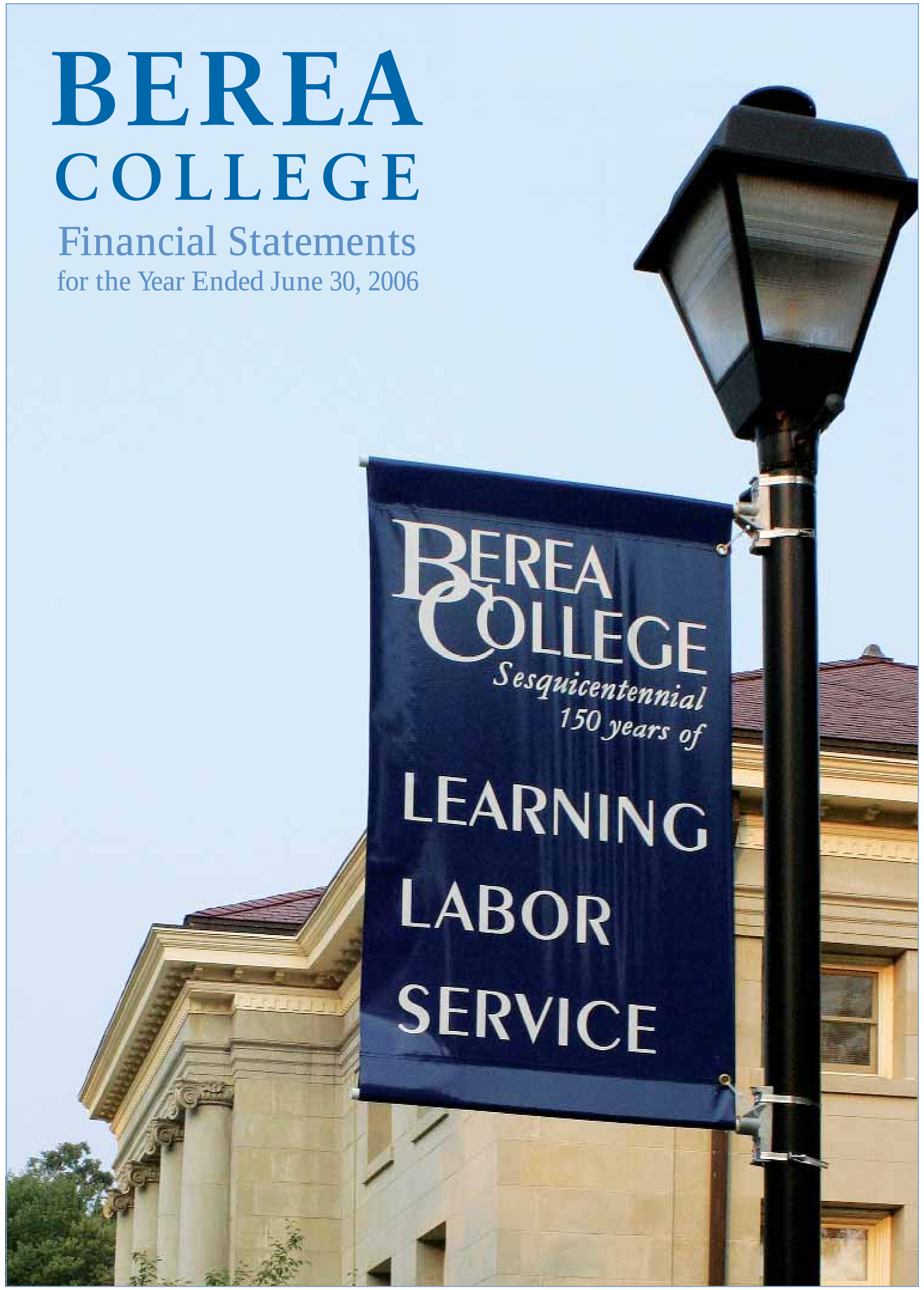
BEREA COLLEGE

Financial Statements
for the Year Ended June 30, 2006



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CONTENTS

HIGHLIGHTS

	As of or for the Year Ended June 30,	
	2006	2005
OPERATING REVENUE	$ 65,242,491	$ 59,511,470
OPERATING EXPENSES	$ 63,888,149	$ 61,876,447
OPERATING REVENUE IN EXCESS OF (LESS THAN) EXPENSES FROM CONTINUING OPERATIONS	$ 1,354,342	$ (2,364,977)
ADDITIONS TO PROPERTY, PLANT AND EQUIPMENT	$ 18,103,843	$ 7,592,032
LONG-TERM INVESTMENTS OF THE ENDOWMENT AND TUITION REPLACEMENT FUNDS		
Original gift value	$328,194,014	$310,184,731
Investments at market	$948,737,700	$861,678,500
Interest and dividends, net	$ 24,286,500	$ 19,194,300
Return	2.9%	2.4%
Market price increase	$ 82,572,413	$ 64,563,137
Return	9.7%	8.4%
Total return	$106,858,913	$ 83,757,437
Percent - time weighted	12.6%	10.8%
CASH AND IN-KIND CONTRIBUTIONS		
Cash gifts	$ 12,552,863	$ 10,087,615
Bequests	9,703,456	15,217,070
Total cash gifts	22,256,319	25,304,685
Gifts-in-kind	97,674	96,889
Total	$ 22,353,993	$ 25,401,574

