BEREA COLLEGE

FINANCIAL STATEMENTS

for the Year Ended June 30, 2008

CONTENTS

HIGHLIGHTS

	As of or for the Year Ended June 30, 2008	2007
OPERATING REVENUE	$ 75,224,258	$ 72,636,125
OPERATING EXPENSES	$ 67,964,732	$ 66,081,142
OPERATING REVENUE IN EXCESS OF EXPENSES FROM CONTINUING OPERATIONS	$ 7,259,526	$ 6,554,983
ADDITIONS TO PROPERTY, PLANT AND EQUIPMENT	$ 9,158,367	$ 10,345,297
LONG-TERM INVESTMENTS OF THE ENDOWMENT AND TUITION REPLACEMENT FUNDS		
Original gift value	$ 368,689,457	$ 349,235,652
Investments at market	$1,023,254,700	$1,102,272,000
Interest and dividends, net	$ 21,175,329	$ 21,860,036
Return	1.9%	2.3%
Market price (decrease) increase	$ (72,956,786)	$ 153,003,328
Return	-6.6%	16.1%
Total return	$ (51,781,457)	$ 174,863,364
Percent - time weighted	-4.7%	18.4%
CASH AND IN-KIND CONTRIBUTIONS		
Cash gifts	$ 9,871,990	$ 8,712,036
Bequests	16,398,891	16,734,630
Total cash gifts	26,270,881	25,446,666
Gifts-in-kind	125,907	1,049,387
Total	$ 26,396,788	$ 26,496,053

REPORT OF THE VICE PRESIDENT FOR FINANCE

September, 2008

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

As we reflect on another successful year of furthering the mission of Berea College by "investing in lives of great promise," we are reminded of the tremendous responsibility we share as stewards of the College's fiscal and human resources. This is especially true in light of the unsettling and uncertain economic times we are facing today. The College experienced its first year of negative endowment investment performance since the year ending June 30, 2002. However, we know that the College has faced significant financial challenges during its history and has always been able to recover and grow through sound fiscal foresight and planning. A review of the financial reports of 1908, one hundred years ago, reveals that President Frost spent much of his time focusing on securing money month by month to keep the College functioning. Berea's current programmatic and financial planning has created more stability not only in funding but in better positioning of the College for the future.

The market value of the College's endowment remained above $1 billion throughout the year and ended June 30, 2008, with a value of $1,023.3 million, or $79 million less than June 30, 2007. The $1,023.3 million is composed of original gifts of $368.7 million and net market appreciation after endowment spending of $654.6 million. The policy of adding all unrestricted bequests to the College's quasi endowment that was put in place by the Berea College Board of Trustees on October 20, 1920, has significantly contributed to the growth of the endowment and will continue to do so for the future. The market value of the quasi endowment portion of the investments as of June 30, 2008, was $449.6 million, or almost 44% of the total endowment investments. The net return for the total endowment was -4.7% for the fiscal year ending June 30, 2008. The average annual compound rates of return for the 10-year, 5-year and 3-year periods ending June 30, 2008 are 8.2%, 10.4%, and 8.3%, respectively. During the year, $19.5 million was added to the endowment as a result of new gifts and matured split-interest agreements, and $46.7 million was distributed from the endowment in support of College operations.

The College experienced its third best fundraising year in its history, receiving a total of $26.4 million in gifts. Of this total, $4.4 million was raised in Berea's annual fund for current operations and $18.7 million in gifts to the endowment. Weak financial markets make us more aware of the importance of annual endowment gifts and bequests in helping to offset the negative investment performance, and these gifts are absolutely critical for the future growth of the endowment. The dollar amount of deferred gifts, also known as split-interest agreements, exceeded $3 million for the second time in the history of the College and generated an estimated gift value of $1.4 million. The total number of gifts was 15,738 and 74.0% of the dollars raised were from non-alumni, 9.8% from alumni and 16.2% from corporations, foundations and other sources. The Berea Fund goal was exceeded by 4%, and the College experienced a modest increase in the number of donors, which reversed the downward trend of the last several years.

Several capital projects were started or completed during the year. On August 23, approximately 85 first-year women students were welcomed to a newly renovated Elizabeth Rogers Hall. The $10.8 million renovation of Boone Tavern is well underway and is planned to be completed in early 2009. The $4.5 million Emery Building renovation began in June, 2008 and is scheduled to be completed in August, 2009. This renovation will bring the building, which was built in 1925, into the 21st century while still retaining much of its original character. Construction of the John G. Fee Glade began in May, 2008. The Glade will contain green space and pedestrian paths honoring Berea's founder along with a Legacy Wall that will provide a memorial to the many generous donors who have provided funding to the College through bequests. Stones with quotes from John G. Fee and rest areas along the walking paths within the Glade will offer opportunities for all who visit to reflect on the early history of the College.

