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HIGHLIGHTS

| | June 30, | |
|---|-----------------|-----------------|
| | 2003 | 2002 |
| OPERATING REVENUE | \$ 67,600,435 | \$ 63,492,145 |
| OPERATING EXPENSES | \$ 63,829,436 | \$ 59,690,181 |
| OPERATING REVENUE IN EXCESS OF EXPENSES | \$ 3,770,999 | \$ 3,801,964 |
| ADDITIONS TO PROPERTY, PLANT AND EQUIPMENT | \$ 25,229,309 | \$ 17,700,073 |
| LONG-TERM INVESTMENTS OF THE ENDOWMENT AND TUITION REPLACEMENT FUNDS | | |
| Original gift value | \$ 270,794,617 | \$ 253,657,334 |
| Investments at market | \$ 695,812,000 | \$ 716,522,800 |
| Interest and dividends, net | \$ 14,802,646 | \$ 17,414,310 |
| Return | 2.3% | 2.3% |
| Market price decrease | \$ (14,420,253) | \$ (75,458,734) |
| Return | -2.0% | -9.8% |
| Total return | \$ 382,393 | \$ (58,044,424) |
| Percent | 0.3% | -7.5% |
| CASH AND IN-KIND CONTRIBUTIONS | | |
| Cash gifts | \$ 12,110,515 | \$ 10,185,683 |
| Bequests | 11,710,149 | 13,191,167 |
| Total cash gifts | 23,820,664 | 23,376,850 |
| Gifts-in-kind | 172,527 | 43,132 |
| Total | \$ 23,993,191 | \$ 23,419,982 |

REPORT OF THE VICE PRESIDENT FOR FINANCE

August, 2003

To the Board of Trustees, President Shinn,
And Friends of Berea College,

The issuance of these financial statements marks the end to the 2002-03 fiscal year for Berea College and helps to remind us how special Berea truly is. This is an institution that is committed to Christian values and to providing a quality education for its students without charging tuition. However, this special place brings with it special challenges. One of those challenges is providing the funding for high quality programs primarily from the earnings of an endowment that has been decreasing during these volatile and slow economic times. Early during the current fiscal year the campus knew that the endowment spending formula (providing over 74% of the operating revenue for the College) would not be able to provide the expected revenue resources to meet the budgeted demands of the College. The campus leadership, working through the Budget Committee, was able to reduce the College's budget by almost \$600,000 during the 2002-03 fiscal year. In addition, the Budget Committee was able to identify another \$1.0 million in reductions for the next (2003-04) fiscal year. These reductions along with a reallocation of resources that were wisely set aside by the Trustees on an annual basis, have helped the College meet the budget challenges without loss of academic quality for our students.

Berea College continues to experience strong demand from the best and brightest students in the Appalachia area. Last fall's full-time equivalent student enrollment of 1,526 students compared with 1,620 the previous year. Due to successful retention activity, the College admitted a smaller freshman class than usual in order to reduce the student count to a more traditional and sustainable level. Berea's target enrollment is 1,500. The College graduated 214 students this past May and 284 students (winter and spring) overall in 2002-2003, which was exactly the same number of graduates from the previous year.

Berea's development efforts are still producing strong results. During the year the College raised a total of \$24.0 million, which includes \$.2 million in gifts-in-kind. Approximately \$4 million was raised for current operations with the remainder going into the endowment or designated for specific campus projects. The College will start the public phase of a \$150 million comprehensive fund raising campaign at the end of September. Campaign proceeds will go to fund several specific initiatives identified by the strategic planning process on campus and for scholarships for Berea students.

Financial Position

Even with the prevailing economic challenges, the College remains in a strong financial position. As of June 30, 2003, *total net assets* (total assets less liabilities) of the College approximated \$815.3 million. This shows a reduction from the previous year by approximately \$21.0 million. This reduction reflects the decrease in the market value of

our long-term investments during the year from \$758.2 million as of June 30, 2002, to \$736.7 million as of June 30, 2003.

At June 30, 2003, *total assets* were \$904.9 million. Of this amount, long-term investments (including endowment funds, annuity and life income and other funds) comprised \$736.7 million, property, plant and equipment and bond proceeds for capital additions net of depreciation totaled \$133.9 million, and current assets were over \$25.0 million. Contributions receivable and bequests in probate totaled \$6.3 million and student educational loans totaled approximately \$1.8 million.

Total liabilities increased by approximately \$16.7 million due primarily to the issuance of \$18.5 million in long-term debt to fund renovations of two academic buildings and one residence hall. The increase in total liabilities was partially offset by the payment of current maturities of long-term debt of approximately \$1 million.

Current Operations

The 2002-03 fiscal year ended with a surplus from budgeted operations of over \$775,000. This surplus was due to the realization of less than budgeted administrative salaries and net controllable expenses. The 2003-04 budget includes continued funding of the strategic planning initiatives, and provides an increase in salary and wages for current employees of 2.0%. However, the employee size has been reduced by 23.3 positions and results in a total decrease in salaries and wages of nearly 1%. Overall, the budget for current operations has decreased by 0.87% from the previous year.

