



WAKE FOREST UNIVERSITY

OMB Circular A-133 Reports

Year ended June 30, 2005

EIN #1 – 56-053-2138-A1

WAKE FOREST UNIVERSITY

OMB Circular A-133 Reports

Table of Contents

| | Page |
|---|-------------|
| Basic Financial Statements – Year ended June 30, 2005 With Independent Auditors’ Report Thereon | 1 |
| Schedule of Expenditures of Federal and State Awards – Year ended June 30, 2005 | 26 |
| Notes to Schedule of Expenditures of Federal and State Awards | 30 |
| Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> | 32 |
| Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 | 33 |
| Schedule of Findings and Questioned Costs | 35 |



KPMG LLP
Suite 700
301 N. Elm Street
Greensboro, NC 27401

Independent Auditors' Report

The Board of Trustees
Wake Forest University:

We have audited the accompanying statement of financial position of Wake Forest University (the University) as of June 30, 2005, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University's June 30, 2004 financial statements and, in our report September 10, 2004 we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Wake Forest University as of June 30, 2005, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 9, 2005 on our consideration of Wake Forest University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Wake Forest University taken as a whole. The supplementary information included in the statements of financial position, activities and cash flows and the notes related to the College of Arts and Sciences, Schools of

Law, Management, and Divinity, the Reynolda House, Inc. and Wake Forest University Health Sciences (collectively the University) is presented for purposes of additional analysis of the financial statements rather than to present the financial position, changes in net assets and cash flows of the individual entities. Such supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying schedule of expenditures of federal and state awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

September 9, 2005

WAKE FOREST UNIVERSITY
Consolidated Statement of Financial Position
June 30, 2005
(with comparative financial information as of June 30, 2004)
(Dollars in thousands)

| Assets | Supplementary Information | | | | |
|---|----------------------------------|----------------|---------------------------|------------------|------------------|
| | College | WFUHS | Reynolda House | 2005 | 2004 |
| Cash and cash equivalents | \$ 12,552 | 6,972 | 1,009 | 20,533 | 11,103 |
| Accounts receivable, net | 3,693 | 42,613 | 40 | 46,346 | 36,561 |
| Clinic receivables, net | — | 48,795 | — | 48,795 | 52,045 |
| Grants receivable | 1,101 | 10,750 | 227 | 12,078 | 10,378 |
| Contributions receivable, net | 40,964 | 7,172 | 128 | 48,264 | 47,877 |
| Notes receivable, net | 19,520 | 1,369 | — | 20,889 | 20,807 |
| Investments | 501,535 | 502,357 | 28,928 | 1,032,820 | 945,197 |
| Investments in real estate | 27,308 | 888 | — | 28,196 | 28,655 |
| Land, buildings, and equipment, less accumulated depreciation | 228,468 | 310,440 | 24,021 | 562,929 | 534,668 |
| Other assets | 4,230 | 13,690 | 153 | 18,073 | 23,358 |
| Total assets | \$ 839,371 | 945,046 | 54,506 | 1,838,923 | 1,710,649 |
| Liabilities and Net Assets | | | | | |
| Liabilities: | | | | | |
| Accounts payable and accruals | \$ 14,034 | 58,706 | 2,999 | 75,739 | 64,610 |
| Other liabilities and deferrals | 21,786 | 74,409 | — | 96,195 | 74,209 |
| Annuities payable | 21,679 | 4,627 | — | 26,306 | 18,598 |
| Notes payable | 7,135 | 39,752 | — | 46,887 | 25,118 |
| Bonds payable | 79,695 | 196,050 | — | 275,745 | 279,895 |
| Postretirement benefits | 7,752 | 976 | — | 8,728 | 9,387 |
| Government grants refundable | 10,831 | 798 | — | 11,629 | 12,006 |
| Total liabilities | 162,912 | 375,318 | 2,999 | 541,229 | 483,823 |
| Net assets: | | | | | |
| Unrestricted undesignated | 221,166 | 336,057 | 24,700 | 581,923 | 558,478 |
| Net investment in plant | 141,638 | 74,638 | 24,021 | 240,297 | 229,655 |
| Total unrestricted | 362,804 | 410,695 | 48,721 | 822,220 | 788,133 |
| Temporarily restricted | 158,237 | 57,395 | 586 | 216,218 | 199,036 |
| Permanently restricted | 155,418 | 101,638 | 2,200 | 259,256 | 239,657 |
| Total net assets | 676,459 | 569,728 | 51,507 | 1,297,694 | 1,226,826 |
| Total liabilities and net assets | \$ 839,371 | 945,046 | 54,506 | 1,838,923 | 1,710,649 |

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY
Consolidated Statement of Activities
Year ended June 30, 2005
(with summarized financial information for the year ended June 30, 2004)
(Dollars in thousands)

| | 2005 | | | 2004 total |
|---|--------------|---------------------------|---------------------------|---------------|
| | Unrestricted | Temporarily restricted | Permanently restricted | |
| Revenues, gains, and other support: | | | | |
| Educational and general: | | | | |
| Student tuition and fees | \$ 169,202 | — | — | 169,202 |
| Scholarship allowance | (51,053) | — | — | (46,973) |
| Net student tuition and fees | 118,149 | — | — | 112,040 |
| Federal grants and contracts | 143,075 | — | — | 126,847 |
| State grants and contracts | 13,780 | — | — | 11,634 |
| Private gifts, grants, and contracts | 34,205 | 24,439 | 16,005 | 67,815 |
| Dividends, interest, and rents | 12,345 | 6,326 | 83 | 19,592 |
| Interest on short-term investments and other income | 3,053 | 50 | 590 | 3,596 |
| Net realized and unrealized appreciation on investments | 46,718 | 26,682 | 3,751 | 98,149 |
| Organized activities relating to educational departments | 3,216 | 432 | 53 | 3,858 |
| Clinic services | 328,563 | — | — | 312,915 |
| Other sources | 67,385 | — | — | 52,645 |
| Total educational and general | 770,489 | 57,929 | 20,482 | 809,091 |
| Sales and services of auxiliary enterprises | 71,075 | 2,782 | 1,120 | 69,607 |
| Total revenues and gains | 841,564 | 60,711 | 21,602 | 878,698 |
| Net assets released from restrictions | 43,147 | (43,147) | — | — |
| Total revenues, gains, and other support | 884,711 | 17,564 | 21,602 | 878,698 |
| Expenses and losses: | | | | |
| Educational and general: | | | | |
| Instruction, departmental research, and clinical | 508,289 | — | — | 472,232 |
| Sponsored research, training, and other programs | 157,992 | — | — | 142,103 |
| Organized activities | 2,393 | — | — | 1,996 |
| Academic support | 17,581 | — | — | 15,936 |
| Libraries | 14,698 | — | — | 13,994 |
| Student services | 12,759 | — | — | 13,107 |
| Institutional support | 67,134 | — | — | 66,772 |
| Total educational and general | 780,846 | — | — | 726,140 |
| Auxiliary enterprises | 59,243 | 86 | 84 | 56,672 |
| Actuarial loss on annuity obligations | — | 14 | 4,558 | 6,879 |
| Unrealized (gain) loss on interest rate swap | 7,021 | — | — | (7,098) |
| Other | 3,514 | 282 | (2,639) | 418 |
| Total expenses and losses | 850,624 | 382 | 2,003 | 783,011 |
| Increase in net assets | 34,087 | 17,182 | 19,599 | 95,687 |
| Net assets at beginning of year | 788,133 | 199,036 | 239,657 | 1,131,139 |
| Net assets at end of year | \$ 822,220 | 216,218 | 259,256 | 1,226,826 |

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Statement of Activities

College of Arts and Sciences, Schools of Law, Management, and Divinity
(Supplementary Information)

Year ended June 30, 2005

(Dollars in thousands)

