no case shall the annual fiscal year distribution (dollar dividend amount per BUF unit) exceed 7% of the previous 48-months’ rolling average net asset market value per BUF unit. The dividend amount remained the same for the years ended May 31, 2013 and 2012. Endowment earnings distributed include endowment distributions in accordance with the University’s BUF spending policy, as well as, distributions of income from other endowment assets.

In establishing this spending policy, the University considered the long-term expected return on its endowment assets. Accordingly, the University expects the current spending policy to preserve the real purchasing power of the endowment assets, while helping to maintain intergenerational value of the assets, as well as to provide additional real growth through new gifts and investment return.

4. LONG-TERM INVESTMENTS

The University diversifies its investments among various financial instruments and asset categories and uses multiple investment strategies. As with most large endowments, these financial assets are managed primarily through external investment management firms selected and monitored by the University's Office of Investments and the Baylor Executive Investment Committee in accordance with the University's Endowment Investment Policy. The investment management firms are predominately organized in limited partnership, registered investment company (mutual fund), and trust format. At May 31, 2013 and 2012, excluding income interests and perpetual trusts, the University's long-term investments were invested with 79 and 67 different managers, respectively. Of those, alternative assets were invested with 65 and 56 managers, respectively.

Fixed income securities are assets invested (directly or indirectly) in domestic and international government or corporate bonds for which active trading markets exist, including open and closed-end mutual funds holding such securities.

Public equities are assets invested (directly or indirectly) in publicly traded equity shares which are listed on national and international exchanges as well as publicly traded open and closed-end mutual funds holding such securities.

Alternative assets consist of private equities, real assets, and hedge funds investments and are primarily held in partnership format. Capital is allocated to domestic and international markets in the various alternative investment funds. Most of the underlying assets in the private equity and real asset partnerships and trusts are not immediately liquid. Private equity fund strategies include buyouts, venture capital, distressed/special situations, emerging markets and secondary markets. Real asset funds are predominately private limited partnerships investing in numerous types of properties and strategies such as commercial real estate, energy, power and infrastructure, as well as timber and other natural resources and commodities including industrial and precious metals. Private equity and real asset funds are held as long-term investments and are structured as closed-end, commitment-based investment funds where the investor commits a specified amount of capital upon inception of the fund which is then drawn down over a specified period of the fund's life. These funds generally cannot be redeemed prior to the specified termination date and will only receive distributions upon a disposition of the underlying assets of the portfolio. As a limited partner, the University will not generally have any influence over the amount and timing of capital contributions and distributions. At May 31, 2013, the remaining life of private equity and real asset funds ranged from one to ten years. Hedge fund investments are generally open-end funds structured in limited partnership format. These funds employ various investment strategies such as long/short equity, fundamental value, multi-strategy (including a small allocation to fund-of-funds), distressed asset and debt, and short credit. The amount of liquidity available to investors is directly related to the liquidity and risk associated with the underlying portfolio. Hedge funds typically offer subscription and redemption options to investors over time periods shorter than private equity/real asset funds; however, the frequency of subscriptions or redemptions is dictated by each fund's governing documents. Liquidity of individual hedge funds also varies due to illiquid "side-pocket" investments, as well as contractual restrictions on redemption such as gating and holdback provisions. Redemption terms of hedge funds range from monthly upon thirty day notice to rolling three years upon forty-five day notice. At May 31, 2013, of twenty-six hedge funds totaling $234,932,000, six funds totaling $12,891,000 have been suspended or gated; five of these six are in liquidation mode. These six funds are included in level 3 assets as discussed in Note 2.

Real estate & other investments represent direct real estate and asset holdings of the University and are not held in the fund, limited partnership, and trust structures described above.

Mineral rights are held and managed for the benefit of the University under various contractual and revocable trust arrangements and are not held in the fund and limited partnership structures described above. The University retains ultimate ownership and control of these assets.

Income interests/perpetual trusts are held and managed by outside trustees under various annuity and trust arrangements for the benefit of Baylor. The University receives income distributions over time in accordance with the governing annuity, trust and gift instruments. The underlying investments of the income interests/perpetual trusts are primarily comprised of publicly traded equity and fixed income investments held in common trust funds and other funds managed or selected by the outside trustees.