During the year, conversations in Washington, D. C. focused on higher education affordability and access. I January 2008, Senators Max Baucus and Charles Grassley contacted 136 colleges with endowments greater tha $500 million to request a report on endowment institutional data and procedures. Berea's response provided a opportunity to tell the "Berea story" of the College's historical commitment to low-income families and to explai how the endowment is used to fund four-year scholarships for all students. We made clear how dangerous a "one size-fits-all" approach would be to a school like Berea that must be creative, frugal, and conservative financially t fund 80% of its budget from its endowment income from year to year regardless of the ups and downs of th financial markets.

Financial Position

Although the financial markets were challenging throughout the year, the financial position of the College remain very strong. **Total Net Assets** (total assets less liabilities) of the College were $1,188.7 million, decreasing b $81.6 million or 6.4 percent. This change reflects a decrease in the market value of long-term investments durin the year from $1,158.0 million as of June 30, 2007, to $1,075.7 million as of June 30, 2008.

At June 30, 2008, **Total Assets** of the College were $1,275.3 million. Of this amount, long-term investment (including endowment funds, annuity and life income funds and other funds) comprised $1,075.7 million; ne property, plant and equipment, and bond defeasance escrow investments totaled $142.7 million; and current asset totaled $34.6 million. Contributions receivable and bequests in probate totaled $19.8 million; non-current prepai expenses totaled $1.2 million; and student educational loans totaled approximately $1.3 million.

Total Liabilities decreased by $3.4 million, due primarily to $4.6 million of principal payments on bonds tha reduced the total debt outstanding from $66.9 million to $62.3 million. This decrease was partially offset by a increase in accrued liabilities for construction expenditures and an increase in the actuarial liability for annuitie payable.

Current Operations

The fiscal year ended with a significant surplus from budgeted operations of $1.9 million. This surplus wa primarily due to less than budgeted faculty and staff salaries, lower than budgeted natural gas and electricit expenses and more Berea Fund gifts. The new heating/cooling plant has helped the College to use 24 percent les natural gas than 2006-2007 and nearly 54 percent less than the year immediately preceding the construction of th new heating/cooling plant.

Concluding Comments

Berea College has a compelling history and has always remained true to its core mission while also striving to thin beyond conventional wisdom in order to enrich the educational experiences of students. How can we help student prepare to live and work in a complex world where change is occurring at an exponential rate? How do we teac students to be able to solve problems that currently do not exist? We cannot know the details of Berea's future However, we do know that there are many loyal, committed, selfless and generous individuals who serve Bere College in 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 move forward and truly invest i lives of great promise.

Thank you for your continued support and please visit us on campus whenever possible.

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 Dean Dorton Ford PSC, 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 of 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 of the College as of June 30, 2008 and 2007, and the changes in its net assets and cash flows for the years then ended.

September, 2008

Larry D. Shinn
President

Jeffrey S. Amburgey
Vice President for Finance

DEAN || DORTON || FORD PSC

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, 2008 and 2007, 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, the financial statements referred to above present fairly, in all material respects, the financial position of the College 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 accounting principles generally accepted in the United States of America.

Dean, Dorton & Ford, PSC

September 4, 2008
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Berea College

STATEMENTS OF FINANCIAL POSITION

	June 30, 2008	June 30, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 23,165,985	$ 16,522,405
Other investments - absolute return fund	5,448,357	8,632,942
Accrued interest on investments	2,337,135	1,998,983
Accounts and notes receivable	1,981,139	3,598,399
Inventories	1,624,956	1,882,716
Prepaid expenses and other assets	51,925	21,632
Total current assets	34,609,497	32,657,077
NON-CURRENT PREPAID EXPENSES AND OTHER ASSETS	1,219,279	2,535,082
CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE	19,824,508	25,873,681
LONG-TERM RECEIVABLES		
Institutional student loans	1,061,557	1,161,013
Federal student loans	273,677	273,729
Total long-term receivables	1,335,234	1,434,742
LONG-TERM INVESTMENTS		
Donor-restricted endowment	573,607,800	621,276,200
Tuition replacement	449,646,900	480,995,800
Annuity and life income	28,767,600	30,739,700
Funds held in trust by others	23,684,800	24,940,500
Total long-term investments	1,075,707,100	1,157,952,200
BOND DEFEASANCE ESCROW	503,443	1,014,022
NET PROPERTY, PLANT AND EQUIPMENT	142,149,654	138,870,536
Total assets	$1,275,348,715	$1,360,337,340

See notes to financial statements.

