



THE REED INSTITUTE

Financial Statements

June 30, 2008 and 2007

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Trustees
The Reed Institute:

We have audited the accompanying statements of financial position of The Reed Institute as of June 30, 2008 and 2007, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of The Reed Institute'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 Reed Institute'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.

As discussed in note 3, the Reed Institute has approximately 77% of its total investments, or approximately \$358 million, in investments where readily determinable fair values do not exist.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Reed Institute as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 10, 2008

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Statements of Financial Position
June 30, 2008 and 2007

Assets	2008	2007
Current assets:		
Cash and cash equivalents	\$ 14,228,789	1,926,166
Accounts receivable – student and other (note 9)	364,014	378,737
Short-term investments (note 3)	103,217	1,192,700
Contributions receivable, net of allowance \$40,000 in 2008 and \$23,000 in 2007 (note 9)	758,178	436,109
Prepaid expenses and other assets	2,177,474	1,703,450
Total current assets	17,631,672	5,637,162
Noncurrent assets:		
Cash and cash equivalents whose use is limited	2,067,695	1,867,108
Accounts receivable noncurrent – student and other, net of allowance of \$60,000 in 2008 and 2007 (note 9)	4,721,657	4,678,220
Property, plant, and equipment, net (note 4)	111,861,840	90,259,754
Contributions receivable – noncurrent net of allowance of \$1,063,000 in 2008 and \$541,000 in 2007 (note 9)	20,191,773	10,263,604
Funds held in trust by others (note 8)	14,419,352	14,983,037
Long-term investments (note 3)	464,411,894	497,794,820
Other assets	458,578	457,971
Total noncurrent assets	618,132,789	620,304,514
Total assets	\$ 635,764,461	625,941,676
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 7,370,427	5,078,319
Postretirement benefits payable (note 7)	624,461	672,639
Debt and capital leases, current portion (note 5)	1,185,296	857,716
Deferred revenue	861,148	2,052,383
Other current liabilities	1,167,333	138,040
Total current liabilities	11,208,665	8,799,097
Long-term liabilities:		
Accrued liabilities	36,823	117,136
Liability for split interest agreements	10,635,777	10,829,469
Postretirement benefits payable (note 7)	16,053,418	17,962,998
Refundable loan programs	3,064,870	3,108,176
Asset retirement obligation	2,829,607	2,181,117
Debt and capital leases, net of current portion costs (note 5)	66,122,539	36,857,435
Total long-term liabilities	98,743,034	71,056,331
Total liabilities	109,951,699	79,855,428
Net assets (note 10):		
Unrestricted	384,582,921	422,879,755
Temporarily restricted	36,291,399	27,641,110
Permanently restricted	104,938,442	95,565,383
Total net assets	525,812,762	546,086,248
Total liabilities and net assets	\$ 635,764,461	625,941,676

See accompanying notes to financial statements.

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Statement of Activities and Changes in Net Assets

Year ended June 30, 2008

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2008</u>
Revenues, gains, and other support:				
Tuition and fees	\$ 49,174,352	—	—	49,174,352
Less college-funded scholarships	(16,278,569)	—	—	(16,278,569)
Net tuition and fees	<u>32,895,783</u>	<u>—</u>	<u>—</u>	<u>32,895,783</u>
Auxiliary enterprises	10,625,648	—	—	10,625,648
Gifts and private grants	10,728,081	1,083,253	16,142,784	27,954,118
Government grants, contracts, and student aid	1,591,217	—	—	1,591,217
Realized and unrealized gains and losses	(23,667,752)	—	—	(23,667,752)
Other investment income	1,348,733	—	—	1,348,733
Other revenues and additions	1,026,168	—	220	1,026,388
Subtotal	<u>1,652,095</u>	<u>1,083,253</u>	<u>16,143,004</u>	<u>18,878,352</u>
Net assets released from restrictions	<u>1,622,660</u>	<u>(1,622,660)</u>	<u>—</u>	<u>—</u>
Total revenues, gifts, and other support	<u>36,170,538</u>	<u>(539,407)</u>	<u>16,143,004</u>	<u>51,774,135</u>
Expenses:				
Educational and general:				
Instruction	25,553,682	—	—	25,553,682
Research	1,225,039	—	—	1,225,039
Academic support	7,910,323	—	—	7,910,323
General institutional support	10,178,604	—	—	10,178,604
Student services	5,210,226	—	—	5,210,226
Public affairs	4,517,507	—	—	4,517,507
Total educational and general	<u>54,595,381</u>	<u>—</u>	<u>—</u>	<u>54,595,381</u>
Auxiliary enterprises	14,958,020	—	—	14,958,020
Total expenses	<u>69,553,401</u>	<u>—</u>	<u>—</u>	<u>69,553,401</u>
(Decrease) increase from operations	<u>(33,382,863)</u>	<u>(539,407)</u>	<u>16,143,004</u>	<u>(17,779,266)</u>
Nonoperating activity:				
Other interest expense	(133,776)	—	—	(133,776)
Change in value of split interest agreements	—	(2,532,869)	(611,487)	(3,144,356)
UPMIFA reclassification	(11,722,565)	11,722,565	—	—
Other reclassification of net assets	6,151,321	—	(6,151,321)	—
Other additions (deductions)	791,049	—	(7,137)	783,912
Total nonoperating activity	<u>(4,913,971)</u>	<u>9,189,696</u>	<u>(6,769,945)</u>	<u>(2,494,220)</u>
(Decrease) increase in net assets	<u>(38,296,834)</u>	<u>8,650,289</u>	<u>9,373,059</u>	<u>(20,273,486)</u>
Net assets, beginning of year	422,879,755	27,641,110	95,565,383	546,086,248
Net assets, end of year	\$ <u>384,582,921</u>	<u>36,291,399</u>	<u>104,938,442</u>	<u>525,812,762</u>

See accompanying notes to financial statements.