Concluding Comments

The fiscal year of 2002-03 has shown the importance of good financial planning and the benefit of having good staff and faculty to serve our students. The exceptional leadership of the Board of Trustees and support from friends of the College has made it possible for Berea College to successfully meet the many challenges now facing our operations and programs. Your presence is always welcome on the Berea College campus and we look forward to opportunities to share our accomplishments and experiences.

Respectfully submitted,



Ronald E. Smith
Vice President for Finance

Deloitte & Touche LLP
Suite 2100
220 W. Main Street
Louisville, Kentucky 40202-5313

Tel: (502) 562-2000
Fax: (502) 562-2073
www.deloitte.com

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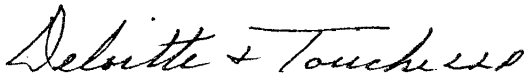
INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Berea College
Berea, Kentucky

We have audited the accompanying statements of financial position of Berea College (College) as of June 30, 2003 and 2002, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the College as of June 30, 2003 and 2002, and the related changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



August 22, 2003
Louisville, Kentucky

Berea College

STATEMENTS OF FINANCIAL POSITION

| | June 30, | |
|---|-----------------------|-----------------------|
| | 2003 | 2002 |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 15,464,725 | \$ 7,677,860 |
| Other investments - absolute return fund | 3,280,296 | 3,138,424 |
| Accrued interest on investments | 2,311,094 | 1,383,816 |
| Accounts and notes receivable | 1,755,485 | 1,660,234 |
| Inventories | 2,307,258 | 2,264,254 |
| Prepaid expenses and other assets | 28,905 | 832,116 |
| Total current assets | <u>25,147,763</u> | <u>16,956,704</u> |
| NON-CURRENT PREPAID EXPENSES AND OTHER ASSETS | <u>1,044,349</u> | <u>834,240</u> |
| CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE | <u>6,313,721</u> | <u>11,897,594</u> |
| LONG-TERM RECEIVABLES | | |
| Institutional student loans | 1,477,133 | 1,451,303 |
| Federal student loans | 301,097 | 258,282 |
| Total long-term receivables | <u>1,778,230</u> | <u>1,709,585</u> |
| LONG-TERM INVESTMENTS | | |
| Donor-restricted endowment | 386,166,800 | 397,529,200 |
| Tuition replacement | 309,645,200 | 318,993,600 |
| Annuity and life income | 24,401,000 | 25,154,100 |
| Funds held in trust by others | 16,438,300 | 16,555,200 |
| Total long-term investments | <u>736,651,300</u> | <u>758,232,100</u> |
| BOND PROCEEDS FOR CAPITAL ADDITIONS | <u>5,470,706</u> | <u>11,676,229</u> |
| PROPERTY, PLANT AND EQUIPMENT | | |
| Educational property, plant and equipment | 126,425,871 | 103,515,611 |
| Electric and water utility plant | 27,248,886 | 26,275,460 |
| Student industry plant and equipment | 8,147,653 | 7,986,916 |
| Rental property | 2,698,911 | 2,746,718 |
| Forest and farms | 583,658 | 583,658 |
| Collections and works of art | 3,101,031 | 3,101,031 |
| Less accumulated depreciation | <u>(39,750,867)</u> | <u>(36,293,766)</u> |
| Property, plant and equipment, net | <u>128,455,143</u> | <u>107,915,628</u> |
| Total assets | <u>\$ 904,861,212</u> | <u>\$ 909,222,080</u> |

See notes to financial statements.