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|--------------|
| Revenues, gains, and other support: | | | | |
| Educational and general: | | | | |
| Student tuition and fees | \$ 146,340 | — | — | 146,340 |
| Scholarship allowance | (42,687) | — | — | (42,687) |
| Net student tuition and fees | 103,653 | — | — | 103,653 |
| Federal grants and contracts | 5,529 | — | — | 5,529 |
| State grants and contracts | 1,266 | — | — | 1,266 |
| Private gifts, grants, and contracts | 12,203 | 5,081 | 7,416 | 24,700 |
| Dividends, interest, and rents | 4,244 | 5,189 | 32 | 9,465 |
| Interest on short-term investments and other income | 228 | 45 | 480 | 753 |
| Net realized and unrealized appreciation | | | | |
| on investments | 18,639 | 18,867 | 1,738 | 39,244 |
| Organized activities relating to educational department: | 3,216 | 432 | 53 | 3,701 |
| Clinic services | — | — | — | — |
| Other sources | 1,350 | — | — | 1,350 |
| Total educational and general | 150,328 | 29,614 | 9,719 | 189,661 |
| Sales and services of auxiliary enterprises | 70,048 | 2,782 | 1,120 | 73,950 |
| Total revenues and gains | 220,376 | 32,396 | 10,839 | 263,611 |
| Net assets released from restrictions | 19,121 | (19,121) | — | — |
| Total revenues, gains, and other support | 239,497 | 13,275 | 10,839 | 263,611 |
| Expenses and losses: | | | | |
| Educational and general: | | | | |
| Instruction, departmental research, and clinical | 97,946 | — | — | 97,946 |
| Sponsored research, training, and other programs | — | — | — | — |
| Organized activities | 2,393 | — | — | 2,393 |
| Academic support | 5,616 | — | — | 5,616 |
| Libraries | 10,312 | — | — | 10,312 |
| Student services | 11,040 | — | — | 11,040 |
| Institutional support | 33,614 | — | — | 33,614 |
| Total educational and general | 160,921 | — | — | 160,921 |
| Auxiliary enterprises | 58,294 | 86 | 84 | 58,464 |
| Actuarial loss on annuity obligations | — | 14 | 2,789 | 2,803 |
| Unrealized (gain) loss on interest rate swap | 331 | — | — | 331 |
| Other | 2,422 | 282 | (2,639) | 65 |
| Total expenses and losses | 221,968 | 382 | 234 | 222,584 |
| Increase in net assets | 17,529 | 12,893 | 10,605 | 41,027 |
| Net assets at beginning of year | 345,275 | 145,344 | 144,813 | 635,432 |
| Net assets at end of year | \$ 362,804 | 158,237 | 155,418 | 676,459 |

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY
Statement of Activities
Wake Forest University Health Sciences
(Supplementary Information)
Year ended June 30, 2005
(Dollars in thousands)

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|--|---------------------|-----------------------------------|-----------------------------------|--------------|
| Revenues, gains, and other support: | | | | |
| Educational and general: | | | | |
| Student tuition and fees | \$ 22,862 | — | — | 22,862 |
| Scholarship allowance | (8,366) | — | — | (8,366) |
| Net student tuition and fees | 14,496 | — | — | 14,496 |
| Federal grants and contracts | 137,546 | — | — | 137,546 |
| State grants and contracts | 12,514 | — | — | 12,514 |
| Private gifts, grants, and contracts | 21,353 | 18,202 | 8,589 | 48,144 |
| Dividends, interest, and rents | 7,659 | 1,094 | 51 | 8,804 |
| Interest on short-term investments and other income | 2,815 | — | 110 | 2,925 |
| Net realized and unrealized appreciation on investments | 23,875 | 7,399 | 2,013 | 33,287 |
| Organized activities relating to educational department: | — | — | — | — |
| Clinic services | 328,563 | — | — | 328,563 |
| Other sources | 65,827 | — | — | 65,827 |
| Total educational and general | 614,648 | 26,695 | 10,763 | 652,106 |
| Sales and services of auxiliary enterprises | 1,027 | — | — | 1,027 |
| Total revenues and gains | 615,675 | 26,695 | 10,763 | 653,133 |
| Net assets released from restrictions | 21,152 | (21,152) | — | — |
| Total revenues, gains, and other support | 636,827 | 5,543 | 10,763 | 653,133 |
| Expenses and losses: | | | | |
| Educational and general: | | | | |
| Instruction, departmental research, and clinical | 410,343 | — | — | 410,343 |
| Sponsored research, training, and other programs | 157,992 | — | — | 157,992 |
| Organized activities | — | — | — | — |
| Academic support | 8,231 | — | — | 8,231 |
| Libraries | 4,386 | — | — | 4,386 |
| Student services | 1,719 | — | — | 1,719 |
| Institutional support | 33,520 | — | — | 33,520 |
| Total educational and general | 616,191 | — | — | 616,191 |
| Auxiliary enterprises | 949 | — | — | 949 |
| Actuarial loss on annuity obligations | — | — | 1,769 | 1,769 |
| Unrealized (gain) loss on interest rate swap | 6,690 | — | — | 6,690 |
| Other | 1,747 | — | — | 1,747 |
| Total expenses and losses | 625,577 | — | 1,769 | 627,346 |
| Increase in net assets | 11,250 | 5,543 | 8,994 | 25,787 |
| Net assets at beginning of year | 399,445 | 51,852 | 92,644 | 543,941 |
| Net assets at end of year | \$ 410,695 | 57,395 | 101,638 | 569,728 |

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Statement of Activities

Reynolda House
(Supplementary Information)

Year ended June 30, 2005

(Dollars in thousands)

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|--------------|
| Revenues, gains, and other support: | | | | |
| Educational and general: | | | | |
| Student tuition and fees | \$ — | — | — | — |
| Scholarship allowance | — | — | — | — |
| Net student tuition and fees | — | — | — | — |
| Federal grants and contracts | | | | — |
| State grants and contracts | | | | — |
| Private gifts, grants, and contracts | 649 | 1,156 | — | 1,805 |
| Dividends, interest, and rents | 442 | 43 | — | 485 |
| Interest on short-term investments and other income | 10 | 5 | — | 15 |
| Net realized and unrealized appreciation on investment: | 4,204 | 416 | — | 4,620 |
| Organized activities relating to educational department: | | | | |
| Clinic services | — | — | — | — |
| Other sources | 208 | — | — | 208 |
| Total educational and general | 5,513 | 1,620 | — | 7,133 |
| Sales and services of auxiliary enterprises | — | — | — | — |
| Total revenues and gains | 5,513 | 1,620 | — | 7,133 |
| Net assets released from restrictions | 2,874 | (2,874) | — | — |
| Total revenues, gains (losses), and other support | 8,387 | (1,254) | — | 7,133 |
| Expenses and losses: | | | | |
| Educational and general: | | | | |
| Instruction, departmental research, and clinical | — | — | — | — |
| Sponsored research, training, and other programs | — | — | — | — |
| Organized activities | — | — | — | — |
| Academic support | 3,734 | — | — | 3,734 |
| Libraries | — | — | — | — |
| Student services | — | — | — | — |
| Institutional support | — | — | — | — |
| Total educational and general | 3,734 | — | — | 3,734 |
| Auxiliary enterprises | — | — | — | — |
| Actuarial loss on annuity obligations: | | | | |
| Other | (655) | — | — | (655) |
| Total expenses and losses | 3,079 | — | — | 3,079 |
| Increase (decrease) in net assets | 5,308 | (1,254) | — | 4,054 |
| Net assets at beginning of year | 43,413 | 1,840 | 2,200 | 47,453 |
| Net assets at end of year | \$ 48,721 | 586 | 2,200 | 51,507 |

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY
Consolidated Statement of Cash Flows
Year ended June 30, 2005
(with comparative financial information for the year ended June 30, 2004)
(Dollars in thousands)