The following table presents information about the University's long-term investments that are measured at fair value as of May 31, 2013 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value *(in thousands of dollars)*:

	Level 1	Level 2	Level 3	Total
Fixed income securities	$ 70,952	$ --	$ --	$ 70,952
Public equities	311,198	--	667	311,865
Alternative assets	--	185,362	358,182	543,544
Real estate & other	--	--	4,374	4,374
Mineral rights	--	--	26,461	26,461
Income interests/perpetual trusts	--	--	172,463	172,463
Total	$ 382,150	$ 185,362	$ 562,147	$ 1,129,659

Alternative assets reflected as Level 2 have been valued using net asset value as a practical expedient of fair value.

The following table presents additional information about assets that have been measured at fair value as of May 31, 2013 on a recurring basis using significant unobservable inputs (Level 3) *(in thousands of dollars)*:

	May 31, 2012 Balance	Transfers In (Out) of Level 3	Additions	Distributions	Realized & Unrealized Gains (Losses)	May 31, 2013 Balance
Fixed income securities	$ --	$ --	$ --	$ --	$ --	$ --
Public equities	559	--	--	--	108	667
Alternative assets	405,254	(25,384)	47,491	(87,556)	18,377	358,182
Real estate & other	3,089	--	1,256	(1)	30	4,374
Mineral rights	29,553	--	5,525	(5,526)	(3,091)	26,461
Income interests/ perpetual trusts	156,475	--	5,668	(4,783)	15,103	172,463
Total	$ 594,930	$ (25,384)	$ 59,940	$ (97,866)	$ 30,527	$ 562,147

For the fiscal year ended May 31, 2013, transfers of $25,384,000 were made out of Level 3 into Level 2 based upon information related to investment asset fund structures, characteristics, holdings and liquidity provisions. These transfers were valued using May 31, 2012 balances. There were no other transfers in or out of Levels 1, 2 or 3 for the year ended May 31, 2013.

The following table presents information about the University's long-term investments that are measured at fair value as of May 31, 2012 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value *(in thousands of dollars)*:

	Level 1	Level 2	Level 3	Total
Fixed income securities	$ 81,312	$ --	$ --	$ 81,312
Public equities	241,492	--	559	242,051
Alternative assets	--	112,128	405,254	517,382
Real estate & other	--	--	3,089	3,089
Mineral rights	--	--	29,553	29,553
Income interests/perpetual trusts	--	--	156,475	156,475
Total	$ 322,804	$ 112,128	$ 594,930	$ 1,029,862

Alternative assets reflected as Level 2 have been valued using net asset value as a practical expedient of fair value.

The following table presents additional information about assets that have been measured at fair value as of May 31, 2012 on a recurring basis using significant unobservable inputs (Level 3) *(in thousands of dollars)*:

	May 31, 2011 Balance	Transfers In (Out) of Level 3	Additions	Distributions	Realized & Unrealized Gains (Losses)	May 31, 2012 Balance
Fixed income securities	$ --	$ --	$ --	$ --	$ --	$ --
Public equities	441	--	--	--	118	559
Alternative assets	452,239	(9,843)	50,569	(95,184)	7,473	405,254
Real estate & other	3,377	--	20	(337)	29	3,089
Mineral rights	37,647	--	7,948	(7,954)	(8,088)	29,553
Income interests/ perpetual trusts	167,120	--	3,606	(1,003)	(13,248)	156,475
Total	$ 660,824	$ (9,843)	$ 62,143	$ (104,478)	$ (13,716)	$ 594,930

For the fiscal year ended May 31, 2012, transfers of $20,721,000 were made out of Level 3 into Level 2 and $10,878,000 were made out of Level 2 into Level 3 based upon additional information related to investment asset fund structures, characteristics, holdings and liquidity provisions. These transfers were valued using May 31, 2011 balances. There were no other transfers in or out of Levels 1, 2 or 3 for the year ended May 31, 2012.