Berea College

STATEMENTS OF FINANCIAL POSITION

| | June 30, | |
|---|-----------------------|-----------------------|
| | <u>2003</u> | <u>2002</u> |
| LIABILITIES AND NET ASSETS | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 4,313,037 | \$ 5,614,485 |
| Accrued salaries and wages | 2,565,354 | 2,376,360 |
| Deposits and agency funds | 525,921 | 525,194 |
| Deferred income | 47,660 | 55,214 |
| Current maturities of long-term debt | 1,015,225 | 933,467 |
| Total current liabilities | <u>8,467,197</u> | <u>9,504,720</u> |
| LONG-TERM LIABILITIES | | |
| Annuity payment and deferred giving liability | 11,726,600 | 11,493,400 |
| Long-term debt | 69,401,556 | 51,916,782 |
| Total long-term liabilities | <u>81,128,156</u> | <u>63,410,182</u> |
| Total liabilities | <u>89,595,353</u> | <u>72,914,902</u> |
| NET ASSETS | | |
| Unrestricted - | | |
| For current operations | 79,456 | 76,516 |
| Designated for specific purposes | 22,955,817 | 21,019,146 |
| Invested in property, plant and equipment | 24,775,794 | 22,512,694 |
| Support of future operations from: | | |
| Contributions receivable and bequests in probate | 1,799,599 | 4,313,833 |
| Appreciation on endowment investments | 200,408,653 | 216,129,770 |
| Tuition replacement funds | 309,645,200 | 318,993,600 |
| Total unrestricted | <u>559,664,519</u> | <u>583,045,559</u> |
| Temporarily restricted - | | |
| Unexpended contributions restricted for operations | 4,571,806 | 4,119,113 |
| Unexpended contributions restricted for plant renewals and replacement | 3,970,416 | 2,950,505 |
| Annuity and life income contracts | 6,636,730 | 7,485,343 |
| Expended contributions for long-lived assets being amortized | 25,995,950 | 26,033,590 |
| Appreciation on endowment investments primarily to support various programs/services | 49,549,132 | 54,904,363 |
| Total temporarily restricted | <u>90,724,034</u> | <u>95,492,914</u> |
| Permanently restricted - | | |
| Loan funds | 2,966,926 | 2,780,021 |
| Annuity and life income contracts | 6,037,670 | 6,175,357 |
| Funds held in trust by others | 16,438,300 | 16,555,200 |
| Endowment investments | 139,434,410 | 132,258,127 |
| Total permanently restricted | <u>164,877,306</u> | <u>157,768,705</u> |
| Total net assets | <u>815,265,859</u> | <u>836,307,178</u> |
| Total liabilities and net assets | <u>\$ 904,861,212</u> | <u>\$ 909,222,080</u> |

See notes to financial statements.

STATEMENTS OF ACTIVITIES

Changes in Unrestricted Net Assets

| | Year Ended June 30, | |
|--|---------------------|-----------------|
| | 2003 | 2002 |
| OPERATING REVENUE | | |
| Spendable return from long-term investments | \$ 34,299,979 | \$ 32,143,310 |
| Gifts and donations | 4,890,623 | 4,694,409 |
| Federal grants, primarily for student labor | 4,149,121 | 4,097,216 |
| Cost of education fees paid by federal and state scholarships | 2,514,418 | 2,398,000 |
| Fees paid by students | 935,212 | 549,197 |
| Other income | 2,965,793 | 3,124,974 |
| Residence halls and food service | 4,987,433 | 4,967,897 |
| Utilities, student industries, and rentals | 11,365,259 | 10,528,354 |
| Net assets released from restrictions | 4,122,021 | 3,632,171 |
| Gross operating revenue | 70,229,859 | 66,135,528 |
| Less: Student aid | (2,629,424) | (2,643,383) |
| Net operating revenue | 67,600,435 | 63,492,145 |
| OPERATING EXPENSES | | |
| Program Services - | | |
| Instruction | 18,369,714 | 16,981,209 |
| Public service | 3,027,213 | 2,876,458 |
| Academic support | 8,050,926 | 6,131,208 |
| Student services | 7,203,419 | 7,081,877 |
| Residence halls and food service | 5,049,893 | 5,025,387 |
| Utilities, student industries, and rentals | 11,575,624 | 10,781,629 |
| Total Program Services | 53,276,789 | 48,877,768 |
| Support Services, including fund raising expense of \$2,521,900 in 2003 and \$2,576,400 in 2002 | 10,552,647 | 10,812,413 |
| Total operating expenses | 63,829,436 | 59,690,181 |
| Operating revenue in excess of operating expenses | 3,770,999 | 3,801,964 |
| Gain on disposal of property, plant and equipment | 576,304 | - |
| REVENUES DESIGNATED FOR LONG-TERM INVESTMENT | | |
| Unrestricted bequests | 4,142,902 | 9,646,823 |
| Matured annuity and life income contracts | 611,815 | 1,666,069 |
| Unrestricted capital losses on long-term investments | (32,483,060) | (79,811,579) |
| Total decrease in revenues designated for long-term investment | (27,728,343) | (68,498,687) |
| Decrease in unrestricted net assets | \$ (23,381,040) | \$ (64,696,723) |

See notes to financial statements.