| | Supplementary information | | | 2005 | 2004 |
|---|----------------------------------|-----------------|-----------------------|-----------------|-----------------|
| | College | WFUHS | Reynolda House | | |
| Cash flows from operating activities: | | | | | |
| Increase in net assets | \$ 41,027 | 25,787 | 4,054 | 70,868 | 95,687 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | | | | |
| Depreciation and amortization | 18,748 | 25,357 | 409 | 44,514 | 41,987 |
| Net realized and unrealized appreciation on investments | (39,244) | (33,287) | (4,620) | (77,151) | (98,149) |
| Noncash gifts of property | (1,460) | — | — | (1,460) | (82) |
| Private gifts restricted for long-term investment | (7,416) | (8,589) | — | (16,005) | (13,876) |
| Other revenue restricted for long-term investment | (1,685) | (161) | — | (1,846) | (480) |
| (Gain) loss on disposal of property and equipment | (47) | 2,830 | 14 | 2,797 | 657 |
| Unrealized (gain) loss on interest rate swap | 331 | 6,690 | — | 7,021 | (7,098) |
| Bad debt expense | — | 26,900 | — | 26,900 | 25,158 |
| Changes in assets and liabilities: | | | | | |
| Accounts and clinic receivables | (1,049) | (32,440) | 54 | (33,435) | (40,109) |
| Grants receivable | (318) | (1,217) | (165) | (1,700) | (1,666) |
| Contributions receivable | 1,004 | (1,853) | 462 | (387) | (1,932) |
| Notes receivable | (24) | 313 | — | 289 | 132 |
| Other assets | 961 | 4,791 | (23) | 5,729 | (4,507) |
| Accounts payable and accruals | 1,162 | 8,893 | 1,074 | 11,129 | 10,142 |
| Other liabilities and deferrals | 6,806 | 8,160 | (1) | 14,965 | 10,621 |
| Postretirement benefits | 603 | (1,262) | — | (659) | 2,419 |
| Annuities payable | 6,499 | 1,209 | — | 7,708 | 6,912 |
| Net cash provided by operating activities | <u>25,898</u> | <u>32,121</u> | <u>1,258</u> | <u>59,277</u> | <u>25,816</u> |
| Cash flows from investing activities: | | | | | |
| Purchases of land, buildings and equipment | (14,920) | (56,929) | (1,757) | (73,606) | (75,005) |
| Proceeds from sale of property and equipment | 937 | — | 2 | 939 | 1,391 |
| Disbursements of loans to students, faculty, and staff | (3,761) | (82) | — | (3,843) | (3,943) |
| Repayments of loans from students, faculty, and staff | 3,005 | 467 | — | 3,472 | 4,019 |
| Purchases of investments | (440,217) | (1,151,522) | (10,122) | (1,601,861) | (3,417,965) |
| Net proceeds from sales and maturities of investments | 432,270 | 1,147,185 | 10,912 | 1,590,367 | 3,444,284 |
| Net cash used in investing activities | <u>(22,686)</u> | <u>(60,881)</u> | <u>(965)</u> | <u>(84,532)</u> | <u>(47,219)</u> |
| Cash flows from financing activities: | | | | | |
| Change in government grants refundable | (80) | (297) | — | (377) | (101) |
| Payments on notes payable | (623) | (920) | — | (1,543) | (1,545) |
| Proceeds from notes payable | — | 23,312 | — | 23,312 | 800 |
| Payments on bonds payable | (68,765) | (2,750) | — | (71,515) | (3,825) |
| Proceeds from issuance of bonds payable | 67,365 | — | — | 67,365 | — |
| Payment on bond issuance costs | (575) | — | — | (575) | (13) |
| Proceeds from private gifts restricted for long-term investment | 7,416 | 8,589 | — | 16,005 | 13,876 |
| Net realized gains (losses) restricted for long-term investment | (484) | 651 | — | 167 | 7,410 |
| Other revenue restricted for long-term investment | 1,685 | 161 | — | 1,846 | 480 |
| Net cash provided by financing activities | <u>5,939</u> | <u>28,746</u> | <u>—</u> | <u>34,685</u> | <u>17,082</u> |
| Net increase (decrease) in cash and cash equivalents | 9,151 | (14) | 293 | 9,430 | (4,321) |
| Cash and cash equivalents at beginning of year | 3,401 | 6,986 | 716 | 11,103 | 15,424 |
| Cash and cash equivalents at end of year | <u>\$ 12,552</u> | <u>6,972</u> | <u>1,009</u> | <u>20,533</u> | <u>11,103</u> |

Supplemental disclosure of cash flow information:
The University paid \$9,146 in interest during 2005.

See accompanying notes to consolidated financial statements.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(1) Summary of Significant Accounting Policies

(a) *Description of the University*

Wake Forest University (the University) is a private, coeducational, not-for-profit institution of higher education and research located in Winston-Salem, North Carolina. The consolidated financial statements of the University include the College of Art and Sciences, Schools of Law, Management, and Divinity (the College), the Reynolda House, Inc. (Reynolda House), Wake Forest University Health Sciences (WFUHS) and all entities over which the University has control, including all of the subsidiaries of WFUHS. All significant intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements have, in all material respects, been prepared on the accrual basis in conformity with the accounting principles generally accepted in the United States of America.

(b) *Basis of Presentation*

Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the University and changes therein are classified and reported as follows:

- Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.
- Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the University and/or the passage of time.
- Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, the donors of these assets permit the University to use all of, or part of, the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Expirations of restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets. Contributions, including unconditional promises to give, are recognized as revenues in the period received. 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 after one year are discounted to their present value at a risk free investment rate, generally the 10-year treasury bill rate (2.94% at June 30, 2005). Amortization of discounts is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for uncollectible contributions receivable is provided based upon management's judgment, based on such factors as prior collection history, type of contribution and nature of fundraising activity.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

Income and realized and unrealized gains on investments of permanently restricted net assets are reported as follows:

- as increases in permanently restricted net assets if the terms of the gift or the University's interpretation of relevant state law require that they be added to the principal of a permanent endowment fund;
- as increases in temporarily restricted net assets if the terms of the gifts impose restrictions on their use;
- as increases in unrestricted net assets in all other cases.

(c) ***Endowment Accounting***

Permanent endowment funds are subject to the restrictions of gift instruments, which require that the principal be invested in perpetuity. While quasi-endowment funds have been established by the board of trustees for the same purpose as permanent endowment funds, any portion of the quasi-endowment funds may be expended at the discretion of the Board and, accordingly, such funds are reported as unrestricted net assets. Realized and unrealized gains of the permanent endowment funds are classified as temporarily restricted net assets if the income distributed from these funds is restricted, and as unrestricted net assets if the income distributed from these funds is unrestricted.

The University has implemented a spending policy designed to stabilize annual spending levels and preserve the real value of the endowment over time. In accordance with the University's policy, a predetermined endowment spending rate consistent with the University's total return objective has been established and approved by the Board of Trustees. Should endowment yields prove to be insufficient to support this policy, the balance is provided from capital gains. Should endowment yields exceed the amounts necessary to maintain this objective, the balance is reinvested in the endowment. The endowment spending rate for the years ended June 30, 2005 and 2004 was 5.3%, calculated as a percentage of the average of the previous three-year semiannual moving market value per unit (see note 3).

(d) ***Temporarily Restricted Accounting***

Revenues, which have donor stipulations that limit their use, are recorded as temporarily restricted net assets and released from restriction when the stipulated time restriction expires or purpose restriction is met.

(e) ***Cash Equivalents***

For purposes of reporting cash flows, the University considers interest-bearing deposits in financial institutions with remaining maturities at date of purchase of three months or less to be cash equivalents. Cash equivalents consist primarily of temporary investments in bank repurchase agreements and money market accounts.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(f) *Financial Instruments*

The carrying amounts of cash and cash equivalents; accounts, grants, and clinic receivables and accounts payable approximate fair value because of the short maturity of these financial instruments.

The carrying value of investments in debt securities and equity securities is based upon fair market value. In the limited cases where such values are not available, estimates of fair value are used.

The carrying amounts of contributions receivable and annuities payable represent the present value of estimated future cash flows, which approximates fair value.

A reasonable estimate of the fair value of notes receivable from students under government loan programs cannot be made because such loans are not sellable and can only be assigned to the U.S. government or its designees. The fair value of receivables from students under University loan programs approximates carrying value.

The carrying amounts of notes and bonds payable with variable interest rates approximate their fair value because substantially all of these financial instruments bear interest at variable rates which approximate current market rates for loans with similar maturities and credit quality.

(g) *Split-Interest Agreements*

The University's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts for which the University serves as trustee. Assets held in these trusts are included in investments or investments in real estate. Contribution revenues are recognized at the dates the trusts are established. Annuity and other split-interest obligations are adjusted annually at the end of each fiscal year.

(h) *Investments*

Investments are generally recorded at fair value, which are based on quoted market prices. In the case of certain less marketable investments, principally private equity investments, value is established based on certain external events which substantiate a change in value or a reasonable methodology that exists to capture and quantify changes in value. Where the University's ownership is considered to be more than minor, the equity method of accounting is used. The University receives income from perpetual trusts but will never gain control of the trusts. The fair value of these trusts is the present value of the estimated future cash flows.

Investments in real estate are valued at the lower of cost or market. Accordingly, if there is a decline in market value that is other than temporary, the carrying amount of the investment is reduced to market value. The University records depreciation on rental properties over 40 years, which is the estimated useful life of the rental properties. Depreciation is calculated using the straight-line method.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(i) Land, Buildings, and Equipment

Land, buildings, and equipment are recorded at cost at date of acquisition or estimated fair market value on the date received for donated items. Depreciation is calculated on the straight-line basis over the estimated useful life of each class or component of depreciable asset. Estimated lives range from 3 to 60 years.

