# Berea College

## Financial Statements

### for the Year Ended June 30, 2012

## Board of Trustees



## Officers

# CONTENTS

# HIGHLIGHTS

| | As of or for the Year Ended June 30, | |
|---|---|---|
| | 2012 | 2011 |
| **OPERATING REVENUE** | $ 81,828,210 | $ 79,088,086 |
| **OPERATING EXPENSES** | $ 79,501,192 | $ 67,658,991 |
| **OPERATING REVENUE IN EXCESS OF EXPENSES FROM CONTINUING OPERATIONS** | $ 2,327,018 | $ 11,429,095 |
| **ADDITIONS TO PROPERTY, PLANT AND EQUIPMENT** | $ 4,573,022 | $ 2,726,770 |
| **LONG-TERM INVESTMENTS OF THE ENDOWMENT AND TUITION REPLACEMENT FUNDS** | | |
| Original gift value | $ 444,416,884 | $ 434,472,604 |
| Investments at market | $ 942,618,000 | $ 978,734,900 |
| Interest and dividends, net | $ 15,986,973 | $ 17,036,405 |
| Return | 1.6% | 2.0% |
| Market price (decrease) increase | $ (19,034,205) | $ 146,976,983 |
| Return | -1.9% | 17.4% |
| Total return | $ (3,047,232) | $ 164,013,388 |
| Percent - time weighted | -0.3% | 19.4% |
| **CASH AND IN-KIND CONTRIBUTIONS** | | |
| Cash gifts | $ 8,908,499 | $ 7,005,168 |
| Bequests | 6,460,395 | 14,041,786 |
| Total cash gifts | 15,368,894 | 21,046,954 |
| Gifts-in-kind | 35,804 | 89,008 |
| Total | $ 15,404,698 | $ 21,135,962 |

# REPORT OF THE VICE PRESIDENT FOR FINANCE

September, 2012

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

As we complete another fiscal year, we celebrate the privilege of being part of the Berea learning community that is committed to preparing young people to make a positive difference in the world. Working together at Berea College this past year, we have engaged in thinking openly and creatively about how Berea can best expand its enrollment and provide full-tuition scholarships to more students with very limited economic resources. Since endowment spendable return is the primary funding source of Berea's operating budget, the College must limit student enrollment. However, the financial support and partnership with a major external trust has enabled Berea to begin planning for the exciting possibility of expanding the number of students Berea can serve. This endeavor would also strengthen the College's programs and educational outcomes for all students.

This year has been very rewarding in many respects. We began the academic year with a freshman class of 437 students and 100 new transfer students for a total of 537 first-year students. Most of the incoming students were from Berea's In-Territory of Kentucky and the Appalachian region, but also included students from 32 states and 28 countries. This year's class was the most diverse since the repeal of the Day Law in 1950 with 21.5% African American students and also had the strongest academic record of an entering class in more than two decades.

During the Fall, the College's GEAR UP (Gaining Early Awareness and Readiness for Undergraduate Programs) program was awarded two federal grants from the Department of Education, which together are worth $10.8 million a year. These two grants, which total approximately $76 million over the seven-year grant period, will provide intensive services to more than 13,000 students in 19 school districts in 17 Kentucky counties. Also, in January of 2012, Berea's Externally Sponsored Programs was awarded a Promise Neighborhood Implementation grant from the Department of Education in the amount of $5.9 million annually. This grant, which totals almost $30 million over the five-year project period, provides funds for a continuum of solutions from birth to career for children living in the distressed, high poverty Kentucky counties of Jackson, Clay and Owsley. In addition, Berea's Externally Sponsored Programs was awarded a new $3 million "Investing in Innovation (I3)" grant from the U.S. Department of Education to support STEM (Science, Technology, Engineering, and Mathematics) education and college-preparedness in the Eastern Kentucky schools served by the College's Promise Neighborhood program. This five-year grant combined with the seven-year GEAR UP grants and others provide more than $20 million per year in educational outreach to nearby Kentucky counties and represent a significant enhancement to Berea's ongoing impact in the Appalachian region.

In April, the College began construction on what will be the most energy-efficient residence hall in Kentucky. The 42,000-square-foot "Deep Green Residence Hall" is being constructed adjacent to Boone Tavern Hotel and Restaurant and will house 120 students in 66 rooms. The first new residential facility constructed since the Ecovillage a decade ago, the new $16.5 million residence hall will meet LEED (Leadership in Energy and Environmental Design) Platinum certification. To reduce the building's ecological footprint, the residence hall will feature solar photovoltaic systems that will provide approximately 14% of the building's energy needs; an ultra-efficient geothermal heat pump recirculation system; active daylighting; a highly insulated, state-of-the-art building envelope; triple-pane operable windows with solar shading; low-flow water fixtures; and real-time monitoring of energy consumption. The "deep green" features of the facility are designed to provide a sustainable and comfortable residence for student living and learning. Construction is expected to be completed by August, 2013.

Dr. Larry D. Shinn, the College's President since 1994, retired effective June 30, 2012. Dr. Shinn, and wife Nancy, served the College passionately and tirelessly over the last eighteen years – a time of challenges and successes. During this time, the College's 1994 endowment of $353 million grew to over $1 billion, only to experience the Great Recession of 2008 that challenged the sustainability of Berea's endowment-dependent funding model. Dr. Shinn's leadership saw the college through this difficult time. As President, he implemented many initiatives that have bettered the College and will impact the lives of future students. We all express our heartfelt gratitude to the Shinns for their great service of labor to Berea.

On July 1, 2012, Dr. Lyle D. Roelofs became the ninth president of Berea College. Dr. Roelofs, along with wife Laurie, will lead Berea on the next leg of its mission-centered journey. Dr. Roelofs has more than 35 years experience in teaching and research at the University of Maryland, Calvin College, Brown University, Haverford College and Colgate University. He is also an experienced administrator, having served as associate provost at Haverford College, as provost and dean of faculty, and as interim president at Colgate University. The Berea community has warmly welcomed the Roelofs and is eager to work together to meet the challenges of the future.

Fundraising during 2012 was mixed. The College experienced a decline in the amount of gifts received during the year, from $21.1 million in 2011 to $15.4 million in 2012. The decrease of $5.7 million was primarily due to lower endowment gifts. Of the $15.4 million received in 2012, $4.5 million ($3.9 million from donors plus $0.6 million from perpetual trusts) was raised in Berea's annual fund for current operations, $3.7 million for other restricted purposes and $7.2 million in gifts, mostly in the form of bequests, to the endowment. The number of gifts during the year increased from 16,080 to 17,331 and the number of donors increased from 9,891 to 10,433.