STATEMENTS OF ACTIVITIES

Changes in Total Net Assets

| | Year Ended June 30, | |
|---|---------------------|----------------|
| | 2003 | 2002 |
| UNRESTRICTED NET ASSETS | | |
| Operating revenue in excess of operating expenses | \$ 3,770,999 | \$ 3,801,964 |
| Gain on sale of property, plant and equipment | 576,304 | - |
| Decrease in revenues designated for long-term investment | (27,728,343) | (68,498,687) |
| Decrease in unrestricted net assets | (23,381,040) | (64,696,723) |
| TEMPORARILY RESTRICTED NET ASSETS | | |
| Restricted gifts and donations | 2,245,253 | 2,224,588 |
| Restricted spendable return on endowment investments | 3,664,498 | 3,316,485 |
| Restricted capital losses on endowment investments | (5,365,022) | (13,929,616) |
| Net adjustment of annuity payment and deferred giving liability | (579,773) | (2,474,867) |
| Reclassification of net assets released from restrictions | (4,122,021) | (3,632,171) |
| Reclassification of matured annuity and life income contracts to revenues designated for long-term investment | (611,815) | (1,666,069) |
| Decrease in temporarily restricted net assets | (4,768,880) | (16,161,650) |
| PERMANENTLY RESTRICTED NET ASSETS | | |
| Gifts and donations | 7,212,333 | 9,482,741 |
| Restricted spendable return on endowment investments | 265,998 | 236,976 |
| Restricted capital losses on funds held in trust by others | (116,900) | (2,019,400) |
| Net adjustment of annuity payment and deferred giving liability | (252,830) | (754,854) |
| Increase in permanently restricted net assets | 7,108,601 | 6,945,463 |
| Total change in net assets | (21,041,319) | (73,912,910) |
| NET ASSETS | | |
| Beginning of year | 836,307,178 | 910,220,088 |
| End of year | \$ 815,265,859 | \$ 836,307,178 |

STATEMENTS OF CASH FLOWS

| | Year Ended June 30, | |
|--|----------------------|---------------------|
| | 2003 | 2002 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Decrease in net assets | \$ (21,041,319) | \$ (73,912,910) |
| Adjustments to reconcile change in net assets to net cash provided or used by operating activities - | | |
| Market price decrease on long-term investments | 37,964,982 | 95,760,595 |
| Gifts and bequests for financing activities | (12,108,229) | (19,349,215) |
| (Increase) decrease in contributions receivable and bequests in probate | 5,583,873 | (2,923,014) |
| Gift value of annuity contracts written | (1,100,142) | (817,913) |
| Depreciation | 4,642,903 | 3,893,243 |
| (Gain) loss on disposal of property, plant and equipment | (576,304) | 24,555 |
| Net adjustment of annuity payment liability | 832,603 | 3,229,721 |
| (Increase) decrease in non-current prepaid expenses and other assets | (210,109) | 45,587 |
| (Increase) decrease in current assets other than cash and other investments | (262,322) | 635,907 |
| Increase (decrease) in current liabilities other than current maturities of long-term debt | (1,119,281) | 2,489,515 |
| Restricted spendable return on endowment funds | (265,998) | (236,976) |
| Net cash provided by operating activities | <u>12,340,657</u> | <u>8,839,095</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of securities held for long-term investment | (311,962,895) | (284,063,181) |
| Proceeds from sales and maturities of investments | 301,784,235 | 278,319,257 |
| Purchase of other investments - absolute return fund | (141,872) | (3,138,424) |
| Purchase of property, plant and equipment | (25,229,309) | (17,700,073) |
| Proceeds from sale of property, plant and equipment | 623,195 | - |
| Long-term student loans | (365,182) | (428,599) |
| Long-term student loan repayments | 296,537 | 314,572 |
| Faculty and staff mortgage loans | - | (84,770) |
| Faculty and staff mortgage loan repayments | - | 573,588 |
| Proceeds from sale of faculty and staff mortgage portfolio | - | 2,082,765 |
| Gain (loss) on annuity and life income investments | 587,594 | (2,206,075) |
| Net cash used by investing activities | <u>(34,407,697)</u> | <u>(26,330,940)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Gifts and bequests received for - | | |
| Long-term investment | 10,575,448 | 17,738,258 |
| Property, plant and equipment | 1,510,161 | 1,610,373 |
| Student loans | 22,620 | 584 |
| Proceeds received on annuity and life income contracts | 1,761,314 | 1,670,993 |
| Contractual payments on annuity and life income contracts | (1,817,970) | (1,960,980) |
| Third party payments of matured annuity and life income contracts | (30,198) | (1,416,146) |
| Endowment return restricted for long-term investments | 265,998 | 236,976 |
| Repayment of indebtedness | (933,468) | (1,887,167) |
| Long-term debt issued | 18,500,000 | - |
| Net cash provided by financing activities | <u>29,853,905</u> | <u>15,992,891</u> |
| Net change in cash and cash equivalents | 7,786,865 | (1,498,954) |
| Cash and cash equivalents, beginning of year | <u>7,677,860</u> | <u>9,176,814</u> |
| Cash and cash equivalents, end of year | <u>\$ 15,464,725</u> | <u>\$ 7,677,860</u> |

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

(1) SUMMARY OF ACCOUNTING POLICIES

General

Berea College (the College) is a not-for-profit institution providing liberal arts education to students with limited family financial resources primarily from the Southern Appalachian Mountain region. All students are provided a full tuition scholarship and, accordingly, the College is dependent on gifts and donations to help provide a low cost but high quality education. The College has one campus located in Berea, Kentucky with an enrollment of approximately 1,500 students and approximately 600 employees.

