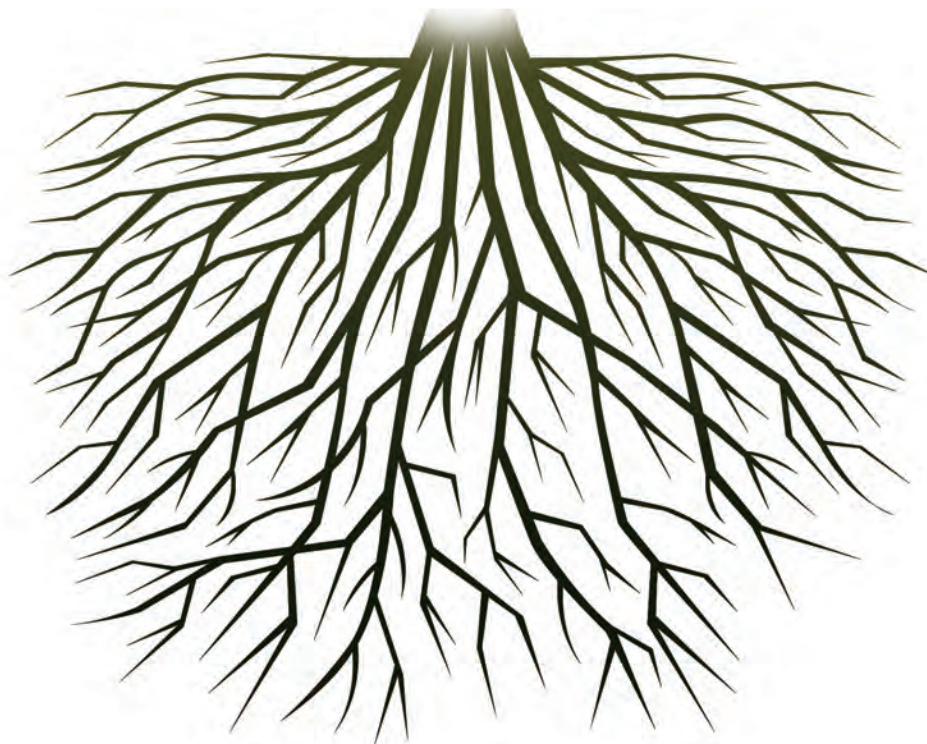




# PEPPERDINE

AUDITED FINANCIAL STATEMENTS 2012-2013



**PEPPERDINE UNIVERSITY**

CONSOLIDATED FINANCIAL STATEMENTS

July 31, 2013 and 2012

**PEPPERDINE UNIVERSITY**

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## Independent Auditor's Report

To the Board of Regents of  
Pepperdine University

We have audited the accompanying consolidated financial statements of Pepperdine University (the "University"), which comprise the consolidated statements of financial position as of July 31, 2013 and 2012 and the related consolidated statements of activities and cash flows for the years then ended.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the consolidated 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the University's **preparation and fair presentation of** the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's **internal control. Accordingly,** we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pepperdine University at July 31, 2013 and 2012 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

November 22, 2013

**PEPPERDINE UNIVERSITY**  
**Consolidated Statements of Financial Position**  
**At July 31, 2013 and 2012**  
**(In thousands)**

	2013	2012
<b>ASSETS</b>		
Cash and cash equivalents.....	\$ 68,941	\$ 73,625
Student receivables, less allowance for doubtful accounts of \$1,343 and \$1,410, respectively...	1,295	1,183
Other accounts receivable.....	4,062	3,119
Prepaid expenses, inventories and other assets.....	5,512	4,903
Student loans, less allowance for loan losses of \$1,599 and \$1,707, respectively.....	22,749	23,812
Contributions receivable, net.....	30,597	28,905
Investments.....	830,726	767,261
Assets held as trustee or agent.....	123,843	124,459
Property, facilities and equipment, net.....	362,409	341,180
Total assets.....	\$1,450,134	\$1,368,447
<b>LIABILITIES AND NET ASSETS</b>		
Liabilities:		
Accounts payable and accrued liabilities.....	\$ 28,855	\$ 15,730
Accrued salaries and wages.....	3,579	3,364
Student deposits, advance payments and deferred revenue.....	9,977	10,012
Asset retirement obligations.....	5,912	5,720
U.S. government-funded student loans.....	15,340	15,006
Trust and agency obligations.....	70,754	74,951
Long-term obligations.....	238,750	239,422
Total liabilities.....	373,167	364,205
Net assets:		
Unrestricted.....	630,777	595,418
Temporarily restricted.....	118,605	103,043
Permanently restricted.....	327,585	305,781
Total net assets.....	1,076,967	1,004,242
Total liabilities and net assets.....	\$1,450,134	\$1,368,447

See accompanying notes to consolidated financial statements.

**PEPPERDINE UNIVERSITY**  
**Consolidated Statement of Activities**  
**For the year ended July 31, 2013**  
**(In thousands)**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>REVENUES</b>				
Student tuition and fees.....	\$ 280,531	\$ -	\$ -	\$ 280,531
Less student aid.....	(88,797)			(88,797)
Net student tuition and fees.....	191,734	-	-	191,734
Room and board.....	34,675	-	-	34,675
Private gifts and grants.....	12,098	5,171	4,265	21,534
Endowment support.....	32,855	-	365	33,220
Government grants.....	3,546	-	-	3,546
Sales and services.....	7,032	-	-	7,032
Other revenue.....	5,455	4,621	614	10,690
Net assets released from restriction.....	8,890	(8,890)	-	-
Total revenues.....	296,285	902	5,244	302,431
<b>EXPENSES</b>				
Instruction and research.....	86,348	-	-	86,348
Academic support.....	51,670	-	-	51,670
Student services.....	48,381	-	-	48,381
Public service.....	14,168	-	-	14,168
Auxiliary enterprises.....	26,331	-	-	26,331
Management and general.....	52,609	-	-	52,609
Membership development.....	2,036	-	-	2,036
Fundraising.....	7,431	-	-	7,431
Total expenses.....	288,974	-	-	288,974
Change in net assets before nonoperating revenues and expenses.....	7,311	902	5,244	13,457
<b>NON-OPERATING REVENUES AND EXPENSES</b>				
Actuarial adjustment.....	-	4,090	(76)	4,014
Investment income:				
Dividends.....	6,773	2,016	7	8,796
Interest.....	299	8	83	390
Other.....	6,731	-	3	6,734
Investment expenses.....	(3,018)	(965)	-	(3,983)
Net realized and unrealized investment gains.....	17,806	7,526	14,424	39,756
Foreign currency translation.....	1,362			1,362
Other.....	(1,905)	1,985	2,119	2,199
Total nonoperating revenues and expenses.....	28,048	14,660	16,560	59,268
Change in net assets.....	35,359	15,562	21,804	72,725
Net assets at beginning of year.....	595,418	103,043	305,781	1,004,242
Net assets at end of year.....	\$ 630,777	\$ 118,605	\$ 327,585	\$ 1,076,967

See accompanying notes to consolidated financial statements.