Berea College

STATEMENTS OF FINANCIAL POSITION

	June 30, 2008	June 30, 2007
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 6,235,943	$ 5,704,693
Accrued salaries and wages	2,631,745	2,551,384
Deposits and agency funds	418,251	396,190
Deferred income	111,707	96,871
Current maturities of long-term debt	2,195,000	2,267,503
Total current liabilities	11,592,646	11,016,641
LONG-TERM LIABILITIES		
Actuarial liability for annuities payable and other liabilities	14,989,580	14,504,661
Long-term debt	60,105,000	64,602,772
Total long-term liabilities	75,094,580	79,107,433
Total liabilities	86,687,226	90,124,074
NET ASSETS		
Unrestricted -		
For current operations	93,730	89,494
Designated for specific purposes	23,449,686	24,807,479
Invested in property, plant and equipment	43,612,774	35,455,534
Support of future operations from:		
Contributions receivable and bequests in probate	5,404,832	12,612,473
Appreciation on endowment investments	294,147,515	333,241,648
Tuition replacement funds	449,646,900	480,995,800
Total unrestricted	816,355,437	887,202,428
Temporarily restricted -		
Unexpended contributions restricted for operations	8,196,115	8,304,459
Unexpended contributions restricted for plant renewals and replacement	1,050,768	986,680
Annuity and life income contracts	5,842,734	7,176,511
Expended contributions for long-lived assets being amortized	27,975,348	28,283,195
Appreciation on endowment investments primarily to support various programs/services	83,918,514	100,144,942
Total temporarily restricted	126,983,479	144,895,787
Permanently restricted -		
Loan funds	2,871,833	2,735,261
Annuity and life income contracts	9,457,466	9,924,389
Funds held in trust by others	23,684,800	24,940,500
Endowment investments	209,308,474	200,514,901
Total permanently restricted	245,322,573	238,115,051
Total net assets	1,188,661,489	1,270,213,266
Total liabilities and net assets	$1,275,348,715	$1,360,337,340

See notes to financial statements.

STATEMENTS OF ACTIVITIES

Changes in Unrestricted Net Assets

	Year Ended June 30, 2008	2007
OPERATING REVENUE		
Spendable return from long-term investments	$ 41,511,289	$ 37,605,617
Gifts and donations	5,260,535	5,623,130
Federal grants	7,346,497	7,502,927
Cost of education fees paid by federal and state scholarships	2,615,000	2,576,000
Fees paid by students	1,430,102	1,285,134
Other income	3,854,924	4,658,711
Residence halls and food service	7,280,522	6,951,895
Student industries and rentals	3,748,822	4,592,096
Net assets released from restrictions	5,202,704	4,624,346
Gross operating revenue	78,250,395	75,419,856
Less: Student aid	(3,026,137)	(2,783,731)
Net operating revenue	75,224,258	72,636,125
OPERATING EXPENSES		
Program Services -		
Instruction	22,378,496	21,798,387
Public service	6,064,969	5,695,155
Academic support	6,918,095	7,220,196
Student services	8,438,758	7,669,691
Residence halls and food service	7,421,851	6,861,089
Student industries and rentals	4,703,052	5,608,842
Total Program Services	55,925,221	54,853,360
Support Services, including fund raising expense of $2,716,700 in 2008 and $2,462,600 in 2007	12,039,511	11,227,782
Total operating expenses	67,964,732	66,081,142
Operating revenue in excess of operating expenses from continuing operations	7,259,526	6,554,983
OTHER UNRESTRICTED ACTIVITY		
Gain on sale of property, plant and equipment	24,540	7,885
Loss on valuation of interest rate swaps	(2,013,900)	(44,100)
Total other unrestricted activity	(1,989,360)	(36,215)
REVENUES DESIGNATED FOR LONG-TERM INVESTMENT		
Unrestricted bequests	5,474,562	14,493,433
Matured annuity and life income contracts	639,660	649,063
Investment return (less than) in excess of amounts designated for current operations	(82,231,379)	111,498,136
Total (decrease) increase in revenues designated for long-term investment	(76,117,157)	126,640,632
(Decrease) increase in unrestricted net assets	$ (70,846,991)	$ 133,159,400

See notes to financial statements.

