

Financial Statements Together with
Report of Independent Certified Public Accountants

GALLAUDET UNIVERSITY

September 30, 2013 and 2012

GALLAUDET UNIVERSITY

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Trustees of
Gallaudet University:

We have audited the accompanying financial statements of Gallaudet University (the “University”), which comprise the statements of financial position as of September 30, 2013 and 2012, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management’s responsibility for the financial statements

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

Auditor’s responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Gallaudet University as of September 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Washington, D.C.
December 19, 2013

GALLAUDET UNIVERSITY
Statements of Financial Position
As of September 30, 2013 and 2012

ASSETS	2013	2012
Cash and cash equivalents	\$ 16,850,153	\$ 28,075,003
Accounts receivable, net (Note 3)	5,523,019	5,362,274
Receivable from U.S. government	1,677,582	1,110,682
Contributions receivable, net (Note 4)	1,578,410	4,838,173
Prepaid expenses	749,865	910,545
Deposits with trustee (Notes 5 and 9)	6,719,887	12,493,532
Inventories	1,321,539	1,315,310
Student loans receivable (Note 3)	1,148,570	1,205,507
Investments (Note 5)	184,316,636	162,617,802
Split-interest agreements (Note 5)	696,059	762,929
Deferred financing costs, net	851,664	908,459
Land, buildings, and other property, net (Note 6)	<u>191,315,912</u>	<u>188,977,908</u>
Total assets	<u>\$ 412,749,296</u>	<u>\$ 408,578,124</u>
 LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 8,917,325	\$ 11,211,064
Accrued payroll	8,614,824	9,713,114
Deferred tuition revenue	3,225,000	2,400,000
Obligations under capital leases (Note 12)	2,063,766	2,440,831
Conditional asset retirement obligations (Note 6)	558,345	535,117
Bonds payable, net (Note 9)	38,698,088	39,407,960
Refundable advances under U.S. government loan program	<u>1,241,545</u>	<u>1,278,230</u>
Total liabilities	<u>63,318,893</u>	<u>66,986,316</u>
 Commitments and contingencies (Notes 5 and 12)		
Net Assets (Notes 10 and 11):		
Unrestricted	200,845,773	197,363,726
Temporarily restricted	27,418,595	23,500,941
Permanently restricted	<u>121,166,035</u>	<u>120,727,141</u>
Total net assets	<u>349,430,403</u>	<u>341,591,808</u>
Total liabilities and net assets	<u>\$ 412,749,296</u>	<u>\$ 408,578,124</u>

The accompanying notes are an integral part of these financial statements.

GALLAUDET UNIVERSITY

Statement of Activities

For the year ended September 30, 2013, with comparative totals for 2012

	2013			2012	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Operating revenues:					
Tuition and fees	\$ 23,924,935	\$ -	\$ -	\$ 23,924,935	\$ 22,300,010
Less: scholarships and fellowships	(7,240,906)	-	-	(7,240,906)	(7,780,254)
Net tuition and fees	16,684,029			16,684,029	14,519,756
Governmental appropriations – operations	111,393,304	-	-	111,393,304	117,541,426
Governmental appropriations – capital	75,190	-	-	75,190	1,950
Governmental grants and contracts	5,825,331	-	-	5,825,331	5,568,186
Contributions	1,528,379	823,689	-	2,352,068	5,721,498
Investment return used for operations (Note 5)	7,369,539	330,990	-	7,700,529	6,096,640
Auxiliary enterprises	21,015,754	-	-	21,015,754	20,916,059
Other	1,179,106	-	-	1,179,106	1,364,727
Total operating revenues	165,070,632	1,154,679		166,225,311	171,730,242
Net assets released from restrictions	3,068,730	(3,068,730)	-	-	-
Total operating revenues and other support	168,139,362	(1,914,051)	-	166,225,311	171,730,242
Expenses:					
Instruction	64,175,771	-	-	64,175,771	63,304,053
Research	9,588,484	-	-	9,588,484	9,368,932
Public service	4,822,505	-	-	4,822,505	4,942,611
Academic support	15,597,535	-	-	15,597,535	17,790,811
Student services	21,407,344	-	-	21,407,344	21,591,431
Institutional support	24,423,139	-	-	24,423,139	25,659,316
Auxiliary enterprises	26,147,580	-	-	26,147,580	23,143,875
Total expenses	166,162,358	-	-	166,162,358	165,801,029
Changes in net assets from operations	1,977,004	(1,914,051)	-	62,953	5,929,213
Nonoperating activities:					
Investment income, net of amounts used for operations (Notes 5 and 11)	1,506,374	5,795,136	14,922	7,316,432	13,438,758
Contributions for endowment	-	-	465,625	465,625	526,054
Change in the value of split-interest agreements	(7,577)	(12,447)	(41,117)	(61,141)	88,565
Recovery (loss) on uncollectible pledges	-	49,016	(536)	48,480	150,000
Gain on fixed asset related activities (Note 6)	6,246	-	-	6,246	22,091
Cost of asset retirement obligation settlement	-	-	-	-	(21,395)
Total nonoperating activities	1,505,043	5,831,705	438,894	7,775,642	14,204,073
Changes in net assets	3,482,047	3,917,654	438,894	7,838,595	20,133,286
Net assets, beginning of year	197,363,726	23,500,941	120,727,141	341,591,808	321,458,522
Net assets, end of year	\$ 200,845,773	\$ 27,418,595	\$ 121,166,035	\$ 349,430,403	\$ 341,591,808