**PEPPERDINE UNIVERSITY**  
**Consolidated Statement of Activities**  
**For the year ended July 31, 2012**  
**(In thousands)**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>REVENUES</b>				
Student tuition and fees.....	\$ 269,884	\$ -	\$ -	\$ 269,884
Less student aid.....	(81,350)	-	-	(81,350)
Net student tuition and fees.....	<u>188,534</u>	<u>-</u>	<u>-</u>	<u>188,534</u>
Room and board.....	32,465	-	-	32,465
Private gifts and grants.....	10,905	6,058	5,960	22,923
Endowment support.....	31,527	115	361	32,003
Government grants.....	3,624	3	-	3,627
Sales and services.....	6,273	-	-	6,273
Other revenue.....	4,344	18	1,054	5,416
Net assets released from restriction.....	26,744	(26,881)	137	-
Total revenues.....	<u>304,416</u>	<u>(20,687)</u>	<u>7,512</u>	<u>291,241</u>
<b>EXPENSES</b>				
Instruction and research.....	84,163	-	-	84,163
Academic support.....	49,506	-	-	49,506
Student services.....	48,806	-	-	48,806
Public service.....	15,009	-	-	15,009
Auxiliary enterprises.....	23,744	-	-	23,744
Management and general.....	46,608	-	-	46,608
Membership development.....	1,824	-	-	1,824
Fundraising.....	7,707	-	-	7,707
Total expenses.....	<u>277,367</u>	<u>-</u>	<u>-</u>	<u>277,367</u>
Change in net assets before nonoperating revenues and expenses.....	27,049	(20,687)	7,512	13,874
<b>NON-OPERATING REVENUES AND EXPENSES</b>				
Actuarial adjustment.....	-	(5,635)	(2,030)	(7,665)
Investment income:				
Dividends.....	6,632	1,776	1	8,409
Interest.....	1,135	5	147	1,287
Other.....	7,599	16	4	7,619
Investment expenses.....	(3,246)	(901)	-	(4,147)
Net realized and unrealized investment losses.....	(16,788)	(6,585)	(3,723)	(27,096)
Foreign currency translation.....	(2,606)	-	-	(2,606)
Other.....	(60)	2,676	(1,130)	1,486
Total nonoperating revenues and expenses.....	<u>(7,334)</u>	<u>(8,648)</u>	<u>(6,731)</u>	<u>(22,713)</u>
Change in net assets.....	19,715	(29,335)	781	(8,839)
Net assets at beginning of year.....	\$ 575,703	\$ 132,378	\$ 305,000	\$ 1,013,081
Net assets at end of year.....	<u>\$ 595,418</u>	<u>\$ 103,043</u>	<u>\$ 305,781</u>	<u>\$ 1,004,242</u>

See accompanying notes to consolidated financial statements.

**PEPPERDINE UNIVERSITY**  
**Consolidated Statements of Cash Flows**  
**For the Years Ended July 31, 2013 and 2012**  
(In thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	2013	2012
Change in net assets.....	\$ 72,725	\$ (8,839)
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization.....	19,630	19,781
Provision for doubtful accounts.....	-	200
Loss on early extinguishment of debt.....	-	333
Non-cash gifts.....	(8,869)	(8,876)
Adjustment of actuarial liability.....	(4,014)	7,665
Contributions restricted for long-term investment.....	(2,030)	(2,931)
Income restricted for long-term investment.....	(365)	(361)
Premium on issuance of long-term debt.....	-	8,488
Loss from sale of property, facilities and equipment.....	70	200
Net realized and unrealized (gains) losses on investments.....	(39,756)	27,096
Change in assets and liabilities:		
Student receivables.....	(112)	454
Other accounts receivable.....	(943)	1,703
Contributions receivable.....	(3,507)	(2,072)
Prepaid expenses, inventories and other assets.....	(764)	(759)
Accounts payable and accrued liabilities.....	4,262	(1,028)
Accrued salaries and wages.....	215	148
Student deposits, advance payments and deferred revenue.....	24	1,428
Net cash and cash equivalents provided by operating activities.....	36,566	42,630
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales of investments.....	73,724	163,060
Purchases of investments.....	(95,014)	(168,193)
Purchases of property, facilities and equipment.....	(26,886)	(13,977)
Student loans repaid.....	4,565	4,319
Student loans issued.....	(3,502)	(3,618)
Net cash and cash equivalents used in investing activities.....	(47,113)	(18,409)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from contributions restricted for long-term investment.....	3,845	3,851
Income restricted for long-term investment.....	365	361
Proceeds from issuance of long-term obligations.....	-	50,000
Principal payments on long-term obligations.....	-	(45,000)
Increase in U.S. government student loan funds.....	333	321
Investment income (losses) and gains on annuities payable.....	8,885	(2,435)
Payment of trust and agency obligations.....	(7,565)	(7,866)
Net cash and cash equivalents provided by (used in) financing activities.....	5,863	(768)
Net change in cash and cash equivalents.....	(4,684)	23,453
Cash and cash equivalents at beginning of year.....	73,625	50,172
Cash and cash equivalents at end of year.....	\$ 68,941	\$ 73,625

See accompanying notes to consolidated financial statements.



# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 1. Nature of Operations

Pepperdine University (the “University”) is an independent private Christian university committed to the highest standards of academic excellence and Christian values, where students are strengthened for lives of purpose, service, and leadership. The University enrolls approximately 7,300 students in its five colleges and schools. Seaver College, the University’s undergraduate liberal arts college, the School of Law, and the School of Public Policy are headquartered on 830 acres in the Santa Monica Mountains overlooking the Pacific Ocean in Malibu, California. The Graduate School of Education and Psychology and the George L. Graziadio School of Business and Management are headquartered at the University’s West Los Angeles, California graduate campus.

Mr. George Pepperdine, the founder of Western Auto Supply Company, established George Pepperdine College in 1937. He envisioned a college with the highest academic standards guided by the spiritual and ethical ideals of Christian faith. University status was achieved in 1970 with the addition of the graduate and professional schools. Through the generosity of Mrs. Frank Roger Seaver, the University’s Malibu campus of Seaver College opened in 1972. Since then, the Malibu campus expanded to include the School of Law in 1978, and the Drescher Graduate Campus in 2003.

The University operates several consolidated affiliated companies. All material transactions and balances between the University and its affiliates have been eliminated in consolidation.

### 2. Summary of Significant Accounting Policies

#### *Basis of Presentation*

The accompanying Consolidated Financial Statements of the University are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“GAAP”) applicable to not-for-profit organizations. In preparing the Consolidated Financial Statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities and revenues and expenses for the periods presented. Significant items which could be materially affected by such estimates include: the allowance for doubtful accounts, the allowance for loan losses, contributions receivable, investments, assets held as trustee or agent, accounts payable and accrued liabilities and trust and agency obligations. The University’s actual results could differ significantly from management’s estimates. Management also utilizes certain estimates based on square footage to allocate depreciation, interest expense and central plant operations expense to the functional expense categories included on the Consolidated Statements of Activities.

#### *Adoption of New Accounting Pronouncements*

The University has adopted the required disclosures under ASU 2011-04, *Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. These disclosures primarily relate to Level 3 measurements including a description of the valuation processes and a narrative description of the sensitivity of the fair value to changes in unobservable inputs, quantitative disclosure about unobservable inputs and assumptions excluding investments measured at Net Asset Value (“NAV”). In addition, the new guidance requires disclosure of all transfers between Level 1 and Level 2, regardless of significance. The University adopted this guidance effective August 1, 2012, with no material impact on the financial statements.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

The University has also adopted the required disclosures under ASU 2013-03 *Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities*. This update clarifies that nonpublic entities are not required to disclose the level of the fair value hierarchy (i.e., Level 1, 2, or 3) for fair value measurements that are disclosed in the footnotes to the financial statements but not reported at fair value in the statement of financial position. The University adopted this guidance effective February 7, 2013, with no material impact on the financial statements.

### *Income Taxes*

As a not-for-profit educational institution, the University is exempt from Federal and California income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code, except for taxes on unrelated business income. Since the University's unrelated business income for the years ended July 31, 2013 and 2012 was immaterial, no provision for income taxes has been made in the accompanying Consolidated Financial Statements.

### *Net Assets*

The University is required to classify its net assets into the following three categories according to donor-imposed restrictions or provisions of law:

Unrestricted net assets represent resources that are not restricted, either temporarily or permanently, by donor-imposed stipulations. They are available for support of all organizational operations and services.

Temporarily restricted net assets represent contributions and other assets whose use are limited by donor-imposed stipulations. These restrictions are temporary in that they either expire by the passage of time or by the fulfillment of certain obligations of the University pursuant to those stipulations.

Permanently restricted net assets represent contributions and other assets whose use by the University are limited by donor-imposed stipulations. These restrictions are permanent in that they neither expire by passage of time nor can they be otherwise removed by the University. Income from these assets can be unrestricted or restricted based on donor stipulations.

During the year ended July 31, 2012, \$21.9 million of net assets related to capital projects completed in prior years were released from restriction. The University does not believe that this correction has a material impact to the current or previously issued financial statements.

