

Note 1. Summary of Significant Accounting Policies

The University of Richmond is a private four-year institution of higher education. Richmond Quadrangle, LLC, a wholly controlled affiliate of the University of Richmond, was formed on April 9, 2003, for the purpose of owning and operating the building and land located at 6601 Broad Street, Richmond, Virginia, formerly known as the Alcoa-Reynolds Building. All financial statements and footnotes are presented on a consolidated basis.

The major accounting policies followed by the University are described below:

Basis of Presentation:

The consolidated financial statements include the University of Richmond and its affiliate (collectively, the University) and have been prepared on the accrual basis of accounting.

The consolidated financial statements as of and for the year ended June 30, 2003 include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2003, from which the summarized information was derived. Certain reclassifications have been made for the year ended June 30, 2003 to conform to classifications adopted in 2004.

The assets and liabilities on the consolidated statement of financial position are presented in order of liquidity with the exception of investments, which have certain components which are considered short term and others which are considered long term.

Net Asset Classes:

The accompanying consolidated financial statements present information regarding the University's financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. The three classes are differentiated by donor restrictions.

Unrestricted net assets may be designated for specific purposes by the University or may be limited by contractual agreements with outside parties.

Temporarily restricted net assets are subject to donor stipulations that expire by the passage of time or can be fulfilled or removed by actions pursuant to the stipulations. Temporarily restricted net assets consist principally of gifts restricted by donors for capital projects, which have not yet been completed, and other operating purposes, and unconditional pledges receivable that are not permanently restricted.

Permanently restricted net assets are subject to donor stipulations requiring that they be maintained permanently, thereby restricting the use of principal. Usually, donor stipulations allow part or all of the income earned to be used currently for a restricted purpose. Permanently restricted net assets consist principally of contributed permanent endowment balances, including unconditional pledges.

Contributions:

Contributions, including unconditional pledges, are recognized as revenues when donors' commitments are received. Conditional pledges become unconditional and are recognized as revenues when the conditions are substantially met. Unconditional pledges are recognized at the estimated net present value, net of an allowance for uncollectible amounts, and are classified as either permanently restricted or temporarily restricted. Gifts whose restrictions are met in the same fiscal year as their receipt are combined with unrestricted gifts and reported as unrestricted contribution revenues. Permanently restricted contributions and contributions of a long-term nature are included as non-operating contributions. Other contributions are considered operating revenues.

Income Taxes:

The University has received a letter from the IRS dated September 1941, exempting the University from income taxes on related income under Section 501(c)(3) of the Internal Revenue Code. In addition, the University is a public charity under section 509(a)(1) of the Internal Revenue Code. Richmond Quadrangle is a limited liability corporation, which will ultimately pass all of its income through to the University.

Investments:

Spider Management Company (SMC) is a separate support corporation organized and controlled by the University whose sole responsibility is to manage the University of Richmond's investment assets. The University's investment management fees for the year ended June 30, 2004 were \$2,433,032 and have been reported on the accompanying consolidated statement of activities as an institutional support expense. Investments are recorded at fair value. Revenues from realized and unrealized changes in the fair value of investments are reported separately in the consolidated statement of activities. Fair values of investments are based on quoted market prices or estimates provided by external investment managers or other independent sources. If not available, they are based on management's best estimate of fair value.

Financial Instruments:

The carrying amounts of student accounts receivable, accounts payable and accrued liabilities approximate fair value because of the short maturity of these financial instruments. A reasonable estimate of the fair value of the notes receivable from students under government loan programs could not be made because the notes receivable are not salable and can only be assigned to the U. S. Government or its designees.

Cash and Cash Equivalents:

Cash equivalents with a maturity at date of purchase of three months or less are reported as cash and cash equivalents. There are cash equivalents held by the investment custodians that are reported as cash and cash equivalents in the accompanying consolidated financial statements. The cash equivalents at June 30, 2004 are \$10,609,373.

Inventories:

Inventories are stated at cost, which is lower than market. Cost is determined by the first in, first out method.