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Statement of Activities and Changes in Net Assets

Year ended June 30, 2007

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2007</u>
Revenues, gains, and other support:				
Tuition and fees	\$ 44,682,691	—	—	44,682,691
Less college-funded scholarships	(15,743,193)	—	—	(15,743,193)
Net tuition and fees	<u>28,939,498</u>	<u>—</u>	<u>—</u>	<u>28,939,498</u>
Auxiliary enterprises	9,971,475	—	—	9,971,475
Gifts and private grants	3,872,393	5,207,418	17,424,112	26,503,923
Government grants, contracts, and student aid	1,354,937	—	—	1,354,937
Realized and unrealized gains and losses	76,244,431	—	—	76,244,431
Other investment income	1,656,311	—	—	1,656,311
Other revenues and additions	<u>1,087,620</u>	<u>—</u>	<u>—</u>	<u>1,087,620</u>
Subtotal	<u>94,187,167</u>	<u>5,207,418</u>	<u>17,424,112</u>	<u>116,818,697</u>
Net assets released from restrictions	<u>2,374,994</u>	<u>(2,374,994)</u>	<u>—</u>	<u>—</u>
Total revenues, gifts, and other support	<u>125,501,659</u>	<u>2,832,424</u>	<u>17,424,112</u>	<u>145,758,195</u>
Expenses:				
Educational and general:				
Instruction	23,501,134	—	—	23,501,134
Research	1,079,582	—	—	1,079,582
Academic support	7,132,408	—	—	7,132,408
General institutional support	11,915,168	—	—	11,915,168
Student services	4,608,710	—	—	4,608,710
Public affairs	<u>4,134,067</u>	<u>—</u>	<u>—</u>	<u>4,134,067</u>
Total educational and general	<u>52,371,069</u>	<u>—</u>	<u>—</u>	<u>52,371,069</u>
Auxiliary enterprises	<u>13,209,235</u>	<u>—</u>	<u>—</u>	<u>13,209,235</u>
Total expenses	<u>65,580,304</u>	<u>—</u>	<u>—</u>	<u>65,580,304</u>
Increase from operations	<u>59,921,355</u>	<u>2,832,424</u>	<u>17,424,112</u>	<u>80,177,891</u>
Nonoperating activity:				
Other interest expense	(285,528)	—	—	(285,528)
Change in value of split interest agreements	—	3,830,996	1,234,434	5,065,430
Reclassification of net assets	—	(4,308,019)	4,308,019	—
Other deductions	<u>(281,996)</u>	<u>—</u>	<u>—</u>	<u>(281,996)</u>
Total nonoperating activity	<u>(567,524)</u>	<u>(477,023)</u>	<u>5,542,453</u>	<u>4,497,906</u>
Increase in net assets	59,353,831	2,355,401	22,966,565	84,675,797
Net assets, beginning of year	<u>363,525,924</u>	<u>25,285,709</u>	<u>72,598,818</u>	<u>461,410,451</u>
Net assets, end of year	\$ <u><u>422,879,755</u></u>	<u><u>27,641,110</u></u>	<u><u>95,565,383</u></u>	<u><u>546,086,248</u></u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
(Decrease) increase in net assets	\$ (20,273,486)	84,675,797
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization costs	3,765,674	3,886,234
Contributions restricted for long-term investment	(2,897,081)	(19,028,942)
Noncash contributions	(3,800,755)	(5,309,948)
Net realized and unrealized losses (gains) on investments	22,638,459	(76,201,153)
Change in value of split interest agreements	3,144,356	(5,065,430)
Change in fair value of derivative instruments	1,029,293	374,298
Change in asset retirement obligation	648,490	31,357
Changes in operating assets and liabilities:		
Increase in cash and cash equivalents whose use is limited	(200,587)	(101,020)
Decrease (increase) in accounts receivable – students and other	(28,714)	19,122
Increase in contributions receivable	(10,250,238)	(5,771,667)
Increase in prepaid expenses and other assets	(506,830)	(333,759)
(Decrease) increase in accounts payable and accrued liabilities	2,211,795	(420,347)
Increase (decrease) in postretirement benefits payable	(1,957,758)	2,111,608
(Decrease) increase in deferred revenue	(1,191,235)	(2,431,918)
Net cash used in operating activities	(7,668,617)	(23,565,768)
Cash flows from investing activities:		
Proceeds from maturities/sales of investments	159,956,617	174,035,931
Purchases of investments	(146,902,583)	(165,859,810)
Contracts receivable collected	34,672	22,904
Purchase of property, plant, and equipment	(25,370,233)	(6,222,433)
Net cash (used in) provided by investing activities	(12,281,527)	1,976,592
Cash flows from financing activities:		
Contributions restricted for long-term investment	2,897,081	19,028,942
Issuance of new debt	77,060,000	—
Payment of debt principal and capital lease obligations	(47,467,316)	(17,451,799)
Payments of obligations for split interest agreements	(1,467,535)	(1,394,608)
Increase in obligations for split interest agreements	1,273,843	4,647,466
Changes in governmental loan funds	(43,306)	(52,221)
Net cash provided by financing activities	32,252,767	4,777,780
Net increase (decrease) in cash and cash equivalents	12,302,623	(16,811,396)
Cash and cash equivalents, beginning of year	1,926,166	18,737,562
Cash and cash equivalents, end of year	\$ 14,228,789	1,926,166
Supplemental disclosures:		
Interest paid	3,660,858	1,905,091
Assets acquired under capital leases	—	55,000