### *Revenue Recognition*

Student tuition and fees and room and board are recorded as revenues in the period the services are rendered. Private gifts, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets. Conditional or contingent grant awards are not recorded as revenue until the conditions on which they depend have been substantially met. Grants received from departments or agencies of the government considered to be exchange transactions are not recorded as revenue until related costs are incurred. These revenues are subject to audit by government authorities. A receivable is recorded to represent expenditures incurred prior to the fiscal year end for which cash reimbursement has not been received. Endowment support, limited to the payout calculated under the Total Rate of Return methodology, is comprised of ordinary income earned on endowment and quasi-endowment assets as well as accumulated gains earned on endowment and quasi-endowment assets in previous years.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### *Concentrations of Financial Aid*

A significant number of students attending the University receive financial assistance from U.S. government student financial aid programs. These programs require the University to comply with record keeping, eligibility and other requirements. Failure to comply with such U.S. government requirements could result in the loss of U.S. government financial assistance to the University's students and adversely impact the operations of the University.

### *Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand, cash in checking and savings accounts, money-market funds, cash held by external investment managers and short-term investments with an original maturity of three months or less. Other short-term resources held by external investment managers are classified as investments.

### *Student Receivables*

Student receivables are carried at cost, less an allowance for doubtful accounts.

Management believes that the allowance for doubtful accounts is adequate. Management uses available information to recognize losses on student receivables. Future additions to the allowance may be necessary based on changes in economic conditions and other factors.

### *Student Loans*

Student loans are recorded at the contractual amounts owed by students adjusted for unamortized discounts, premiums, unearned income, undisbursed funds, deferred loan fees and the allowance for loan losses. Interest income is recorded on the accrual basis of accounting in accordance with the terms of the receivables, except that interest accruals are discontinued when the payment of principal or interest is 90 or more days past due or when repayment of principal and interest in full is doubtful. Payments received on non-accrual loans are applied to the principal outstanding until the loan is restored to accrual status.

A student loan is impaired when it is probable that the University will be unable to collect all amounts due according to the contractual terms of the loan agreement. The measurement of impairment may be based on (i) the present value of the expected future cash flows of the impaired loan discounted at the loan's original effective interest rate or (ii) the observable market price of the impaired loan. If the recorded investment of the loan exceeds the measure of impairment, a valuation allowance is recorded in the amount of the excess. The University measures impairment by utilizing a discounted cash flow analysis. The University's income recognition policies for impaired loans are consistent with those for non-accrual loans. All loans designated as impaired are either placed on non-accrual status or are designated as restructured. Payments received on impaired loans are applied to the principal outstanding until the loan is returned to accrual status.

On an ongoing basis, management monitors the student loan portfolio and evaluates the adequacy of the allowance for loan losses. In determining the adequacy of the allowance for loan losses, management considers such factors as historical loss experience, known problem loans, assessment of economic conditions and other appropriate data to identify the risks in the student loan portfolio. The amount of the allowance for loan losses is based on estimates and the University's actual losses may

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

vary from management's estimates. Loans deemed by management to be uncollectible are charged to the allowance for loan losses. Recoveries on loans previously charged off are credited to the allowance for loan losses. Provisions for loan losses are charged to expense and credited to the allowance for loan losses in amounts that are deemed appropriate by management based upon its evaluation of the known and inherent risks in the student loan portfolio.

Management believes that the allowance for loan losses is adequate. Management uses available information to recognize losses on loans. Future additions to the allowance may be necessary based on changes in economic conditions and other factors.

### *Contributions Receivable*

Contributions, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets. Contributions where donor restrictions are met in the same fiscal year as the contribution is made are reported as unrestricted support. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received in future periods are discounted at a credit-adjusted interest rate.

### *Investments*

Investments are stated at fair value and all related transactions are recorded on the trade date. The fair value of investments is based on quoted market prices from national security exchanges, except for alternative investments for which quoted market prices are not available. The fair value of certain alternative investments, which include limited partnerships in venture capital, real estate and other private debt and equity funds, is typically Net Asset Value ("NAV"), provided by the external investment managers or general partners, adjusted for receipts and disbursements of cash and distributions of securities if the date of valuation is prior to the University's fiscal year end. Such valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments and other pertinent information. The University believes the carrying amount of these financial instruments is a reasonable estimate of fair value. For those investments that are not traded on a ready market, the estimates of their fair value may differ from the value that would have been used had a ready market for those investments existed.

Realized and unrealized gains and losses are accounted for within unrestricted net assets, or as changes in temporarily or permanently restricted net assets if so stipulated by the donor of such assets.

### *Pooled Assets*

The University manages two separate investment pools designated as Pool A and Pool D. Pooled investments and allocation of pooled investment income are accounted for using the unit market value method.

The Total Rate of Return methodology is utilized for Pool A which consists primarily of funds functioning as endowment, including both quasi and true endowment funds. The annual total payout is calculated based on an approved spending rate that is applied to a five-year monthly average market value of Pool A funds. For fiscal years 2013 and 2012 the approved spending rate was 5.0%.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

Pool D is the charitable gift annuity reserve pool and is invested in accordance with California State Insurance Commission requirements.

### *Endowment*

The University's endowment consists of 362 individual donor-restricted endowment funds and 61 University-designated quasi-endowment funds for a variety of purposes. The net assets associated with endowment funds, including funds designated by the University to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The University has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as allowing the University to appropriate for expenditure or accumulate so much of an endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment funding is established, subject to the intent of the donor as expressed in the gift instrument. As a result of this interpretation, the University 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. The remaining portion of donor-restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate endowment funds:

- 1) The duration and preservation of the fund
- 2) The purposes of the University and the donor-restricted endowment fund
- 3) General economic conditions
- 4) The possible effect of inflation and deflation
- 5) The expected total return from income and the appreciation of investments
- 6) Other resources of the University
- 7) The investment policies of the University

Additionally, the University is the irrevocable income and principal beneficiary of the Blanche E. Seaver Endowed Trust which was recorded at \$139.6 million and \$125.2 million at July 31, 2013 and 2012, respectively.

### *Derivatives*

From time to time, the University enters into derivative transactions either as part of its overall investment asset allocation or as a specific hedge or risk management tool. Derivatives used as part of the asset allocation strategy are recorded at fair value with realized and unrealized gains and losses reflected in the Consolidated Statements of Activities. These derivatives are included in the investment portfolio.

Derivatives used to economically hedge specific operations, such as interest rate swaps and foreign currency contracts, are discussed under the heading, "Foreign Currency Management."

### *Assets Held As Trustee or Agent*

The University uses the actuarial method of recording charitable gift annuities and charitable remainder trusts. When a gift is received, the fair value of the gift received is recorded as an asset and

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

the present value of the related amounts due is recorded as a liability based on United States Internal Revenue Service life expectancy tables and the remainder is recorded as private gift and grant revenue in the appropriate net asset category on the Consolidated Statements of Activities. Investment income is credited, and annuity payments, direct costs of funds management, and investment losses are charged to the related liability. In situations where trust assets are not readily convertible to cash, annuitant payments have been made by the University. For life contingent gifts, the liability is adjusted annually based on the changes in the expected life. This adjustment is reflected as an adjustment of the actuarial liability on the Consolidated Statements of Activities. At July 31, 2013 and 2012, the estimated future payments to be made by the University have been discounted at 1.4% per annum and 1.2% per annum, respectively.

Remainder interests in real estate are recorded at their estimated fair value at the date of gift. Investment income and gains are credited, and direct costs of asset management and investment losses are charged to the related net asset category.

The University and its consolidated subsidiaries have legal title, either in their name or as trustee, to the charitable gift annuities, charitable remainder trusts, and life estates subject to life interests of the beneficiaries. No significant financial benefit can be realized until the contractual obligations are released.

### *Deferred Compensation Plans*

Contributions to the University's deferred compensation plan under Section 457(b) and 457(f) of the United States Internal Revenue Code are carried at fair value with an equal and offsetting obligation to pay the employees as a component of trust and agency obligations on the Consolidated Statements of Financial Position.