REPORT OF THE VICE PRESIDENT FOR FINANCE

September 2006

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

We can truly say that the 2005-2006 fiscal year was an historic period for the College. Sesquicentennial events provided many opportunities to reflect upon the College's distinguished history over the last 150 years. Also, the comprehensive campaign, *Extending Berea's Legacy: A Campaign for the 21st Century*, that began in July 1999 ended quite successfully on December 31, 2005. The total dollars raised exceeded $162 million, which was $12 million in excess of the campaign goal of $150 million.

Approximately 35,000 donors made over 106,000 gifts to the comprehensive campaign. One fascinating aspect of the campaign was the uncommon giving patterns that emerged. Of all the gifts received, 92,000 were $500 or less and only 463 gifts were $25,000 or more. There were only four outright, individual gifts of more than $1 million and over $86 million in estate gifts were received. Indeed the campaign was successful in helping to fund key initiatives, such as providing endowment support for the student laptop computer program (EDGE), constructing the Ecovillage and the Child Development Laboratory, funding two chairs and program endowments in support of the Entrepreneurship for the Public Good (EPG) program, monies for two additional endowed chairs, and providing additional funds for an enhanced Study Abroad program.

In addition to the successful comprehensive campaign, the College experienced another outstanding fundraising year in 2005-2006, receiving a total of $22.4 million in gifts. Of this total, $4.1 million was designated for current operations, $15.5 million were gifts to the endowment, and the remainder was for specific projects or purposes.

During the year, the College implemented its comprehensive financial plan, approved by the Board in May 2005. This plan utilizes an integrated approach to the stewardship of the College's endowment and financial assets, people and program resources, and physical plant assets. In accordance with the plan, in May 2006 the Board of Trustees approved the 2006-2007 operating budget, which was limited to 4.5% growth and requires any excess unrestricted endowment spendable return be allocated to operating budget reserves and debt service reserves. Also as part of the plan, construction began on the $4.8 million renovation of Pearsons Residence Hall, which will be funded with endowment spendable return. This project has a scheduled completion date of August 2007.

Since 1995, the College has worked diligently to decrease its ecological footprint for ethical, educational, and economic reasons. The overall goal for the College is to reduce its energy demand for heating and cooling by 45% through the efficiencies of a new heating and cooling plant, building retrofits (e.g., new windows, insulation, etc.) and other means by 2015. During the year just ended, the College made great strides toward this goal.

In September 2005 the College issued $9 million of tax-exempt bonds (with an average interest rate of 4.16%) that provided external funding for the construction of the new, state-of-the-art heating and cooling plant, distribution system, and low-energy building retrofits. Internal sources have provided additional funding. The new heating and cooling plant became fully operational in August 2006. Also during the year, $2.8 million of building retrofits were completed. Working toward the goal of becoming more and more energy efficient, the College has completed over $112 million of energy efficient building renovations or additions in the last decade. We are committed to continuing to allocate resources to improve our energy efficiency while simultaneously addressing important deferred renovation needs.

Prudent stewardship of financial resources has always been a top priority at Berea. Given that the College's pooled long-term investments provide (through the endowment spending policy) nearly 77% of the funds needed for the annual operating budget, it is vitally important that the endowment grow through market appreciation and the addition of new gifts. Through a well-diversified investment portfolio and positive equity markets, the total net return for the endowment was 12.6% for the fiscal year ending June 30, 2006. This represents a net market-price increase of more than $82 million. In addition, over $18 million was added to the endowment as a result of new gifts and matured planned giving instruments, resulting in another all-time high year-end market value of $948.7 million at June 30, 2006. For the year, $37.8 million was provided by the endowment spending policy in support of overall College operations.

Financial Position

The financial position of the College as of June 30, 2006 is the strongest it has ever been. **Total Net Assets** (total assets less liabilities) of the College exceeded $1 billion for the first time, increasing by $90.7 million to approximately $1.1 billion. This change reflects an increase in the market value of long-term investments during the year from $911.9 million as of June 30, 2005, to $998.9 million as of June 30, 2006.

At June 30, 2006, **Total Assets** of the College were $1.2 billion. Of this amount, long-term investments (including endowment funds, annuity and life income funds and other funds) comprised $998.9 million; net property, plant and equipment, and bond defeasance escrow investments totaled $142 million; and current assets totaled $32 million. Contributions receivable and bequests in probate totaled $9.8 million; non-current prepaid expenses totaled $1.2 million; and student educational loans totaled approximately $1.4 million.