**Financial Position**

The financial markets, especially the international equities markets, presented investment performance challenges. The market value of the College's endowment decreased from $978.7 million on June 30, 2011 to $942.6 million on June 30, 2012, or $36.1 million. The $942.6 million is composed of cumulative original gifts of $444.6 million and cumulative net market appreciation after endowment spending of $498.0 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 Berea's endowment and will continue to do so for the future. So too has Berea's long-standing deferred gifts program paid enormous dividends in increasing monies received from bequests. The market value of the quasi endowment portion of the investments as of June 30, 2012, was $416.1 million, or 44% of the total endowment investments. The net investment return for the total endowment was -0.3% for the fiscal year ending June 30, 2012. The average annual compound rates of return for the 20-year, 10-year, 5-year and 3-year periods ending June 30, 2012 are 8.1%, 5.6%, -0.1%, and 9.7%, respectively. During the year, $9.9 million was added to the endowment as a result of new gifts and matured split-interest agreements, and $43.0 million was distributed from the endowment in support of College operations.

The financial position of the College remains strong. **Total Net Assets** (total assets less liabilities) of the College were $1,128.9 million, decreasing by $30.1 million or 2.6 percent during the year. This change reflects a decrease in the market value of total long-term investments during the year from $1,030.8 million as of June 30, 2011 to $991.9 million as of June 30, 2012.

At June 30, 2012, **Total Assets** of the College were $1,216.6 million. Of this amount, long-term investments (including endowment funds, annuity and life income funds and other funds) comprised $991.9 million; net property, plant and equipment totaled $141.0 million; and current assets totaled $71.1 million. Long-term contributions receivable and bequests in probate totaled $5.9 million; non-current prepaid expenses totaled $1.0 million; and long-term receivables totaled approximately $5.7 million.

**Total Liabilities** increased by $5.8 million from $81.9 million as of June 30, 2011 to $87.7 million as of June 30, 2012. Most of this increase was due to a $4.4 million increase in the liability for interest rate swaps.

**Concluding Comments**

Berea is indeed a wonderful learning community and is fortunate to have such a strong, enthusiastic and caring faculty and staff to nurture its students to their full potential. These promising students, and the alumni they become, so ably demonstrate through their many successes the positive outcomes of a Berea College education. The exceptional leadership of the Board of Trustees, along with the tremendous generosity of Berea's alumni and many friends, sustain the unique Berea mission and ensure the promise of Berea College to future generations. For your role in this mission, whether as student, faculty, staff, alumni, trustee or friend, we truly thank you.

We look forward to another challenging and rewarding year at Berea College and invite you to visit soon. Your presence is always welcome on the campus of Berea College.

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 Allen Ford, PLLC, 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.

President Roelofs affirms that, since taking office on July 1, 2012, no information has come to his attention that is inconsistent with the financial statements or other information presented in this annual report. Accordingly, we believe the following financial statements present fairly, in all material respects, the financial position of the College as of June 30, 2012 and 2011, and the changes in its net assets and cash flows for the years then ended.

September, 2012

Lyle D. Roelofs

Lyle D. Roelofs
President

Jeffrey S. Amburgey

Jeffrey S. Amburgey
Vice President for Finance

## Independent Auditors' Report

To the Board of Trustees
Berea College
Berea, Kentucky

We have audited the accompanying statements of financial position of Berea College (the College) as of June 30, 2012 and 2011, 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, 2012 and 2011, 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 Allen Ford, PLLC

September 6, 2012
Lexington, Kentucky

106 West Vine Street
Suite 600
Lexington, KY 40507
859.255.2341 *phone*
859.255.0125 *fax*

First Trust Centre
200 South Fifth Street
Suite 201 South
Louisville, KY 40202
502.589.6050 *phone*
502.581.9016 *fax*

*www.ddafcpa.com*

# Berea College

## STATEMENTS OF FINANCIAL POSITION

| | June 30, 2012 | June 30, 2011 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 50,417,011 | $ 49,615,614 |
| Accrued interest on investments | 785,315 | 2,409,919 |
| Accounts receivable - U.S. Government | 4,160,849 | 1,738,851 |
| Other accounts and notes receivable | 1,404,628 | 1,356,272 |
| Inventories | 1,283,401 | 1,199,901 |
| Prepaid expenses and other assets | 144,388 | 143,946 |
| Contributions receivable and bequests in probate | 12,850,478 | 4,604,112 |
| Total current assets | 71,046,070 | 61,068,615 |
| **PREPAID EXPENSES AND OTHER ASSETS** | 964,656 | 1,024,817 |
| **CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE** | 5,935,874 | 3,164,942 |
| **LONG-TERM RECEIVABLES** | | |
| Cash collateral advanced under interest rate swap agreements | 4,700,000 | 660,000 |
| Institutional student loans | 893,342 | 909,379 |
| Federal student loans | 138,370 | 170,259 |
| Total long-term receivables | 5,731,712 | 1,739,638 |
| **LONG-TERM INVESTMENTS** | | |
| Donor-restricted endowment | 526,468,200 | 548,244,000 |
| Tuition replacement | 416,149,800 | 430,490,900 |
| Annuity and life income | 25,613,200 | 27,643,400 |
| Funds held in trust by others | 23,708,800 | 24,424,000 |
| Total long-term investments | 991,940,000 | 1,030,802,300 |
| **NET PROPERTY, PLANT AND EQUIPMENT** | 140,965,563 | 143,076,757 |
| Total assets | $1,216,583,875 | $1,240,877,069 |