### *Property, Facilities and Equipment*

Property, facilities and equipment are stated at cost or, if received by gift, at fair value at the date of the gift. Depreciation on buildings, improvements, furniture, fixtures and equipment is provided on a straight-line basis over the estimated useful lives as described in the table below:

<u>Asset Class</u>	<u>Useful Life</u>
Furniture and Other Equipment	10-15 years
Computer Hardware and Software	2-10 years
Motor Vehicles	5 years
Buildings	20-70 years
Land Improvements	20 years

Amounts spent for repairs and maintenance are charged to expense as incurred. When assets are sold or retired, the associated cost and accumulated depreciation are removed. Any gain or loss from such disposition is recorded as a component of other non-operating revenues and expenses on the Consolidated Statements of Activities.

### *Debt Issuance Costs*

Capitalized debt issue costs are included in prepaid expenses, inventories, and other assets and are amortized over the life of the related debt using the effective interest method.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### *U.S. Government-Funded Student Loans*

Funds provided by the United States government under the Federal Perkins Loan Program are loaned to qualified students and may be loaned again after their collection. These funds are ultimately refundable to the U.S. government and as such are included as liabilities in the Consolidated Statements of Financial Position.

### *Foreign Currency Management*

The University uses derivative financial instruments to reduce its net exposure to currency fluctuations. As such, the University enters into forward contracts and purchases currency futures (principally the Euro, the British pound, Argentinian Peso, and Swiss francs) to economically hedge forecasted cash flows denominated in foreign currencies. The purpose of the University's foreign currency hedging activities is to reduce the risk that eventual United States dollar net cash outflows resulting from costs outside the U.S. will be adversely affected by changes in exchange rates.

For the years ended July 31, 2013 and 2012, the University recorded approximately \$1.4 million in net gains and \$2.6 million in net losses on foreign currency hedging transactions, respectively.

### *Asset Retirement Obligations*

The University recognizes liabilities for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation is conditional on a future event. The fair value of a liability for a conditional asset retirement obligation is recognized in the period in which it occurs if a reasonable estimate of fair value can be made.

### *Reclassifications*

Certain amounts were reclassified for the year ended July 31, 2012 to conform to year ended July 31, 2013 presentation.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 3. Student Receivables

Student receivables consist of the following at July 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
	(In thousands)	
Graziadio School of Business and Management. ...	\$1,306	\$1,456
Seaver College.....	911	556
Graduate School of Education and Psychology.....	296	521
Other .....	<u>125</u>	<u>60</u>
Gross student receivables .....	2,638	2,593
Allowance for doubtful accounts.....	(1,343)	(1,410)
	<u>\$1,295</u>	<u>\$1,183</u>

Activity in the allowance for doubtful accounts was as follows:

	<u>For the year ended July 31,</u>	
	<u>2013</u>	<u>2012</u>
	(In thousands)	
Beginning balance .....	\$1,410	\$1,374
Provision for doubtful accounts.....	-	200
Accounts charged off.....	(217)	(462)
Recoveries of previously charged-off accounts	<u>150</u>	<u>298</u>
Net charge-offs .....	<u>(67)</u>	<u>(164)</u>
Ending balance .....	<u>\$1,343</u>	<u>\$1,410</u>



**PEPPERDINE UNIVERSITY**

Notes to Consolidated Financial Statements

**4. Student Loans**

Student loans consist of the following at July 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
	<u>(In thousands)</u>	
Perkins.....	\$13,477	\$14,242
Weingart.....	9,006	9,676
Other.....	<u>1,865</u>	<u>1,601</u>
Gross student loans.....	24,348	25,519
Allowance for loan losses.....	<u>(1,599)</u>	<u>(1,707)</u>
	<u>\$22,749</u>	<u>\$23,812</u>

Activity in the allowance for loan losses was as follows:

	<u>For the year ended July 31,</u>	
	<u>2013</u>	<u>2012</u>
	<u>(In thousands)</u>	
Beginning balance.....	1,707	\$1,697
Loans charged-off.....	(228)	(169)
Recoveries of previously charged-off loans.....	<u>120</u>	<u>179</u>
Net charge offs.....	<u>(108)</u>	<u>10</u>
Ending balance.....	<u>\$1,599</u>	<u>\$1,707</u>

The following is an aging of student loans at July 31, 2013:

	<u>Current</u>	<u>1-60 days past due</u>	<u>61-120 days past due</u>	<u>&gt; 120 days past due</u>	<u>Total</u>
	<u>(In thousands)</u>				
Perkins.....	\$11,977	\$ 356	\$189	\$955	\$13,477
Weingart.....	8,592	270	11	133	9,006
Other.....	<u>1,540</u>	<u>213</u>	<u>19</u>	<u>93</u>	<u>1,865</u>
	<u>\$22,109</u>	\$ <u>839</u>	\$ <u>219</u>	\$ <u>1,181</u>	\$ <u>24,348</u>

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 5. Contributions Receivable

Unconditional promises to give with payments due in future periods are reported as temporarily or permanently restricted support. Unconditional promises to give are recorded at their discounted present value based on a credit-adjusted interest rate. At July 31, 2013, the discount rate applied to contributions receivable ranged from 0.11% per annum to 2.68% per annum and at July 31, 2012 ranged from 0.16% per annum to 1.63% per annum.

The following table provides a summary of contributions receivable by expected collection date at July 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
	<u>(In thousands)</u>	
In one year or less.....	\$ 3,858	\$ 1,018
Between one and five years.....	3,013	9,043
More than five years.....	<u>23,919</u>	<u>19,106</u>
	30,790	29,167
Less discount.....	<u>(193)</u>	<u>(262)</u>
	<u>\$30,597</u>	<u>\$28,905</u>

The following table provides a summary of the intended use of contributions receivable at July 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
	<u>(In thousands)</u>	
General support.....	\$22,588	\$18,038
Endowment.....	5,574	7,891
Educational and administrative programs.....	1,335	1,608
Facilities and equipment.....	<u>1,100</u>	<u>1,368</u>
	<u>\$30,597</u>	<u>\$28,905</u>

During the years ended July 31, 2013 and 2012, the University received payments on prior year promises to give of \$3.5 million and \$1.7 million, respectively.

Contributions receivable include assets held by external trustees totaling \$27.0 million at July 31, 2013 and \$22.0 million at July 31, 2012.

In the event contributions receivable are deemed uncollectable, they are charged to expense as a component of "Other non-operating revenues and expenses." Receivables written off during the years ended July 31, 2013 and 2012 amounted to \$643,000 and \$400,000, respectively.

During the years ended July 31, 2013 and 2012 promises to give in the net amount of \$8.1 million and \$8.0 million were received but not recognized, respectively. Promises to give may not be recognized because a donor has not provided sufficient documentation, the promise is conditional, or the promise is revocable.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 6. Investments

The University's investments consist of the following at July 31, 2013 and 2012:

	2013		2012	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
	(In thousands)			
Cash and cash equivalents .....	\$ 7,289	\$ 7,289	\$ 2,554	\$ 2,554
Absolute return.....	67,639	95,747	59,429	75,450
Assets held by trustee.....	12,250	139,608	12,250	125,176
Mutual funds .....	12,306	13,006	12,314	12,925
Bonds .....	1,000	1,001	9,843	9,860
Fixed income.....	62,941	61,869	53,161	53,853
Notes receivable.....	12,250	11,603	18,612	15,377
Opportunistic distressed.....	28,752	37,917	34,362	37,047
Private equity .....	114,137	120,666	120,701	130,801
Natural resources .....	39,769	43,895	36,328	42,255
Private real estate .....	53,731	40,989	57,997	43,711
Public equity .....	191,547	224,249	166,032	184,258
Real estate .....	25,029	28,798	23,527	30,979
Other investments .....	<u>6,379</u>	<u>4,089</u>	<u>5,305</u>	<u>3,015</u>
	<u>\$635,019</u>	<u>\$830,726</u>	<u>\$612,415</u>	<u>\$767,261</u>
Unrestricted.....	\$436,050	483,091	419,586	449,063
Temporarily restricted.....	47,949	53,304	43,059	45,995
Permanently restricted .....	<u>151,020</u>	<u>294,331</u>	<u>149,770</u>	<u>272,203</u>
	<u>\$635,019</u>	<u>\$830,726</u>	<u>\$612,415</u>	<u>\$767,261</u>
Pooled investments .....	\$562,889	\$629,591	522,471	561,761
Separately invested .....	<u>72,130</u>	<u>201,135</u>	<u>89,944</u>	<u>205,500</u>
	<u>\$635,019</u>	<u>\$830,726</u>	<u>\$612,415</u>	<u>\$767,261</u>