Whereas the preceding tables reflect income interests and perpetual trusts separately based on fair value hierarchy, the following table reflects total investments, regardless of fair value hierarchy, using traditional classification descriptions as used by the University to manage its investment portfolio. Accordingly, the underlying assets of income interests/perpetual trusts are reflected within the traditional investment classifications. Additionally, alternative assets are reflected by major asset category. Estimated fair value of long-term investments as of May 31, 2013 and 2012, are as follows *(in thousands of dollars)*:

	2013	2012
Fixed income securities:		
Short term funds	$ 10,453	$ 22,117
Bonds	98,424	96,799
Public equities:		
Domestic	208,589	179,415
International	204,014	145,302
Alternative assets:		
Private equities	155,623	175,227
Hedge funds	234,932	161,695
Real assets	182,572	209,088
Mineral rights	35,052	40,219
Total	$ 1,129,659	$ 1,029,862

Long-term investments include operating, endowment and annuity and life income assets. The annuity and life income assets under split-interest agreements total $23,954,000 and $21,805,000 as of May 31, 2013 and 2012, respectively.

The cost of long-term investments was $891,605,000 and $861,021,000 as of May 31, 2013 and 2012, respectively.

Return on long-term investments for the years ended May 31, 2013 and 2012, consist of the following *(in thousands of dollars)*:

	2013	2012
Investment earnings	$ 19,987	$ 23,434
Investment expenses	(3,795)	(3,868)
Net realized & unrealized gains (losses)	109,017	(45,052)
Total return on long-term investments	$ 125,209	$ (25,486)

Investment earnings consist of interest income, dividends, mineral and other earnings.

Distributions from long-term investments include distributions of endowment assets invested in long-term investments as well as distributions from funds other than endowment that are included in the long-term investments pool. Endowment distributions and other distributions are included in endowment distributions & investment income in the statements of activities.

Both the return on long-term investments and distributions from long-term investments are shown under other changes in the statements of activities.

As part of the University's alternative assets program, the University is obligated under certain limited partnership agreements to advance funding up to specified levels upon the request of the general partner. The University had unfunded commitments consisting of the following at May 31, 2013 and 2012, respectively, which are expected to be called over the next three years *(in thousands of dollars)*.

	2013	2012
Alternative assets:		
Private equities	$ 107,496	$ 86,859
Real assets	27,064	11,354
Total unfunded commitments	$ 134,560	$ 98,213

5. CONTRIBUTIONS RECEIVABLE

As gift 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 unconditional promise to give is recorded as a contribution receivable at the present value of the estimated future cash flows. Unconditional promises to give related to split interest agreements are discounted based on life expectancies of the annuity recipients.

As of May 31, 2013 and 2012, contributions receivable consist of the following *(in thousands of dollars)*:

	2013	2012
Due in 1 year	$ 23,001	$ 7,601
Due in 2 to 5 years	68,681	27,812
Due in 6 to 10 years	19,082	12,070
Due in greater than 10 years	863	--
Split interest agreements	22,843	21,355
Less: Present value adjustment	(12,132)	(10,561)
Less: Allowance for uncollectible contributions receivable	(1,669)	--
Total contributions receivable, net	$ 120,669	$ 58,277

Contributions receivable expected to be fulfilled more than one year from the date of the financial statements are discounted at .40% to 2.16%, with the discount amortized over the life of the unconditional promise. At May 31, 2013, contributions receivable primarily consisted of unconditional promises related to the construction of a new football stadium and Business School facility, of which less than ten donors represented 69% of the total.

An intent to give is not recorded as gifts revenue until collected or converted to an unconditional promise to give. Intents to give total $29,535,000 and $26,246,000 as of May 31, 2013 and 2012, respectively. Payments on these intents to give are due in varying periods. Additionally, the University is the beneficiary under various wills and trust agreements of which the realizable amounts 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.