The accompanying notes are an integral part of this financial statement.

GALLAUDET UNIVERSITY
Statement of Activities
For the year ended September 30, 2012

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating revenues:				
Tuition and fees	\$ 22,300,010	\$ -	\$ -	\$ 22,300,010
Less: scholarships and fellowships	<u>(7,780,254)</u>	<u>-</u>	<u>-</u>	<u>(7,780,254)</u>
Net tuition and fees	14,519,756	-	-	14,519,756
Governmental appropriations – operations	117,541,426	-	-	117,541,426
Governmental appropriations – capital	1,950	-	-	1,950
Governmental grants and contracts	5,568,186	-	-	5,568,186
Contributions	1,013,530	4,707,968	-	5,721,498
Investment return used for operations (Note 5)	5,862,069	234,571	-	6,096,640
Auxiliary enterprises	20,916,059	-	-	20,916,059
Other	<u>1,364,727</u>	<u>-</u>	<u>-</u>	<u>1,364,727</u>
Total operating revenues	166,787,703	4,942,539	-	171,730,242
Net assets released from restrictions and reclassifications	<u>2,370,543</u>	<u>(2,693,841)</u>	<u>323,298</u>	<u>-</u>
Total operating revenues and other support	<u>169,158,246</u>	<u>2,248,698</u>	<u>323,298</u>	<u>171,730,242</u>
Expenses:				
Instruction	63,304,053	-	-	63,304,053
Research	9,368,932	-	-	9,368,932
Public service	4,942,611	-	-	4,942,611
Academic support	17,790,811	-	-	17,790,811
Student services	21,591,431	-	-	21,591,431
Institutional support	25,659,316	-	-	25,659,316
Auxiliary enterprises	<u>23,143,875</u>	<u>-</u>	<u>-</u>	<u>23,143,875</u>
Total expenses	<u>165,801,029</u>	<u>-</u>	<u>-</u>	<u>165,801,029</u>
Changes in net assets from operations	<u>3,357,217</u>	<u>2,248,698</u>	<u>323,298</u>	<u>5,929,213</u>
Nonoperating activities:				
Investment income, net of amounts used for operations (Notes 5 and 11)	4,070,735	8,677,728	690,295	13,438,758
Contributions for endowment	-	-	526,054	526,054
Change in the value of split-interest agreements	13,657	9,689	65,219	88,565
Recovery on uncollectible pledges	-	150,000	-	150,000
Gain on fixed asset related activities (Note 6)	22,091	-	-	22,091
Cost of asset retirement obligation settlement	<u>(21,395)</u>	<u>-</u>	<u>-</u>	<u>(21,395)</u>
Total nonoperating activities	<u>4,085,088</u>	<u>8,837,417</u>	<u>1,281,568</u>	<u>14,204,073</u>
Changes in net assets	7,442,305	11,086,115	1,604,866	20,133,286
Net assets, beginning of year	<u>189,921,421</u>	<u>12,414,826</u>	<u>119,122,275</u>	<u>321,458,522</u>
Net assets, end of year	<u>\$ 197,363,726</u>	<u>\$ 23,500,941</u>	<u>\$ 120,727,141</u>	<u>\$ 341,591,808</u>

The accompanying notes are an integral part of this financial statement.