STATEMENTS OF ACTIVITIES

Changes in Total Net Assets

	Year Ended June 30, 2008	2007
UNRESTRICTED NET ASSETS		
Operating revenue in excess of operating expenses from continuing operations	$ 7,259,526	$ 6,554,983
Other unrestricted activity	(1,989,360)	(36,215)
(Decrease) increase in revenues designated for long-term investment	(76,117,157)	126,640,632
(Decrease) increase in unrestricted net assets	(70,846,991)	133,159,400
TEMPORARILY RESTRICTED NET ASSETS		
Restricted gifts and donations	998,809	1,004,773
Restricted spendable return on endowment investments	5,022,702	4,583,301
Investment return (less than) in excess of amounts designated for current operations	(16,239,727)	20,994,526
Net adjustment of annuity payment and deferred giving liability	(732,520)	668,251
Reclassification of net assets released from restrictions	(5,202,704)	(4,624,346)
Reclassification of matured annuity and life income contracts to revenues designated for long-term investment	(639,660)	(649,063)
Reclassification of net assets	(1,119,208)	(375,375)
(Decrease) increase in temporarily restricted net assets	(17,912,308)	21,602,067
PERMANENTLY RESTRICTED NET ASSETS		
Gifts and donations	9,176,510	21,456,505
Restricted return on endowment investments	155,658	181,784
Restricted capital (losses) gains on funds held in trust by others	(1,818,500)	2,355,400
Net adjustment of annuity payment and deferred giving liability	(1,425,354)	2,233,590
Reclassification of net assets	1,119,208	375,375
Increase in permanently restricted net assets	7,207,522	26,602,654
Total (decrease) increase in net assets	(81,551,777)	181,364,121
NET ASSETS		
Beginning of year	1,270,213,266	1,088,849,145
End of year	$1,188,661,489	$1,270,213,266

See notes to financial statements.

STATEMENTS OF CASH FLOWS

	Year Ended June 30, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
(Decrease) increase in net assets	$ (81,551,777)	$ 181,364,121
Adjustments to reconcile change in net assets to net cash used in operating activities -		
Realized and unrealized losses (gains) on long-term investments	76,652,965	(159,427,427)
Realized and unrealized losses (gains) on absolute return fund	184,585	(1,118,467)
Restricted return on endowment funds	(155,658)	(181,784)
Gifts and bequests for financing activities	(19,834,764)	(20,459,330)
Decrease (increase) in contributions receivable and bequests in probate	6,049,173	(16,081,787)
Gift value of annuity contracts written	(1,390,964)	(1,040,476)
Depreciation	5,879,249	5,584,003
Gain on sale of property, plant and equipment	(24,540)	(7,885)
Increase in actuarial annuity payment liability and other liabilities	484,919	719,792
Decrease in non-current prepaid expenses and other assets	1,315,803	68,660
Decrease in current assets other than cash and other investments	1,506,575	526,049
Increase in current liabilities other than current maturities of long-term debt	648,508	1,115,886
Net cash used in operating activities	(10,235,926)	(8,938,645)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities held for long-term investment	(769,477,530)	(1,001,299,548)
Proceeds from sales and maturities of investments	776,460,629	1,002,747,951
Proceeds from sale of other investments - absolute return fund	3,000,000	3,000,000
Proceeds from sale of bond defeasance escrow	510,579	6,791,390
Purchase of property, plant and equipment	(9,158,367)	(10,345,297)
Proceeds from sale of property, plant and equipment	24,540	68,243
Decrease in long-term student loans	99,508	3,408
Net cash provided by investing activities	1,459,359	966,147
CASH FLOWS FROM FINANCING ACTIVITIES		
Gifts and bequests received for -		
Long-term investment	18,716,915	19,038,879
Property, plant and equipment	1,066,119	1,416,226
Student loans	51,730	4,225
Endowment return restricted for long-term investments	155,658	181,784
Repayment of indebtedness	(4,570,275)	(8,198,570)
Net cash provided by financing activities	15,420,147	12,442,544
Net increase in cash and cash equivalents	6,643,580	4,470,046
Cash and cash equivalents, beginning of year	16,522,405	12,052,359
Cash and cash equivalents, end of year	$ 23,165,985	$ 16,522,405

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 (GAAP) 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 the June 30, 2008, five-year Daily Treasury Yield Curve Rate of 3.34%. 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.