6. PROPERTY, PLANT & EQUIPMENT

At May 31, 2013 and 2012, property, plant and equipment assets consist of the following *(in thousands of dollars)*:

	2013	2012
Land	$ 73,823	$ 70,969
Land/leasehold improvements	73,272	70,352
Buildings	744,213	692,788
Equipment	80,216	77,221
Arts/collections	10,915	10,717
Other	39,019	38,506
	1,021,458	960,553
Less accumulated depreciation	(375,826)	(353,471)
	645,632	607,082
Construction-in-progress	166,162	64,758
Property, plant & equipment, net	$ 811,794	$ 671,840

Depreciation expense was $31,046,000 and $30,937,000 as of May 31, 2013 and 2012, respectively. The "Equipment" category includes computers, software and other types of equipment above the $5,000 threshold. The "Other" category includes vehicles, library materials and miscellaneous other assets. Real and personal property were insured for $1.4 billion at May 31, 2013. The liability for conditional asset retirement obligations was $3,809,000 and $4,087,000 as of May 31, 2013 and 2012, respectively, and is included in other liabilities in the accompanying balance sheets.

7. NOTES & BONDS PAYABLE

Notes and bonds payable consist of both non-interest bearing unsecured notes and interest bearing unsecured and secured notes, commercial paper with varying maturities, and bonds with varying terms and maturity dates to March 1, 2043. Interest payments on a cash basis totaled $21,177,000 and $12,012,000, and interest expense was $23,177,000 and $14,191,000 for the years ended May 31, 2013 and 2012, respectively. These amounts are exclusive of premium amortization. The amount of bond premium amortization that offset interest expense was $953,000 and $950,000 for the years ended May 31, 2013 and 2012, respectively. Interest expense (net of earnings) of $3,519,000 and $291,000 was capitalized to projects for the year ended May 31, 2013 and 2012, respectively.

As of May 31, 2013 and 2012, unamortized bond and commercial paper issuance costs of $4,302,000 and $3,022,000, respectively, were included in prepaid expenses and other in the University's balance sheets. Amortization expense for issuance costs was $177,000 and $118,000 for the years ended May 31, 2013 and 2012, respectively.

Notes and bonds payable at May 31, 2013 and 2012, consist of the following *(in thousands of dollars)*:

	2013	2012
Non-interest bearing unsecured note payable to a foundation, due in annual installments beginning June 30, 2004 to June 30, 2013	$ 500	$ 1,000
Non-interest bearing unsecured note payable to a corporation, due in annual installments through July 31, 2022	2,658	2,377
Taxable Commercial Paper Notes, Series A, with varying maturities and discount rates rolled at each maturity	15,000	15,000
Series 2008A Waco Education Finance Corporation Tax-Exempt Variable Rate Demand Bonds, swapped to a fixed rate of 2.476% (see Note 9), interest payable monthly, principal payable annually to February 1, 2032	69,610	71,800
Series 2008C Waco Education Finance Corporation Tax-Exempt Fixed Rate Bonds, interest ranging from 5.0% to 5.25% payable semiannually, principal payable annually beginning March 1, 2019 to March 1, 2036	112,100	112,100
Series 2011 Clifton Higher Education Finance Corporation Tax-Exempt Fixed Rate Bonds, interest ranging from 3.0% to 5.25% payable semiannually, principal payable annually beginning March 1, 2012 to March 1, 2032	97,245	100,145
Series 2012 Waco Education Finance Corporation Tax-Exempt Fixed Rate Bonds, interest ranging from 4.125% to 5.00% payable semiannually, principal payable March 1, 2043	120,000	120,000
Series 2012A Baylor University Taxable Fixed Rate Bonds, bearing interest at 4.313% payable semiannually, principal payable March 1, 2042	200,000	--
Total notes & bonds payable prior to unamortized bond premium	617,113	422,422
Unamortized bond premium	14,676	15,629
Total notes & bonds payable	$ 631,789	$ 438,051

The fair values of notes and bonds payable were approximately $636,340,000 and $461,868,000 as of May 31, 2013 and 2012, respectively. These fair values were measured using Level 2 valuation techniques.

Bond premiums are being amortized using the effective interest method over the life of the bonds.

The Series 2008A Tax-Exempt Variable Rate Demand Bonds are subject to purchase upon tender with proper notice and delivery to the remarketing agent. The University has a Standby Bond Purchase Agreement (SBPA) with a bank to purchase the bonds in the event the remarketing agent is unable to remarket the bonds. The SBPA, which was renewed on April 5, 2013, is for a three year term, renewable in April 2016, and includes a term out period of twenty equal quarterly installments commencing on the first business day of the fourth full month after the purchase of the bonds.