Property, Plant and Equipment:

Property, plant and equipment consisting of land, improvements, buildings, equipment and library books are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method based on estimated useful lives of 30 to 50 years for buildings, 10 to 20 years for improvements, 5 to 10 years for equipment and 10 years for library books.

Estimates:

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**UNIVERSITY OF RICHMOND AND ITS AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2004

Note 2. Investments

The costs and fair values of the investments at June 30, 2004 and 2003 are as follows:

	2004	2004	2003	2003
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Cash equivalents	\$ 1,169,050	\$ 1,169,050	\$ 547,207	\$ 547,207
U. S. government bonds	66,096,786	64,622,516	51,283,214	51,959,106
Corporate and global bonds	26,344,408	31,026,066	27,610,803	33,934,242
Common and preferred stock	264,160,212	317,532,198	237,159,971	249,661,723
Hedge funds	275,295,252	424,412,425	262,308,503	401,862,897
Venture capital partnerships	329,673,831	218,064,071	308,918,904	214,418,573
Other investments	<u>60,810,823</u>	<u>86,227,574</u>	<u>83,119,001</u>	<u>108,484,796</u>
	\$ <u>1,023,550,362</u>	\$ <u>1,143,053,900</u>	\$ <u>970,947,603</u>	\$ <u>1,060,868,544</u>

Other investments include primarily mutual funds, notes receivable, real estate loans and real estate.

Assets of endowment and similar funds, except certain nonmarketable investments, are pooled on a market value basis, with each individual fund subscribing to or disposing of units on the basis of the value per unit at market value at the end of the calendar quarter within which the transaction takes place. Of the 1,992,760 total units (each having a market value of \$537.17), 913,870 units are classified as unrestricted net assets, 36,589 units are classified as temporarily restricted net assets, and 1,042,301 are classified as permanently restricted net assets at June 30, 2004.

At June 30, 2004, the University has committed to make additional capital contributions of approximately \$221,500,000 to various venture capital partnerships over the next five years.

The University's endowment investment portfolio includes derivative financial instruments that have been acquired to reduce overall portfolio risk by hedging exposure to certain assets held in the portfolio. The endowment also employs certain derivative financial instruments to replicate long or short asset positions more cost effectively than through purchases or sales of the underlying assets. At June 30, 2004, the endowment portfolio held a total return swap agreement. The market and credit risks related to this derivative investment are not materially different from the risks associated with similar underlying assets in the portfolio.

Total investment return for the year ending June 30, 2004 is \$145,612,370 and is classified within operating revenues and non-operating activities as investment income, endowment income and realized and unrealized gains. Operating investment return includes income generated from short-term investments and the endowment spending formula, and non-operating activities investment return includes income and gains earned on the investment pool.

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June 30, 2004

Note 3. Notes Payable

Virginia College Building Authority:	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Series of 1994: Due November 1, 2019 with initial annual interest at 5.55%; on November 1, 2004, interest rate will be redetermined. Bondholders have "put" options on that date.	17,000,000	17,000,000
Series of 1996: Due November 1, 2026 with a monthly variable interest rate determined by the Remarketing Agents based on prevailing market conditions (1.07% at June 30, 2004).	22,500,000	22,500,000
Series of 1999: Due November 1, 2022 with a monthly variable interest rate determined by the Remarketing Agents based on prevailing market conditions (1.07% at June 30, 2004).	15,400,000	15,400,000
Series of 2002: Due March 1, 2032 with initial interest at 4.40%; Due March 1, 2032 with initial interest at 5.00%; Due March 1, 2032 with initial interest at 5.00%; On the mandatory tender date of March 1, 2009, the interest rate will be redetermined. This series refunded all of the Series of 1992, and provided funds for several projects, including Weinstein Hall, Gottwald Science Center and Marsh Hall.	7,170,000 15,000,000 7,445,000	7,170,000 15,000,000 7,445,000
Total VCBA Notes	84,515,000	84,515,000
Note Payable to SunTrust Bank Note paid off February 1, 2004.	-	11,550,000
	<u>\$ 84,515,000</u>	<u>\$ 96,065,000</u>

The aggregate future principal requirements of maturities on notes payable are:

Years after 2009	\$ <u>84,515,000</u>
	\$ <u>84,515,000</u>

Interest expense on long-term debt was \$2,947,850 for the year ended June 30, 2004.