**PEPPERDINE UNIVERSITY**

Notes to Consolidated Financial Statements

**7. Endowment Activities**

Changes in endowment net assets for the year ended July 31, 2013 are as follows:

	<u>Unrestricted Appropriations</u>	<u>Unrestricted Principal</u>	<u>Temporarily Restricted</u> (In thousands)	<u>Permanently Restricted</u>	<u>Total</u>
<b>Endowment net assets, beginning of year</b> .....	\$10,756	\$279,936	\$44,924	\$272,337	\$607,953
Investment income .....	101	5,159	2,013	12	7,285
Net realized and unrealized appreciation.....	6	36,112	22,873	14,424	73,415
Private gifts and grants.....	-	230	-	3,124	3,354
Endowment support (appropriation of endowment assets for expenditure).....	32,855	(17,485)	(15,370)	-	-
Management (transfer out)/transfer in or redesignation.....	(13,207)	61,503	(1,182)	4,633	51,747
Net expenditures of endowment assets .....	<u>(24,107)</u>	<u>(2,982)</u>	<u>(984)</u>	<u>(21)</u>	<u>(28,094)</u>
<b>Endowment net assets, end of year</b> .....	\$ <u>6,404</u>	\$ <u>362,473</u>	\$ <u>52,274</u>	\$ <u>294,509</u>	\$ <u>715,660</u>

Designations of endowment funds for the year ended July 31, 2013 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
	(In thousands)			
Donor-restricted funds .....	\$ 3,138	\$47,716	\$294,509	\$345,363
University-designated funds .....	<u>365,739</u>	<u>4,558</u>	<u>-</u>	<u>370,297</u>
Total .....	\$ <u>368,877</u>	\$ <u>52,274</u>	\$ <u>294,509</u>	\$ <u>715,660</u>

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

Changes in endowment net assets for the year ended July 31, 2012 are as follows:

	<u>Unrestricted Appropriations</u>	<u>Unrestricted Principal</u>	<u>Temporarily Restricted</u> (In thousands)	<u>Permanently Restricted</u>	<u>Total</u>
<b>Endowment net assets, beginning of year</b> .....	\$13,564	\$289,380	\$51,137	\$268,499	\$622,580
Investment income .....	45	4,815	1,767	11	6,638
Net realized and unrealized appreciation.....	-	(1,433)	8,862	(3,723)	3,706
Private gifts and grants.....	5	136	-	4,339	4,480
Transfer of assets from assets held as trustee or agent to endowment assets....	-	792	500	2,094	3,386
Endowment support / (appropriation of endowment assets for expenditure).....	31,527	(16,015)	(15,512)	-	-
Net (expenditures) reinvestments of endowment assets .....	(34,385)	<u>2,261</u>	<u>(1,830)</u>	<u>1,117</u>	<u>(32,837)</u>
<b>Endowment net assets, end of year</b> .....	<u>\$10,756</u>	<u>\$279,936</u>	<u>\$44,924</u>	<u>\$272,337</u>	<u>\$607,953</u>

Designations of endowment funds for the year ended July 31, 2012 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
	(In thousands)			
Donor-restricted funds .....	\$ (4,729)	\$40,621	\$272,337	\$308,229
University-designated funds .....	<u>295,421</u>	<u>4,303</u>	-	<u>299,724</u>
Total .....	<u>\$290,692</u>	<u>\$44,924</u>	<u>\$272,337</u>	<u>\$607,953</u>

The University has recorded deficiencies resulting from the decline in fair value of endowment funds to amounts below the original gift amount as a reduction of unrestricted net assets. Such deficiencies totaled \$5.6 million and \$8.5 million and affected 85 and 99 donor-restricted true endowment funds with a market value of \$37.7 million and \$40.3 million at July 31, 2013 and July 31, 2012, respectively.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 8. Assets Held as Trustee or Agent

The University's assets held as trustee or agent consist of the following at July 31, 2013 and 2012:

	2013		2012	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
	(In thousands)			
Publicly traded stocks .....	5,192	6,358	7,088	7,713
Bonds .....	760	735	834	870
Mutual funds .....	60,231	71,199	62,434	67,675
Notes receivable.....	7,070	7,178	6,958	6,996
Real estate .....	29,299	29,014	28,814	29,300
Alternative investments .....	2,934	1,482	2,936	1,366
Other investments .....	<u>7,656</u>	<u>7,877</u>	<u>9,182</u>	<u>10,539</u>
	<u>\$113,142</u>	<u>\$123,843</u>	<u>\$118,246</u>	<u>\$124,459</u>
Unrestricted.....	\$ 19,150	\$ 20,056	\$ 19,300	\$ 19,462
Temporarily restricted.....	72,612	81,481	77,849	84,207
Permanently restricted .....	19,592	20,384	19,344	18,951
Agency .....	<u>1,788</u>	<u>1,922</u>	<u>1,753</u>	<u>1,839</u>
	<u>\$113,142</u>	<u>\$123,843</u>	<u>\$118,246</u>	<u>\$124,459</u>
Pooled investments .....	\$ 24,818	\$ 26,809	\$ 26,719	\$ 27,357
Separately invested .....	<u>88,324</u>	<u>97,034</u>	<u>91,527</u>	<u>97,102</u>
	<u>\$113,142</u>	<u>\$123,843</u>	<u>\$118,246</u>	<u>\$124,459</u>

### 9. Pooled Investments

The following table sets forth data for the University's investment pools at July 31, 2013 and 2012:

	2013		2012	
	<u>Pool A</u>	<u>Pool D</u>	<u>Pool A</u>	<u>Pool D</u>
Per unit fair value at end of year.....	\$375.73	\$ 122.54	\$ 355.97	\$ 113.42
Number of units owned at end of year:				
Unrestricted.....	1,146,794	101,633	1,077,926	67,531
Temporarily restricted.....	12,132	42,484	12,086	66,412
Permanently restricted .....	516,706	64,373	489,797	96,425
Agency .....	<u>3,355</u>	<u>-</u>	<u>1,752</u>	<u>-</u>
Total units.....	<u>1,678,987</u>	<u>208,490</u>	<u>1,581,561</u>	<u>230,368</u>
Average annual income per unit.....	\$2.73	\$4.30	\$2.76	\$3.09

Investment expenses for the years ended July 31, 2013 and 2012 includes investment management fees totaling \$3.4 million and \$3.8 million, respectively.

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 10. Property, Facilities and Equipment

Property, facilities and equipment consist of the following at July 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
	(In thousands)	
Land .....	\$ 28,596	\$ 25,712
Buildings and improvements .....	439,649	411,336
Furniture, fixtures and equipment.....	69,660	58,767
Construction in progress .....	<u>13,576</u>	<u>14,218</u>
Total cost .....	551,481	510,033
Less: accumulated depreciation .....	<u>(189,072)</u>	<u>(168,853)</u>
	<u>\$362,409</u>	<u>\$341,180</u>

### 11. Lines of Credit

At July 31, 2013 and 2012, the University had a \$500,000 line of credit with no expiration date, available to fund the purchase of up to \$5.0 million worth of foreign currency forward contracts for the funding of its international programs at Comerica Bank's prime rate plus 3.0% per annum.