*See notes to financial statements.*

# Berea College

## STATEMENTS OF FINANCIAL POSITION

| LIABILITIES AND NET ASSETS | June 30, 2012 | June 30, 2011 |
|---|---|---|
| **CURRENT LIABILITIES** | | |
| Accounts payable and accrued expenses | $ 8,033,917 | $ 4,114,970 |
| Capital expenditure accounts payable | 806,574 | 113,187 |
| Accrued salaries and wages | 2,728,112 | 2,585,871 |
| Deposits and agency funds | 502,421 | 546,228 |
| Deferred income | 198,518 | 182,428 |
| Current maturities of long-term debt | 2,187,069 | 2,108,923 |
| Total current liabilities | 14,456,611 | 9,651,607 |
| **LONG-TERM LIABILITIES** | | |
| Actuarial liability for annuities payable and other liabilities | 12,653,591 | 13,262,523 |
| Interest rate swap valuation | 7,526,400 | 3,122,900 |
| Long-term debt | 53,099,642 | 55,811,711 |
| Total long-term liabilities | 73,279,633 | 72,197,134 |
| Total liabilities | 87,736,244 | 81,848,741 |
| **NET ASSETS** | | |
| Unrestricted - | | |
| For current operations | 97,740 | 96,270 |
| Designated for specific purposes | 37,077,833 | 41,338,608 |
| Invested in property, plant and equipment | 51,816,078 | 50,676,717 |
| Support of future operations from: | | |
| Contributions receivable and bequests in probate | 4,529,154 | 5,381,606 |
| Donor-restricted endowment funds | (7,903,956) | (5,072,911) |
| Tuition replacement funds | 416,149,800 | 430,490,900 |
| Total unrestricted | 501,766,649 | 522,911,190 |
| Temporarily restricted - | | |
| Unexpended contributions restricted for operations | 12,469,654 | 10,948,816 |
| Unexpended contributions restricted for plant renewals and replacement | 13,659,427 | 1,274,521 |
| Annuity and life income contracts | 5,601,702 | 5,715,453 |
| Expended contributions for long-lived assets being amortized | 25,601,242 | 26,217,874 |
| Donor-restricted endowment funds | 299,517,552 | 322,532,365 |
| Total temporarily restricted | 356,849,577 | 366,689,029 |
| Permanently restricted - | | |
| Loan funds | 2,777,406 | 2,754,674 |
| Annuity and life income contracts | 8,378,998 | 9,474,047 |
| Contributions receivable and bequests in probate | 511,597 | 1,990,842 |
| Funds held in trust by others | 23,708,800 | 24,424,000 |
| Donor-restricted endowment funds | 234,854,604 | 230,784,546 |
| Total permanently restricted | 270,231,405 | 269,428,109 |
| Total net assets | 1,128,847,631 | 1,159,028,328 |
| Total liabilities and net assets | $ 1,216,583,875 | $ 1,240,877,069 |

*See notes to financial statements.*

# STATEMENTS OF ACTIVITIES

## Changes in Unrestricted Net Assets

| | Year Ended June 30, 2012 | 2011 |
|---|---|---|
| **OPERATING REVENUE** | | |
| Spendable return from long-term investments | $ 37,401,970 | $ 41,173,362 |
| Gifts and donations | 5,197,022 | 6,455,952 |
| Federal grants | 14,015,203 | 8,067,225 |
| Cost of education fees paid by federal and state scholarships | 3,850,000 | 3,650,000 |
| Fees paid by students | 1,599,296 | 1,491,227 |
| Other income | 3,325,633 | 3,434,001 |
| Residence halls and food service | 7,998,618 | 7,413,041 |
| Student industries and rentals | 4,427,429 | 4,173,354 |
| Net assets released from restrictions | 7,775,772 | 5,708,358 |
| Gross operating revenue | 85,590,943 | 81,566,520 |
| Less: Student aid | (3,762,733) | (2,478,434) |
| Net operating revenue | 81,828,210 | 79,088,086 |
| **OPERATING EXPENSES** | | |
| Program Services - | | |
| Instruction | 24,079,572 | 21,081,523 |
| Public service | 11,880,331 | 6,545,482 |
| Academic support | 7,605,584 | 6,821,093 |
| Student services | 9,104,092 | 8,542,113 |
| Residence halls and food service | 7,926,822 | 7,161,121 |
| Student industries and rentals | 5,156,052 | 4,872,553 |
| Total Program Services | 65,752,453 | 55,023,885 |
| Support Services, including fund raising expense of $2,532,100 in 2012 and $2,349,100 in 2011 | 13,748,739 | 12,635,106 |
| Total operating expenses | 79,501,192 | 67,658,991 |
| Operating revenue in excess of operating expenses from continuing operations | 2,327,018 | 11,429,095 |
| **OTHER UNRESTRICTED ACTIVITY** | | |
| Gain on sale of property, plant and equipment | 64,939 | 75,108 |
| (Loss) gain on valuation of interest rate swaps | (4,403,500) | 999,300 |
| Total other unrestricted activity | (4,338,561) | 1,074,408 |
| **REVENUES DESIGNATED FOR LONG-TERM INVESTMENT** | | |
| Unrestricted bequests | 3,043,200 | 5,857,612 |
| Matured annuity and life income contracts | 856,185 | 342,107 |
| Reclassification of net assets | - | (1,400,293) |
| Investment return (less) more than amounts designated for current operations | (23,032,383) | 99,339,935 |
| Total (decrease) increase in revenues designated for long-term investment | (19,132,998) | 104,139,361 |
| Net asset reclassification based on change in law | - | (254,900,058) |
| Decrease in unrestricted net assets | $ (21,144,541) | $ (138,257,194) |

*See notes to financial statements.*

# STATEMENTS OF ACTIVITIES

## Changes in Total Net Assets

| | Year Ended June 30, 2012 | Year Ended June 30, 2011 |
|---|---|---|
| **UNRESTRICTED NET ASSETS** | | |
| Operating revenue in excess of operating expenses from continuing operations | $ 2,327,018 | $ 11,429,095 |
| Other unrestricted activity | (4,338,561) | 1,074,408 |
| (Decrease) increase in revenues designated for long-term investment | (19,132,998) | 104,139,361 |
| Net asset reclassification based on change in law | - | (254,900,058) |
| Decrease in unrestricted net assets | (21,144,541) | (138,257,194) |
| **TEMPORARILY RESTRICTED NET ASSETS** | | |
| Restricted gifts and donations | 16,194,131 | 1,220,185 |
| Restricted spendable return on endowment investments | 5,483,083 | 4,575,122 |
| Investment return (less) more than amounts designated for current operations | (23,028,797) | 18,787,969 |
| Net adjustment of annuity payment and deferred giving liability | 42,058 | 1,385,475 |
| Reclassification of net assets released from restrictions | (7,775,772) | (5,708,358) |
| Reclassification of matured annuity and life income contracts to revenues designated for long-term investment | (856,185) | (342,107) |
| Reclassification of net assets | 102,030 | 38,557 |
| Net asset reclassification based on change in law | - | 254,900,058 |
| (Decrease) increase in temporarily restricted net assets | (9,839,452) | 274,856,901 |
| **PERMANENTLY RESTRICTED NET ASSETS** | | |
| Gifts and donations | 1,987,642 | 5,471,077 |
| Restricted return on endowment investments | 128,895 | 137,000 |
| Restricted capital (loss) gain on funds held in trust by others | (715,200) | 3,413,800 |
| Net adjustment of annuity payment and deferred giving liability | (496,011) | 1,689,538 |
| Reclassification of net assets | (102,030) | 1,361,736 |
| Increase in permanently restricted net assets | 803,296 | 12,073,151 |
| Total (decrease) increase in net assets | (30,180,697) | 148,672,858 |
| **NET ASSETS** | | |
| Beginning of year | 1,159,028,328 | 1,010,355,470 |
| End of year | $ 1,128,847,631 | $ 1,159,028,328 |