(j) Works of Art and Historical Treasures

Works of art and historical treasures include the original Reynolda House and its contents, as well as paintings and other items subsequently acquired. The Reynolda House, Inc. has capitalized all such items since its inception. If purchased, they are capitalized at cost, and if donated, they are capitalized at their appraised or estimated fair value. The Reynolda House's paintings are cataloged for educational, research, scientific and curatorial purposes, and activities verifying their existence and assessing their condition are performed on an ongoing basis. The works of art and historical treasures are included with buildings and other improvements and equipment and furnishings (see note 5).

(k) Clinic Services Revenue

WFUHS records clinic services revenue net of contractual adjustments and discount allowances. WFUHS has agreements with third-party payors that provide for payments to WFUHS at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Clinic services revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. The clinic receivables are recorded net of allowance for contractual adjustments and uncollectible accounts of \$26,167 and \$33,112, respectively, at June 30, 2005; and \$26,132 and \$32,451, respectively, at June 30, 2004.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with these and other laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

(l) Bond Issuance Costs

Bond issuance costs related to the registration and issuance of bonds are carried at cost less accumulated amortization, are being amortized over the life of the bonds on a method that

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

approximates the effective interest method and are included in other assets in the consolidated statement of financial position.

(m) *Functional Expenses*

Expenses are reported in the statement of activities in categories recommended by the National Association of College and University Business Officers. The University's primary program services are instruction, clinical, research, and organized activities. Expenses reported as academic support, libraries, student services, institutional support, and auxiliary enterprises are incurred in support of these primary program services. The University's fundraising expenses are immaterial and are included in institutional support.

Depreciation of plant assets, interest expense and plant operation and maintenance expense are allocated to program and supporting activities based on periodic inventories of facilities.

(n) *Government Grants Refundable*

Funds provided by the United States Government under the Federal Perkins and Health Professions Student Loan Programs are loaned to qualified students and may be re-loaned after collections. These funds are ultimately refundable to the government and are reported as liabilities.

(o) *Sponsored Grants and Contracts*

Revenue under grants and contracts with sponsoring organizations are recognized as expenses as incurred for agreement purposes. The revenues include recoveries of indirect costs and fringe benefits, which are generally determined as a negotiated or agreed-upon percentage of direct costs with certain exclusions.

(p) *Derivative Instruments*

Under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, an *Amendment of SFAS 133*, the University records all derivative instruments on the statement of financial position at their respective fair values and all changes in fair value in the statement of activities.

(q) *Allocated Net Assets*

WFUHS's unrestricted undesignated net asset balance is internally allocated for individual departmental research and development and for use in the clinical practices.

(r) *Use of Estimates*

The University prepares its financial statements in accordance with accounting principles generally accepted in the United States of America which require management to make estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(s) **Reclassifications**

In certain instances, amounts previously reported in the 2004 financial statements have been reclassified to conform to the 2005 presentation. Such reclassifications have no effect on the increase in net assets as previously reported.

(t) **Comparative Financial Information**

The financial statements include certain prior year information for comparative purposes which 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, 2004 from which this information was derived.

(2) **Contributions Receivable**

The following is an analysis of the maturities of the University's contributions receivable at June 30, 2005:

| | <u>College</u> | <u>WFUHS</u> | <u>Reynolda House</u> | <u>Total</u> |
|--------------------------------------|------------------|--------------|---------------------------|---------------|
| One year or less | \$ 11,955 | 3,906 | 118 | 15,979 |
| Between one and five years | 30,922 | 3,223 | 25 | 34,170 |
| More than five years | 13,342 | 2,245 | — | 15,587 |
| Gross contributions receivable | 56,219 | 9,374 | 143 | 65,736 |
| Less estimated uncollectible amounts | 9,376 | 1,163 | 1 | 10,540 |
| Less discount to present value | 5,879 | 1,039 | 14 | 6,932 |
| Contributions receivable, net | \$ <u>40,964</u> | <u>7,172</u> | <u>128</u> | <u>48,264</u> |

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(3) Investments

Investments at June 30, 2005 consist of the following:

| | | |
|--|----|-------------------------|
| Short-term investments | \$ | 60,773 |
| Real assets | | 70,863 |
| Real estate | | 29,520 |
| Fixed income securities | | 238,706 |
| Beneficial interests in perpetual trusts | | 24,564 |
| Public equity | | 408,269 |
| Private equity | | 46,607 |
| Hedge strategies | | 146,856 |
| Other investments | | <u>6,662</u> |
| Total investments | \$ | <u><u>1,032,820</u></u> |

The University places a substantial portion of assets into a pool on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of each quarter within which the transaction took place. At June 30, 2005, a total of 16,619,171 units existed in the pool with a fair value of \$47.13 per unit.

Net realized and unrealized appreciation on investments is decreased by \$3,524 in investment fees.

(4) Investments in Real Estate

The University maintains rental properties and has entered into long-term operating lease agreements for this real estate providing for future rental income as follows:

| | <u>College</u> | <u>WFUHS</u> | <u>Total</u> |
|---------------------|------------------|--------------|---------------|
| Year ended June 30: | | | |
| 2006 | \$ 7,837 | 2,041 | 9,878 |
| 2007 | 7,986 | 2,016 | 10,002 |
| 2008 | 8,645 | 579 | 9,224 |
| 2009 | 9,094 | 308 | 9,402 |
| 2010 | <u>9,167</u> | <u>220</u> | <u>9,387</u> |
| | <u>\$ 42,729</u> | <u>5,164</u> | <u>47,893</u> |

Total income from rental real estate was \$8,007 for the College and \$1,978 for WFUHS for the year ended June 30, 2005.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(5) Land, Buildings, and Equipment

Land, buildings, and equipment is summarized as follows at June 30, 2005:

| | <u>College</u> | <u>WFUHS</u> | <u>Reynolda House</u> | <u>Total</u> |
|----------------------------------|-------------------|----------------|---------------------------|----------------|
| Land | \$ 5,272 | 35,186 | 1,122 | 41,580 |
| Buildings and other improvements | 321,106 | 339,731 | 14,713 | 675,550 |
| Equipment and furnishings | 137,270 | 107,947 | 10,421 | 255,638 |
| Construction in progress | 12,531 | 35,411 | 55 | 47,997 |
| | 476,179 | 518,275 | 26,311 | 1,020,765 |
| Less accumulated depreciation | (247,711) | (207,835) | (2,290) | (457,836) |
| | <u>\$ 228,468</u> | <u>310,440</u> | <u>24,021</u> | <u>562,929</u> |

Total depreciation expense on land, buildings and equipment was \$43,200 for the year ended June 30, 2005.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(6) Notes and Bonds Payable

Notes and bonds payable at June 30, 2005 consist of the following:

| | College | WFUHS | Total |
|--|----------------|--------------|--------------|
| Variable rate loan (4.09% at June 30, 2005) with principal of \$77 and interest payable monthly and final balloon payment due December 31, 2011 | \$ — | 15,640 | 15,640 |
| Variable rate loan (4.19% at June 30, 2005) with \$480 of principal and interest payable semiannually through 2014 | 7,135 | — | 7,135 |
| Variable rate construction loan agreement (3.64% at June 30, 2005) with interest payable monthly and final principal and interest balloon payment due April 19, 2006 | — | 23,312 | 23,312 |
| Noninterest bearing promissory note due September 2012 | — | 800 | 800 |
| Notes payable | \$ 7,135 | 39,752 | 46,887 |
| Series 1994 taxable bonds payable | \$ 2,400 | — | 2,400 |
| Series 1997 taxable bonds payable | 7,500 | — | 7,500 |
| Series 1997 tax-exempt bonds payable | 2,430 | — | 2,430 |
| Series 2002 tax-exempt bonds payable | — | 196,050 | 196,050 |
| Series 2004A tax-exempt bonds payable | 36,605 | — | 36,605 |
| Series 2004B tax-exempt bonds payable | 30,760 | — | 30,760 |
| Bonds payable | \$ 79,695 | 196,050 | 275,745 |

The University has outstanding \$2,400 of taxable variable rate demand bonds, Series 1994, pursuant to a trust agreement with a commercial bank. The Series 1994 bonds mature serially through 2009 in the amount of \$600 annually. The variable interest rate is determined weekly and at the option of the University may be converted to an alternative variable rate option or to a fixed rate. The University has an unconditional obligation to repay the bonds and certain property and rights with an approximate net book value of \$22,600 are pledged and assigned as security under terms of the bond indenture. The interest rate on the bonds at June 30, 2005 was 3.36%.