GALLAUDET UNIVERSITY
Statements of Cash Flows
For the years ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 7,838,595	\$ 20,133,286
Adjustments to reconcile changes in net assets to net cash flows provided by operating activities:		
Depreciation and amortization	12,101,511	10,667,277
Amortization of deferred financing costs	56,795	58,952
Amortization of bond discount	(4,872)	(9,194)
Settlement of conditional asset retirement obligations	-	(76,965)
Accretion of interest on conditional asset retirement obligations	23,228	22,683
Bad debt expense	583,815	831,359
Gain on fixed asset related activities	(6,246)	(22,091)
Recovery on uncollectible pledges	(48,480)	(150,000)
Net gain on investments	(11,783,005)	(16,588,450)
(Increase) decrease in assets:		
Receivables	1,996,783	(2,686,752)
Split-interest agreements	66,870	(62,998)
Prepaid expenses	160,680	(176,320)
Inventories	(6,229)	(31,904)
Increase (decrease) in liabilities:		
Accounts payable, accrued expenses and other liabilities	(5,017,015)	468,384
Deferred tuition revenue	825,000	500,000
Contributions restricted for investment in property	(751,595)	-
Contributions restricted for permanent endowment	(482,687)	(917,169)
Investment income restricted for permanent endowment	(14,922)	(690,295)
Net cash provided by operating activities	<u>5,538,226</u>	<u>11,269,803</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and redemptions of investments	33,764,706	101,938,367
Purchases of investments	(43,680,534)	(98,348,615)
Proceeds from the disposal/sale of fixed assets	101,193	328,156
Purchases of fixed assets	(12,765,599)	(31,188,343)
Disbursements of loans to students	(159,500)	(173,500)
Repayment of loans by students	216,437	264,268
Net cash used in investing activities	<u>(22,523,297)</u>	<u>(27,179,667)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Decrease in refundable advances from U.S. government	(36,685)	(22,547)
Proceeds from contributions and investment income restricted to permanent endowment	497,609	1,607,464
Payments under capital leases	(520,943)	(557,830)
Contributions restricted for investment in property	751,595	-
Payment of principal on bonds payable	(705,000)	-
Decrease in deposits with trustee	5,773,645	20,739,076
Net cash provided by financing activities	<u>5,760,221</u>	<u>21,766,163</u>
Net (decrease) increase in cash and cash equivalents	(11,224,850)	5,856,299
Cash and cash equivalents, beginning of year	<u>28,075,003</u>	<u>22,218,704</u>
Cash and cash equivalents, end of year	<u>\$ 16,850,153</u>	<u>\$ 28,075,003</u>
SUPPLEMENTAL DISCLOSURES:		
Fixed asset purchases included in accounts payable	\$ 1,074,277	\$ 1,969,098
Construction retainage	\$ 550,709	\$ 333,580
Cash paid for interest	\$ 140,341	\$ 90,598

The accompanying notes are an integral part of these financial statements.

GALLAUDET UNIVERSITY

Notes to Financial Statements

September 30, 2013 and 2012

1. NATURE OF OPERATIONS

Gallaudet University was established by an Act of Congress in 1864. Gallaudet is the only accredited university in the world established exclusively for deaf or hard of hearing students. In addition to its undergraduate and graduate academic programs, the University offers national demonstration elementary and secondary education programs, continuing education programs, and a wide range of public service programs.

The Gallaudet University Foundation (the "Foundation") was formed in December of 2012 to benefit, promote and support, by gift or otherwise, Gallaudet University in the ownership and/or development of real estate on campus or around the University. The Foundation is incorporated in the District of Columbia and has applied to be recognized under the provisions of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, as a tax-exempt organization and Gallaudet University serves as its sole corporate member. The activities of the Foundation consolidate with Gallaudet University and have been limited principally to administrative costs incurred in connection with its development during fiscal 2013 and aggregate approximately \$165,000. Gallaudet University, together with the Foundation are collectively referred to as the "University" or "Gallaudet."

Gallaudet University is a private university that receives a substantial proportion of its annual revenue by direct appropriation from the federal government under the authority of the Education of the Deaf Act. In fiscal years 2013 and 2012, approximately 66% and 69%, respectively, of the University's unrestricted revenues were derived from federal appropriations. In fiscal years 2013 and 2012, Gallaudet also received a capital appropriation to construct, repair and restore land and buildings on campus.

Gallaudet University is divided into two major component programs for budgeting and operating purposes: the University and the Laurent Clerc National Deaf Education Center ("Clerc Center"). The Clerc Center consists of the Model Secondary School for the Deaf and the Kendall Demonstration Elementary School. The University enrolls 1,821 undergraduate and graduate students, and the Clerc Center enrolls 244 elementary and secondary school students.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The significant accounting policies employed by Gallaudet in the preparation of its financial statements are described below.

Net Assets

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

Permanently restricted - Net assets subject to donor-imposed stipulations that they be maintained permanently. Generally, the donors of these assets permit Gallaudet to use all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted - Net assets subject to donor-imposed stipulations that will be met either by actions of Gallaudet and/or the passage of time.