*See notes to financial statements.*

## STATEMENTS OF CASH FLOWS

| | Year Ended June 30, 2012 | 2011 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| (Decrease) increase in net assets | $ (30,180,697) | $ 148,672,858 |
| Adjustments to reconcile (decrease) increase in net assets to net cash used in operating activities - | | |
| Realized and unrealized losses (gains) on long-term investments | 20,237,643 | (155,135,818) |
| Realized and unrealized losses on absolute return fund | - | 90,735 |
| Restricted return on endowment funds | (128,895) | (137,000) |
| Gifts and bequests for financing activities | (8,672,463) | (15,291,481) |
| (Increase) decrease in contributions receivable and bequests in probate | (11,017,298) | 2,131,136 |
| Gift value of annuity contracts written | (485,700) | (425,220) |
| Depreciation | 6,683,765 | 6,630,232 |
| Gain on sale of property, plant and equipment | (64,940) | (75,108) |
| (Decrease) increase in actuarial annuity payment liability and other liabilities | (608,932) | 304,760 |
| Increase (decrease) in interest rate swap liability | 4,403,500 | (999,300) |
| Decrease in non-current prepaid expenses and other assets | 60,161 | 240,399 |
| Increase in other current assets | (929,692) | (1,712,797) |
| Increase (decrease) in current liabilities other than capital expenditure accounts payable and current maturities of long-term debt | 4,033,471 | (2,552,949) |
| Net cash used in operating activities | (16,670,077) | (18,259,553) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchases of securities held for long-term investment | (235,004,609) | (637,598,933) |
| Proceeds from sales and maturities of investments | 254,114,966 | 654,584,671 |
| Cash collateral (advanced) returned under interest rate swap agreements | (4,040,000) | 410,000 |
| Proceeds from sale of investments for capital additions | - | 499,756 |
| Proceeds from sale of other investments - absolute return fund | - | 124,037 |
| Purchase of property, plant and equipment | (4,573,022) | (2,726,770) |
| Increase (decrease) in capital expenditure accounts payable | 693,387 | (331,786) |
| Proceeds from sale of property, plant and equipment | 65,391 | 163,116 |
| Decrease in long-term student loans | 47,926 | 125,401 |
| Net cash provided by investing activities | 11,304,039 | 15,249,492 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Gifts and bequests received for - | | |
| Long-term investment | 7,233,054 | 13,072,474 |
| Property, plant and equipment | 1,437,309 | 2,216,407 |
| Student loans | 2,100 | 2,600 |
| Endowment return restricted for long-term investments | 128,895 | 137,000 |
| Repayment of indebtedness | (2,633,923) | (10,969,933) |
| Long-term debt issued | - | 7,330,000 |
| Net cash provided by financing activities | 6,167,435 | 11,788,548 |
| Net increase in cash and cash equivalents | 801,397 | 8,778,487 |
| Cash and cash equivalents, beginning of year | 49,615,614 | 40,837,127 |
| Cash and cash equivalents, end of year | $ 50,417,011 | $ 49,615,614 |

*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 1,600 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. Cumulative net appreciation associated with donor-restricted endowments is classified as temporarily restricted net assets (see Note 2). 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, five-year Daily Treasury Yield Curve Rate for the fiscal year the pledge was initially recorded, currently at rates ranging from 0.72% to 1.79%. 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.

(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 and Cash Equivalents**

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.

**Inventories**

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

**Loans**

The College makes uncollateralized loans to students based on financial need. At June 30, 2012 and 2011, student loans totaled $1,336,712 (net of $440,000 loan loss reserve) and $1,394,638 (net of $400,000 loan loss reserve), respectively. Of the net loan totals, $1,198,342 and $1,224,378 for June 30, 2012 and 2011, respectively, were funded from institutional resources and the remaining loans were funded through Federal government loan programs. Reserves for loan losses are established when no payments are received for over six months. Loan balances are written off when they are deemed to be permanently uncollectible.

**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, commodities, 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.

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

**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 in 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.

*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 straight-line method based on the following composite depreciation guidelines:

| | |
|---|---|
| Buildings and additions | 30 - 75 years |
| Building improvements and renovations | 15 - 30 years |
| Furniture, equipment and books | 3 - 10 years |

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

| | 2012 | 2011 |
|---|---|---|
| Educational and general purposes | $6,013,304 | $6,009,992 |
| Student industries | 670,461 | 620,240 |
| | $6,683,765 | $ 6,630,232 |

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.

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

**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.

**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.

| | 2012 | 2011 |
|---|---|---|
| Interest | $2,215,243 | $2,406,156 |
| Depreciation | 6,683,765 | 6,630,232 |
| Plant Operations | 6,618,908 | 5,202,448 |

**Recent Accounting Pronouncements**

On March 25, 2010, Kentucky adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) with an effective date of July 15, 2010. UPMIFA does not impact the financial position, operating results, or cash flows of the College, but does impact the way the College accounts for and reports donor-restricted and board designated endowments. The impact of the change in law on the financial statements is discussed in Note 2.

**Reclassification**

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 presentation with no effect on total assets, liabilities, net assets or the change in net assets.

## NOTES TO FINANCIAL STATEMENTS

(2) LONG-TERM INVESTMENTS

| | June 30, 2012 | June 30, 2011 |
|---|---|---|
| **Endowment and Tuition Replacement:** | | |
| Pooled Investments - | | |
| U. S. equities | $ 225,550,600 | $ 222,751,500 |
| International equities | 253,397,000 | 230,037,500 |
| Corporate notes and bonds | 60,445,700 | 58,650,300 |
| U. S. Government securities | 63,819,100 | 70,210,400 |
| Structured notes | - | 43,933,900 |
| Private equity - venture capital | 4,660,500 | 4,834,900 |
| Private equity - buy out | 40,547,300 | 37,613,600 |
| Private equity - debt funds | 9,061,300 | 9,661,700 |
| Private equity - fund of funds | 24,467,000 | 37,273,900 |
| Hedge funds | 149,575,300 | 152,006,200 |
| Commodities | 49,878,900 | 18,869,400 |
| Real estate | 12,026,900 | 25,256,500 |
| Short-term investments and cash | 44,399,000 | 63,221,700 |
| Total | 937,828,600 | 974,321,500 |
| Non Pooled Investments - | | |
| U. S. equities | 38,000 | 29,600 |
| Corporate notes and bonds | 5,100 | 2,400 |
| Real estate | 2,876,900 | 2,536,900 |
| Short-term investments and cash | 1,869,400 | 1,844,500 |
| Total | 4,789,400 | 4,413,400 |
| Total endowment and tuition replacement | 942,618,000 | 978,734,900 |
| **Annuity and Life Income:** | | |
| U. S. equities | 8,724,900 | 12,286,600 |
| International equities | 4,961,500 | 6,505,300 |
| Corporate notes and bonds | 3,487,100 | 4,468,100 |
| U. S. Government securities | 3,336,100 | 3,255,400 |
| International bonds | 1,280,400 | - |
| Real estate | 3,329,000 | 330,000 |
| Insurance policies | 79,600 | 75,600 |
| Short-term investments and cash | 414,600 | 722,400 |
| Total annuity and life income | 25,613,200 | 27,643,400 |
| **Funds Held in Trust by Others,** where Berea College receives all or a stipulated percent of income | 23,708,800 | 24,424,000 |
| Total long-term investments | $ 991,940,000 | $1,030,802,300 |