The University has outstanding \$7,500 of Wake Forest University taxable variable demand rate bonds Series 1997 (the Series 1997 taxable bonds) pursuant to a trust agreement with a commercial bank. The Series 1997 taxable bonds mature annually from 2010 through 2017 in varying amounts of \$800 to \$1,100. The variable interest rate is determined weekly and at the option of the University may be converted to an alternative variable option or to a fixed rate. (A letter of credit has been issued by a commercial bank for \$7,663, which expires on September 5, 2006). The University's obligation under the loan agreement is an unsecured, unconditional obligation. The interest rate on the bonds at June 30, 2005 was 3.33%.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

The University has outstanding \$2,430 of fixed rate, tax exempt revenue bonds, Series 1997 (the Series 1997 tax-exempt bonds), pursuant to a trust and loan agreement with the Education Facilities Finance Agency. The final payment of \$2,430 on the Series 1997 tax-exempt bonds is due November 2005. The interest rates on the Series 1997 tax-exempt bonds range from 4.0% to 5.0%. The average interest rate on the bonds at June 30, 2005, was 4.92%.

WFUHS has outstanding \$196,050 of Wake Forest University Health Care Facilities Revenue Bonds, Series 2002, issued by the North Carolina Medical Care Commission. The bonds payable are comprised of Subseries A and Subseries B, each in the amount of \$98,025. The obligations of WFUHS are evidenced by a promissory note issued under a Master Trust Indenture, dated August 1, 2002, by and between WFUHS and First Citizens Bank and Trust Company, as master trustee. The Series 2002 bonds mature in full in 2034 and, at the option of WFUHS, the bonds may be converted to various interest rates or to a fixed rate. Subject to certain provisions regarding serialization, the Series 2002 bonds are subject to mandatory redemption beginning in 2005 through 2034 in increasing annual amounts from \$2,750 to \$12,950. The interest rates on the bonds at June 30, 2005 were variable at 2.31% for the Subseries A and variable at 2.75% for Subseries B (note 13). WFUHS' obligation under the loan agreement is secured by all of its assets.

WFUHS received a grant from the City of Winston-Salem (the City) for \$800 in 2003, the purpose of which was to fund the development of the Green Park Courtyard (the Park). As part of this grant, WFUHS executed a noninterest bearing promissory note to the City in the amount of \$800 and a deed of trust subjecting the Park to the lien of the promissory note. The grant states that in the event that an additional \$17,400 in taxable property value is created within the Park within ten years, then the promissory note shall be marked satisfied in full and cancelled of record. At such time that this condition is fulfilled, the note will be recorded as a contribution in the statement of activities.

In 2005, WFUHS entered into a construction loan financing agreement with a commercial bank that permits WFUHS to borrow through 2006 up to \$69,000, bearing interest at LIBOR plus 0.30%. Interest is payable monthly. Upon completion of the construction, permanent financing will be obtained to repay the existing construction loan.

On December 21, 2004, The North Carolina Capital Facilities Finance Agency issued the North Carolina Capital Facilities Finance Agency Revenue Bonds, Series 2004 in the principal amount of \$67,365. The bonds are made up of Subseries A, in the amount of \$36,605, and Subseries B, in the amount of \$30,760. A portion of the Series 2004 bonds was used to refund in advance of their maturity, the non-taxable Series 2000 and non-taxable Series 1997 bonds, and a portion of the taxable Series 1997 bonds. A loss of \$2,942 was recognized on the refunding. The obligations of the University are evidenced by Loan Agreement dated December 1, 2004, by and between the University and First Citizens Bank and Trust Company, as trustee. The Series 2004 tax-exempt bonds are due annually through 2020 in varying amounts from \$295 to \$7,340. The interest rate on the bonds is determined weekly, and at the option of the University may be converted to a fixed rate. The University's obligation under the Loan Agreement is an unsecured, unconditional obligation. The interest rates on the bonds at June 30, 2005 were variable at 2.20% for the Subseries A and at 2.26% for the Subseries B.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

Trust indentures underlying the Series 1994 and Series 1997 taxable and tax-exempt bonds, Series 2002 and Series 2004 tax-exempt bonds contain certain covenants and restrictions. At June 30, 2005, management believes the University is in compliance with such requirements.

Aggregate annual maturities of notes and bonds payable for each of the five fiscal years subsequent to June 30, 2005 and thereafter are as follows:

| | <u>College</u> | <u>WFUHS</u> | <u>Total</u> |
|------------|------------------|----------------|----------------|
| 2006 | \$ 3,993 | 27,132 | 31,125 |
| 2007 | 1,601 | 3,970 | 5,571 |
| 2008 | 1,641 | 4,170 | 5,811 |
| 2009 | 3,666 | 4,320 | 7,986 |
| 2008 | 6,008 | 4,520 | 10,528 |
| Thereafter | 69,921 | 191,690 | 261,611 |
| | <u>\$ 86,830</u> | <u>235,802</u> | <u>322,632</u> |

Total interest costs incurred on indebtedness were \$8,868 for the year ended June 30, 2005.

(7) Postretirement Benefits

The University sponsors defined benefit postretirement medical and dental plans that cover all its full-time employees who elect coverage and satisfy the plans' eligibility requirements when they retire. To be eligible, retired employees of the College must be at least 62 years of age with ten or more years of service or be at least 65 years of age with five or more years of service. Retired employees of WFUHS must satisfy the "Rule of 75," meaning that the employee's age and years of service must equal or exceed seventy-five at retirement with a minimum age of fifty-five. Employees of the Reynolda House are not eligible for the plans. The plans are contributory with retiree contributions established based on the University contributions being fixed amounts.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

The following table provides a reconciliation of the changes in each plan's benefit obligation, fair value of plan assets and funded status for the year ended June 30, 2005:

| | <u>College</u> | <u>WFUHS</u> | <u>Total</u> |
|--|-------------------|---------------|----------------|
| Change in benefit obligation: | | | |
| Benefit obligation at beginning of year | \$ 7,825 | 28,572 | 36,397 |
| Service cost | 462 | 1,485 | 1,947 |
| Interest cost | 477 | 1,752 | 2,229 |
| Actuarial gain | 1,153 | 5,592 | 6,745 |
| Benefits paid | (422) | (1,697) | (2,119) |
| Change in plan provisions | — | (242) | (242) |
| Benefit obligation at end of year | <u>9,495</u> | <u>35,462</u> | <u>44,957</u> |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | — | 13,955 | 13,955 |
| Actual return on plan assets | — | 157 | 157 |
| Employer contributions | 422 | 3,937 | 4,359 |
| Benefits paid | (422) | (1,697) | (2,119) |
| Fair value of plan assets at end of year | <u>—</u> | <u>16,352</u> | <u>16,352</u> |
| Funded status | (9,495) | (19,110) | (28,605) |
| Unrecognized net actuarial loss | 1,206 | 16,408 | 17,614 |
| Unrecognized prior service cost | 537 | 1,726 | 2,263 |
| Net liability recognized | \$ <u>(7,752)</u> | <u>(976)</u> | <u>(8,728)</u> |

The following table provides the components of net periodic benefit cost for the year ended June 30, 2005:

| | <u>College</u> | <u>WFUHS</u> | <u>Total</u> |
|--------------------------------------|-----------------|--------------|--------------|
| Service cost | \$ 462 | 1,485 | 1,947 |
| Interest cost | 477 | 1,752 | 2,229 |
| Expected return on plan assets | — | (1,407) | (1,407) |
| Amortization of unrecognized amounts | 87 | 328 | 415 |
| Recognized net actuarial gain | — | 516 | 516 |
| Net periodic benefit cost | \$ <u>1,026</u> | <u>2,674</u> | <u>3,700</u> |

The prior service costs are amortized on a straight-line basis over the average remaining service period of active participants. Gains in excess of 10% of the greater of the benefit obligation and the market-related value of assets are amortized over the average remaining service period of active participants.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

The weighted average discount rate used to determine the accumulated postretirement benefit obligation was 5.25% and 6.25% at June 30, 2005 and 2004, respectively. For management purposes, a 11% annual rate of increase in the per capita cost of covered health care benefits was assumed for the first year, and a 4% rate was assumed as the ultimate rate. The expected return assumed on plan assets for WFUHS is 9%. The rate is reviewed annually and adjusted as appropriate to reflect changes in the expected market performance of the investments.