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2008 and 2007

(1) Background

The Reed Institute (Reed College), founded in 1908 by Simeon and Amanda Reed, is today one of the nation's preeminent institutions of the liberal arts and sciences. The Reed College educational program pays particular attention to a balance between broad study in the various areas of human knowledge and close, in-depth study in a recognized academic discipline.

(2) Summary of Significant Accounting Policies

(a) *Accrual Basis*

The financial statements of Reed College have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

(b) *Basis of Presentation*

Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. The definitions used to classify and report net assets are as follows:

- Unrestricted net assets – net assets that are not subject to donor-imposed restrictions.
- Temporarily restricted net assets – net assets subject to donor-imposed restrictions that will be met either by actions of Reed College or the passage of time.
- Permanently restricted net assets – net assets subject to donor-imposed restrictions that they be permanently maintained by Reed College. Generally, the donors of these assets permit Reed College to use all or part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless their use is limited by donor-imposed restrictions. All expenses are reported as decreases in unrestricted net assets with the exception of activity related to split interest agreements. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted either by donor stipulation or by law. Expirations of temporary restrictions are reported as reclassifications between the applicable classes of net assets and are reported as net assets released from restrictions in the statement of activities and changes in net assets.

Income and net gains on investments of endowment and similar funds are reported as follows:

- Increases in permanently restricted net assets if the terms of the gift or Reed College's interpretation of relevant state law require they be added to the principal of a permanently restricted net asset.
- Increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income.
- Increases in unrestricted net assets in all other cases.

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Notes to Financial Statements

June 30, 2008 and 2007

(c) *Use of Estimates*

The preparation of the financial statements, in accordance with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(d) *Revenues and Revenue Distribution*

The principal sources of revenue, consisting of tuition, room and board, various other educational fees, unrestricted income from funds functioning as endowments, unrestricted gifts, and net assets released from restrictions, are accounted for as increases to unrestricted net assets. Unrestricted net assets also include revenue from grants, auxiliary enterprises, endowment gains and gains on disposal of assets.

Prepayments of student tuition and fees related to future academic years are deferred and recognized as revenues in the appropriate fiscal year.

The following assets have become available for general operating purposes from release from donor restrictions through the passage of time and through the maturation of various planned giving agreements for the years ended June 30, 2008 and 2007, respectively:

	<u>2008</u>	<u>2007</u>
Maturation of planned giving agreements	\$ 413,300	466,812
Passage of time	<u>1,209,360</u>	<u>1,908,182</u>
Total net assets released from restrictions	<u>\$ 1,622,660</u>	<u>2,374,994</u>

With a few exceptions, the monies in the endowment and similar funds are invested as a pool, and the related income of the pool is distributed to each participating fund based upon a spending formula and its relative proportion of the pool.

Reed College utilizes the “total return” method of pooled investment management. This technique considers both realized and unrealized appreciation or depreciation in the fair value of investments, in addition to conventional income sources such as dividends, interest, and rents, net of investment fees as being part of current return. Based on this method, a predetermined percentage of the total return of the endowment funds (computed on a thirteen-quarter moving average fair value) is made available each year for operating purposes.

In addition, monies that are not required to meet short-term demands are combined and invested. The income earned on these intermediate investments is designated to each participating fund based upon its relative proportion of the combined investment.

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Notes to Financial Statements

June 30, 2008 and 2007

(e) ***Investments***

Investments are stated at fair value. The fair value of all debt and equity securities with a readily determinable fair value are based on quotations obtained from national securities exchanges. The alternative investments, which are not readily marketable, are estimated by management based on information provided by the investment managers. Those estimated fair values may differ significantly from the values that would have been used had a ready market for those securities existed. Reed College has certain investments in real estate and related assets that are recorded at fair value.

With the exception of split interest agreements, gains and losses arising from the sale, collection or other disposition of investments and other noncash assets are accounted for in unrestricted net assets.

(f) ***Split Interest Agreements***

Reed College has been named as a remainder beneficiary for various split interest agreements. Each agreement provides for contractual payments to stated beneficiaries for their lifetimes, after which the remaining principal and interest revert to Reed College. Assets contributed are recorded at fair value. In addition, Reed College has recognized the present value of estimated future payments to be made to beneficiaries over their expected lifetimes as a liability. The present values of these estimated payments are determined on the basis of published actuarial factors for ages of the respective beneficiaries discounted using various rate tables. Annual adjustments are made between the liability and net assets to record actuarial gains or losses. Differences between the assets contributed and expected payments to be made to beneficiaries are recorded as donations in the year established. These donations are either temporarily restricted on the basis of time or permanently restricted based on the intent of the donor.