## 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.

In 2011, the College used an endowment spending formula based on a 5% spending rate of the prior twelve quarter moving average of the market value of the long-term pooled investments. However, a new weighted-average endowment spending formula was adopted by the Board of Trustees effective July 1, 2011. Under the new formula, the amount available for spending per unit from the pooled endowment funds is calculated by increasing the prior year's spendable return by the annual change in the Consumer Price Index for all Urban Consumers compiled by the U. S. Department of Labor, Bureau of Labor Statistics (CPI) for the previous twelve month period plus 0.5% multiplied by a weighting factor of 70%. Added to this amount is 5% of the average market value of the pooled investments for the immediately preceding 6 calendar quarters multiplied by a weighting factor of 30%. To help maintain intergenerational equity and ensure a prudent level of spending, if the endowment spendable return calculated under this formula is less than 4.0% or more than 6.0% of the prior June 30 market value of the pooled endowment, the Board of Trustees determines whether to make any adjustments to the endowment spendable return.

In order to provide a stable transition from the previous spending formula, the endowment spendable return for the adoption year (2011-2012) of the weighted average formula was adjusted to yield approximately the same amount as would have been generated from the previous formula based on an assumed 8.2% investment return for the year ended June 30, 2011.

For 2012 and 2011, spendable return under the formulas amounted to $43,000,120 and $45,873,155, respectively. In 2012, actual cash income earned on pooled investments, net of $1,982,701 for investment management and custodial fees, amounted to $15,973,145, or $27,026,975 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 $13,828 in 2012 and $12,330 in 2011, while the market value of these investments of $4,789,400 at June 30, 2012 and $4,413,400 at June 30, 2011 increased by $3,737 in 2012 and increased by $1,366,300 in 2011. Additions to non-pooled endowment investments during 2012 and 2011 amounted to $372,263 and $7,500, respectively.

Dividend and interest income of $15,986,973 and $17,036,405 reported net of external investment manager fees of $1,982,701 and $2,209,369 is included in the statements of activities for the years ended June 30, 2012 and 2011, respectively.

(2) LONG-TERM INVESTMENTS (continued)

Effective July 15, 2010, the Commonwealth of Kentucky adopted legislation incorporating the provisions outlined in the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The statutory guidelines relate to prudent management, investment and expenditure of donor-restricted endowments held by charitable organizations. The legislation specifies factors for fiduciaries to consider prior to making a decision to appropriate from or accumulate into an organization's endowment funds. Within the context of this legislation, GAAP requires the cumulative net appreciation associated with donor-restricted endowments to be reclassified from unrestricted net assets to temporarily restricted net assets as a cumulative change in accounting principle. As a result, cumulative net appreciation associated with donor-restricted endowments of $254.9 million was reclassified from unrestricted net assets to temporarily restricted net assets in 2011.

The College has interpreted the Kentucky enacted version of UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the College classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. Any remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the College in a manner consistent with the standard of prudence prescribed by UPMIFA. From time to time, the fair value of assets associated with an endowed fund may fall below the level that a donor or UPMIFA requires in terms of maintenance of perpetual duration endowments. The cumulative value of these deficiencies is classified as unrestricted net assets.

The College interprets its fiduciary responsibility for donor-restricted endowments under UPMIFA, unless there are donor-specific provisions to the contrary, as preserving intergenerational equity to the extent possible. Under this broad guideline, future endowment beneficiaries should essentially receive at least the same level of economic support that the current generation enjoys. Endowment assets are invested to provide growth of the endowment through real investment return that exceeds spending over the long term. The overarching objective is to meet the College's goal of preserving and enhancing the real (inflation-adjusted) purchasing power of the endowment fund in perpetuity. Assets are invested to provide a stream of earnings to meet spending needs and attain long-term objectives without the assumption of undue risks.

In accordance with UPMIFA, the College considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the endowment fund

(2) The purposes of the institution and the endowment fund

(3) General economic conditions

(4) The possible effect of inflation or deflation

(5) The expected total return from income and the appreciation of investments

(6) Other resources of the institution

(7) The investment policy of the institution

(2) LONG-TERM INVESTMENTS (continued)

During 2012, the unit value of pooled investments changed as follows:

| | 2011-12 Market Value | 2011-12 Number of Units | 2011-12 Value Per Unit | 2011-12 Time Weighted Return Net of Fees | 2010-11 Market Value |
|---|---|---|---|---|---|
| Beginning Balance | $ 974,321,500 | 715,035.999 | $1,362.619 | | $843,736,700 |
| Market price change | (19,037,942) | | (26.542) | -1.9% | 145,610,683 |
| Net income earned | 15,973,145 | | 22.339 | 1.6% | 17,024,075 |
| Spendable return | (43,000,120) | | (60.137) | - | (45,873,155) |
| | (46,064,917) | | (64.340) | -0.3% | 116,761,603 |
| Additions | 9,572,017 | 7,326.976 | - | | 13,823,197 |
| Ending Balance | $ 937,828,600 | 722,362.975 | $1,298.279 | | $974,321,500 |

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

| | 2012 | 2011 |
|---|---|---|
| Pooled Investments - | | |
| Cash income, net | $ 15,973,145 | $ 17,024,075 |
| Market price (decrease) increase | (19,037,942) | 145,610,683 |
| Non-Pooled Investments - | | |
| Cash income | 13,828 | 12,330 |
| Market price increase | 3,737 | 1,366,300 |
| Total Return | $ (3,047,232) | $ 164,013,388 |
| Distributed to - | | |
| Unrestricted Net Assets | | |
| Spendable return | $ 37,401,970 | $ 41,173,362 |
| Long-term investments | (23,032,383) | 99,339,935 |
| Temporarily Restricted Net Assets | | |
| Spendable return | 5,483,083 | 4,575,122 |
| Investment return (less) more than amounts designated for current operations | (23,028,797) | 18,787,969 |
| Permanently Restricted | | |
| Restricted earnings | 128,895 | 137,000 |
| Total | $ (3,047,232) | $ 164,013,388 |