During the fiscal year ended May 31, 2013, the University issued $200,000,000 of taxable bonds to provide funds for additions and improvements to facilities and infrastructure. During the fiscal year ended May 31, 2012, the University issued $120,000,000 of tax-exempt bonds to refinance $15,000,000 of taxable commercial paper notes and to provide funds for a new residence facility, infrastructure improvements, renovations to an academic building and real estate acquisitions. The Series 2012 bonds were issued at a premium of $9,497,000.

Excluding the maturity of commercial paper, scheduled principal payments on long-term notes and bonds for the periods subsequent to May 31, 2013, are as follows *(in thousands of dollars)*:

2014	$ 6,110
2015	5,850
2016	6,130
2017	6,420
2018	6,715
2019 and thereafter	570,888
Total	$ 602,113

The University has a taxable commercial paper program that provides for borrowings in the form of individual notes up to an aggregate of $50,000,000. The notes bear a fixed discount rate, established on the borrowing date, with no more than $15,000,000 maturing on any one day and maturities not to exceed 270 days. At May 31, 2013, the University had an outstanding balance of $15,000,000 in commercial paper notes that matured on August 13, 2013 with a discount rate of 0.15%. On August 13, 2013, these commercial paper notes were rolled at maturity to notes that mature on November 12, 2013 with a discount rate of 0.15%. The University anticipates that the commercial paper will continue to be rolled at maturity until such time that it is refunded by long-term debt or repaid by the University.

The estimated fair value of the commercial paper notes approximates the face value.

8. NET ASSETS

The University's unrestricted, temporarily restricted and permanently restricted net assets for the year ended May 31, 2013 are categorized by purpose as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Unrestricted-designated for operations	$ 40,185	$ --	$ --	$ 40,185
Unrestricted-designated for plant	45,657	--	--	45,657
Restricted	--	14,188	5,815	20,003
Endowment	(4,971)	250,665	636,396	882,090
Endowment-Board designated	163,085	15,982	--	179,067
Annuity & living trusts	--	14,529	18,354	32,883
Invested in or restricted for plant	239,683	138,672	--	378,355
Total net assets	$ 483,639	$ 434,036	$ 660,565	$ 1,578,240

The University's unrestricted, temporarily restricted and permanently restricted net assets for the year ended May 31, 2012 are categorized by purpose as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Unrestricted-designated for operations	$ 34,505	$ --	$ --	$ 34,505
Unrestricted-designated for plant	35,539	--	--	35,539
Restricted	--	10,555	5,733	16,288
Endowment	(12,207)	209,867	602,242	799,902
Endowment-Board designated	150,012	14,247	--	164,259
Annuity & living trusts	--	12,200	16,714	28,914
Invested in or restricted for plant	242,278	51,714	--	293,992
Total net assets	$ 450,127	$ 298,583	$ 624,689	$ 1,373,399

9. DERIVATIVE FINANCIAL INSTRUMENTS

On June 11, 2010, the University entered into a swap arrangement with a financial institution counterparty in order to swap the University's Series 2008A variable rate demand bonds with an original balance of $75,860,000 as of May 31, 2010 for a fixed rate of 2.476% through February 1, 2032, in exchange for monthly payments equal to 68% of three-month London Interbank Offered Rate (LIBOR). The notional amount of the swap declines in accordance with the scheduled repayment of the Series 2008A bonds. The fair value of the University's interest rate swap liability was $4,871,000 and $8,443,000 at May 31, 2013 and 2012, respectively, and is included in other liabilities in the balance sheets. The fair value was measured using Level 2 valuation techniques.

10. EXPENSES BY NATURAL CLASSIFICATION

While the statements of activities present expenses by function, the University's expenses by natural classification are as follows *(in thousands of dollars)*:

	2013	2012
Salaries & wages	$ 200,042	$ 190,147
Personnel benefits	67,732	65,170
Student wages & fellowships	26,250	24,714
Operating expenses	156,173	150,098
Depreciation & accretion	31,257	31,165
Interest on indebtedness	18,705	12,950
Total expenses	$ 500,159	$ 474,244

11. RETIREMENT PLAN

The University provides a defined contribution retirement income plan and a voluntary tax deferred annuity program for faculty and staff that are administered by outside sources. The defined contribution plan is not a matching plan. 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, 2013 and 2012 were $19,352,000 and $18,576,000, respectively.