Basis of Presentation

The financial statements have been prepared on the accrual basis of accounting. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect the reported amounts of assets, liabilities and disclosures of contingencies at the date of the financial statements and revenues and expenses recognized during the reporting period. Actual results could differ from those estimates.

Under established financial reporting standards for not-for-profit organizations, net assets and revenues, expenses, and 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:

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the College. Generally, the donors of these assets permit the institution to use all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met by actions of the College and/or the passage of time.

Unrestricted net assets - Net assets not subject to donor-imposed stipulations.

Revenues from sources other than contributions are reported as increases in unrestricted net assets. Contributions are reported as increases in the appropriate category of net assets, except that contributions which impose restrictions that are met in the same fiscal year they are received are included in unrestricted revenues. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications from temporarily restricted net assets to unrestricted net assets.

Contributions, including unconditional promises to give and bequests, are recognized as revenues in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value at the date of the gift. Contributions to be received after one year are discounted at a rate commensurate with the risk involved. Amortization of the discount is recorded as additional contribution revenue and used in accordance with donor-imposed restrictions, if any, on the contributions. Allowance is made for uncollectible contributions based upon management's judgment and analysis of the creditworthiness of the donors, past collection experience and other relevant factors.

NOTES TO FINANCIAL STATEMENTS

(1) SUMMARY OF ACCOUNTING POLICIES (continued)

Contributions of exhaustible long-lived assets, or of cash or other assets to be used to acquire them, without donor stipulations concerning the use of such long-lived assets, are reported as revenues of the temporarily restricted net asset class; the restrictions are considered to be released over the estimated useful lives of the long-lived assets using the College's depreciation policies.

All contributions of works of art, historical treasures and similar assets, whether held as part of a collection (for education, research or public exhibition rather than for sale) or for sale or other purposes, have been recognized at their estimated fair value at the date of receipt based upon appraisals or similar valuations. All such items, whether contributed or purchased, have been capitalized.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market.

Investments

Investments are reported at their respective fair values. The values of publicly traded fixed income and equity securities are based upon quoted market prices. Private equities and certain other nonmarketable securities are valued using information provided by the general partner or investment manager for the respective funds. Investments in real estate through limited partnerships are stated at appraised market values, while other real estate investments are stated at cost on the date of acquisition or fair market value at date of receipt in the case of gifts. Net realized and unrealized gains and losses on investments are reflected in the Statements of Activities.

The College's investments do not have a significant concentration of credit risk within any industry or specific institution.

The market risk inherent in certain of the College's investments is primarily the potential loss arising from adverse changes in quoted market prices on equity securities and in interest rates on fixed income securities. Investment securities, in general, are exposed to various risks, such as interest rates, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the Statement of Financial Position. In an effort to mitigate this market risk, the College has adopted a policy of maintaining a diverse investment pool through the use of target asset allocation guidelines. These guidelines require that the College's investment pool be made up of a mix of publicly traded fixed income and equity securities, private equities and other nonmarketable securities, and real estate investments.

Derivatives

The change in value of forward foreign currency contracts is included in the reported fair value of foreign securities.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation.

NOTES TO FINANCIAL STATEMENTS

(1) SUMMARY OF ACCOUNTING POLICIES (continued)

Depreciation on the property, plant and equipment owned by the College has been computed using the following composite depreciation guidelines:

| | |
|---------------------------------------|---------------|
| Buildings and additions | 75 years |
| Building improvements and renovations | 15 - 30 years |
| Furniture, equipment and books | 10 years |
| Electric and water utility property | 10 - 80 years |

Using these guidelines and guidelines established by the Kentucky Public Service Commission for utility properties, depreciation expense for 2003 and 2002 was:

| | 2003 | 2002 |
|------------------------------------|--------------|--------------|
| Educational and general properties | \$ 3,667,721 | \$ 2,926,598 |
| Student industry equipment | 320,393 | 315,587 |
| Utility plant and equipment | 654,789 | 651,058 |
| | \$ 4,642,903 | \$ 3,893,243 |

Unrestricted Bequests

The College follows the policy of designating all unrestricted bequests as additions to the tuition replacement funds. Such bequests are reported as revenues designated for long-term investment in the statements of activities.

Cash Flow Information

For financial statement purposes, the College considers all investments (not held for long-term investment) with original maturities of three months or less as cash equivalents.

Cash payments for interest amounted to \$2,014,788 in 2003 and \$2,047,490 in 2002.

Functional Allocation of Expenses

The costs of providing the various programs and supporting services have been summarized on a functional basis in the statements of activities. Certain costs have been allocated among the programs and supporting services benefited.

Reclassification

Certain reclassifications have been made to the 2002 financial statements to conform to the 2003 presentation.