(2) LONG-TERM INVESTMENTS (continued)

Endowment Investments Net Asset Composition by Type of Fund as of June 30, 2012:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Donor-restricted endowment funds | $ (7,903,956) | $ 299,517,552 | $ 234,854,604 | $ 526,468,200 |
| Board-designated endowment funds | 416,149,800 | - | - | 416,149,800 |
| | $ 408,245,844 | $ 299,517,552 | $ 234,854,604 | $ 942,618,000 |

Changes in Endowment Investments Net Assets for the Fiscal Year Ended June 30, 2012:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Endowment investments net assets, beginning of year | $ 425,417,989 | $ 322,532,365 | $ 230,784,546 | $ 978,734,900 |
| Investment return: | | | | |
| Investment income | 15,986,973 | - | - | 15,986,973 |
| Net depreciation (realized and unrealized) | (11,172,958) | (7,861,247) | - | (19,034,205) |
| Total investment return | 4,814,015 | (7,861,247) | - | (3,047,232) |
| Contributions | - | - | 3,339,463 | 3,339,463 |
| Other restricted additions | - | 13,983 | 730,595 | 744,578 |
| Board designated additions | 5,860,239 | - | - | 5,860,239 |
| Appropriation of endowment assets for expenditure | (27,846,399) | (15,167,549) | - | (43,013,948) |
| Endowment investments net assets, end of year | $ 408,245,844 | $ 299,517,552 | $ 234,854,604 | $ 942,618,000 |

(2) LONG-TERM INVESTMENTS (continued)

Endowment Investments Net Asset Composition by Type of Fund
as of June 30, 2011:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Donor-restricted endowment funds | $ (5,072,911) | $ 322,532,365 | $ 230,784,546 | $ 548,244,000 |
| Board-designated endowment funds | 430,490,900 | - | - | 430,490,900 |
| | $ 425,417,989 | $ 322,532,365 | $ 230,784,546 | $ 978,734,900 |

Changes in Endowment Investments Net Assets
for the Fiscal Year Ended June 30, 2011:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Endowment investments net assets, beginning of year | $ 576,638,038 | $ 48,718,837 | $ 221,419,425 | $ 846,776,300 |
| Net asset reclassification based on change in law | (254,900,058) | 254,900,058 | - | - |
| Endowment net assets after reclassification | 321,737,980 | 303,618,895 | 221,419,425 | 846,776,300 |
| Investment return: | | | | |
| Investment income | 17,036,405 | - | - | 17,036,405 |
| Net appreciation (realized and unrealized) | 123,522,499 | 23,454,484 | - | 146,976,983 |
| Total investment return | 140,558,904 | 23,454,484 | - | 164,013,388 |
| Contributions | - | 300 | 7,673,914 | 7,674,214 |
| Other restricted additions | - | 137,580 | 278,535 | 416,115 |
| Board designated additions | 5,740,368 | - | - | 5,740,368 |
| Appropriation of endowment assets for expenditure | (41,218,970) | (4,666,515) | - | (45,885,485) |
| Reclassification | (1,400,293) | (12,379) | 1,412,672 | - |
| Endowment investments net assets, end of year | $ 425,417,989 | $ 322,532,365 | $ 230,784,546 | $ 978,734,900 |

The College's endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As of June 30, 2012, the College has approximately 4,700 individual endowment funds of which approximately 1,950 are donor-restricted funds that are used to provide funding for cost of education for students, direct student aid, various academic support programs, and other restricted uses.

## NOTES TO FINANCIAL STATEMENTS

(3) FAIR VALUE MEASUREMENTS

GAAP 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. One key component of the fair value measurement required by GAAP 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 or liabilities

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 amortized 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 following summarizes the fair value of assets and liabilities and the Level 3 reconciliation at June 30, 2012:

| | June 30, 2012 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 | $ 942,618,000 | $ 619,196,679 | $ 88,966,527 | $ 234,454,794 |
| Other investments | 100,000 | - | 100,000 | - |
| Funds held in trust by others | 23,708,800 | - | - | 23,708,800 |
| Split-interest agreements | 25,613,200 | - | - | 25,613,200 |
| Total assets | 992,040,000 | 619,196,679 | 89,066,527 | 283,776,794 |
| **Liabilities** | | | | |
| Split-interest agreement liability | 11,632,500 | - | - | 11,632,500 |
| Interest rate swap agreements | 7,526,400 | - | 7,526,400 | - |
| Asset retirement obligation | 632,333 | - | - | 632,333 |
| Total liabilities | 19,791,233 | - | 7,526,400 | 12,264,833 |
| Total fair value | $ 972,248,767 | $ 619,196,679 | $ 81,540,127 | $ 271,511,961 |

(3) FAIR VALUE MEASUREMENTS (continued)

Level 3 Reconciliation

| | Balances June 30, 2011 | Net realized and unrealized gains (losses) included in change in net assets | Purchases, sales, issuances and settlement, net | Net transfers in (out) of Level 3 | Balances June 30, 2012 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Endowment investments | $ 244,419,535 | $ 2,506,257 | $ (12,470,998) | $ - | $ 234,454,794 |
| Funds held in trust by others | 24,424,000 | (715,200) | - | - | 23,708,800 |
| Split-interest agreements | 27,643,400 | (488,239) | (1,541,961) | - | 25,613,200 |
| Total assets | 296,486,935 | 1,302,818 | (14,012,959) | - | 283,776,794 |
| **Liabilities** | | | | | |
| Split-interest agreement liability | 12,453,900 | (821,400) | - | - | 11,632,500 |
| Asset retirement obligation | 610,241 | 22,092 | - | - | 632,333 |
| Total liabilities | 13,064,141 | (799,308) | - | - | 12,264,833 |
| Total fair value | $ 283,422,794 | $ 2,102,126 | $ (14,012,959) | $ - | $ 271,511,961 |

The College's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstance that caused the transfer.

| | |
|---|---|
| The amount of total gains or losses for the period included in change in net assets attributable to the change in unrealized gains or losses relating to financial instruments still held in endowment investments at June 30, 2012 | $ (12,884,300) |

The loss of $12,884,300 is included in "Investment return (less) more than amounts designated for current operations" in the statements of activities.