Plan assets for WFUHS are held in trust and are invested in commingled mutual funds that preclude the ability to analyze the precise composition of the investments, thus no asset detail is presented.

Assumed health care cost trend rates have a significant effect on the amounts reported for the post-retirement benefit plan. A 1% change in assumed health care cost trend rates would have the following effects:

| | 1% increase | 1% decrease |
|---|--------------------|--------------------|
| Effect on total service and interest cost components of net periodic benefit cost | \$ 230 | (198) |
| Effect on postretirement benefit obligation | 1,494 | (1,313) |

In May 2004, the Financial Accounting Standards (FASB) issued FASB Staff Position No. 106-2 (FSP 106-2), "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the Act). The Act introduces a prescription drug benefit under Medicare (Medicare Part D). The availability of the new drug benefit could cause plan participants to leave their current employer-sponsored plans depending on the drug benefits provided under those plans relative to the benefits provided by Medicare. The Act also provides that a nontaxable federal subsidy will be paid to sponsors of the postretirement benefit plans that provide retirees with a drug benefit that is at least "actuarially equivalent" to the Medicare Part D benefit. During 2005, the University assessed the impact of the Act on its plans noting that since it was a Medicare replacement plan they are not eligible for reimbursement. Further, the University deems the drug coverage provided by the plans superior to Medicare Part D and as such does not estimate any impact on the balances reported.

Aggregate benefits expected to be paid by the University in each of the next ten fiscal years subsequent to June 30, 2005 are as follows:

| | College | WFUHS | Total |
|-----------------------|----------------|--------------|--------------|
| 2006 | \$ 403 | 1,036 | 1,439 |
| 2007 | 453 | 1,220 | 1,673 |
| 2008 | 492 | 1,418 | 1,910 |
| 2009 | 541 | 1,594 | 2,135 |
| 2010 | 594 | 1,759 | 2,353 |
| Five years thereafter | 3,858 | 12,197 | 16,055 |
| | \$ 6,341 | 19,224 | 25,565 |

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

The expected benefits to be paid are based on the same assumptions used to measure the University's benefit obligation at June 30, 2005 and include estimated future employee service.

(8) Net Assets

Temporarily restricted net assets are available for the following purposes at June 30, 2005:

| | <u>College</u> | <u>WFUHS</u> | <u>Reynolda House</u> | <u>Total</u> |
|---|-------------------|---------------|---------------------------|----------------|
| Instruction, research, scholarships and operations | \$ 23,694 | — | — | 23,694 |
| Term endowment funds | 130,484 | 25,907 | 586 | 156,977 |
| Interests in other trusts | 4,059 | 31,488 | — | 35,547 |
| | <u>\$ 158,237</u> | <u>57,395</u> | <u>586</u> | <u>216,218</u> |

During 2005, net assets of \$43,147 were released from donor restrictions by incurring expenses satisfying the restricted purposes or by the passage of time.

Permanently restricted net assets consist of the following at June 30, 2005:

| | <u>College</u> | <u>WFUHS</u> | <u>Reynolda House</u> | <u>Total</u> |
|---|-------------------|----------------|---------------------------|----------------|
| Student loan funds | \$ 7,696 | 3,982 | — | 11,678 |
| Permanent endowment funds | 144,971 | 74,174 | 2,200 | 221,345 |
| Interests in perpetual and other trusts | 2,751 | 23,482 | — | 26,233 |
| | <u>\$ 155,418</u> | <u>101,638</u> | <u>2,200</u> | <u>259,256</u> |

The income from these investments in perpetuity is expendable for instruction, scholarships, and operations.

(9) Benefit Plans

Substantially all employees of the University are eligible to participate in defined contribution benefit plans. The University contributes a specified percentage of each employee's salary to the plans. Total contributions for the year ended June 30, 2005 were \$6,433, \$16,693, and \$78 for the College, WFUHS, and Reynolda House, respectively.

(10) Related Party Transactions

WFUHS and the North Carolina Baptist Hospital, Inc. and subsidiaries (the Hospital) participate in various expansion projects, share certain facilities and provide various services and incur certain expenses on

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

behalf of each other. The costs associated with operating and maintaining jointly occupied facilities are ultimately paid by the party having beneficial occupancy.

During the year ended June 30, 2005, \$50,333 was received from the Hospital for reimbursement of services provided or expenses incurred by WFUHS on behalf of the Hospital. Such services or expenses include physician salaries, facility expenses, library expenses, printing services, laboratory services and materials. Accounts payable and accruals at June 30, 2005 include \$1,024 due to the Hospital for such items. During the year ended June 30, 2005, \$46,896 was paid to the Hospital for reimbursement of services provided or expenses incurred by the Hospital on behalf of WFUHS. Such services or expenses include laboratory fees collected by the Wake Forest University Physicians business office, computer services, telephone service, insurance premiums, and certain utilities. Accounts payable and accruals at June 30, 2005 include \$1,227 due to the Hospital for such items.

The Medical Center Corporation (the Center), a North Carolina nonprofit corporation formed to act on behalf of WFUHS and the Hospital in connection with facilities planning, informational services, fundraising and budget formulation and review, is directing the planning and supervision of numerous construction projects as well as the fundraising campaigns in connection therewith. Construction costs are paid in accordance with the respective occupancy percentages of the facilities. WFUHS and the Hospital have negotiated a land and facilities sharing agreement whereby WFUHS and the Hospital independently hold title to certain land and facilities, as designated by the agreement.

(11) Contingencies and Other Commitments

The estimated cost to complete construction in progress at June 30, 2005 is \$13,034, \$50,956, and \$296 for the College, WFUHS, and the Reynolda House, respectively.

Grant awards not yet funded and for which services have not yet been performed are not recorded until services have been performed. At June 30, 2005, such grant awards amounted to \$3,372 and \$183,647 for the College and WFUHS, respectively.

Expenditures and indirect costs related to federal and state grants and contracts are subject to adjustment based upon review by the granting agencies. The amounts, if any, of expenditures, which may be disallowed by the granting agencies cannot be determined at this time, although management expects they will not have a material effect on the University's financial position.

The University is involved in various legal actions occurring in the normal course of activities. While the final outcomes cannot be determined at this time, management is of the opinion that the resolution of these legal actions will not have a material effect on the University's financial position.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(12) Professional Liability Insurance

WFUHS maintains professional liability coverage on a combined basis with the North Carolina Baptist Hospital (the Hospital) (see note 10), which includes a \$4,000 per occurrence and a \$16,000 annual aggregate for the year ended June 30, 2005. WFUHS estimates its professional liability on a discounted actuarial basis. The discount rate at June 30, 2005 was 5.5%. Accrued professional liability costs, including estimated claims incurred but not reported, amounted to approximately \$23,052 at June 30, 2005, and are included in other liabilities and deferrals in the accompanying consolidated statement of financial position. In the opinion of management, adequate provision has been made for the related risk.

(13) Derivative Instruments and Other Financial Instruments

The University has only limited involvement with derivative financial instruments and does not use them for trading purposes. In the normal course of its business, WFUHS entered into long-term interest rate swap agreement having a notional amount of \$90,000, which effectively fixed the interest rate on the Series 2002B variable rate bond issue at 3.67% through July 1, 2034. WFUHS receives 67% of LIBOR (London InterBank Offered Rate) and makes payments at 3.67% and settles with the counterparty on a monthly basis. LIBOR is the interest rate index used as a basis for repricing the Series 2002B variable rate bonds, however, the rate may vary from LIBOR in any rate period. WFUHS selected the combination of a variable rate bond issue and long-term interest rate swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The net settlement amount incurred on the swap is included in interest expense. The fair value of the interest rate swap is the estimated amount WFUHS would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties. At June 30, 2005, the fair value of the interest rate swap is a liability of \$6,752 and is included in other liabilities and deferrals in the consolidated statement of financial position.

In the normal course of its business, the College entered into two long-term interest rate swap agreements having a total notional amount of \$30,760, which effectively fixed the interest rate on the Series 2004B variable rate bond issue at 3.019% through June 30, 2018. The College receives 68% of LIBOR and makes payments of 3.019% and settles with each counterparty on a monthly basis. BMA is the interest rate index used as a basis for repricing the Series 2004B variable rate bonds, however, the rate may vary from BMA in any rate period. The College selected the combination of a variable rate bond issue and long-term interest rate swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The net settlement amount incurred on the swap is included in interest expense. The fair value of the interest rate swap is the estimated amount the College would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties. At June 30, 2005, the fair value of the interest rate swap is a liability of \$331 and is included in other liabilities and deferrals in the consolidated statement of financial position.