12. 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. Group medical benefits have no lifetime maximum, and the maximum benefit for life insurance is $20,000.

Through May 31, 2002, full-time faculty and staff became eligible for these benefits upon reaching age fifty-five and having twenty years of full-time service at retirement. Effective June 1, 2002, employees with twenty years of continuous, full-time service at the University as of May 31, 2007, continue under the postretirement medical and life insurance programs in effect before June 1, 2002. Employees not meeting the above eligibility requirements may still participate in the postretirement medical program upon reaching age fifty-five and having ten years of full-time service at retirement. These employees will not receive 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 fifty-five and having ten years of full-time service at retirement. Effective June 1, 2002, upon death of a retiree, the surviving spouse (current spouse upon retirement) has the same option of continuation in the postretirement medical program. These surviving spouses will not receive postretirement life insurance benefits and will not be reimbursed for Medicare Part B premiums.

Subsequent to May 31, 2013, the University approved the establishment of a Health Reimbursement Arrangement to provide fixed funding for post-65 retirees medical expenses. Effective January 1, 2014, post-65 retirees will transition from the existing medical plan benefits to the Health Reimbursement Arrangement.

The following tables set forth the required disclosures for postretirement benefits, as well as the components of net periodic benefit costs and weighted-average assumptions as of the measurement date, May 31 *(in thousands of dollars)*:

	2013	2012
Change in benefit obligation:		
Measurement date	5/31/2013	5/31/2012
Accumulated postretirement benefit obligation (APBO) at beginning of year	$ 52,849	$ 52,161
Service cost	1,771	1,616
Interest cost	2,536	2,979
Plan participants' contributions	1,576	1,541
Actuarial (gain) loss	3,907	(2,641)
Retiree drug subsidy paid	191	276
Benefit payments	(3,225)	(3,083)
Accumulated postretirement benefit obligation (APBO) at end of year	$ 59,605	$ 52,849
Change in plan assets:		
Fair value of plan assets at beginning of year	$ --	$ --
Employer contributions	1,649	1,542
Plan participants' contributions	1,576	1,541
Benefit payments	(3,225)	(3,083)
Fair value of plan assets at end of year	$ --	$ --
Funded (unfunded) status of plan	$ (59,605)	$ (52,849)

Amounts recognized as changes in unrestricted net assets arising from postretirement benefits plan but not yet included in periodic benefit cost:

	2013	2012
Transition obligation	$ --	$ 274
Prior service cost	868	1,511
Net loss	17,981	14,638
Total	$ 18,849	$ 16,423

The University expects to amortize, from accumulated unrestricted net assets, $643,000 of prior service costs and $737,000 of net losses as components of net periodic benefit cost during the fiscal year ending May 31, 2014.

Weighted-average assumptions at measurement date:	5/31/2013	5/31/2012
Discount rate	4.64%	4.87%
Health care cost trend rate	7.00%	7.50%
Ultimate health care cost trend rate	5.00%	5.00%
Year ultimate trend rate reached	2017	2017

Beginning in 2018, 0.3% has been added to the ultimate health care cost trend rates for the expected effect of provisions of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (i.e. trend rates beginning 2018 are 5.3%). The inflation rates for retiree contributions and Retiree Drug Subsidy (RDS) are assumed to be the same as the medical cost inflation rates.

Plan contributions:

The University expects to contribute $1,602,000 to its postretirement benefit plan during the fiscal year ending May 31, 2014.