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS

| | June 30, | |
|--|----------------|----------------|
| | 2003 | 2002 |
| Endowment and Tuition Replacement: | | |
| Pooled Investments - | | |
| Domestic common stocks | \$ 444,995,300 | \$ 449,396,100 |
| International common stocks | 108,548,700 | 134,372,200 |
| Corporate notes and bonds | 72,328,100 | 46,329,000 |
| U. S. Government securities | 20,380,500 | 27,039,100 |
| Foreign bonds | 1,398,500 | 109,500 |
| Real estate | 25,434,200 | 31,732,600 |
| Short-term investments and cash | 18,811,700 | 23,546,200 |
| Total | 691,897,000 | 712,524,700 |
| Non Pooled Investments - | | |
| Domestic common stocks | 205,900 | 96,400 |
| Real estate | 2,772,900 | 2,772,900 |
| Notes and bonds | - | 127,900 |
| Short-term investments and cash | 936,200 | 1,000,900 |
| Total | 3,915,000 | 3,998,100 |
| Total endowment and tuition replacement | 695,812,000 | 716,522,800 |
| Annuity and Life Income: | | |
| Pooled Annuity Investments - | | |
| Domestic common stocks | 8,287,000 | 8,698,500 |
| International common stocks | 2,019,400 | 2,598,700 |
| Corporate notes and bonds | 1,345,600 | 896,000 |
| U. S. Government securities | 379,200 | 525,400 |
| Foreign bonds | 26,000 | 2,100 |
| Real estate | 524,800 | 667,300 |
| Short-term investments and cash | 367,400 | 474,700 |
| Total | 12,949,400 | 13,862,700 |
| Separately Invested Trusts - | | |
| Common stocks | 3,834,000 | 4,502,000 |
| Corporate notes and bonds | 4,310,100 | 4,383,200 |
| U. S. Government securities | 2,016,800 | 2,284,800 |
| Real estate | 525,000 | 578,500 |
| Short-term investments and cash (overdrafts) | 765,700 | (457,100) |
| Total | 11,451,600 | 11,291,400 |
| Total annuity and life income | 24,401,000 | 25,154,100 |
| Funds Held in Trust by Others, where Berea College receives all or a stipulated percent of income | | |
| | 16,438,300 | 16,555,200 |
| Total long-term investments | \$ 736,651,300 | \$ 758,232,100 |

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS (continued)

The College's investment objective for its pooled long-term investments is to provide a predictable and growing stream of inflation-adjusted spendable return while maintaining the real (inflation-adjusted) value of the pooled investments. In connection with these investment objectives, the Board of Trustees has adopted a spending formula for determining that part of total return which can be expended annually.

The College has an endowment spending formula which utilizes a 5% spending rate of the prior twelve quarter moving average of the market value of the long-term pooled investments. For 2003 and 2002, spendable return under the formula amounted to \$38,826,639 and \$36,278,934, respectively. In 2003, actual cash income earned on pooled investments, net of \$1,344,815 for investment management and custodial fees, amounted to \$15,398,809, or \$23,427,830 less than the spendable return provided by the formula. This difference was taken from the accumulated net appreciation earned on investments.

During 2003, the unit value of pooled investments changed as follows:

| | 2002-03 | | | 2001-02 | |
|---------------------|-----------------------|------------------|--------------------|----------------------------------|-----------------------|
| | Market Value | Number of Units | Value Per Unit | Total Return Percent Net of Fees | Market Value |
| Beginning Balance | \$ 726,387,400 | 591,721.8 | \$ 1,227.58 | | \$ 799,726,200 |
| Market price change | (15,064,142) | - | (26.78) | -2.0% | (78,203,279) |
| Net income earned | 15,398,809 | - | 26.02 | 2.3% | 17,996,473 |
| Spendable return | (38,826,639) | - | (65.62) | - | (36,278,934) |
| | <u>(38,491,972)</u> | <u>-</u> | <u>(66.38)</u> | <u>0.3%</u> | <u>(96,485,740)</u> |
| Additions | <u>16,950,972</u> | <u>15,275.3</u> | <u>-</u> | | <u>23,146,940</u> |
| Ending Balance | <u>\$ 704,846,400</u> | <u>606,997.1</u> | <u>\$ 1,161.20</u> | | <u>\$ 726,387,400</u> |

The College follows the policy of spending only cash income received on non-pooled endowment investments. Such income amounted to \$145,042 in 2003 and \$170,538 in 2002, while the market value of these investments of \$3,915,000 at June 30, 2003 and \$3,998,100 at June 30, 2002 decreased by \$88,206 in 2003 and increased by \$752,659 in 2002. Net additions to non-pooled endowment investments during 2003 amounted to \$5,106 and no transfers were made to pooled investments.