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.

NOTES TO FINANCIAL STATEMENTS

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

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.

Cash, Cash Equivalents and Concentration of Credit Risk

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. The College maintains some cash balances in an interest-bearing deposit account that is not collateralized and is not insured by the Federal Deposit Insurance Corporation. The balance totaled $9,438,593 and $10,237,788 as of June 30, 2008 and 2007, respectively. The College has not experienced any loss in this account.

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, hedge funds, 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.

Fair Value of Financial Instruments

The following methods and assumptions were used by the College in estimating the fair value of its financial instruments:

Long-Term Debt: The fair value of the College's long-term debt is disclosed at Note 8 and is based on quoted market prices for the same or similar issues, giving consideration to the interest rates, maturity and other factors.

NOTES TO FINANCIAL STATEMENTS

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

Cash, Investments and Other Items for Which Fair Value Disclosure is Required: The carrying amount reported in the statements of financial position for such items is either fair value or approximates fair value. The valuation of long-term investments is discussed in Note 2.

Split-Interest Agreements and Interest in Trusts Held by Others

The College's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts, charitable gift annuities, and life income funds for which the College serves as trustee. Assets held in these split-interest agreements are included in investments. Contribution revenue is recognized at the dates the split-interest agreements are established, net of the liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. Annually, the College records the change in value of split-interest agreements by marking to market the assets that are associated with each agreement and recalculating the liability for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The discount rate and actuarial assumptions used in calculating the annuity obligation are those provided in Internal Revenue Service guidelines and actuarial tables.

For agreements where the College is not the trustee, the College has recorded its beneficial interest in the agreements as an asset reported in the line item "Contributions Receivable and Bequests in Probate".

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	30 - 75 years
Building improvements and renovations	15 - 30 years
Furniture, equipment and books	10 years

Using these guidelines, depreciation expense for the years ended June 30 was:

	2008	2007
Educational and general purposes	$5,634,431	$ 5,340,491
Student industry equipment	244,818	243,512
	$5,879,249	$ 5,584,003

Equipment with a unit cost of $5,000 or more and having an estimated useful life of greater than one year is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred. The College capitalizes, but does not depreciate, works of art and historical treasures that are held for education, research or public exhibition.

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.

NOTES TO FINANCIAL STATEMENTS

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

Measure of Operations

In its statements of activities, the College includes in its definition of operations all revenues and expenses that are an integral part of its programs and supporting activities. Items excluded are permanently restricted contributions, gifts for capital construction, changes in the value of interest rate swap agreements, endowment return in excess of amounts designated for current operations and certain other non-recurring items. Spendable return from the endowment is calculated using the spending formula adopted by the Board of Trustees. The amount designated for current operations is approved by the Board of Trustees annually.

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.

	2008	2007
Interest	$2,572,643	$ 2,905,262
Depreciation	5,879,249	5,584,003
Plant Operations	5,239,457	6,275,528

Recent Accounting Pronouncements

On August 6, 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds.*

This FSP provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). UPMIFA is a model act that serves as a guideline for states to use in enacting legislation. This FSP also improves disclosures about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds), regardless whether the organization is subject to UPMIFA.

The provisions of this FSP are effective for fiscal years ending after December 15, 2008. The Commonwealth of Kentucky has not enacted any version of UPMIFA. Therefore, the guidance on the net asset classification of donor-restricted endowment funds will not be applicable to the College unless and until UPMIFA is adopted in some form.

Reclassification

Certain reclassifications have been made to the 2007 financial statements to conform to the 2008 presentation with no affect on total assets, liabilities, net assets or the change in net assets.