The following summarizes the fair value of assets and liabilities and the Level 3 reconciliation at June 30, 2011:

| | June 30, 2011 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 | $ 978,734,900 | $ 589,655,190 | $ 144,660,175 | $ 244,419,535 |
| Other investments | 100,000 | - | 100,000 | - |
| Funds held in trust by others | 24,424,000 | - | - | 24,424,000 |
| Split-interest agreements | 27,643,400 | - | - | 27,643,400 |
| Total assets | 1,030,902,300 | 589,655,190 | 144,760,175 | 296,486,935 |
| **Liabilities** | | | | |
| Split-interest agreement liability | 12,453,900 | - | - | 12,453,900 |
| Interest rate swap agreements | 3,122,900 | - | 3,122,900 | - |
| Asset retirement obligation | 610,241 | - | - | 610,241 |
| Total liabilities | 16,187,041 | - | 3,122,900 | 13,064,141 |
| Total fair value | $ 1,014,715,259 | $ 589,655,190 | $ 141,637,275 | $ 283,422,794 |

(3) FAIR VALUE MEASUREMENTS (continued)

| | Balances June 30, 2010 | Net realized and unrealized gains (losses) included in change in net assets | Purchases, sales, issuances and settlement, net | Net transfers in (out) of Level 3 | Balances June 30, 2011 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Endowment investments | $ 211,633,662 | $ 25,053,945 | $ 7,731,928 | $ - | $ 244,419,535 |
| Other investments | 214,772 | (90,735) | (124,037) | - | - |
| Funds held in trust by others | 21,010,200 | 3,413,800 | - | - | 24,424,000 |
| Split-interest agreements | 24,440,500 | 4,745,035 | (1,542,135) | - | 27,643,400 |
| Total assets | 257,299,134 | 33,122,045 | 6,065,756 | - | 296,486,935 |
| **Liabilities** | | | | | |
| Split-interest agreement liability | 12,176,600 | 277,300 | - | - | 12,453,900 |
| Asset retirement obligation | 593,893 | 16,348 | - | - | 610,241 |
| Total liabilities | 12,770,493 | 293,648 | - | - | 13,064,141 |
| Total fair value | $ 244,528,641 | $ 32,828,397 | $ 6,065,756 | $ - | $ 283,422,794 |

The College's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstance that caused the transfer.

| | |
|---|---|
| The amount of total gains or losses for the period included in change in net assets attributable to the change in unrealized gains or losses relating to financial instruments still held in endowment investments at June 30, 2011 | $ 4,922,000 |

The gain of $4,922,000 is included in "Investment return (less) more than amounts designated for current operations" in the statements of activities.

The following methods and assumptions were used to estimate the fair value for each class of financial instrument measured at fair value:

**Endowment and other investments**

Short-term investments - The fair value of short-term investments, consisting primarily of money market funds, is classified as Level 2 as these funds are not traded on a regular basis.

Equity mutual funds - Investments in equity mutual funds are classified as Level 1 as these funds are traded in an active market for which closing prices are readily available.

Alternative investments - Investments in hedge funds, private equity funds, and funds of funds are classified as level 3 as the valuation is based on significant unobservable inputs.

**Funds held in trust by others**

The College's beneficial interest in perpetual trusts administered by a third party are classified as Level 3 as the fair values are based on a combination of Level 2 inputs (interest rates and yield curves) and significant unobservable inputs (entity specific estimates of cash flows). Since the College has an irrevocable right to receive the income earned from the trusts' assets, the fair value of the College's beneficial interest is estimated to approximate the fair value of the trusts' assets.

(3) FAIR VALUE MEASUREMENTS (continued)

**Split-interest agreements**

The College's beneficial interest in irrevocable split-interest agreements in which the College serves as trustee are classified as Level 3 as the fair values of the net assets (gross assets less estimated future payment obligations) are based on a combination of Level 2 inputs (interest rates and yield curves) and significant unobservable inputs (estimates of cash flows). The estimated fair value of assets is reduced by the estimated future payment liability.

**Interest rate swap agreements**

Interest rate swap agreements are classified as Level 2 as the fair value is based on observable inputs to a valuation model (interest rates, credit spreads, etc.) which take into account the present value of the estimated future cash flows and credit valuation adjustments.

**Asset retirement obligation**

The asset retirement obligation fair value represents expected future costs associated with asbestos abatement. The fair value is based upon significant unobservable inputs (the amount of hidden asbestos in buildings to be renovated, timing of renovations, future remediation methods, discount rate, etc.) and therefore is classified as Level 3.

(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 $7,526,400 and negative $3,122,900 at June 30, 2012 and 2011, respectively and is included with long-term liabilities in the statements of financial position. The decrease in market value of the interest rate swaps of $4,403,500 and the increase of $999,300 have been reflected in the statements of activities in other unrestricted activity for the years ended June 30, 2012 and 2011, respectively. If the fair market value of the interest rate swaps results in an estimated liability in excess of $3,000,000, the College must post collateral with the counterparty, UBS AG. Conversely, if the fair market value of the interest rate swaps results in an estimated asset in excess of $3,000,000, the counterparty must post collateral with the College. The College had cash collateral posted with the counterparty in varying amounts throughout 2012. Collateral in the amount of $4,700,000 and $660,000 was posted with the counterparty as of June 30, 2012 and 2011, respectively.

(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 $1,818,108 in 2012 and $1,658,322 in 2011.

(6) PROPERTY, PLANT AND EQUIPMENT

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

| Property, Plant and Equipment | 2012 | 2011 |
|---|---|---|
| Educational property, plant and equipment | $ 183,205,177 | $ 181,955,145 |
| Student industry plant and equipment | 19,110,325 | 18,579,186 |
| Rental property | 2,538,308 | 2,551,773 |
| Forest and farms | 1,250,902 | 1,250,902 |
| Collections and works of art | 4,097,531 | 4,097,531 |
| Construction in process | 2,970,008 | 178,503 |
| Less accumulated depreciation | (72,206,688) | (65,536,283) |
| | $ 140,965,563 | $ 143,076,757 |

(7) CONDITIONAL ASSET RETIREMENT OBLIGATIONS

Under GAAP, 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 for as an additional element of cost and is depreciated over the useful life of the asset. The College's 2012 and 2011 accounting for costs associated with asbestos abatement is as follows:

| | 2012 | 2011 |
|---|---|---|
| Beginning balance | $ 610,241 | $ 593,893 |
| Accretion expense | 23,442 | 23,550 |
| Liabilities settled during the year | (1,350) | (7,202) |
| Ending balance | $ 632,333 | $ 610,241 |