(g) ***Grants and Contracts***

Revenues and reimbursements receivable from research and instructional grants and contracts are recorded at the time when reimbursable costs are incurred. Indirect cost support for these grants and contracts is generally based upon a standard rate negotiated with the U.S. Department of Health and Human Services.

(h) ***Contributions Receivable***

Unconditional promises to give (contributions) are recorded as gifts and private grant income and contributions receivable. Conditional promises to give are not recognized until they become unconditional, that is, when the donor-imposed restrictions are substantially met. Contributions other than cash are recorded at their estimated fair value. Management estimates an allowance for uncollectible contributions based on risk factors such as prior collection history, type of contribution, and the nature of the fund-raising activity. Contributions are generally receivable within five years of the date the commitment was made and are discounted to present value using a discount rate commensurate with the risks involved.

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Notes to Financial Statements

June 30, 2008 and 2007

(i) Derivative Instruments

Reed College accounts for derivatives (interest rate swap) in accordance with Financial Accounting Standards Board Statement (SFAS) No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities*, as amended, which requires that all derivative instruments be recorded on the statement of financial position at their respective fair values.

(j) Property, Plant, and Equipment, Net

Property, plant, and equipment are stated at cost at the date of acquisition, if purchased, or at fair market value, at the date of receipt, if acquired by donation. Depreciation is computed on a straight-line basis over the estimated useful lives of buildings (twenty to fifty years) and equipment and furniture (five years). Equipment held under capital leases are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Routine repair and maintenance expenses and equipment replacement costs are expensed as incurred.

(k) Donated Materials

Donated materials are included in the statement of activities and changes in net assets as gifts and private grants at their estimated values at date of receipt when such values are communicated to Reed College by the donor. These materials are subsequently expensed when used.

(l) Income Tax Status

As a qualified educational institution under the provisions of Section 501(c)(3) of the Internal Revenue Code, Reed College is exempt from federal and state income taxes on related activities. No tax provision has been made in the accompanying financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more-likely than-not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure. The provisions of FIN 48 were effective for Reed College in fiscal 2008, with any cumulative effect of the change in accounting principle recorded as an adjustment to opening net assets. As Reed College is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code as a qualified educational institution and is generally not subject to federal or state income taxes, the adoption of FIN 48 did not have a material impact on Reed College's consolidated financial statements.

(m) Cash and Cash Equivalents

Cash and cash equivalents represent cash and other liquid investments with original maturities of three months or less. Cash and cash equivalents whose use is limited are restricted for the Federal Perkins Loan program.

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June 30, 2008 and 2007

(n) Deferred Revenue

Deferred revenue consists primarily of prepayments of tuition and fees related to future academic years.

(o) Postretirement Benefits

Reed College maintains a postretirement benefit plan and accounts for the plan within the framework of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* and, as still applicable, SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*, respectively.

Reed College records annual amounts related to its pension and post-retirement plans based on calculations that incorporate various actuarial and other assumptions. Critical assumptions include the discount rate, mortality, and the expected increase in costs of covered healthcare benefits, which are important elements of expense and/or liability measurement. Reed College evaluates assumptions annually and modifies them as appropriate. Reed College believes the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions. Reed College uses the measurement date of June 30.

(p) Concentration of Risk

Reed College's standard financial instruments include commercial paper, U.S. Government and agency securities, corporate obligations, equity securities, mutual funds, and real estate. These financial instruments may subject Reed College to risk as cash balances may exceed amounts insured by the Federal Deposit Insurance Corporation and the value of securities is dependent on the ability of the issuer to honor its contractual commitments. The investments are subject to fluctuations in fair value (see note 3).

(q) Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

(3) Investments

The fair values of investments at June 30, 2008 and 2007 are as follows:

	Fair value	
	2008	2007
Investments:		
Short-term investments	\$ 103,217	1,192,700
Equity mutual funds	42,797,918	135,358,492
Government fixed income	25,000	1,812,482
Hedge funds	252,210,824	241,206,000
Private equity	100,475,072	86,096,940
Real estate	5,587,637	2,821,961
Money market	63,315,443	30,498,945
Total investments	<u>\$ 464,515,111</u>	<u>498,987,520</u>

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Notes to Financial Statements

June 30, 2008 and 2007

At June 30, 2008, Reed College has approximately \$358.3 million in investments that are not readily marketable. These investments represent 77% of total investments and 68% of net assets at June 30, 2008. These investment instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and nonmarketable investments), and nondisclosure of portfolio composition. Because these investments 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. Such difference could be material.

Included in investments is \$23,909,168 and \$25,695,656 of planned giving trusts that are not available for spending as of June 30, 2008 and 2007, respectively.

Included within private equity and hedge funds, Reed College has funds invested in twenty-four limited partnerships with ownership interests ranging from 0.04% to 6.00% at June 30, 2008 and 0.07% to 6.56% at June 30, 2007. Included in the assets of the various partnerships is a small portion of derivative instruments.