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS

	June 30, 2008	June 30, 2007
Endowment and Tuition Replacement:		
Pooled Investments -		
U.S. equities	$ 314,991,100	$ 369,533,500
International equities	222,820,000	268,885,600
Corporate notes and bonds	91,079,100	90,434,100
U. S. Government securities	38,404,300	43,007,400
Foreign bonds	454,800	148,600
Structured notes	69,621,600	75,479,700
Private equity - venture capital	11,905,900	11,524,200
Private equity - buy out	17,709,800	9,653,100
Private equity - debt funds	5,229,400	5,867,000
Private equity - fund of funds	51,953,100	47,778,500
Hedge funds	133,908,800	120,192,900
Real estate	1,247,900	1,484,300
Short-term investments and cash	60,542,600	53,388,700
Total	1,019,868,400	1,097,377,600
Non Pooled Investments -		
U.S. equities	248,600	242,800
Corporate notes and bonds	101,400	104,600
U. S. Government securities	20,700	19,000
Real estate	2,978,500	2,978,500
Short-term investments and cash	37,100	1,549,500
Total	3,386,300	4,894,400
Total endowment and tuition replacement	1,023,254,700	1,102,272,000
Annuity and Life Income:		
Pooled Annuity Investments -		
U.S. equities	9,045,200	10,307,400
International equities	1,952,900	2,370,300
Corporate notes and bonds	4,338,000	4,119,200
Short-term investments and cash	237,700	134,200
Total	15,573,800	16,931,100
Separately Invested Trusts -		
U.S. equities	6,112,300	6,741,000
International equities	1,394,100	1,462,500
Corporate notes and bonds	4,726,500	4,438,400
U. S. Government securities	330,200	528,600
Real estate	330,000	330,000
Short-term investments and cash	300,700	308,100
Total	13,193,800	13,808,600
Total annuity and life income	28,767,600	30,739,700
Funds Held in Trust by Others, where Berea College receives all or a stipulated percent of income	23,684,800	24,940,500
Total long-term investments	$1,075,707,100	$1,157,952,200

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 2008 and 2007, spendable return under the formula amounted to $46,529,735 and $42,203,084, respectively. In 2008, actual cash income earned on pooled investments, net of $2,418,187 for investment management and custodial fees, amounted to $21,015,416, or $25,514,319 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 $159,913 in 2008 and $167,618 in 2007, while the market value of these investments of $3,386,300 at June 30, 2008 and $4,894,400 at June 30, 2007 decreased by $13,100 in 2008 and increased by $956,400 in 2007. Additions to non-pooled endowment investments during 2008 amounted to $5,000 and $1,500,000 of interstate exchange proceeds were transferred to the Capital and Plant Fund to help fund capital renovations.

Dividend and interest income of $21,175,329 and $21,860,036 reported net of external investment manager fees of $2,418,187 and $2,165,762 is included in the statements of activities for the years ended June 30, 2008 and 2007, respectively.

NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS (continued)

During 2008, the unit value of pooled investments changed as follows:

	2007-08				2006-07
	Market Value	Number of Units	Value Per Unit	Time Weighted Return Net of Fees	Market Value
Beginning Balance	$1,097,377,600	651,134.0	$1,685.33		$ 944,804,700
Market price change	(72,943,686)		(110.10)	-6.6%	152,046,928
Net income earned	21,015,416		32.28	1.9%	21,692,418
Spendable return	(46,529,735)		(71.46)	-	(42,203,084)
	(98,458,005)		(149.28)	-4.7%	131,536,262
Additions	20,948,805	12,822.2	-		21,036,638
Ending Balance	$1,019,868,400	663,956.2	$ 1,536.05		$1,097,377,600

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

	2008	2007
Pooled Investments -		
Cash income, net	$ 21,015,416	$ 21,692,418
Market price (decrease) increase	(72,943,686)	152,046,928
Non-Pooled Investments -		
Cash income	159,913	167,618
Market price (decrease) increase	(13,100)	956,400
Total Return	(51,781,457)	174,863,364
Distributed to -		
Unrestricted Net Assets		
Spendable return	41,511,289	37,605,617
Long-term investments	(82,231,379)	111,498,136
Temporarily Restricted Net Assets		
Spendable return	5,022,702	4,583,301
Investment return (less than) in excess of amounts designated for current operations	(16,239,727)	20,994,526
Permanently Restricted		
Restricted earnings	155,658	181,784
Total	$ (51,781,457)	$ 174,863,364

NOTES TO FINANCIAL STATEMENTS

(3) FAIR VALUE MEASUREMENTS

In 2008, the College partially adopted SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The statement establishes a framework for measuring fair value and expands disclosures regarding fair value measurements in accordance with GAAP. SFAS 157 applies to fair value measurements already required or permitted by existing standards.

One key component of the implementation of SFAS 157 includes the development of a three-tiered fair value hierarchy. Assets and liabilities reported at fair value are placed in one of the three tiers based upon the "inputs" used to determine fair value at the measurement date. These inputs are summarized in the three broad levels listed below:

Level 1 - quoted prices in active markets for identical assets.

Level 2 - other significant inputs (including quoted prices of similar securities, interest rates, prepayment spreads, credit risk, etc.)