Projected cash flows:	Gross Benefit Payments Net of Employee Contributions	Gross Subsidy Receipts
2014 Fiscal year	$ 1,863	$ 261
2015 Fiscal year	2,004	298
2016 Fiscal year	2,129	344
2017 Fiscal year	2,295	387
2018 Fiscal year	2,443	434
2019-2023 Fiscal years	15,198	3,027

Components of net periodic postretirement benefit cost:	6/1/2012-5/31/2013	6/1/2011-5/31/2012
Measurement date	5/31/2012	5/31/2011
Service cost	$ 1,771	$ 1,616
Interest cost	2,536	2,979
Amortization of:		
Transition obligation	274	274
Prior service cost	643	643
Actuarial loss	565	767
Net periodic postretirement benefit cost	$ 5,789	$ 6,279

Other changes in plan assets & benefit obligation recognized:		
Net actuarial (gain) loss	$ 3,907	$ (2,641)
Amortization of:		
Transition obligation	(274)	(274)
Prior service cost	(643)	(643)
Actuarial gain	(565)	(767)
Total (gain) loss recognized in net assets	$ 2,425	$ (4,325)
Total recognized in net assets & net periodic benefit cost	$ 8,214	$ 1,954

Weighted-average assumptions for net periodic postretirement benefit cost:		
Measurement date	5/31/2012	5/31/2011
Discount rate	4.87%	5.80%
Health care cost trend rate	7.50%	8.00%
Ultimate health care cost trend rate	5.00%	5.00%
Year ultimate trend rate reached	2017	2017
Average future working lifetime (years)	16.6	16.7

Other information:	6/1/2012-5/31/2013	6/1/2011-5/31/2012
1% increase in trend rates		
Effect on service + interest cost	$ 974	$ 679
Effect on APBO	10,168	8,550
1% decrease in trend rates		
Effect on service + interest cost	$ (729)	$ (519)
Effect on APBO	(7,939)	(6,704)

13. TAX STATUS & ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES

The University is exempt from income tax under section 501(a) of the Internal Revenue Code ("IRC") of 1986, as amended, as an organization described in section 501(c)(3) of the IRC as evidenced by its most recent determination letter dated May 23, 2002. The University has been classified as an organization that is not a private foundation because it qualifies under section 509(a)(1) as an educational institution, and donations to it qualify for deduction as charitable contributions. However, income generated from activities unrelated to the University's exempt purpose is subject to tax under IRC section 511. The University files unrelated business income tax and other returns as required by government authorities.

Tax positions taken relating to the University's tax-exempt status, unrelated business income activities taxable income and deductibility of expenses, and other miscellaneous tax positions taken by the University would more likely than not be sustained by examination. Accordingly, the University has not recorded an income tax liability for uncertain tax benefits. As of May 31, 2013, the University's tax years ended May 31, 2009 through 2013, generally, remain subject to examination.

14. RELATED PARTY TRANSACTIONS

Members of the University’s Board of Regents and senior administration may, from time to time, be associated, either directly or indirectly, with entities doing business with the University. Accordingly, the University has Board of Regents, faculty and staff written conflict of interest policies that require any such association, including those of immediate family members, to be disclosed on an annual basis and updated as appropriate during the year. If such associations exist, measures are taken to mitigate any actual or perceived conflict. For the years ended May 31, 2013 and 2012, there were no related party transactions that were considered to be significant or that were not effectively mitigated.

15. COMMITMENTS & CONTINGENCIES

Capital Expenditures & Other Commitments

At May 31, 2013, the University has commitments to expend approximately $202,231,000 to fulfill contracts related to the construction of a new football stadium and other capital projects.

The University also is contractually obligated under various agreements ensuring access to, or advantageous pricing of, goods and services used in the operations of the University.

Leases

The University incurred $1,337,000 and $1,519,000 in operating lease expenses for facilities and equipment in the fiscal years ended May 31, 2013 and 2012, respectively. As of May 31, 2013, the University has lease commitments for future periods as follows *(in thousands of dollars)*:

	2014	2015	2016	2017	2018	2019 and Thereafter	Total
Equipment	$ 373	$ 365	$ 365	$ 25	$ 25	$ --	$ 1,153
Other	677	677	681	649	645	75	3,404
Total	$ 1,050	$ 1,042	$ 1,046	$ 674	$ 670	$ 75	$ 4,557

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 federal and state 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.

16. SUBSEQUENT EVENTS

The University has evaluated subsequent events through September 25, 2013, the date when financial statements were issued. Other than the roll of $15,000,000 of maturing commercial paper notes as discussed in Note 7 and the adoption of a Health Reimbursement Arrangement for post-65 retirees as discussed in Note 12, the University did not identify any subsequent events to be disclosed.