Total investment income and realized and unrealized gains (losses) on investments that are not readily marketable was (\$7,743,635) and \$69,954,704 for the years ended June 30, 2008 and 2007, respectively.

(4) Property, Plant, and Equipment, Net

Property, plant, and equipment, net at June 30, 2008 and 2007, consist of the following:

	<u>2008</u>	<u>2007</u>
Land and land improvements	\$ 11,203,950	11,061,382
Buildings	118,218,508	114,502,150
Construction in progress	24,455,101	3,203,336
Equipment, furniture, and fixtures	11,149,873	10,890,333
	<u>165,027,432</u>	<u>139,657,201</u>
Less accumulated depreciation	<u>(53,165,592)</u>	<u>(49,397,447)</u>
Net property, plant, and equipment	<u>\$ 111,861,840</u>	<u>90,259,754</u>

(5) Long-Term Debt

(a) Capital Lease Obligations

Reed College leases copiers over various terms. The book values of assets under capital lease at June 30, 2008 and 2007 are \$269,792 and \$361,663, respectively. Amortization costs of \$91,871 and \$85,454 are included in depreciation expense for the years ended June 30, 2008 and 2007, respectively.

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The payment schedule for the capital lease obligation is as follows:

	\$	99,198
2009		96,811
2010		81,088
2011		8,029
2012		<u>285,126</u>
		285,126
Less amount representing interest		<u>(15,334)</u>
	\$	<u><u>269,792</u></u>

(b) Notes Payable

Reed College borrowed \$20,000,000 from the State of Oregon on May 1, 2000. The purpose of the issuance was to finance the construction of certain renovations, additions, alterations, and improvements to the premises and educational facilities of Reed College, and the equipping, furnishing and landscaping thereof. The full amount borrowed, net of unamortized discount and issuance costs, was expended on projects during the year ended June 30, 2002. The notes bear interest from 5.00% to 5.75% and mature in varying amounts from 2005 to 2032.

Reed College borrowed \$14,825,000 from the State of Oregon on May 1, 1991. Effective December 1, 1995, Reed College refinanced all but \$1,565,000 of the 1991 State of Oregon notes payable and borrowed an additional \$7,105,000.

Effective June 7, 2006, Reed College refinanced the callable portion of the 1995 State of Oregon notes payable in the amount of \$16,650,000. The 2006 State of Oregon notes mature July 1, 2025 and bear interest at a variable rate set on a weekly basis by a dutch auction process or at a default rate if the auction is not successful.

Reed College borrowed \$30,000,000 through the Oregon Facilities Authority of the State of Oregon on August 1, 2007. The purpose of the issuance was to finance the construction of five residence halls, construction of a pedestrian bridge, and certain other renovations, additions, alterations and improvements to the premises and educational facilities of Reed College, and the equipping, furnishing and landscaping thereof. These bonds were issued initially as auction rate certificates (ARC's), and were scheduled to mature on July 1, 2038 and bear interest at a variable rate set on a weekly basis by a dutch auction process. These bonds were subsequently refinanced by the 2008 State of Oregon notes.

Effective April 23, 2008, Reed College refinanced the 2006 and the 2007 State of Oregon bonds in the amount of \$47,060,000. The 2008 State of Oregon notes mature July 1, 2038 and bear interest based on a weekly basis set through the remarketing process. In connection with the extinguishment of 2006 and 2007 State of Oregon bonds, Reed College expensed \$761,016 of remaining unamortized financing costs as a loss on refinancing, which is included in the accompanying statement of activities during the year ended June 30, 2008.

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Notes payable are summarized as follows:

	<u>2008</u>	<u>2007</u>
2000 State of Oregon notes	\$ 19,345,000	19,465,000
1995 State of Oregon notes	1,335,000	1,955,000
2006 State of Oregon notes	—	16,600,000
2008 State of Oregon notes	47,060,000	—
	<u>67,740,000</u>	<u>38,020,000</u>
Less discount	<u>(701,957)</u>	<u>(666,512)</u>
	<u>\$ 67,038,043</u>	<u>37,353,488</u>

Principal payments on the notes payable and bonds become due as follows:

	<u>2000</u> <u>State of</u> <u>Oregon</u> <u>notes</u>	<u>1995</u> <u>State of</u> <u>Oregon</u> <u>notes</u>	<u>2008</u> <u>State of</u> <u>Oregon</u> <u>notes</u>	<u>Total</u>
2009	\$ 130,000	650,000	350,000	1,130,000
2010	135,000	685,000	375,000	1,195,000
2011	140,000	—	1,080,000	1,220,000
2012	155,000	—	1,140,000	1,295,000
2013	160,000	—	1,180,000	1,340,000
Thereafter	18,625,000	—	42,935,000	61,560,000
	<u>\$ 19,345,000</u>	<u>1,335,000</u>	<u>47,060,000</u>	<u>67,740,000</u>

Interest on the State of Oregon notes payable bonds and amortization of discount and issuance costs are as follows:

	<u>2008</u>	<u>2007</u>
Interest	\$ 3,234,211	1,835,873
Amortization of discount and issuance costs	<u>426,647</u>	<u>69,218</u>
Total interest expensed	<u>\$ 3,660,858</u>	<u>1,905,091</u>

Notes payable discount, net of amortization was \$701,957 and \$666,512 at June 30, 2008 and 2007, respectively. Issuance costs, net of amortization was \$401,291 and \$403,382 at June 30, 2008 and 2007, respectively, and are included in other assets. Amortization is calculated over the life of the notes.