Total Liabilities increased by $5.6 million, due primarily to the $9 million bond issue. This increase was partially offset by the payment of current maturities of long-term debt of $2 million and a change in market value associated with interest rate swap agreements on variable rate debt. The market value change of the swap agreements converted what was a liability in 2005 to an asset in 2006.

Current Operations

The 2005-2006 fiscal year ended with a small surplus from budgeted operations of just over $50,000. This surplus was primarily due to less than budgeted faculty and staff salaries and greater interest income earned on treasury cash. The surplus was reduced by a significant increase in natural gas prices. The new 2006-2007 operating budget includes a 5.7% increase in endowment spendable return, which provides for a modest 4.5% increase in the overall educational and general budget.

Concluding Comments

We are thankful for the individuals who serve Berea College in so many ways and who understand and support the Great Commitments of the College. Your support—whether as student, faculty, staff, alumni, trustee or friend—enables the College to continue to invest in lives of great promise.

The loyalty, dedication, selflessness, and generosity of so many ordinary people allows Berea to be the truly extraordinary institution that it is, striving through its commitment to excellence in education and service to others to make the world a better place for all. I, like many others, feel blessed to be associated with an institution so well grounded in such a noble mission.

As always, we invite and welcome you to visit us on campus.

Respectfully submitted,

Jeffrey S. Amburgey

Jeffrey S. Amburgey
Vice President for Finance

RESPONSIBILITY FOR THE COLLEGE'S FINANCIAL STATEMENTS

The Office of Financial Affairs of Berea College is directly responsible for the preparation, integrity and fair presentation of the financial statements and the other information included in this annual report. This office, through the Vice President for Finance, reports directly to the President of the College with oversight by the College's Board of Trustees.

The College maintains a system of internal controls over financial reporting, which is designed to provide reasonable assurance to the College's administration and Board of Trustees that the College's assets are protected and that transactions and events are recorded properly in the financial statements.

The College's financial statements have been audited by the independent accounting firm of Deloitte & Touche LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of trustees. The Vice President for Finance and personnel of the Office for Financial Affairs believe that the representations made to the independent auditors during their audit were valid and appropriate in all material respects.

The Board of Trustees of Berea College, through the Audit Committee comprised of trustees not employed by the College, has adopted an Audit Committee Charter that includes engaging the independent auditors and meeting with the College administration, the College's internal auditor, and the independent auditors to ensure that each is carrying out its responsibilities and to discuss auditing, internal control, and financial reporting matters. The independent auditors have full and free access to the Audit Committee and meet with the Audit Committee at least annually.

We believe the following financial statements present fairly, in all materials respects, the financial position, changes in net assets, and cash flows of the College for the fiscal year ending June 30, 2006.

September 2006

Larry D. Shinn
President

Jeffrey S. Amburgey
Vice President for Finance

Deloitte.

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Berea College
Berea, Kentucky

We have audited the accompanying statements of financial position of Berea College (the "College") as of June 30, 2006 and 2005, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the College as of June 30, 2006 and 2005, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the College changed its method of accounting for asset retirement obligations and interest rate swaps in fiscal year 2006.

Deloitte & Touche LLP

September 19, 2006

Berea College

STATEMENTS OF FINANCIAL POSITION

	June 30, 2006	June 30, 2005
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 12,052,359	$ 19,575,461
Other investments - absolute return fund	10,514,475	6,742,765
Accrued interest on investments	2,921,337	3,682,781
Accounts and notes receivable	3,103,189	1,382,791
Inventories	1,973,703	1,857,042
Prepaid expenses and other assets	1,468,950	18,905
Total current assets	32,034,013	33,259,745
NON-CURRENT PREPAID EXPENSES AND OTHER ASSETS	1,164,342	965,461
CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE	9,791,894	10,946,675
LONG-TERM RECEIVABLES		
Institutional student loans	1,141,910	1,666,564
Federal student loans	296,240	354,319
Total long-term receivables	1,438,150	2,020,883
LONG-TERM INVESTMENTS		
Donor-restricted endowment	531,420,200	477,633,600
Tuition replacement	417,317,500	384,044,900
Annuity and life income	27,609,900	28,041,500
Funds held in trust by others	22,585,100	22,203,300
Total long-term investments	998,932,700	911,923,300
BOND DEFEASANCE ESCROW	7,805,412	8,409,474
NET PROPERTY, PLANT AND EQUIPMENT	134,169,600	121,595,925
Total assets	$1,185,336,111	$1,089,121,463

See notes to financial statements.