The fair value of all outstanding long-term obligations at June 30, 2004 and 2003 was approximately \$87,000,000 and \$101,000,000 respectively.

Note 4. Property, Plant and Equipment

Property, plant and equipment consists of the following at June 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Land	\$ 15,194,677	\$ 15,194,677
Buildings	185,494,750	170,190,291
Improvements	16,539,877	15,810,241
Equipment	57,553,321	55,099,001
Library books	37,885,880	34,923,726
Construction in progress	<u>36,702,056</u>	<u>24,159,107</u>
	\$ 349,370,561	\$ 315,377,043
Accumulated depreciation	< <u>181,179,746</u> >	< <u>171,404,978</u> >
	\$ <u>168,190,815</u>	\$ <u>143,972,065</u>

Contracts have been let for construction in the amount of \$46,486,000 including construction in progress of \$36,702,056 at June 30, 2004.

Land and buildings totaling \$20,907,463 were transferred to Richmond Quadrangle, LLC on April 9, 2003 and are included in the balances above. These assets include 34.1 acres of land and the building previously known as the Alcoa-Reynolds Building in Richmond, Virginia.

Note 5. Pledges Receivable

Unconditional pledges at June 30, 2004 are expected to be realized in the following periods:

Less than one year	\$ 1,273,345
One year to five years	19,643,739
More than five years	<u>2,443,079</u>
Less: Discount rates varying from 3.6% to 11%	< <u>2,040,380</u> >
	\$ <u>21,319,783</u>

In addition to the above, the University is named beneficiary of conditional gifts and bequests, the fair value of which is not determinable.

Note 6. Retirement Plans

The University has certain contributory defined contribution retirement annuity plans, funded through the Teachers' Insurance and Annuity Association, the Vanguard Group, and the American Funds, for academic and nonacademic employees. Contributions are based on a percentage of the employee's salary. The University contributed \$5,328,000 to these plans for the year ended June 30, 2004, which was charged to expense in the consolidated statement of activities.

Note 7. Postretirement Benefits

The University sponsors defined benefit health care plans that provide postretirement medical benefits to full-time employees who meet minimum age and service requirements. These plans are not funded. The status of the plans at June 30, 2004 and 2003 was as follows:

	<u>2004</u>	<u>2003</u>
Accumulated postretirement benefit obligation:		
Retirees	\$ 4,979,799	\$ 5,258,280
Fully eligible active plan participants	311,016	314,820
Other active plan participants	2,409,769	2,110,157
Unrecognized net (loss)	<u>(997,905)</u>	<u>(1,017,035)</u>
	\$ <u>6,702,679</u>	\$ <u>6,666,222</u>

Net periodic postretirement benefit cost for 2004 included service cost of \$151,902 and interest cost on the accumulated postretirement benefit obligation of \$515,090, and amortization of unrecognized net loss of \$19,131 for a total net periodic postretirement benefit cost of \$686,123. Employer contributions for 2004 were \$608,641 and benefits paid were \$649,666.

The weighted average annual assumed rate of increase in the per capita cost of covered benefits is 10% for 2004 and is assumed to decrease gradually to 5.0% by the year 2012 and remain at that level thereafter. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the postretirement liability as of June 30, 2004 by \$89,551 and increase the net periodic postretirement benefit cost for the year ended June 30, 2004 by \$6,260.

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 7.0% at June 30, 2004.

Note 8. Explanation of Net Asset Balances

Temporarily restricted net assets consist of the following at June 30, 2004 and 2003.