The University is exposed to credit loss in the event of nonperformance by each counterparty to its long-term interest rate swaps.

WAKE FOREST UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2005

(Dollars in thousands)

(14) Income Taxes

The University is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is generally exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Accordingly, no provision for income taxes is made in the financial statements.

WAKE FOREST UNIVERSITY

Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2005

| Federal and state grantors/pass-through grantors/agencies, or cluster title | Federal CFDA Number | Expenditures |
|--|------------------------------------|---------------------|
| Federal Award Expenditures: | | |
| Research and Development Cluster: | | |
| Wake Forest University Health Sciences: | | |
| Department of Health and Human Services: | | |
| National Institute of Health | 93.RD | \$ 118,087,847 |
| Pass-through programs from: | | |
| Albert Einstein College of Medicine | 93.RD | 315,485 |
| Association of Teachers of Preventive Medicine | 93.RD | 535,528 |
| Booz Allen Hamilton | 93.RD | 51,521 |
| Brown University | 93.RD | 96,343 |
| Cancer & Leukemia Group B Foundation | 93.RD | 112,481 |
| Case Western University | 93.RD | 169,397 |
| Cedars-Sinai Medical Center | 93.RD | 286,463 |
| Center for Disease Control & Prevention | 93.RD | 13,497 |
| Children's Hospital, Boston | 93.RD | 568,432 |
| Children's Hospital, Cincinnati | 93.RD | 157,193 |
| Children's Hospital Oakland | 93.RD | 9,964 |
| Children's Oncology Group | 93.RD | 70,806 |
| Columbia University | 93.RD | 17,390 |
| Constella Health Sciences | 93.RD | 29,348 |
| Dartmouth University | 93.RD | 37,332 |
| Duke University Clinical Research Institute | 93.RD | 28,122 |
| Duke University | 93.RD | 709,863 |
| Fred Hutchinson Cancer Research Center | 93.RD | 238,453 |
| George Washington University | 93.RD | 22,786 |
| Georgetown University | 93.RD | 227,763 |
| Gynecology Oncology Group | 93.RD | 64,913 |
| Health Resource and Services Administration | 93.RD | 737,822 |
| Henry M. Jackson Research Foundation | 93.RD | 37,001 |
| Hipple Cancer Research Center | 93.RD | 10,720 |
| Ixion Corporation | 93.RD | 90,270 |
| Johns Hopkins University | 93.RD | 474,296 |
| Joslin Diabetes Center | 93.RD | 35,631 |
| Massachusetts General Hospital | 93.RD | 10,053 |
| Mayo Clinic | 93.RD | 98,011 |
| Millar Instruments, Inc. | 93.RD | 52,624 |
| NanoSonic | 93.RD | 5,861 |
| National Marrow Donor Program | 93.RD | 2,291 |
| National Network of Libraries of Medicine | 93.RD | 20,223 |
| New England Research Institute | 93.RD | 12,456 |
| North Carolina Department of Health & Human Services | 93.RD | 3,378 |
| Pacific Health Research | 93.RD | 574,476 |
| Pennsylvania State University | 93.RD | 192,297 |
| Pleuron | 93.RD | 3,905 |
| Southwest Oncology Group | 93.RD | 1,734 |
| Stanford University | 93.RD | 155,056 |
| State University of New York | 93.RD | 52,715 |
| Strang Cancer Research Center | 93.RD | 182,113 |
| Susan G. Korman Breast Cancer Foundation | 93.RD | 753 |
| Tufts University | 93.RD | 98,987 |

WAKE FOREST UNIVERSITY

Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2005

| Federal and state grantors/pass-through grantors/agencies, or cluster title | Federal CFDA Number | Expenditures |
|--|------------------------------------|---------------------|
| Tulane University | 93.RD | \$ 34,083 |
| University of Alabama | 93.RD | 82,532 |
| University of California at Davis | 93.RD | 31,188 |
| University of California at Los Angeles | 93.RD | 12,131 |
| University of California at San Diego | 93.RD | 9,321 |
| University of Chicago | 93.RD | 106,931 |
| University of Colorado | 93.RD | 67,994 |
| University of Florida | 93.RD | 544,414 |
| University of Illinois | 93.RD | 84,323 |
| University of Kentucky | 93.RD | 44,348 |
| University of Maryland | 93.RD | 293,688 |
| University of Miami | 93.RD | 28,918 |
| University of Michigan | 93.RD | 4,963 |
| University of Minnesota | 93.RD | 263,126 |
| University of Mississippi | 93.RD | 533,797 |
| University of North Carolina at Chapel Hill | 93.RD | 889,530 |
| University of Pennsylvania | 93.RD | 472,082 |
| University of Pittsburgh | 93.RD | 1,548,915 |
| University of Rochester | 93.RD | 1,908 |
| University of South Carolina | 93.RD | 69,359 |
| University of Texas | 93.RD | 25,439 |
| University of Texas Medical Center | 93.RD | 8,207 |
| University of Vermont | 93.RD | 147,519 |
| University of Washington | 93.RD | 168,700 |
| University of Wisconsin | 93.RD | 76,977 |
| U.S. Civilian Research and Development Foundation | 93.RD | 290 |
| Van Andel Research Institute | 93.RD | 30,036 |
| Washington University, St. Louis | 93.RD | 48,584 |
| Winston-Salem State University | 93.RD | 96,514 |
| World Precision Institute | 93.RD | 2,990 |
| Wright State University | 93.RD | 64,047 |
| Total Department of Health and Human Services | | 130,496,454 |
| Department of Defense: | | |
| Department of Defense | 12.RD | 87,290 |
| Defense Advance Resarch Project | 12.RD | 2,465,503 |
| U.S. Army | 12.RD | 2,378,255 |
| Pass-through programs from: | | |
| Medical University of South Carolina | 93.RD | 1,156 |
| Ohio State University | 93.RD | 32,885 |
| Total Department of Defense | | 4,965,089 |
| Department of Justice | | |
| Department of Justice | 16.RD | 307,220 |
| National Institute of Justice | 16.RD | 956,587 |
| Pass-through programs from: | | |
| Winston-Salem Forsyth County School System | 16.RD | 81,648 |
| Total Department of Justice | | 1,345,455 |
| Environmental Protection Agency | 66.RD | 190,009 |
| National Aeronautics and Space Administration | 43.RD | 226,732 |
| National Science Foundation | 47.RD | 29,236 |
| Subtotal – Wake Forest University Health Sciences | | 137,252,975 |

WAKE FOREST UNIVERSITY

Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2005

| Federal and state grantors/pass-through grantors/agencies, or cluster title | Federal CFDA Number | Expenditures |
|--|------------------------------------|---------------------|
| College of Arts and Sciences, Schools of Law, Management, and Divinity: | | |
| Department of Health and Human Services: | | |
| National Institute of Health | 93.RD | \$ 1,906,951 |
| Total Department of Health and Human Services | | <u>1,906,951</u> |
| Department of Defense: | | |
| U.S. Army | 12.RD | 598,333 |
| U.S. Air Force | 12.RD | 271,250 |
| Total Department of Justice | | <u>869,583</u> |
| National Science Foundation | 47.RD | 896,582 |
| Department of Agriculture | 10.RD | 4,200 |
| National Aeronautics and Space Administration | 43.RD | 134,869 |
| Department of State | 19.RD | 162,003 |
| Subtotal – College of Arts and Sciences, Schools of Law, Management, and Divinity | | <u>3,974,188</u> |
| Total Research and Development Cluster | | <u>141,227,163</u> |
| Student Financial Aid Cluster: | | |
| Wake Forest University Health Sciences: | | |
| Department of Education: | | |
| Federal Family Education Loan Program | 84.032 | 14,007,520 |
| Subtotal – Wake Forest University Health Sciences | | <u>14,007,520</u> |
| College of Arts and Sciences, Schools of Law, Management, and Divinity: | | |
| Department of Education: | | |
| Federal Supplemental Educational Opportunity Grant | 84.007 | 359,017 |
| Federal Family Education Loan Program | 84.032 | 28,248,526 |
| Federal Work Study Program | 84.033 | 1,142,115 |
| Federal Perkins Loan Program | 84.038 | 3,753,100 |
| Federal Pell Grant Program | 84.063 | 841,180 |
| Subtotal – College of Arts and Sciences, Schools of Law, Management, and Divinity | | <u>34,343,938</u> |
| Total Student Financial Aid Cluster | | <u>48,351,458</u> |
| Other Programs: | | |
| College of Arts and Sciences, Schools of Law, Management and Divinity: | | |
| Department of Energy | 81.049 | \$ 22,150 |
| Institute of Museum and Library Sciences | 45.301 | 23,421 |
| Subtotal – Colleges of Arts and Sciences, Schools of Law, Management, and Divinity | | <u>45,571</u> |
| Wake Forest University Health Sciences: | | |
| Department of Education | 84.116 | 47,179 |
| Total Other Programs | | <u>92,750</u> |
| Total Federal Award Expenditures | | <u>189,671,371</u> |