Level 3 - significant unobservable inputs

The inputs or methodology used to value investments are not necessarily an indication of the risk associated with investing in those securities. For example, money market securities are valued using amortized cost and although amoritized cost approximates the fair value of the securities the valuation is not obtained from a quoted price in an active market. Therefore, money market securities are reflected in Level 2.

The fair value of assets and liabilities at June 30, 2008 are as follows:

	June 30, 2008 Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Endowment investments	$ 1,023,254,700	$ 538,861,100	$ 247,211,500	$ 237,182,100
Other investments	5,448,357	-	-	5,448,357
Funds held in trust by others	23,684,800	15,699,200	7,985,600	-
Split-interest agreements	28,767,600	-	-	28,767,600
Contributions receivable	19,824,508	-	-	19,824,508
Total assets	1,100,979,965	554,560,300	255,197,100	291,222,565
Liabilities				
Split-interest agreement liability	13,467,400	-	-	13,467,400
Interest rate swap agreements	618,600	-	618,600	-
Asset retirement obligation	592,131	-	-	592,131
Total liabilities	14,678,131	-	618,600	14,059,531
Total fair value	$ 1,086,301,834	$ 554,560,300	$ 255,197,100	$ 277,163,034

SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The College elected to early adopt certain disclosures. The statement requires a reconciliation of the beginning and ending balances for fair value measurements using significant unobservable inputs (Level 3). This portion of the statement will be implemented by the College in fiscal year 2009.

NOTES TO FINANCIAL STATEMENTS

(4) 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 negative $618,600 at June 30, 2008 and positive $1,395,300 at June 30, 2007 and is included in the actuarial liability for annuities payable and other liabilities in 2008 and in non-current prepaid and other assets in 2007 in the statements of financial position. The decrease in market value of the interest rate swaps of $2,013,900 has been reflected in the statements of activities in other unrestricted activity.

(5) 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 $1,877,310 in 2008 and $1,775,190 in 2007.

(6) PROPERTY, PLANT AND EQUIPMENT

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

Property, Plant and Equipment	2008	2007
Educational property, plant and equipment	$ 169,216,980	$ 162,262,585
Student industry plant and equipment	7,991,527	7,913,151
Rental property	2,551,773	2,551,773
Forest and farms	1,250,902	1,250,902
Collections and works of art	4,063,531	4,063,531
Construction in process	7,675,221	6,709,401
Less accumulated depreciation	(50,600,280)	(45,880,807)
	$ 142,149,654	$ 138,870,536

Capitalized interest was $0 and $59,615 for the years ended June 30, 2008 and 2007, respectively.

NOTES TO FINANCIAL STATEMENTS

(7) CONDITIONAL ASSET RETIREMENT OBLIGATIONS

In 2006, the College adopted the Financial Accounting Standards Board (FASB)'s Interpretation No. 47, *Accounting for Conditional Asset Obligations – an interpretation of FASB Statement No.143 (FIN 47).* Under Statement of Financial Accounting Standards 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 affects the College's accounting for costs associated with asbestos abatement. A reconciliation of the beginning and ending aggregate carrying amount of the asset retirement obligations for the years ended June 30 is as follows:

	2008	2007
Beginning balance	$ 920,413	$ 948,115
Accretion expense	22,138	36,120
Liabilities settled during the year	(350,420)	(63,822)
Ending balance	$ 592,131	$ 920,413

(8) LONG-TERM DEBT

	June 30, 2008	June 30, 2007
KDFA Loan Agreement - Issued June 1986; due in monthly installments to June 2011; variable interest rate; unsecured; proceeds used for various capital projects	$ -	$ 590,275
Educational Buildings Revenue Bonds, Series of 1997 - Issued August 1997; serial annual payments through August 2017 at rates from 4.5% to 5.0%; proceeds used for Frost Building restoration and renovation	1,860,000	2,000,000
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	500,000	1,000,000
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	5,585,000	5,975,000

NOTES TO FINANCIAL STATEMENTS

(8) LONG-TERM DEBT (continued)