### 12. Long-Term Obligations

Long term obligations consist of the following at July 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
	(In thousands)	
CEFA 5.00% Refunding Revenue Bonds (Pepperdine University) Series 2005 A, due 2035-2036 .....	\$ 92,365	\$ 92,365
CEFA 5.00% Refunding Revenue Bonds (Pepperdine University) Series 2005 B, due 2033 .....	16,340	16,340
Pepperdine University Taxable Bonds Series 2009 A 5.45% interest, due 2019 .....	50,000	50,000
California Infrastructure and Economic Development Bank Refunding Revenue Bonds Series 2010, 5.00% due 2019-2029 .....	15,345	15,345
CEFA Revenue Bonds (Pepperdine University) Series 2012, 3.00%-5.00% due 2013 -2033.....	<u>50,000</u>	<u>50,000</u>
	224,050	224,050
Net premium on long-term obligations.....	<u>14,700</u>	<u>15,372</u>
	<u>\$238,750</u>	<u>\$239,422</u>

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

At July 31, 2013, principal payments on the preceding obligations are due as follows:

	(In thousands)
2013 – 2014 .....	1,490
2014 – 2015 .....	1,535
2015 – 2016 .....	1,580
2016 – 2017 .....	1,645
2017 – 2018 .....	1,710
2018 – 2019 .....	1,775
2019 – 2020 .....	52,940
2020 – 2021 .....	3,085
2021 – 2022 .....	3,245
2022 – 2023 .....	3,405
2023 – 2024 .....	3,580
2024 – 2025 .....	3,760
2025 – 2026 .....	3,950
2026 – 2027 .....	4,150
2027 – 2028 .....	4,355
2028 – 2029 .....	4,575
2029 – 2030 .....	4,810
2030 – 2031 .....	3,190
2031 – 2032 .....	3,355
2032 – 2033 .....	19,855
2033 – 2034 .....	3,695
2034 – 2035 .....	45,060
2035 – 2036 .....	<u>47,305</u>
	<u>\$224,050</u>

### 13. Net Assets

At July 31, 2013 and 2012, temporarily and permanently restricted net assets were available for the following purposes:

	2013		2012	
	Temporarily Restricted	Permanently Restricted	Temporarily Restricted	Permanently Restricted
	(In thousands)			
Educational program support .....	\$ 50,569	\$199,948	\$ 43,326	\$185,753
Student services and athletics .....	1,423	3,464	1,225	3,396
Student loans and scholarships .....	26,663	100,491	22,795	94,874
Annuities and remainder trusts .....	32,308	8,502	29,793	6,396
Facilities .....	3,914	4,619	2,525	4,619
Public service .....	60	6,600	21	6,881
Other .....	<u>3,668</u>	<u>3,961</u>	<u>3,358</u>	<u>3,862</u>
	<u>\$118,605</u>	<u>\$327,585</u>	<u>\$103,043</u>	<u>\$305,781</u>



# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 14. Operating Lease Commitments

The University leases facilities for use primarily in its graduate programs. Future minimum lease payments expiring through 2019 under these non-cancelable operating leases at July 31, 2013 are as follows:

	<b>(In thousands)</b>
2013– 2014 .....	\$ 9,340
2014– 2015 .....	9,663
2015– 2016 .....	9,729
2016– 2017 .....	10,166
2017– 2018 .....	9,221
2018– 2019 .....	<u>3,017</u>
	<u>\$51,136</u>

Leases on facilities contain renewal options and rent escalation clauses based on the Consumer Price Index.

### 15. Employee Retirement and Deferred Compensation Plans

The University participates in a defined contribution plan, which provides retirement benefits for eligible employees. Benefits for the plan are funded by contributions from the University and its employees. University contributions are non-refundable and fully vested. There are no prior service costs. The University contributed \$8.9 million and \$8.8 million to these plans for the years ended July 31, 2013 and 2012, respectively.

In July 2002 the University established deferred compensation programs for senior administrators, tenured Full Professors, highly paid and certain other employees under Sections 457(b) and 457(f) of the Internal Revenue Code. Under this plan, eligible employees may defer a limited amount of their compensation to future years. Although deferred by employees for tax purposes, amounts contributed to these plans by the University are treated as an expense in the year earned. University contributions to these deferred compensation plans for the years ended July 31, 2013 and 2012 were \$301,000 and \$212,000, respectively.

### 16. Faculty and Staff Housing

The University sells condominium units to certain faculty and staff. The sales terms include restrictions on the buyers' eligibility and include a resale price based on a defined index that is not controlled by the University. The University has a right of first refusal to purchase the units when offered for sale by the owner. The University has historically exercised this right and then subsequently sold the units within a short period of time. For the years ended July 31, 2013 and 2012, the University sold nine and five units with associated sales values of \$3.8 million and \$2.1 million, respectively. Should all 122 of the units be available for purchase at July 31, 2013 and 2012, and the University elected to exercise its right of first refusal on all of the units it did not already own, the total value associated with these transactions would be \$53.8 million and \$48.2 million, respectively. At July 31, 2013 and 2012, the University held legal title to eight and 14 units with a value of \$4.0 million and \$7.4 million, respectively.

The land associated with the condominium units has been leased to the homeowner's associations for 99 years from the date of completion of the construction. Monthly rents are paid to the University

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

for the grounds, utilities and other services subject to adjustments based on the Consumer Price Index and on the costs of furnishing utilities and services.

At July 31, 2013, the University guaranteed the performance of \$21.1 million in mortgage loans obtained by its faculty and staff. These mortgage loans were issued by independent third-party lenders and all of the proceeds of these loans were used to facilitate the purchase of on-campus housing.

At July 31, 2013 and 2012, University-owned notes receivable from on-campus housing sales amounted to \$802,000 and \$1.0 million, respectively. These amounts are included as a component of investments on the Consolidated Statements of Financial Position. The notes bear interest at various rates ranging between 5.50% per annum and 7.25% per annum and are collateralized by deeds of trust. Interest income recognized by the University related to these notes was \$47,600 and \$64,500 for the years ended July 31, 2013 and 2012, respectively. No allowance for loan losses has been recorded against these loans based on their collateralization and prior collection history. At July 31, 2013 there were no past due amounts related to these notes receivable.

### 17. Supplemental Cash Flow Information

	<b><u>For the year ended July 31,</u></b>	
	<b><u>2013</u></b>	<b><u>2012</u></b>
	<b>(In thousands)</b>	
Cash paid during the period for:		
Interest .....	\$10,694	\$11,765
Accrued capitalized asset additions .....	10,668	1,552

### 18. Natural Expenses

The University's classifications of expenses in the Consolidated Statements of Activities by natural expense category are as follows:

	<b><u>For the year ended July 31,</u></b>	
	<b><u>2013</u></b>	<b><u>2012</u></b>
	<b>(In thousands)</b>	
Personnel .....	\$166,720	\$162,485
Depreciation .....	20,267	19,710
Professional services .....	19,194	19,698
Travel and development .....	11,607	11,879
Interest .....	10,804	11,083
Rentals .....	10,458	10,880
Equipment .....	8,879	3,576
Student meals .....	7,785	6,758
Maintenance .....	5,948	5,299
Supplies .....	5,747	4,978
Utilities .....	5,396	4,680
Advertising and promotion .....	4,939	5,942
Insurance .....	4,477	4,428
Other .....	<u>6,753</u>	<u>5,971</u>
	<u>\$288,974</u>	<u>\$277,367</u>

# PEPPERDINE UNIVERSITY

## Notes to Consolidated Financial Statements

### 19. Commitments and Contingencies

In the normal course of operations, the University is named as a defendant in lawsuits and is subject to periodic examinations by regulatory agencies. After consultation with legal counsel, management is of the opinion that liabilities, if any, arising from such litigation and examinations would not have a material effect on the University's consolidated financial position or change in net assets.

The University was the subject of an audit by the Internal Revenue Service ("IRS"), covering the fiscal years ended July 31, 2008 and 2009. The IRS has concluded their audit and the University is contesting some of its findings. Management does not believe the resolution of the findings will result in a material effect on the University's consolidated financial position or change in net assets.

The University receives and expends monies under U.S. government grant programs and is subject to audits by related U.S. governmental agencies. Management believes that any liabilities resulting from such audits will not have a material impact on the University.