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS (continued)

| The total return earned by the endowment and charitable gift annuity contract investments for the years ended | June | 30, | was: |
|---|------|---------------|-----------------|
| | | 2003 | 2002 |
| Pooled Investments - | | | |
| Cash income, net | | \$ 15,398,809 | \$ 17,996,473 |
| Market price decrease | | (15,064,142) | (78,203,279) |
| Non-Pooled Investments - | | | |
| Cash income | | 145,042 | 170,538 |
| Market price increase (decrease) | | (88,206) | 752,659 |
| Total Return | | 391,503 | (59,283,609) |
| Less: Charitable Gift Annuity Contracts | | | |
| Cash income | | (741,205) | (752,701) |
| Market price decrease | | 732,095 | 1,991,886 |
| Endowment return | | \$ 382,393 | \$ (58,044,424) |
| Distributed to - | | | |
| Unrestricted Net Assets | | | |
| Spendable return | | \$ 34,299,979 | \$ 32,143,310 |
| Long-term investments | | (32,483,060) | (79,811,579) |
| Temporarily Restricted Net Assets | | | |
| Spendable return | | 3,664,498 | 3,316,485 |
| Capital loss | | (5,365,022) | (13,929,616) |
| Permanently Restricted | | | |
| Restricted earnings | | 265,998 | 236,976 |
| Total | | \$ 382,393 | \$ (58,044,424) |

(3) DERIVATIVE FINANCIAL INSTRUMENTS

The College has only limited involvement with derivative financial instruments and does not use them for trading purposes. From time to time, investment managers for the College may enter into forward contracts to hedge currency exposure on investments in foreign securities. The fair market value of these contracts is reported as a part of the fair value of the underlying foreign bonds and is not significant.

The College has entered into an interest rate swap with UBS AG that is effective July 1, 2003. The contract was designed to reduce the interest rate risk to the College from the underlying variable rate bonds that were issued August 2002 for \$18,500,000. The contract calls for UBS AG to pay the College the variable rate interest based on The Bond Market Association Municipal Swap Index (TBMA) for the first two years of the contract, and 70% of the 30-day LIBOR rate for the remaining 28 years of the contract.

(4) DEFINED CONTRIBUTION RETIREMENT PLAN

The College has a defined contribution retirement plan covering all employees with two or more years of service. Costs of the plan are expensed as incurred and aggregated \$1,757,796 in 2003 and \$1,662,062 in 2002.

NOTES TO FINANCIAL STATEMENTS

(5) LONG-TERM DEBT

| | June 30, | |
|---|---------------|---------------|
| | 2003 | 2002 |
| KDFA Loan Agreement - Issued June 1986; due in monthly installments to June 2011; variable interest rate, 1.80% as of June 2003; unsecured; proceeds used for various capital projects | \$ 1,036,781 | \$ 1,130,249 |
| General Obligation Bonds, Series of 1993 - Issued May 1993, due May 2013 at 5.9%; unsecured; proceeds used for electric utility improvements | 3,500,000 | 3,500,000 |
| Educational Development Bonds of 1994 - Issued March 1994, due March 1, 2014 at 5.45%; unsecured; proceeds used for Physical Education/Convocation Center | 5,000,000 | 5,000,000 |
| General Obligation Bonds, Series of 1997 - Issued June 1997, due June 2017 at 5.9%; unsecured; proceeds used to refinance electric and water utility debt | 6,000,000 | 6,000,000 |
| Educational Buildings Revenue Bonds, Series of 1997 - Issued August 1997; serial annual payments through August 2017 at rates from 4.5% to 5.0%; unsecured; proceeds used for Frost Building restoration and renovation | 2,490,000 | 2,600,000 |
| General Obligation Refunding Bonds, Series of 1998 - Issued July 1, 1998, serial annual payments through 2008 at rates from 4.1% to 4.8%; unsecured; proceeds used to retire bonds used for water filtration plant and other water utility improvements | 2,700,000 | 3,025,000 |
| Educational Development Bonds, Series of 1998 - Issued December 1, 1998; Serial Annual Payments through December 2018 at rates from 4.0% to 4.65%; proceeds used for residence hall and administrative building renovation | 7,390,000 | 7,710,000 |
| Educational Development Revenue Bonds, Series of 2000 - Issued May, 2000; serial annual payments through 2020 at rates from 4.6% to 5.7%; unsecured; proceeds used for residence hall renovation | 2,350,000 | 2,435,000 |
| Variable Rate Demand Educational Facilities Revenue Bonds, Series 2001A - Issued June 1, 2001; variable payments through June 1, 2031; variable interest rate, 0.98% as of June 2003; unsecured; proceeds used for various capital projects | 21,450,000 | 21,450,000 |
| Variable Rate Demand Educational Facilities Revenue Bonds, Series 2002A - Issued August 29, 2002; variable payments through June 1, 2032; variable interest rate, 0.90% as of June, 2003; unsecured; proceeds used for various capital projects | 18,500,000 | - |
| | 70,416,781 | 52,850,249 |
| Less current portion | 1,015,225 | 933,467 |
| | \$ 69,401,556 | \$ 51,916,782 |

Principal payments on long-term debt are required to be made in each of the following fiscal years: \$1,015,225 in 2004; \$1,067,470 in 2005; \$1,125,239 in 2006; \$1,233,570 in 2007; \$1,272,503 in 2008 and \$64,702,774 in subsequent years thereafter.