	June 30, 2008	2007
Educational Development Revenue Bonds, Series of 2000 - Issued May, 2000; serial annual payments through 2020 at rates from 4.6% to 5.7%; proceeds used for residence hall renovation	$ 1,850,000	$ 1,960,000
Variable Rate Demand Educational Facilities Revenue Bonds, Series 2002A - Issued August 29, 2002; due June 1, 2032; variable interest rate, 2.05% as of June, 2008; with synthetic fixed rate of 3.45%; proceeds used for various capital projects	15,830,000	17,675,000
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; proceeds used for various capital projects	19,150,000	19,630,000
Variable Rate Demand Educational Facilities Revenue Bonds, Series 2003B - Issued December 11, 2003; variable payments through June 1, 2029; variable interest rate, 2.05% as of June, 2008 with synthetic fixed rate of 3.746%; proceeds used for various capital projects	9,190,000	9,470,000
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; proceeds used for central heat plant and various capital retrofits	8,335,000	8,570,000
	62,300,000	66,870,275
Less current portion	2,195,000	2,267,503
	$ 60,105,000	$ 64,602,772

Principal payments on long-term debt are required to be made in each of the following fiscal years: $2,195,000 in 2009; $1,760,000 in 2010; $1,815,000 in 2011; $1,890,000 in 2012; $1,960,000 in 2013 and $52,680,000 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 was called on June 1, 2007 @ $102. The series 1998 bond issue in the outstanding amount of $500,000 is not callable and was paid on July 1, 2008.

The fair value of the College's long-term debt that has not been defeased at June 30, 2008 was estimated to be approximately $60,472,000 based upon rates available to the College for debt with similar terms and remaining maturities.

Cash payments for interest amounted to $2,600,547 in 2008 and $3,009,126 in 2007.

NOTES TO FINANCIAL STATEMENTS

(9) CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE

	June 30, 2008 Total	Due In One Year or Less	One Year to Five Years	Over Five Years	June 30, 2007 Total
Unconditional Promises for -					
Unrestricted	$ 24,890	$ 21,790	$ 3,100	$ -	$ 62,220
Restricted	235,250	131,724	103,526	-	362,850
Buildings and equipment	486,850	186,850	300,000	-	321,950
Endowment	887,589	347,589	540,000	-	1,453,467
Reserve for unfulfilled promises	(115,000)	(52,000)	(63,000)	-	(150,000)
Total	1,519,579	635,953	883,626	-	2,050,487
Bequests in Probate	16,844,285	15,587,985	1,256,300	-	22,486,944
External Charitable Remainder Trusts*	962,473	-	-	962,473	1,024,308
Charitable Lead Trusts	642,010	223,257	307,041	111,712	747,076
Total	$ 19,968,347	$ 16,447,195	$ 2,446,967	$ 1,074,185	$ 26,308,815
Present Value of Estimated Future Cash Flows	$ 19,824,508	$ 16,447,195	$ 2,320,051	$ 1,057,262	$ 25,873,681

* Discounted beneficial interest in trusts

(10) 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, 2008, the College was committed under various contracts with alternative investment managers to fund $52,119,207 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	$ 674,375
Buy out	39,344,161
Debt fund	8,738,190
Fund of funds	3,362,481
Total	$ 52,119,207

The College has purchase commitments relating to construction projects of approximately $13,268,000 as of June 30, 2008.

NOTES TO FINANCIAL STATEMENTS

(11) CONCENTRATIONS

The College's operations are heavily dependent upon the spendable return from endowment investments. Therefore, an extended downturn in financial markets could have an adverse effect on the College's programs and activities.

Many of the College's students receive support from state and federal student financial assistance programs. A significant reduction in the level of this support, if it were to occur, might have an adverse effect on the College's programs and activities.

(12) NET ASSETS RELEASED FROM RESTRICTIONS

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

	2008	2007
Purpose Restricted Contributions for -		
Instruction	$ 1,013,562	$ 760,555
Public service	652,384	634,756
Academic support	418,240	321,145
Student services	78,488	94,871
Student aid	1,910,734	1,672,543
Development and alumni	14,116	14,118
	4,087,524	3,497,988
Time-Restricted Contributions - Amortization of Restricted Gifts to Acquire Long-Lived Assets	1,115,180	1,126,358
Total Net Assets Released from Restriction	$ 5,202,704	$ 4,624,346
Matured Annuity and Life Income Contracts -		
Temporarily Restricted Agreements Reclassified to Tuition Replacement Funds in Unrestricted Net Assets	$ 639,660	$ 649,063

(13) 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.

(14) BANK QUALIFIED TAX-EXEMPT LOAN

On July 7, 2008, the College finalized a $4,500,000 bank qualified tax-exempt loan with Branch Banking and Trust Company. The loan is for a term of 7 years at a fixed rate of 3.98% on a 20-year amortization schedule. The proceeds from the loan will be used for the renovation of an academic building.