	<u>2004</u>	<u>2003</u>
Support of particular operating activities	\$ 23,206,714	\$ 21,440,330
Funds functioning as endowment	9,028,487	9,028,487
Acquisition of long-lived assets	<u>29,410,329</u>	<u>20,966,299</u>
	\$ <u>61,645,530</u>	\$ <u>51,435,116</u>

Permanently restricted net assets consist primarily of amounts whose income supports scholarships, professorships, lectureships and library funds at June 30, 2004 and 2003.

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June 30, 2004

Note 9. Allocation of Expenses

The University allocates maintenance of plant, interest and depreciation to the program and support expenses reported in the accompanying consolidated statement of activities based upon each functional line's percentage of the total. The following table reports the amount of these expenses included in the accompanying consolidated statement of activities.

<u>Functional Category</u>	<u>Direct Expenses</u>	<u>Maintenance</u>	<u>Interest</u>	<u>Depreciation</u>	<u>Total Expenses</u>
Instruction	\$ 37,517,049	\$ 4,666,935	\$ 898,295	\$ 3,423,231	\$ 46,505,510
Research	1,801,254	224,068	43,128	164,354	2,232,804
Public service	1,411,151	175,540	33,788	128,760	1,749,239
Libraries	7,644,523	950,941	183,038	697,522	9,476,024
Academic support	12,610,495	1,568,683	301,941	1,150,641	15,631,760
Student services	8,571,522	1,066,255	205,233	782,107	10,625,117
Institutional support	20,318,827	2,527,562	486,507	1,853,985	25,186,881
Auxiliary enterprises	25,919,809	0	795,920	1,470,000	28,185,729
	115,794,630	11,179,984	2,947,850	9,670,600	139,593,064
Maintenance	11,179,984	(11,179,984)			
Interest	2,947,850		(2,947,850)		
Depreciation	9,670,600			(9,670,600)	
Total Operating Expenses	\$ 139,593,064	\$ 0	\$ 0	\$ 0	\$ 139,593,064

Depreciation expense of \$104,168 for the year ended June 30, 2004 for the Richmond Quadrangle is included as part of direct expenses in Institutional support.

Program Services consist of Instruction, Research, Public service and Libraries in the amount of \$59,963,577. Supporting Services consist of Academic support, Student services, Institutional support and Auxiliary enterprises in the amount of \$79,629,487.

Note 10. Lease Commitment

On May 1, 2003, the Richmond Quadrangle, a University affiliate, entered into a lease agreement with Philip Morris USA, Inc. for real estate owned by the affiliate. The lease commenced on November 1, 2003 with an initial lease term of fifteen years and an option to extend the lease for three consecutive five-year terms. The lease is classified as an operating lease.

The following is a schedule by years of minimum future rentals on the noncancelable operating lease as of June 30, 2004:

Year ending June 30:	
2005	\$ 2,714,878
2006	2,771,973
2007	2,830,208
2008	2,889,609
2009	2,950,198
Later Years	<u>31,378,066</u>
	\$ <u>45,534,932</u>

Note 11. Subsequent Event

In August 2004, the University issued VCBA Revenue Bonds Series 2004 in the aggregate principle amount of \$46,000,000. The bonds are due August 1, 2034 with a weekly variable interest rate determined by the Remarketing Agents based on prevailing market conditions. The bond proceeds will be used for refunding the Virginia College Building Authority's Educational Facilities Revenue Bonds Series of 1994 due November 1, 2019, with annual interest at 5.55% and the funding of current capital projects.

In anticipation of the issuance of the VCBA Series 2004 bonds, the University entered into a \$25,000,000 fixed rate forward swap agreement with Goldman Sachs Mitsui Marine Derivative Products, L.P. (Goldman Sachs) on May 26, 2004. The agreement has an effective date of October 1, 2004 and a termination date of August 1, 2034. The fixed interest rate to be paid by the University is 4.00% with the first interest payment due November 1, 2004. The floating rate to be paid by Goldman Sachs is 68% of the one month LIBOR with first payment due November 1, 2004.