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(c) Interest Rate Risk Management

In order to take advantage of low long-term interest rates, Reed College entered into an interest rate swap agreement with a notional amount \$16,650,000, which allows Reed College to change the long-term variable interest rate to a fixed rate on State of Oregon notes payable.

In June 2006, Reed College refinanced the callable portion of its 1995 State of Oregon notes by issuing \$16.65 million of auction rate debt through the Oregon Facilities Authority. The College entered into an interest rate swap of like term, amortization and notional amount with an investment bank to hedge this underlying variable rate debt. Pursuant to this swap, Reed College is receiving a variable interest rate and paying a fixed interest rate. Reed College works with a consulting firm to aid in monitoring changes in interest rates and the impact they may have on long-term debt.

During the years ended June 30, 2008 and 2007, \$62,830 was paid and \$637,456 was received, respectively, and is recorded in the statements of activities and changes in net assets as other investment income. The change in unrealized gain and loss on the swap agreements for the years ended June 30, 2008 and 2007 was a loss of \$1,029,293 and \$374,298 respectively, and are recorded in the statement of activities and changes in net assets as unrealized losses. The fair value of the swap agreements and option as of June 30, 2008 and 2007 was a liability of \$1,167,333 and \$138,040, respectively, which are recorded in the statement of financial position as other current liabilities.

(6) Operating Leases

Reed College leases copiers over various terms. Future minimum payments pertaining to operating leases are as follows:

2009	\$	5,531
2010		4,572
2011		4,572
2012		1,524

Expenses incurred for operating leases were \$5,630 and \$5,109 for the years ended June 30, 2008 and 2007, respectively.

(7) Postretirement Benefits

Reed College has a defined contribution noncontributory postretirement benefit plan administered through Teachers Insurance and Annuity Association – College Retirement Equities Fund. Certain employees are eligible to participate and must be employed for one year and have attained the age of twenty-one. All contributions vest immediately with the employee at the rate of 10% of the participating employees' monthly compensation. Reed College's policy is to fund pension expenses as incurred. Expenses relating to this plan were \$2,431,842 and \$2,192,516 for the years ended June 30, 2008 and 2007, respectively.

Reed College maintains a defined benefit retiree medical insurance plan, which is administered by Pioneer Educators Health Trust (PEHT), and is not funded. In order to participate, employees hired prior to September 2, 2001 must retire from Reed College at or after age fifty-five with at least ten years of

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continuous service. Employees hired after September 1, 2001 must retire from Reed College at or after age fifty-five with twenty years of continuous service. Employees are covered for the lowest premium Reed College plan for his or her lifetime and spouses/domestic partners are covered at the rate of 50% of the lowest premium College plan for his or her lifetime. Employer premium expenses were \$618,058 and \$545,112 for the years ended June 30, 2008 and 2007, respectively.

The accrued liability for postretirement benefits at year-end is as follows:

	2008	2007
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 18,635,637	16,524,029
Service cost	431,134	382,233
Interest cost	1,080,133	1,143,707
Benefits paid	(672,639)	(596,422)
Actuarial loss (gain)	(2,796,386)	1,182,090
Benefit obligation at end of year	16,677,879	18,635,637
Funded status	\$ (16,677,879)	(18,635,637)
Amounts recognized in the balance sheet consist of:		
Postretirement benefits payable – current	\$ (624,461)	(672,639)
Postretirement benefits payable	(16,053,418)	(17,962,998)
	\$ (16,677,879)	(18,635,637)

Net periodic benefit cost for the years ended June 30 included the following components:

	2008	2007
Interest cost	\$ 1,080,133	1,143,707
Service cost	431,134	382,233
Amortization of (gain)/loss	(78,633)	—
Net periodic pension (benefit) cost	\$ 1,432,634	1,525,940

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Reed College used the following actuarial assumptions to determine its employee benefit obligations at and net periodic benefit cost for the years ended June 30, 2008 and 2007, as measured at June 30:

	2008	2007
Benefit obligation:		
Weighted average discount rate	6.60%	6.25%
Rate of increase in per capita cost of covered healthcare benefits	8% trending to 5% in 2013	9% trending to 5% in 2013
Net periodic benefit cost:		
Weighted average discount rate	6.25%	6.50%
Rate of increase in per capita cost of covered healthcare benefits	9% trending to 5% in 2013	9% trending to 5% in 2013

Reed College's policy is to fund the plan as claims payments are made. In the 2008-2009 fiscal year, Reed College expects to contribute, from ongoing cash flows and current assets, \$624,461 to the plan. Benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows for the years ending June 30:

	Expected benefit payments
2009	\$ 624,461
2010	671,741
2011	724,466
2012	772,234
2013	832,533
2014 – 2016	5,034,683

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 provides an employer subsidy of 28% of gross annual prescription drug costs between \$250 and \$5,000 for actuarially equivalent plans. FASB Staff Position 106-2 requires that the estimated impact of this subsidy be reflected in the APBO for periods beginning after June 15, 2004. This reduction in APBO reduces the net periodic postretirement benefit cost due to corresponding reductions in the service cost and interest cost. Actuaries have determined that the Reed College Postretirement Medical Plans are actuarially equivalent to the Medicare Part D plan. Reed College is applying for the employer subsidy and Reed College received the first subsidy in April of 2008 in the amount of \$7,242.