Berea College

STATEMENTS OF FINANCIAL POSITION

LIABILITIES AND NET ASSETS	June 30, 2006	June 30, 2005
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 4,666,976	$ 4,859,890
Accrued salaries and wages	2,517,779	2,483,009
Deposits and agency funds	349,959	312,904
Deferred income	98,538	83,931
Current maturities of long-term debt	2,198,570	1,840,239
Total current liabilities	9,831,822	9,579,973
LONG-TERM LIABILITIES		
Annuity payment/deferred giving liability and other liabilities	13,784,869	15,086,100
Long-term debt	72,870,275	66,268,846
Total long-term liabilities	86,655,144	81,354,946
Total liabilities	96,486,966	90,934,919
NET ASSETS		
Unrestricted -		
For current operations	87,861	86,116
Designated for specific purposes	30,933,152	33,291,486
Invested in property, plant and equipment	22,793,927	16,662,958
Support of future operations from:		
Contributions receivable and bequests in probate	2,774,513	4,090,056
Appreciation on endowment investments	280,136,075	252,146,244
Tuition replacement funds	417,317,500	384,044,900
Total unrestricted	754,043,028	690,321,760
Temporarily restricted -		
Unexpended contributions restricted for operations	7,325,484	5,927,824
Unexpended contributions restricted for plant renewals and replacement	1,711,642	1,607,446
Annuity and life income contracts	7,072,725	6,928,629
Expended contributions for long-lived assets being amortized	28,045,296	28,562,350
Appreciation on endowment investments primarily to support various programs/services	79,138,573	68,286,871
Total temporarily restricted	123,293,720	111,313,120
Permanently restricted -		
Loan funds	2,652,276	3,324,892
Annuity and life income contracts	7,598,375	7,707,671
Funds held in trust by others	22,585,100	22,203,300
Endowment investments	178,676,646	163,315,801
Total permanently restricted	211,512,397	196,551,664
Total net assets	1,088,849,145	998,186,544
Total liabilities and net assets	$1,185,336,111	$1,089,121,463

See notes to financial statements.

STATEMENTS OF ACTIVITIES

Changes in Unrestricted Net Assets

	Year Ended June 30, 2006	Year Ended June 30, 2005
OPERATING REVENUE		
Spendable return from long-term investments	$ 32,879,062	$ 32,312,908
Gifts and donations	4,925,708	5,549,914
Federal grants	7,892,749	4,730,909
Cost of education fees paid by federal and state scholarships	2,538,000	2,260,638
Fees paid by students	1,119,222	1,071,613
Other income	4,737,541	3,077,817
Residence halls and food service	6,558,263	6,111,063
Student industries and rentals	2,895,208	2,943,911
Net assets released from restrictions	5,025,297	4,197,239
Gross operating revenue	68,571,050	62,256,012
Less: Student aid	(3,328,559)	(2,744,542)
Net operating revenue	65,242,491	59,511,470
OPERATING EXPENSES		
Program Services -		
Instruction	22,399,700	18,886,500
Public service	5,576,650	3,085,917
Academic support	6,740,456	6,633,880
Student services	7,641,199	7,219,059
Residence halls and food service	6,705,055	5,805,420
Student industries and rentals	3,760,311	4,228,100
Total Program Services	52,823,371	45,858,876
Support Services, including fund raising expense of $2,725,500 in 2006 and $2,739,200 in 2005	11,064,778	10,850,210
Interest expense (Note 1)	-	5,167,361
Total operating expenses	63,888,149	61,876,447
Operating revenue in excess of (less than) operating expenses from continuing operations	1,354,342	(2,364,977)
OTHER UNRESTRICTED ACTIVITY		
Gain on disposal of property, plant and equipment	323,069	126,539
Gain on valuation of interest rate swaps (Note 1)	2,956,300	-
Income from discontinued operations	-	1,297,418
Cumulative effect of change in accounting principle (Note 1)	(871,420)	-
Total other unrestricted activity	2,407,949	1,423,957
REVENUES DESIGNATED FOR LONG-TERM INVESTMENT		
Unrestricted bequests	1,179,361	6,914,530
Matured annuity and life income contracts	571,061	611,137
Investment return in excess of amounts designated for current operations	58,208,555	40,695,009
Total increase in revenues designated for long-term investment	59,958,977	48,220,676
Increase in unrestricted net assets	$ 63,721,268	$ 47,279,656

See notes to financial statements.

STATEMENTS OF ACTIVITIES

Changes in Total Net Assets

	Year Ended June 30, 2006	2005
UNRESTRICTED NET ASSETS		
Operating revenue in excess of (less than) operating expenses from continuing operations	$ 1,354,342	$ (2,364,977)
Other unrestricted activity	2,407,949	1,423,957
Increase in revenues designated for long-term investment	59,958,977	48,220,676
Increase in unrestricted net assets	63,721,268	47,279,656
TEMPORARILY RESTRICTED NET ASSETS		
Restricted gifts and donations	1,631,755	2,233,516
Restricted spendable return on endowment investments	4,675,937	3,484,646
Investment return in excess of amounts designated for current operations	10,841,362	7,014,498
Net adjustment of annuity payment and deferred giving liability	427,904	434,514
Reclassification of net assets released from restrictions	(5,025,297)	(4,197,239)
Reclassification of matured annuity and life income contracts to revenues designated for long-term investment	(571,061)	(611,137)
Increase in temporarily restricted net assets	11,980,600	8,358,798
PERMANENTLY RESTRICTED NET ASSETS		
Gifts and donations	13,462,388	13,691,201
Restricted spendable return on endowment investments	253,997	250,376
Restricted capital gains on funds held in trust by others	381,800	4,359,300
Net adjustment of annuity payment and deferred giving liability	862,548	672,627
Increase in permanently restricted net assets	14,960,733	18,973,504
Total change in net assets	90,662,601	74,611,958
NET ASSETS		
Beginning of year	998,186,544	923,574,586
End of year	$1,088,849,145	$ 998,186,544

See notes to financial statements.