## NOTES TO FINANCIAL STATEMENTS

(8) LONG-TERM DEBT

| | June 30, 2012 | June 30, 2011 |
|---|---|---|
| Variable Rate Demand Educational Facilities Revenue Bonds, Series 2002A - Issued August 29, 2002; due June 1, 2032; variable interest rate, 0.16% as of June, 2012 with synthetic fixed rate of 3.45%; proceeds used for various capital projects | $ 13,800,000 | $ 14,325,000 |
| 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 | 17,115,000 | 17,645,000 |
| Variable Rate Demand Educational Facilities Revenue Bonds, Series 2003B - Issued December 11, 2003; variable payments through June 1, 2029; variable interest rate, 0.16% as of June, 2012 with synthetic fixed rate of 3.746%; proceeds used for various capital projects | 7,950,000 | 8,275,000 |
| 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 | 7,305,000 | 7,575,000 |
| Industrial Building Revenue Bonds, Series 2008 - Issued July, 2008; bank qualified tax-exempt loan through Branch Banking and Trust Company; final maturity date July 1, 2015; monthly payments at fixed rate of 3.980% for seven years based on 20-year amortization; proceeds used for Emery Building renovation | 3,336,711 | 3,525,634 |
| Industrial Building Revenue Refunding Bonds, Series 2010 - Issued December, 2010; bank qualified tax-exempt loan through JP Morgan Chase Bank, National Association; serial annual payments through June 1, 2020 at fixed 2.25% rate; proceeds used for refunding Series 1997, 1998 and 2000 bonds | 5,780,000 | 6,575,000 |
| | 55,286,711 | 57,920,634 |
| Less current portion | 2,187,069 | 2,108,923 |
| | $ 53,099,642 | $ 55,811,711 |

Principal payments on long-term debt are required to be made in each of the following fiscal years: $2,187,069 in 2013; $2,275,170 in 2014; $2,373,604 in 2015; $2,477,098 in 2016; $2,581,515 in 2017 and $43,392,255 in subsequent years thereafter.

The fair value of the College's long-term debt at June 30, 2012 was estimated to be approximately $55,934,000 based upon rates available to the College for debt with similar terms and remaining maturities.

Cash payments for interest amounted to $2,218,107 in 2012 and $2,458,462 in 2011.

# NOTES TO FINANCIAL STATEMENTS

(9) CONTRIBUTIONS RECEIVABLE AND BEQUESTS IN PROBATE

| | June 30, 2012 Total | Due In One Year or Less | One Year to Five Years | Over Five Years | June 30, 2011 Total |
|---|---|---|---|---|---|
| Unconditional Promises for - | | | | | |
| Unrestricted | $ - | $ - | $ - | $ - | $ 2,125 |
| Restricted [1] | 1,326,062 | 738,473 | 587,589 | - | 80,000 |
| Buildings and equipment [2] | 12,446,426 | 9,927,356 | 2,519,070 | - | 346,010 |
| Endowment | 10,000 | 10,000 | - | - | 46,000 |
| Reserve for unfulfilled promises | (2,457) | (1,741) | (716) | - | (26,699) |
| Total | 13,780,031 | 10,674,088 | 3,105,943 | - | 447,436 |
| Bequests in Probate | 3,440,710 | 2,108,112 | 1,332,598 | - | 5,531,835 |
| External Charitable Remainder Trusts* | 885,099 | - | - | 885,099 * | 1,015,828 |
| Charitable Lead Trusts | 825,590 | 68,278 | 273,112 | 484,200 | 893,868 |
| Total | $ 18,931,430 | $ 12,850,478 | $ 4,711,653 | $ 1,369,299 | $ 7,888,967 |
| Present Value of Estimated Future Cash Flows | $ 18,786,352 | $ 12,850,478 | $ 4,648,118 | $ 1,287,756 | $ 7,769,054 |

[1] June 30, 2012 balance includes $1,311,312 commitment from an external charitable trust ($728,473 due in one year or less, $582,839 due in one year to five years).

[2] June 30, 2012 balance includes $12,389,336 commitment from an external charitable trust ($9,889,336 due in one year or less, $2,500,000 due in one year to five years).

* 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, 2012, the College was committed under various contracts with alternative investment managers to fund $18,703,573 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 | $ 478,475 |
| Buy out | 13,782,207 |
| Debt fund | 1,661,353 |
| Fund of funds | 2,781,538 |
| Total | $ 18,703,573 |

The College has purchase commitments relating to construction projects of approximately $12,963,000 as of June 30, 2012.

## 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:

| | 2012 | 2011 |
|---|---|---|
| Purpose Restricted Contributions for - | | |
| Instruction | $ 1,397,242 | $ 1,315,232 |
| Public service | 754,583 | 747,148 |
| Academic support | 1,134,907 | 620,510 |
| Student services | 273,144 | 169,949 |
| Student aid | 2,689,564 | 1,450,929 |
| Support services | 39,716 | 225,506 |
| Plant operations | 299,099 | 5,500 |
| | 6,588,255 | 4,534,774 |
| Time-Restricted Contributions - Amortization of Restricted Gifts to Acquire Long-Lived Assets | 1,187,517 | 1,173,584 |
| Total Net Assets Released from Restriction | $ 7,775,772 | $ 5,708,358 |
| Matured Annuity and Life Income Contracts - | | |
| Temporarily Restricted Agreements Reclassified to Tuition Replacement Funds in Unrestricted Net Assets | $ 856,185 | $ 342,107 |

# NOTES TO FINANCIAL STATEMENTS

(13) TAX STATUS

Berea College has a determination from the IRS that it is a not-for-profit organization exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code. However, the College is subject to federal income tax on any unrelated business income. No provision for income tax has been made in the accompanying financial statements.

GAAP requires the College to evaluate tax positions taken by the College and recognize a tax liability (or asset) if the College has taken an uncertain position that more likely than not would be sustained upon examination by the IRS. The College has analyzed the tax positions taken by the College and has concluded that there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The College is subject to routine audits by taxing jurisdictions; however there are currently no audits for any tax periods in progress. The College believes it is no longer subject to income tax examinations for years prior to 2009.

(14) SUBSEQUENT EVENTS

We evaluate events and transactions that occur after the statement of financial position date as potential subsequent events. We performed this evaluation through September 6, 2012, the date on which we issued our financial statements. There were no events occuring during the evaluation period that would require recognition or disclosure in the financial statements.

**Remaining Pages**
**Intentionally Left Blank**

GOD HAS MADE OF ONE BLOOD ALL PEOPLES OF THE EARTH

BEREA COLLEGE