The fair value of the College's long-term debt at June 30, 2003 was estimated to be approximately \$72,618,000 based upon rates available to the College for debt with similar terms and remaining maturities.

NOTES TO FINANCIAL STATEMENTS

(6) CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE

| | June 30, | Due In | | | June 30, |
|---|---------------------|---------------------|---------------------------|--------------------|----------------------|
| | 2003 Total | One Year or Less | One Year to Five Years | Over Five Years | 2002 Total |
| Unconditional Promises for - | | | | | |
| Unrestricted | \$ 203,061 | \$ 73,630 | \$ 71,921 | \$ 57,510 | \$ 48,860 |
| Restricted | 110,000 | 16,000 | 54,000 | 40,000 | 90,000 |
| Buildings and equipment | 1,199,287 | 838,313 | 353,152 | 7,822 | 1,140,200 |
| Endowment | 3,500,175 | 1,558,752 | 1,135,423 | 806,000 | 4,384,438 |
| Reserve for unfulfilled promises | <u>(250,000)</u> | <u>(150,000)</u> | <u>(60,000)</u> | <u>(40,000)</u> | <u>(250,000)</u> |
| Total | 4,762,523 | 2,336,695 | 1,554,496 | 871,332 | 5,413,498 |
| Bequests in Probate | 1,562,805 | 1,562,805 | - | - | 6,673,310 |
| Charitable Lead Trusts | <u>158,057</u> | <u>41,183</u> | <u>116,874</u> | <u>-</u> | <u>199,240</u> |
| Total | <u>\$ 6,483,385</u> | <u>\$ 3,940,683</u> | <u>\$ 1,671,370</u> | <u>\$ 871,332</u> | <u>\$ 12,286,048</u> |
| Present Value of Estimated Future Cash Flows | <u>\$ 6,313,721</u> | <u>\$ 3,940,683</u> | <u>\$ 1,601,403</u> | <u>\$ 771,635</u> | <u>\$ 11,897,594</u> |

(7) COMMITMENTS AND CONTINGENCIES

During the normal course of business, the College is involved in various claims and lawsuits. In the opinion of management, the potential loss on all claims and lawsuits, net of insurance proceeds, will not be significant to the College's financial position, results of operations, or liquidity.

At June 30, 2003, the College was committed under various contracts with private equity investment managers to fund approximately \$27,500,000 capital calls for these investments. These capital calls will occur over the term of the respective agreements, which is generally a ten-year period. As these capital calls are made, funds will be reallocated from investments in fixed-income securities. These private equity investments are consistent with the target asset allocation guidelines for long-term investments as established by the College's Board of Trustees.

The College has purchase commitments relating to construction projects of approximately \$6,600,000 as of June 30, 2003.

NOTES TO FINANCIAL STATEMENTS

(8) NET ASSETS RELEASED FROM RESTRICTIONS

Donor-imposed restrictions expired on temporarily restricted net assets during the years ended June 30, as follows:

| | 2003 | 2002 |
|---|--------------|--------------|
| Purpose Restricted Contributions for - | | |
| Instruction | \$ 435,737 | \$ 277,979 |
| Public service | 685,077 | 607,013 |
| Academic support | 400,216 | 218,098 |
| Student services | 181,613 | 132,226 |
| Student aid | 1,544,074 | 1,510,557 |
| General and administrative | 1,479 | - |
| Development and alumni | 28,250 | 28,250 |
| | 3,276,446 | 2,774,123 |
| Time-Restricted Contributions - Amortization of Restricted Gifts to Acquire Long-Lived Assets | 845,575 | 858,048 |
| Total Net Assets Released from Restriction | \$ 4,122,021 | \$ 3,632,171 |
| Matured Annuity and Life Income Contracts - | | |
| Temporarily Restricted Agreements Reclassified to Tuition Replacement Funds in Unrestricted Net Assets | \$ 611,815 | \$ 1,666,069 |

(9) ELECTRIC AND WATER UTILITY REVENUE

The College owns and operates the electric and water utilities and provides these services to customers in the City of Berea. The College is a significant customer of both utilities. The utility revenues generated by College use are as follows:

| | 2003 | 2002 |
|--------------------|--------------|--------------|
| Electric and Water | \$ 1,222,787 | \$ 1,137,384 |

The above revenues and related expenses are eliminated in the Statement of Activities.

(10) BOND INTEREST RATE CHANGE

On July 8, 2003, the College refinanced the 2001A variable rate bond issue of \$21,450,000 and reissued the same amount as a fixed rate issue callable in 2013. This transaction was approved and directed by the Board of Trustees to reduce the interest rate risk associated with the variable rate structure.