STATEMENTS OF CASH FLOWS

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in net assets	$ 90,662,601	$ 74,611,958
Adjustments to reconcile change in net assets to net cash provided by operating activities -		
Market price increase in long-term investments	(69,431,717)	(52,068,807)
Gifts and bequests for financing activities	(15,344,199)	(20,445,878)
(Increase) decrease in contributions receivable and bequests in probate	1,154,781	(2,987,587)
Gift value of annuity contracts written	(738,757)	(1,457,230)
Depreciation	5,436,322	5,273,848
Gain on disposal of property, plant and equipment	(323,069)	(126,539)
Net adjustment of annuity payment liability and increase (decrease) in other long-term liabilities other than long-term debt	(2,237,890)	409,759
(Increase) decrease in non-current prepaid expenses and other assets	(198,881)	1,244,939
Increase in current assets other than cash and other investments	(3,297,370)	(2,022,958)
Increase (decrease) in current liabilities other than current maturities of long-term debt	(127,482)	324,472
Restricted spendable return on endowment funds	(253,997)	(250,376)
Net cash provided by operating activities	5,300,342	2,505,601
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities held for long-term investment	(949,890,332)	(1,191,746,274)
Proceeds from sales and maturities of investments	932,916,711	1,162,907,559
Purchase of other investments - absolute return fund	(3,000,000)	-
Purchase of property, plant and equipment	(18,103,843)	(7,592,032)
Proceeds from sale of property, plant and equipment	416,915	300,692
Proceeds from sale of electric and water utility assets	-	19,317,195
(Increase) decrease in long-term student loans	582,733	(159,019)
Gain on annuity and life income investments	2,125,423	2,235,220
Net cash used by investing activities	(34,952,393)	(14,736,659)
CASH FLOWS FROM FINANCING ACTIVITIES		
Gifts and bequests received for -		
Long-term investment	15,027,964	19,484,785
Property, plant and equipment	297,117	955,412
Student loans	19,118	5,681
Proceeds received on annuity and life income contracts	1,562,494	3,248,483
Contractual payments on annuity and life income contracts	(1,991,501)	(1,873,532)
Endowment return restricted for long-term investments	253,997	250,376
Repayment of indebtedness	(2,040,240)	(5,702,470)
Long-term debt issued	9,000,000	-
Net cash provided by financing activities	22,128,949	16,368,735
Net change in cash and cash equivalents	(7,523,102)	4,137,677
Cash and cash equivalents, beginning of year	19,575,461	15,437,784
Cash and cash equivalents, end of year	$ 12,052,359	$ 19,575,461

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

(1) ORGANIZATION AND 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 550 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 an interest 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.

(1) ORGANIZATION AND 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, including real estate partnerships, and certain other nonmarketable securities are valued using information provided by the general partner or investment manager for the respective funds. 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 such changes could materially affect the amounts reported in the statements 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

Derivative instruments, including certain derivative instruments embedded in other contracts, are valued at fair value and are included in the statements of financial position. The change in fair value of such instruments is included in the statements of activities.

NOTES TO FINANCIAL STATEMENTS

(1) ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES (continued)

Property, Plant and Equipment

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

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 the years ended June 30 was:

	2006	2005
Educational and general purposes	$ 5,053,742	$ 4,910,046
Student industry equipment	382,580	333,072
Utility plant and equipment	-	30,730
	$ 5,436,322	$ 5,273,848

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 $2,984,532 in 2006 and $3,030,136 in 2005.

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 items such as interest expense, depreciation expense and plant operation expenses have been allocated among the programs and supporting services benefited. Interest expense was not allocated to various programs in 2005 but was shown separately in the statements of activities.

NOTES TO FINANCIAL STATEMENTS

(1) ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES (continued)

Accounting Changes

In 2006, the College adopted FIN 47, *Accounting for Conditional Asset Obligations – an interpretation of FASB Statement No. 143.* Under Statement of Financial Accounting Standards (SFAS) 143, *Accounting for Asset Retirement Obligations*, obligations associated with the retirement of long-lived assets are recorded when there is a legal obligation to incur such costs and the fair value of the liability can be reasonably estimated. This amount is accounted as an additional element of cost and is depreciated over the useful life of the asset. FIN 47 primarily affects the College's accounting for costs associated with asbestos abatement. Consequently, in 2006 the College recorded a one-time, non-cash transition charge of $871,420 in the statements of activities in the caption of "Cumulative effect of change in accounting principle". The pro forma liability at the beginning of the first year presented in the financial statements, July 1, 2004, was $873,224. As of June 30, 2006 and 2005 the pro forma liability was $948,115 and $909,899, respectively. Asbestos abatement expense for 2006 included in the statements of activities was $44,149.