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(8) Funds Held in Trust by Others

Reed College has been named beneficiary of a portion of the remainder of six trusts maturing at specified dates in the future. These trusts are administered by other entities. Reed College revalues the receivables associated with these trusts annually based on published actuarial factors for the respective beneficiaries' ages. At June 30, 2008 and 2007, the trusts receivable was \$14,419,352 and \$14,983,037, respectively, and was included under funds held in trust by others – noncurrent.

(9) Contributions and Accounts Receivable

Contributions receivable consist of the following:

	<u>2008</u>	<u>2007</u>
Annual fund	\$ 2,488,610	1,437,121
Campaign fund	257,865	326,015
Endowment fund	18,835,892	7,103,621
Plant fund	<u>2,310,248</u>	<u>3,500,248</u>
Gross contributions receivable	<u>\$ 23,892,615</u>	<u>12,367,005</u>

Contributions receivable reported on the statements of financial position were as follows:

	<u>2008</u>	<u>2007</u>
Current:		
Gross contributions receivable	\$ 798,178	459,109
Less allowance for doubtful accounts	<u>(40,000)</u>	<u>(23,000)</u>
Total current net contributions receivable	<u>758,178</u>	<u>436,109</u>
Long-term (one to five years):		
Gross contributions receivable	23,094,437	11,907,896
Less allowance for doubtful accounts	<u>(1,063,000)</u>	<u>(541,000)</u>
Long-term contributions receivable, net	22,031,437	11,366,896
Less discount to present value	<u>(1,839,664)</u>	<u>(1,103,292)</u>
Total long-term contributions receivable, net	<u>20,191,773</u>	<u>10,263,604</u>
Total contributions receivable, net	<u>\$ 20,949,951</u>	<u>10,699,713</u>

Reed College expects to collect \$6,378,948 in fiscal year 2009.

Contributions receivable due in excess of one year were discounted at 3.2% to 3.5% and 4.7% to 4.8% for the years ended June 30, 2008 and 2007, respectively.

Of the net unconditional promises to give included above, \$18,134,051 and \$4,679,118 at June 30, 2008 and 2007, respectively, represents an unconditional promise to give from 14 members of the Reed College board of trustees due in one to five years.

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Accounts receivable consist of the following at June 30, 2008:

	<u>Unrestricted</u>	<u>Restricted</u>	<u>Loan fund</u>	<u>Endowment</u>	<u>Total</u>
Current:					
Student accounts receivable	\$ 102,745	—	—	—	102,745
Related parties	—	116,999	—	—	116,999
Grants and contracts receivable	—	1,993	—	—	1,993
Other receivables	142,277	—	—	—	142,277
	<u>245,022</u>	<u>118,992</u>	<u>—</u>	<u>—</u>	<u>364,014</u>
Noncurrent:					
Student accounts receivable	—	—	22,866	—	22,866
Reed College loans	—	—	996,038	—	996,038
Related parties	—	—	2,236	—	2,236
Federal Perkins loans	—	—	3,760,756	—	3,760,756
	<u>245,022</u>	<u>118,992</u>	<u>4,781,896</u>	<u>—</u>	<u>5,145,910</u>
Less allowance for doubtful accounts	—	—	(60,239)	—	(60,239)
	<u>\$ 245,022</u>	<u>118,992</u>	<u>4,721,657</u>	<u>—</u>	<u>5,085,671</u>

Accounts receivable consist of the following at June 30, 2007:

	<u>Unrestricted</u>	<u>Restricted</u>	<u>Loan fund</u>	<u>Endowment</u>	<u>Total</u>
Current:					
Student accounts receivable	\$ 89,443	—	—	—	89,443
Related parties	—	72,898	—	—	72,898
Grants and contracts receivable	—	64,810	—	—	64,810
Other receivables	151,586	—	—	—	151,586
	<u>241,029</u>	<u>137,708</u>	<u>—</u>	<u>—</u>	<u>378,737</u>
Noncurrent:					
Student accounts receivable	—	—	25,546	—	25,546
Reed College loans	—	—	858,976	—	858,976
Related parties	—	—	(5,963)	—	(5,963)
Federal Perkins loans	—	—	3,859,900	—	3,859,900
	<u>241,029</u>	<u>137,708</u>	<u>4,738,459</u>	<u>—</u>	<u>5,117,196</u>
Less allowance for doubtful accounts	—	—	(60,239)	—	(60,239)
	<u>\$ 241,029</u>	<u>137,708</u>	<u>4,678,220</u>	<u>—</u>	<u>5,056,957</u>

The Federal Perkins loans and Reed loans are generally payable at interest rates of 5% to 9% over approximately ten years. Repayment begins after a designated grace period following college attendance. Principal payments, interest, and losses due to cancellation are shared by Reed College and the

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U.S. Government in proportion to their share of funds provided. The Federal Perkins loan program provides for cancellation of loans if the student is employed in certain occupations following graduation (employment cancellations). Such employment cancellations are absorbed in full by the U.S. Government.