At July 31, 2013, the University had open commitments to invest approximately \$94.0 million with investment managers and/or limited partnerships over approximately seven years.

At July 31, 2013, the University's maximum exposure under guarantees of Guaranteed Access To Education ("GATE") student loans totaled approximately \$281,000. Since 1997, the University has sold approximately \$14.8 million of GATE student loans into securitization trusts.

At July 31, 2013, the University had outstanding commitments for capital expenditures in connection with the various construction projects of approximately \$18.6 million. The University expects to fund these costs principally through the proceeds of bonds previously issued and unrestricted net assets available. Accordingly, no liability has been recorded in the accompanying Consolidated Statements of Financial Position.

As discussed in Note 16, the University guarantees the performance of certain mortgages for on-campus condominiums.

### 20. Fair Value of Financial Instruments

Financial instruments include cash and cash equivalents, student receivables, other accounts receivable, student loans, contributions receivable, investments, assets held as trustee or agent, U.S. government-funded student loans, trust and agency obligations, long-term obligations and various off-balance sheet items. The fair value of certain alternative investments, which include limited partnerships in venture capital, real estate and other private debt and equity funds, is based on valuations provided by the external investment managers or general partners, generally using NAV as a practical expedient, adjusted for receipts and disbursements of cash and distributions of securities if the date of valuation is prior to the University's fiscal year end. Such valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments and other pertinent information. These estimates are subjective in nature and involve uncertainties and matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. In addition, the fair value estimates presented do not include the value of anticipated future operating activities and the value of assets and liabilities that are not considered financial instruments. The University uses the following methods and assumptions in estimating the fair value disclosures for its financial instruments:

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## Notes to Consolidated Financial Statements

### *Financial Assets*

The carrying values of cash and cash equivalents, student receivables, other accounts receivable, student loans, contributions receivable, and assets held as trustee or agent are considered to approximate fair value. When possible, the fair value of investments and assets held as trustee or agent are determined by reference to quoted market prices. When quoted market prices are not available, fair value is estimated by reference to market values for similar securities or by discounting cash flows at an appropriate risk rate taking into consideration the varying degrees of risk specific to each financial asset. Determination of the fair value of student loans receivable, which are primarily federally sponsored student loans with United States Government mandated interest rates and repayment terms subject to significant restrictions as to their transfer and disposition could not be made without incurring excessive costs.

### *Financial Liabilities*

The carrying value of trust and agency obligations is considered to approximate fair value. The fair value of the University's CEFA and other bonds payable is based on recent trading information available to the University for its debt, or for debt with similar terms and remaining maturities, and approximates Level 2 in the fair value hierarchy. The fair value for notes payable were estimated based upon the discounted amount of future cash flows utilizing current rates offered for debt of similar remaining maturities.

The carrying amount of the University's financial instruments at July 31, 2013 and 2012 are the same as their estimated fair values with the exception of CEFA and other bonds payable which have the values outlined below:

	2013		2012	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
	(In thousands)			
CEFA and other bonds payable.....	\$238,750	\$240,443	\$239,422	\$257,623

### *Off-Balance Sheet and Derivative Financial Instruments*

The fair value of interest rate caps, floors and swaps, forward treasury contracts and interest rate futures, to the extent used by the University, are based on quoted market prices. The fair values of foreign currency derivatives are based on pricing models using currency market rates. These amounts are reflected as a component of prepaid expenses, inventories and other assets on the University's Consolidated Statements of Financial Position.

In accordance with ASC 820, fair value is defined as the price the University would receive to sell an asset or pay a liability in an orderly transaction between the market participants at the reporting date. ASC 820 also establishes a three-level hierarchy for presenting valuations, based on the transparency of inputs used to value investments and other relevant assets. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Valuation inputs may be observable or unobservable, and refer to the assumptions that a market participant would consider significant to value an asset or liability. The determination of "observable" requires judgment by the University. In general, the University considers observable inputs to be data

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## Notes to Consolidated Financial Statements

that are readily available, regularly updated, reliable, and verifiable. Unobservable inputs may be used when observable inputs are not readily available or current. In this situation, one or more valuation techniques may be used including the market approach (inputs based on recent market transactions or comparables) or the income approach (discounted cash flow).

The three levels of the fair value hierarchy under ASC 820 are as follows:

- Level 1 – Quoted prices available in active markets for identical investments.
- Level 2 – Quoted prices in active markets for similar investments; quoted prices for identical investments in markets that are inactive; and prices based on observable inputs other than an unadjusted quoted price.
- Level 3 – Prices based on significant unobservable inputs.

The following table summarizes the valuations of the University's investments and other relevant assets as of July 31, 2013, based on their placement within the fair-value hierarchy:

	<u>Level 1</u>	<u>Level 2</u> (In thousands)	<u>Level 3</u>	<u>Total</u>
<b>Investments</b>				
Cash and cash equivalents .....	\$ 7,289	\$ -	\$ -	\$ 7,289
Absolute return.....	-	14,023	81,724	95,747
Assets held by trustee.....	95,700	3,600	40,308	139,608
Mutual funds .....	13,006	-	-	13,006
Bonds .....	-	1,001	-	1,001
Fixed income.....	-	61,574	295	61,869
Notes receivable.....	-	-	11,603	11,603
Opportunistic distressed.....	-	-	37,917	37,917
Private equity .....	-	-	120,666	120,666
Natural resources .....	-	16,223	27,672	43,895
Private real estate .....	-	4,939	36,049	40,988
Public equity .....	150,629	73,620	-	224,249
Real estate .....	-	-	28,799	28,799
Other investments .....	-	-	4,089	4,089
<b>Total investments</b> .....	<u>\$266,624</u>	<u>\$174,980</u>	<u>\$389,122</u>	<u>\$830,726</u>
<b>Assets held as trustee</b>				
Publicly traded stocks .....	\$ 6,358	\$ -	\$ -	\$ 6,358
Bonds .....	735	-	-	735
Mutual Funds .....	71,199	-	-	71,199
Notes Receivable .....	-	-	7,178	7,178
Real Estate .....	-	-	29,014	29,014
Alternative investments .....	605	-	877	1,482
Other investments .....	7,176	-	701	7,877
<b>Total assets held as trustee</b> .....	<u>86,073</u>	<u>-</u>	<u>37,770</u>	<u>123,843</u>
<b>Total</b> .....	<u>\$352,697</u>	<u>\$174,980</u>	<u>\$426,892</u>	<u>\$954,569</u>

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## Notes to Consolidated Financial Statements

The following summary table illustrates the valuations of the University's investments and other relevant assets as of July 31, 2012, based on their placement within the fair value hierarchy:

	<u>Level 1</u>	<u>Level 2</u> (In thousands)	<u>Level 3</u>	<u>Total</u>
<b>Investments</b>				
Cash and cash equivalents .....	\$ 2,554	\$ -	\$ -	\$ 2,554
Absolute return.....	-	2,557	72,893	75,450
Assets held by trustee.....	82,666	1,718	40,792	125,176
Mutual funds .....	12,594	331	-	12,925
Bonds .....	-	9,860	-	9,860
Fixed income.....	50,044	1,068	2,741	53,853
Notes receivable.....	-	-	15,377	15,377
Opportunistic distressed.....	-	-	37,047	37,047
Private equity .....	-	-	130,801	130,801
Natural resources .....	-	18,413	23,842	42,255
Private real estate .....	-	4,640	39,071	43,711
Public equity .....	118,786	65,472	-	184,258
Real estate .....	-	-	30,979	30,979
Other investments .....	-	-	3,015	3,015
<b>Total investments</b> .....	<u>\$266,644</u>	<u>\$104,059</u>	<u>\$396,558</u>	<u>\$767,261</u>
<b>Assets held as trustee</b>				
Publicly traded stocks .....	\$ 7,713	\$ -	\$ -	\$ 7,713
Bonds .....	870	-	-	870
Mutual funds .....	67,675	-	-	67,675
Notes receivable.....	-	-	6,996	6,996
Real estate .....	-	-	29,300	29,300
Alternative investments .....	-	-	1,366	1,366
Other investments .....	8,204	254	2,081	10,539
<b>Total assets held as trustee</b> .....	<u>84,462</u>	<u>254</u>	<u>39,743</u>	<u>124,459</u>
<b>Total</b> .....	<u>\$351,106</u>	<u>\$104,313</u>	<u>\$436,301</u>	<u>\$891,720</u>

**Level 1** generally includes the University's investments in mutual funds and common stock that are regularly traded in active markets where quoted prices may be easily obtained.