In 2006, the College reported the change in the market value of interest rate swaps in the other unrestricted activity section of the statements of activities; in 2005, the College included the $2,577,800 loss in the market value of the interest rate swaps as a component of interest expense. Also, in 2006, the College allocated $2,694,808 of interest expense to the programs and supporting services that the related borrowings benefited instead of reporting interest expense as a separate item in the statements of activities.

Reclassification

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation.

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS

	June 30, 2006	June 30, 2005
Endowment and Tuition Replacement:		
Pooled Investments -		
Domestic common stocks	$364,794,100	$348,023,900
International common stocks	214,939,000	175,090,800
Corporate notes and bonds	89,189,600	81,907,000
U. S. Government securities	37,693,400	48,550,000
Foreign bonds	622,400	1,772,400
Structured notes	65,344,900	59,841,400
Private equity, venture capital and other	66,249,000	58,758,200
Hedge funds	65,826,500	41,150,500
Real estate	2,113,700	10,446,400
Short-term investments and cash	38,032,100	32,172,600
Total	944,804,700	857,713,200
Non Pooled Investments -		
Domestic common stocks	200,600	304,800
Corporate notes and bonds	18,900	-
U. S. Government securities	103,500	-
Real estate	2,772,900	2,772,900
Short-term investments and cash	837,100	887,600
Total	3,933,000	3,965,300
Total endowment and tuition replacement	948,737,700	861,678,500
Annuity and Life Income:		
Pooled Annuity Investments -		
Domestic common stocks	8,729,900	8,802,600
International common stocks	1,961,700	1,825,900
Corporate notes and bonds	3,605,800	3,792,700
Short-term investments and cash	420,000	190,300
Total	14,717,400	14,611,500
Separately Invested Trusts -		
Common stocks	6,160,100	6,187,700
International common stocks	1,224,900	1,100,200
Corporate notes and bonds	4,185,000	4,545,900
U. S. Government securities	406,100	450,600
Real estate	330,000	525,000
Short-term investments and cash	586,400	620,600
Total	12,892,500	13,430,000
Total annuity and life income	27,609,900	28,041,500
Funds Held in Trust by Others, where Berea College receives all or a stipulated percent of income	22,585,100	22,203,300
Total long-term investments	$998,932,700	$911,923,300

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS (continued)

The hedge funds in which the College invests may include, but are not necessarily limited to, equity securities, short sales positions, distressed securities, fixed income securities, options, currencies, commodities, futures and derivatives. The College's objective for investing in these funds is to provide stable, absolute returns that are uncorrelated to fluctuations in the stock and bond markets. Some hedge funds may be somewhat illiquid since they may require a lock up period where the College will not be able to liquidate a part or all of the investment.

The majority of the private equity partnerships, including buy-out, venture capital, debt, and real estate partnerships are carried at estimated fair value provided by management of these funds. Certain of the investments are carried at fair value as determined by the fund managers at March 31, adjusted by cash receipts, cash disbursements and cash distributions from March 31 through June 30. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that may have been used had a ready market existed and such difference could be material.

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 2006 and 2005, spendable return under the formula amounted to $37,574,050 and $35,889,191, respectively. In 2006, actual cash income earned on pooled investments, net of $1,916,541 for investment management and custodial fees, amounted to $24,051,554, or $13,522,496 less than the spendable return provided by the formula. This difference was provided by the accumulated net appreciation earned on investments.

The College follows the policy of spending only cash income received on non-pooled endowment investments. Such income amounted to $234,946 in 2006 and $158,740 in 2005, while the market value of these investments of $3,933,000 at June 30, 2006 and $3,965,300 at June 30, 2005 decreased by $37,300 in 2006 and increased by $29,300 in 2005. Net additions to non-pooled endowment investments during 2006 amounted to $5,000 and no transfers were made to pooled investments.

Dividend and interest income of $24,286,500 and $19,194,300 reported net of external investment manager fees of $1,916,541 and $1,746,751 is included in the statements of activities for the years ended June 30, 2006 and 2005, respectively.