WAKE FOREST UNIVERSITY
Schedule of Expenditures of Federal and State Awards
Year ended June 30, 2005

| <u>Federal and state grantors/pass-through grantors/agencies, or cluster title</u> | <u>Federal CFDA Number</u> | <u>Expenditures</u> |
|--|------------------------------------|-----------------------|
| State Award Expenditures: | | |
| Wake Forest University Health Sciences: | | |
| Pass-through funds from: | | |
| University of North Carolina at Chapel Hill | — | 5,246,408 |
| Department of Environment, Health and Natural Resources | — | 4,747,935 |
| North Carolina Biotechnology Center | — | 202,506 |
| North Carolina Aid to Medical Education | — | 1,312,000 |
| Board of Governors | — | 756,820 |
| Other | — | 248,449 |
| Subtotal | | <u>12,514,118</u> |
| College of Arts and Sciences, Schools of Law, Management, and Divinity: | | |
| North Carolina Legislative Tuition Grant | — | 1,943,550 |
| North Carolina State Contractual Scholarship Fund | — | 1,222,375 |
| Other | — | 43,441 |
| Subtotal | | <u>3,209,366</u> |
| Total State Award Expenditures | | <u>15,723,484</u> |
| Total Federal and State Award Expenditures | | <u>\$ 205,394,855</u> |

See accompanying notes to schedule of expenditures of Federal and State awards.

WAKE FOREST UNIVERSITY

Notes to Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2005

(1) Basis of Presentation

The accompanying schedule of expenditures of federal and state awards includes all grants, contracts, and similar agreements entered into directly between Wake Forest University (the University) and agencies and departments of the federal and state governments and all subawards to the University by nonfederal organizations pursuant to federal and state grants, contracts and similar agreements and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

(2) Summary of Significant Accounting Policies for Federal and State Award Expenditures

Expenditures for certain federal student financial aid programs are recognized as incurred and include the federal share of students' Federal Supplemental Educational Opportunity Grant program grants and Federal Work Study program earnings, certain other federal financial assistance grants for students and administrative cost allowances, where applicable. Federal Pell grant awards are recognized as agency transactions and are not recorded as expenditures in the financial statements.

Expenditures for other federal awards of the University's academic and other divisions are determined using the cost accounting principles and procedures set forth in OMB Circular A-21, *Cost Principles for Educational Institutions*. Under these cost principles, certain expenditures are not allowable or are limited as to reimbursement.

Expenditures for non-financial aid awards include indirect costs, related primarily to facilities operation and maintenance and general, divisional and departmental administrative services, which are allocated to direct cost objectives (including federal awards) based on negotiated formulas commonly referred to as facilities and administrative cost rates. Facilities and administrative costs allocated to such awards for the year ended June 30, 2005 were based on predetermined fixed rates negotiated with the University's cognizant federal agency, the Department of Health and Human Services.

(3) Summary of Facilities and Administrative Costs and Administrative Cost Allowances - Governmental Sources

Facilities and administrative cost recoveries and administrative cost allowances for the University's academic and other divisions for the year ended June 30, 2005 are summarized as follows:

| | | |
|--------------------------|----|-------------------|
| Research and development | \$ | 31,320,791 |
| Student financial aid | | 244,564 |
| Other | | 60,136 |
| | \$ | <u>31,625,491</u> |

WAKE FOREST UNIVERSITY

Notes to Schedule of Expenditures of Federal and State Awards

Year ended June 30, 2005

(4) Federal Student Financial Aid Loan Programs

The Federal Perkins, Health Professions Student Loan (HPSL) and the Primary Care Loan (PCL) Programs are administered directly by the University and balances and transactions relating to these programs are included in the University's financial statements. The balances of loans outstanding under the Federal Perkins, HPSL, and PCL programs were \$15,781,130, \$139,857 and \$431,338, respectively, as of June 30, 2005.

The University is responsible only for the performance of certain administrative duties with respect to the Federal Family Education Loan Programs and, accordingly, these loans are not included in its financial statements. It is not practicable to determine the balance of loans outstanding to students and former students of the University under these programs as of June 30, 2005.

(5) Subrecipients

Of the federal expenditures presented in the schedule, the University provided federal awards to subrecipients as follows:

| Federal amount granting agency | Amount provided to subrecipients |
|---|---|
| National Institute of Health | \$ <u>24,023,242</u> |



KPMG LLP
Suite 700
301 N. Elm Street
Greensboro, NC 27401

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
Wake Forest University:

We have audited the financial statements of Wake Forest University as of and for the year ended June 30, 2005, and have issued our report thereon dated September 9, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Wake Forest University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Wake Forest University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management in separate letters dated August 26, 2005 and September 9, 2005.

This report is intended solely for the information and use of the audit committee of the board of trustees, management and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

September 9, 2005



KPMG LLP
Suite 700
301 N. Elm Street
Greensboro, NC 27401

Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
Wake Forest University:

Compliance

We have audited the compliance of Wake Forest University with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2005, except those requirements discussed in the third following paragraph. Wake Forest University's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Wake Forest University's management. Our responsibility is to express an opinion on Wake Forest University's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Wake Forest University's compliance with those requirements and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Wake Forest University's compliance with those requirements.

In our opinion, Wake Forest University complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2005, other than those requirements discussed in the following paragraph.

We did not audit Wake Forest University's compliance with requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Federal Perkins Loan Program. Those requirements govern functions that are performed by Educational Loan Servicing, LLC (d/b/a Campus Partners). Since we did not apply auditing procedures to satisfy ourselves as to compliance with those requirements, the scope of our work was not sufficient to enable us to express, and we do not express an opinion, on compliance with those requirements.

Campus Partners' compliance with the requirements governing the functions that they perform for Wake Forest University were examined by other accountants whose report has been furnished to us. The report of the other accountants indicates that compliance with those requirements was examined in accordance with the Department of Education's Audit Guide, *Compliance Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*. Based on our review of the service organization's accountants' report, we have determined that all of the compliance requirements included in the Compliance Supplement that are applicable to the major program in which Wake Forest University participates are addressed in either our report or the report of the service organization's accountants. Further, based on our review of the service organization's accountants' report, we have determined that it does not contain any findings or noncompliance that would have a direct and material effect on Wake Forest University's major program.

Internal Control Over Compliance

The management of Wake Forest University is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Wake Forest University's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for Federal Perkins Loan Program are performed by Campus Partners. Internal control over compliance relating to such functions was reported on by other accountants in accordance with the Department of Education's Audit Guide, Compliance Audits (Attestation Engagements) of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers. A copy of the service organization accountants' report has been furnished to us. However, the scope of our work did not extend to internal control maintained at Campus Partners.

Our consideration of internal control over compliance would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee of the board of trustees, management and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

September 9, 2005

WAKE FOREST UNIVERSITY

Schedule of Findings and Questioned Costs

Year ended June 30, 2005

(1) Summary of Auditors' Results

- (a) The type of report issued on the financial statements: **Unqualified opinion**
- (b) Reportable conditions in internal control were disclosed by the audit of the financial statements: **No**
Material weaknesses: **None**
- (c) Noncompliance which is material to the financial statements: **None**
- (d) Reportable conditions in internal control over major programs: **None reported**
Material weaknesses: **None**
- (e) The type of report issued on compliance for major programs: **Unqualified opinion**
- (f) Any audit findings which are required to be reported under Section 0.510(a) of OMB Circular A-133: **No**
- (g) Major program: **Student financial aid**
- (h) Dollar threshold used to distinguish between Type A and Type B programs: **\$3,000,000**
- (i) Auditee qualified as a low-risk auditee under Section 0.530 of OMB Circular A-133: **Yes**

(2) Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*: None

(3) Findings and Questioned Costs: None