**Level 2** generally includes the University's investments in debt securities and certain unlisted equity funds that offer a high degree of liquidity and transparency. Debt security prices are obtained from pricing services, or from brokers. Non-listed equity funds that consistently transact on a daily, weekly, or monthly basis are valued at reported NAV. Level 2 investments may also be priced using model-based valuation techniques where all assumptions are observable.

**Level 3** generally includes the University's alternative investments, which consist of hedge funds, private equity funds, real estate funds, and other fund of funds. These investments do not typically transact on a regular basis, nor do they have readily determinable fair values. Therefore, the University relies heavily on investment manager-reported valuations, usually in the form of NAV. The University performs due diligence around all reported NAV's to ensure the values are accurate and appropriate.

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## Notes to Consolidated Financial Statements

Level 3 also includes the University's real property. Oil and gas interests are valued by discounting future expected royalty revenues, while real property is valued based on a number of different approaches including third party appraisals, market comparisons, and discounted future rental revenues. Finally, Level 3 includes the University's life insurance policies, which are valued at the present value of the future distributions expected to be received over the term of the agreement.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. In addition, while the University believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table sets forth a reconciliation of beginning and ending balances for financial instruments designated as Level 3 for the year ended July 31, 2013 (in thousands):

<b>Beginning Balance July 31, <u>2012</u></b>	<b>Realized <u>Gains</u></b>	<b>Unrealized <u>Gains</u></b>	<b>Purchase <u>Cost</u></b>	<b>Total <u>Proceeds</u></b>	<b>Transfers into <u>Level 3</u></b>	<b>Transfers out of <u>Level 3</u></b>	<b>Ending Balance July 31, <u>2013</u></b>
<b>(In thousands)</b>							
\$436,301	\$18,855	\$2,545	\$31,889	(\$62,459)	\$6,261	(\$6,500)	\$426,892

All net realized and unrealized gains in the table above are reflected in the accompanying consolidated Statement of Activities.

During the fiscal year ended July 31, 2013, the University reclassified \$60.7 million of Fixed Income securities from Level 1 to Level 2 in the fair value hierarchy. The value of these individual securities is based on unadjusted quoted prices for identical assets in an active market.

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## Notes to Consolidated Financial Statements

The University uses the NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments in other investment companies (in partnership format) by major category for the year ended July 31, 2013:

<u>Investment Category</u>	<u>Strategy</u>	<u>NAV in Funds</u>	<u># of Funds</u>	<u>Remaining Life</u>	<u>Amount of Unfunded Commitments</u>	<u>Redemption Terms</u>	<u>Redemption Restrictions</u>
		(In thousands, except # of funds)					
Absolute Return (level 2 & 3)	US and non-US investments in relative value, event driven, long/short and directional	\$ 95,747	28	Open Ended	\$ -	Ranges between quarterly with 30, 45, 60 or 90 days notice, semi annual with 90 days notice, annual with 45, 60 or 90 days notice	2.3% of NAV is locked up in side-pockets
Assets Held by Trustee (level 2 & 3)	US and non-US investments in relative value, event driven, long/short and directional	43,907	3	Open Ended	-	Redemptions are not permitted during the life of the fund	N/A
Public Natural Resources (level 2)	US and non-US Investments in upstream, midstream, and downstream natural resources	16,223	2	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Natural Resources (level 3)	US and non-US Investments in upstream, midstream, and downstream natural resources	27,673	12	Approx 7 years	13,647	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 2)	US and non-US real estate	4,939	1	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 3)	US and non-US real estate	36,050	20	Approx 7 years	11,821	Redemptions are not permitted during the life of the fund	N/A
Public Equity (level 2)	US and non-US equity securities	73,620	9	Open Ended	-	Ranges from daily to monthly	N/A
Fixed Income (level 2 & 3)	US and non-US fixed income securities	61,869	8	Open Ended	-	Daily	N/A
Opportunistic Distressed (level 3)	US and non-US distressed debt securities	37,917	10	Approx 7 years	15,582	Redemptions are not permitted during the life of the fund	N/A
Private Equity (level 3)	US and non-US equity securities	<u>120,666</u>	52	Approx 7 years	<u>52,980</u>	Redemptions are not permitted during the life of the fund	N/A
Total		<u>\$518,611</u>			<u>\$94,030</u>		



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## Notes to Consolidated Financial Statements

The University uses the NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments in other investment companies (in partnership format) by major category for the year ended July 31, 2012:

<u>Investment Category</u>	<u>Strategy</u>	<u>NAV in Funds</u>	<u># of Funds</u>	<u>Remaining Life</u>	<u>Amount of Unfunded Commitments</u>	<u>Redemption Terms</u>	<u>Redemption Restrictions</u>
(In thousands, except # of funds)							
Absolute Return (level 2 & 3)	US and non-US investments in relative value, event driven, long/short and directional	\$ 75,453	85	Open Ended	\$ -	Ranges between quarterly with 30, 45, 60 or 90 days notice, semi annual with 90 days notice, annual with 45, 60 or 90 days notice	2.3% of NAV is locked up in side-pockets
Assets Held By Trustee (level 2 and 3)	US and non-US investments in relative value, event driven, long/short and directional	\$42,510	3	Approx 7 years	-	Ranges between quarterly with 30, 45, 60 or 90 days notice, semi annual with 90 days notice, annual with 45, 60 or 90 days notice	2.3% of NAV is locked up in side-pockets
Public Natural Resources (level 2)	US and non-US Investments in upstream, midstream, and downstream natural resources	18,413	3	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Natural Resources (level 3)	US and non-US Investments in upstream, midstream, and downstream natural resources	23,842	11	Approx 7 years	18,981	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 2)	US and non-US real estate	4,640	1	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 3)	US and non-US real estate	39,071	21	Approx 7 years	16,307	Redemptions are not permitted during the life of the fund	N/A
Public Equity (level 2)	US and non-US equity securities	65,502	11	Open Ended	-	Ranges from daily to monthly	N/A
Fixed Income (level 2 & 3)	US and non-US fixed income securities	13,668	17	Open Ended	-	Daily	N/A
Opportunistic Distressed (level 3)	US and non-US distressed debt securities	37,047	10	Approx 7 years	19,201	Redemptions are not permitted during the life of the fund	N/A
Private Equity (level 3)	US and non-US equity securities	<u>130,801</u>	55	Approx 7 years	<u>56,114</u>	Redemptions are not permitted during the life of the fund	N/A
Total		<u>\$450,947</u>			<u>\$110,603</u>		

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## Notes to Consolidated Financial Statements

### 21. Asset Retirement Obligations

The following table illustrates the change in conditional asset retirement obligations during the year ended July 31, 2013:

<u>Abatement Timeframe</u>	<u>Average Abatement Date</u>	<u>Conditional Asset Retirement Obligation at July 31, 2012</u>	<u>Add: 2013 Accretion</u> (In thousands)	<u>Less: 2013 Costs Incurred</u>	<u>Conditional Asset Retirement Obligation at July 31, 2013</u>
10 years	2016	\$ 726	\$ 35	\$ -	\$ 761
11-20 years	2022	3,862	187	85	3,964
21-30 years	2036	20	1	-	21
31-40 years	2044	993	48	-	1,041
41-50 years	2048	112	6	-	118
51+ years	2061	<u>7</u>	<u>-</u>	<u>-</u>	<u>7</u>
		<u>\$5,720</u>	<u>\$ 277</u>	<u>\$85</u>	<u>\$5,912</u>

### 22. Subsequent Events

The University has performed an evaluation of subsequent events through November 22, 2013 which is the date these financial statements were issued. There are no subsequent events which require disclosure.