(10) Net Assets

At June 30, 2008 and 2007, net assets consisted of the following:

	2008	2007
Unrestricted:		
Operating	\$ 7,368,712	2,648,021
Designated for special programs	14,037,614	22,115,227
Institutional loan programs	3,708,748	3,422,953
Funds functioning as endowment	88,772,976	85,519,180
Accumulated gains on quasi-endowments	238,700,451	274,783,750
Net investment in plant	31,994,420	34,390,624
Total unrestricted	\$ 384,582,921	422,879,755
Temporarily restricted:		
Educational and general programs	\$ 84,771	157,214
Annuity and life income funds	22,426,403	24,449,319
Other temporarily restricted net assets	13,780,225	3,034,577
Total temporarily restricted	\$ 36,291,399	27,641,110
Permanently restricted:		
True endowment funds	\$ 99,707,485	90,203,264
Annuity and life income funds	5,230,957	5,362,119
Total permanently restricted	\$ 104,938,442	95,565,383

Through December 31, 2007, Reed College's management and investment of donor-restricted endowment funds was subject to the provisions of the Uniform Management of Institutional Funds Act (UMIFA). In 2006, the Uniform Law Commission approved the model act, Uniform Prudent Management of Institutional Funds Act (UPMIFA) that serves as a guideline to states to use in enacting legislation. Among UPMIFA's most significant changes is the elimination of UMIFA's concept of historic dollar value threshold, the amount below which an organization could not spend from the endowment fund in favor of a more robust set of guidelines about what constitutes prudent spending.

Effective January 1, 2008, the State of Oregon enacted UPMIFA, the provisions of which apply to endowment funds existing on or established after that date. Based on its interpretation of the provisions of UPMIFA, the College reviewed its net asset accounts to identify the cumulative amount of unspent endowment earnings that had not yet been appropriated for expenditure as of June 30, 2008. As such, Management has recorded a reclassification of net assets from unrestricted to temporarily restricted of approximately \$11,723,000 during fiscal 2008. Reed College does not believe this net asset reclassification will be operationally significant.

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(11) Commitments and Contingencies

Reed College has placed certain of its medical and dental insurance coverage with Pioneer Educators Health Trust (PEHT). PEHT was formed by seven similar western colleges and universities for the purpose of providing medical and dental insurance to higher education institutions. Under the agreement, member institutions are required to make contributions to the fund at such times and in an amount as determined by the Trustees' for the various benefit programs sufficient to provide the benefits, pay the administrative expenses of the plan which are not otherwise paid by Reed College directly, and to establish and maintain a minimum reserve as determined by the Trustees. In the event that losses of PEHT exceed its capital and secondary coverages, the maximum contingent liability exposure to Reed College is approximately \$142,751. This exposure fluctuates based on changes in actuarial assumptions, medical trend rates, and reinsurance amounts. The level of reinsurance is not expected to fluctuate significantly in the future.

On July 1, 1988 Reed College elected to place its liability insurance coverage with the College Liability Insurance Company, Ltd. (CLIC). CLIC was formed by seven similar western colleges and universities for the purpose of providing liability insurance to higher education institutions and now includes nine members. As a portion of its capital, CLIC has placed a \$2,000,000 standby letter of credit of which Reed College is contingently liable for a pro rata portion based upon premium contributions from covered institutions. In the event the losses of CLIC exceed its capital and secondary coverages, the maximum contingent liability exposure to Reed College is approximately \$145,098. As of June 30, 2008 and 2007, there were no amounts outstanding against the standby letter of credit.

From time to time, Reed College is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, most of these claims and legal actions are covered by insurance and the ultimate disposition of these matters will not have a material effect on Reed College's financial position, statement of activities or cash flow.

(12) Fair Value of Financial Instruments

The estimated fair values of financial instruments have been determined by Reed College using available market information and appropriate valuation methodologies. At June 30, 2008 and 2007, the carrying values of cash, and accounts and notes receivable approximate fair value due to the short-term nature of these instruments. The fair value of investments is estimated based on quoted market prices for those investments that are actively traded securities. For other investments for which there are no quoted market prices, an estimate of the amount that could be realized in a sale was made by management. As of June 30, 2008, management believes the fair value of all investments for which there are not quoted market prices approximates the carrying value. The fair value of interest rate swaps are estimated based on estimates from the holders of the instrument and represent the estimated amount that Reed College would expect to receive or pay to terminate the agreement.

The fair value of Reed College's long-term debt is estimated based on the current rates available to the College for debt of the same remaining maturities. Taking into account current borrowing rates as of June 30, 2008, the fair value of Reed College's bonds approximates \$69,085,130 as compared to its net carrying value of \$67,038,043.

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(13) Fund Raising Expense

Reed College expended \$2,573,084 and \$2,322,142 for the years ended June 30, 2008 and 2007, respectively, for payroll and benefits, informational materials, travel and special events relating to fund raising activities. These expenses are all classified as public affairs in the statements of activities and changes in net assets.

(14) Subsequent Event

Since year-end, major stock indices, including the Dow Jones, the S&P 500, and the NASDAQ have declined significantly. Management is monitoring market conditions and related unrealized losses on investments. Due to the volatility of the U.S. economy and the financial markets as of the date of this report, there is uncertainty regarding the long-term impact of market conditions on the College's investment portfolio.