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS (continued)

During 2006, the unit value of pooled investments changed as follows:

	2005-06				2004-05
	Market Value	Number of Units	Value Per Unit	Total Return Percent Net of Fees	Market Value
Beginning Balance	$857,713,200	625,816.9	$ 1,370.55		$791,031,600
Market price change	82,609,713	-	131.44	9.7%	64,533,837
Net income earned	24,051,554	-	38.43	2.9%	19,035,560
Spendable return	(37,574,050)	-	(60.04)	-	(35,889,191)
	69,087,217		109.83	12.6%	47,680,206
Additions	18,004,283	12,401.5	-		19,001,394
Ending Balance	$944,804,700	638,218.4	$ 1,480.38		$857,713,200

The total return earned by the endowment investments for the years ended June 30, was:

	2006	2005
Pooled Investments -		
Cash income, net	$ 24,051,554	$ 19,035,560
Market price increase	82,609,713	64,533,837
Non-Pooled Investments -		
Cash income	234,946	158,740
Market price increase (decrease)	(37,300)	29,300
Total Return	106,858,913	83,757,437
Distributed to -		
Unrestricted Net Assets		
Spendable return	32,879,062	32,312,908
Long-term investments	58,208,555	40,695,009
Temporarily Restricted Net Assets		
Spendable return	4,675,937	3,484,646
Investment return in excess of amounts designated for current operations	10,841,362	7,014,498
Permanently Restricted		
Restricted earnings	253,997	250,376
Total	$ 106,858,913	$ 83,757,437

NOTES TO FINANCIAL STATEMENTS

(3) DERIVATIVE FINANCIAL INSTRUMENTS

The College uses certain derivative financial instruments to maximize investment income to meet target investment returns and to adjust the duration of fixed income investment portfolios. The fair market value of these contracts is reported as a part of the fair value of the underlying financial instruments.

The College also uses interest rate swaps to reduce exposure to fluctuations in interest costs on its variable rate debt. During 2004, the College entered into interest rate swap contracts with UBS AG. The contracts were 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 and the variable rate bonds that were issued December 2003 for $10,240,000. The contracts call for UBS AG to pay the College the variable rate interest based on The Bond Market Association Municipal Swap Index (TBMA) until July 1, 2005, and 70% of the 30-day LIBOR rate for the remaining term of the bonds. The fair market value of the interest rate swaps was positive $1,439,400 at June 30, 2006 and negative $1,516,900 at June 30, 2005 and is included in non-current prepaid expenses and other assets in 2006 and in the annuity payment/deferred giving liability and other liabilities in the statements of financial position in 2005. The increase in market value of the interest rate swaps of $2,956,300 has been reflected in the statements of activities in other unrestricted activity in 2006 and the decrease in market value of the interest rate swaps of $2,577,800 in 2005 has been reflected in the statements of activities as an increase in interest expense in 2005 (see Note 1).

(4) DEFINED CONTRIBUTION RETIREMENT PLAN

The College has a defined contribution retirement plan covering all eligible employees with one or more years of service. Costs of the plan are expensed as incurred and aggregated $1,850,057 in 2006 and $1,688,921 in 2005.

(5) PROPERTY, PLANT AND EQUIPMENT

The major categories of property, plant and equipment as of June 30 were:

Property, Plant and Equipment	2006	2005
Educational property, plant and equipment	$ 163,454,358	$ 146,692,047
Student industry plant and equipment	8,351,968	7,886,778
Rental property	2,551,773	2,704,762
Forest and farms	1,230,970	1,230,970
Collections and works of art	3,126,031	3,101,031
Less accumulated depreciation	(44,545,500)	(40,019,663)
	$ 134,169,600	$ 121,595,925

(6) LONG-LIVED ASSETS HELD FOR SALE

On July 26, 2004 the Executive Committee of the Board of Trustees, empowered to act for and on behalf of the Board of Trustees, approved the Utility Asset Purchase Agreement between the College and the City of Berea executed by the President of the College and dated June 18, 2004. The agreement provided for the sale of certain Electric and Water Utility assets to the City of Berea at book value. The sale closed on January 26, 2005 and the College received $19,317,195 for the property, plant and equipment and net working capital. No gain or loss was realized on the sale. Net operating results of the Electric and Water Utilities are reflected in discontinued operations in the statements of activities in 2005. The College now purchases electricity and water from the City of Berea.

NOTES TO FINANCIAL STATEMENTS

(7) LONG-TERM DEBT

	June 30, 2006	June 30, 2005
KDFA Loan Agreement - Issued June 1986; due in monthly installments to June 2011; variable interest rate, 5.52% as of June 2006; unsecured; proceeds used for various capital projects	$ 713,845	$ 829,085
* 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	2,130,000	2,255,000
* 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	1,500,000	1,925,000
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	6,350,000	6,710,000
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	2,065,000	2,165,000
Variable Rate Demand Educational Facilities Revenue Bonds, Series 2002A - Issued August 29, 2002; due June 1, 2032; variable interest rate, 3.96% as of June, 2006; with synthetic fixed rate of 3.45%; unsecured; proceeds used for various capital projects	17,675,000	17,675,000

NOTES TO FINANCIAL STATEMENTS

(7) LONG-TERM DEBT (continued)

	June 30, 2006	June 30, 2005
Educational Facilities Revenue Refunding Bonds, Series 2003A - Issued July 8, 2003; serial annual payments through June 1, 2033; at rates from 2.0% to 4.125% with 3.98% average coupon; unsecured; proceeds used for various capital projects	$ 20,100,000	$ 20,560,000
Variable Rate Demand Educational Facilities Revenue Bonds, Series 2003B - Issued December 11, 2003; variable payments through June 1, 2029; variable interest rate, 3.96% as of June, 2006 with synthetic fixed rate of 3.746%; unsecured; proceeds used for various capital projects	9,735,000	9,990,000
Educational Facilities Revenue Bonds, Series 2005A - Issued September, 2005; serial annual payments through June 1, 2030 at rates from 3.25% to 4.50% with 4.16% average coupon; unsecured; proceeds used for central heat plant and various capital retrofits	8,800,000	-
	75,068,845	68,109,085
Less current portion	2,198,570	1,840,239
	$ 72,870,275	$ 66,268,846

Principal payments on long-term debt are required to be made in each of the following fiscal years: $2,198,570 in 2007; $2,267,503 in 2008; $2,337,082 in 2009; $1,912,353 in 2010; $1,978,337 in 2011 and $64,375,000 in subsequent years thereafter.

* On January 26, 2005 the sale of certain electric and water utility assets to the City of Berea was completed. A bond defeasance escrow was established in the amount of $12,131,145 from a portion of the sale proceeds by investing the cash in State and Local Government Securities (SLGS) to defease the interest and principal on the bonds. The series 1993 bond issue in the amount of $3,500,000 was called on May 1, 2005 @ $101. The series 1997 bond issue in the amount of $6,000,000 may be called on June 1, 2007 @ $102. The series 1998 bond issue in the outstanding amount of $1,500,000 is not callable and will be paid based on the scheduled serial maturities.

The fair value of the College's long-term debt that has not been defeased at June 30, 2006 was estimated to be approximately $66,214,000 based upon rates available to the College for debt with similar terms and remaining maturities.

NOTES TO FINANCIAL STATEMENTS

(8) CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE

	June 30, 2006 Total	Due In One Year or Less	Due In One Year to Five Years	Due In Over Five Years	June 30, 2005 Total
Unconditional Promises for -					
Unrestricted	$ 84,753	$ 39,383	$ 45,370	$ -	$ 90,009
Restricted	170,123	69,578	84,905	15,640	205,375
Buildings and equipment	376,275	355,775	20,500	-	546,787
Endowment	1,987,431	648,470	1,336,961	2,000	1,910,877
Reserve for unfulfilled promises	(170,000)	(89,000)	(79,000)	(2,000)	(150,000)
Total	2,448,582	1,024,206	1,408,736	15,640	2,603,048
Bequests in Probate	6,865,130	4,712,882	2,152,248	-	8,549,193
Charitable Lead Trusts	915,021	194,490	552,963	167,568	38,958
Total	$ 10,228,733	$ 5,931,578	$ 4,113,947	$ 183,208	$ 11,191,199
Present Value of Estimated Future Cash Flows	$ 9,791,894	$ 5,931,578	$ 3,717,450	$ 142,866	$ 10,946,675

(9) COMMITMENTS AND CONTINGENCIES

During the normal course of business, the College is involved in various claims and lawsuits. In the opinion of the College's administration, 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.

The College receives grants and contracts from certain federal, state, and local agencies to fund various activities. The costs, both direct and indirect, that have been charged to the grants or contracts are subject to examination and approval by the granting agency. It is the opinion of the College's administration that any disallowance or adjustment of such costs would not have a material effect on the financial statements.

At June 30, 2006, the College was committed under various contracts with alternative investment managers to fund $17,212,095 of capital calls for these private equity investments. These capital calls will occur over the term of the respective agreements, which is generally no more than 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 capital calls are summarized by the type of investment below:

Venture capital	$ 1,514,575
Buy out	3,014,361
Debt fund	525,000
Fund of funds	12,158,159
Total	$ 17,212,095

The College has purchase commitments relating to construction projects of approximately $5,768,000 as of June 30, 2006.

NOTES TO FINANCIAL STATEMENTS

(10) NET ASSETS RELEASED FROM RESTRICTIONS

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

	2006	2005
Purpose Restricted Contributions for -		
Instruction	$ 670,023	$ 514,014
Public service	665,066	596,757
Academic support	434,149	147,423
Student services	74,440	121,798
Student aid	2,110,440	1,783,989
General and administrative	25,000	-
Development and alumni	15,118	-
	3,994,236	3,163,981
Time-Restricted Contributions - Amortization of Restricted Gifts to Acquire Long-Lived Assets	1,031,061	1,033,258
Total Net Assets Released from Restriction	$ 5,025,297	$ 4,197,239
Matured Annuity and Life Income Contracts -		
Temporarily Restricted Agreements Reclassified to Tuition Replacement Funds in Unrestricted Net Assets	$ 571,061	$ 611,137

(11) FEDERAL TAX-EXEMPT STATUS

Berea College has a determination from the Internal Revenue Service that it is a not-for-profit organization exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code.