Unrestricted - Net assets that are not subject to donor-imposed stipulations.

GALLAUDET UNIVERSITY
Notes to Financial Statements
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When a donor-imposed restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. In addition, temporary restrictions on gifts received that must be used to acquire long-lived assets are released in the period in which the assets are acquired, constructed or placed in service. Gifts for these purposes which remain outstanding are included in temporarily restricted net assets until received.

Measure of Operations

The accompanying statements of activities distinguish between operating and nonoperating activities. Operating activities principally include all revenues and expenses that are an integral part of the University's educational programs and supporting activities, investment return pursuant to the University's spending policy, and interest income on operating cash balances. Nonoperating activities include investment return (loss) net of amounts used for operations, net assets released for capital expenditures, contributions for capital or endowment purposes, change in value of split-interest agreements, and other activities which are considered to be nonrecurring in nature.

Contributions

Contributions, including unconditional promises to give, are recognized as revenues in the period received or pledged. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets, other than cash, are recorded at their estimated fair value at the date of gift. Contributed services are recorded at their estimated fair value if they would otherwise be purchased if not provided by donation and provided by professionals in their field.

Allowances are recorded for estimated uncollectible contributions based upon management's judgment and analysis of the creditworthiness of the donors, past collection experience, and other relevant factors. Contributions to be received after one year are discounted using an appropriate discount rate. For new contribution receivables, Gallaudet assigns discount rates based upon rates a market participant would demand and considers other relevant factors such as the creditworthiness of the respective donor. Amortization of the discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any. Contribution receivables are written-off when deemed uncollectible.

Split-Interest Agreements

Gallaudet's split-interest agreements consist of its beneficial interest in remainder and perpetual trusts and charitable gift annuities. Gallaudet records its beneficial interest in remainder and perpetual trusts as revenue in the period in which the University is notified of the irrevocable nature of the trust and the proceeds are measurable. Changes in the value of Gallaudet's interest are recorded in each subsequent period in the net asset category to which the contribution relates.

Changes in the life expectancy of the donor or beneficiary, amortization of the discount, and other changes in the estimates of future annuity payments are recognized annually by the University and are reported as change in value of split-interest agreements in the statement of activities. For the years ended September 30, 2013 and 2012, the discount rates used to value split-interest agreements ranged between 2.00% and 4.41% and 1.78% and 3.11%, respectively, and represented the applicable Internal Revenue Service discount rate at the time of the original gifts. Upon termination of a life interest, the share of the corpus attributable to the life-interest holder becomes available to the University (see Note 5).

GALLAUDET UNIVERSITY
Notes to Financial Statements
September 30, 2013 and 2012

Governmental Appropriations

Amounts received under the federal appropriation are recognized as unrestricted revenue when allowable expenditures are incurred.

Tuition and Fees

Tuition and fees revenue, net of institutional scholarships and fellowships, are recognized as revenues over the academic terms to which they relate.

Tuition and fees and related expenses pertaining to incomplete terms are apportioned, deferred and recognized in the fiscal year in which the instruction occurs.

The University provides for potentially uncollectible student accounts and notes receivables based on historical collection experience.

Grants and Contracts

Revenue from federal grants and contracts is recognized to the extent that qualifying reimbursable expenses have been incurred over the terms of the respective agreements.

Auxiliary Enterprises

Auxiliary enterprises include dormitory, food service, bookstore operations, the University Press, conference activities, and outreach programs. Only those activities which are revenue producing are included under this designation. For Clerc Center programs, costs incurred for dormitory and food service under the Model Secondary School for the Deaf and food service under the Kendall Demonstration Elementary School are reported as part of student services expense. Students are not billed for such services.

Concentrations of Credit Risk

Cash, cash equivalents, and investments are exposed to interest rate, market, and credit risks. The University maintains its cash and cash equivalents in various bank deposit accounts that may exceed federally insured limits at times. To minimize risk, the University places its cash accounts with high credit quality financial institutions and the University's investment portfolio is diversified with several investment managers in a variety of asset classes. The University regularly evaluates its depository arrangements and investments, including performance thereof.

Functional Expenses

Expenses are classified by major program categories and supporting services (institutional support) in the accompanying statements of activities.

Maintenance and operation are allocated to programs and supporting services based on estimates of square footage used. Depreciation, amortization and interest expense are allocated based on estimated use of the physical assets.

GALLAUDET UNIVERSITY
Notes to Financial Statements
September 30, 2013 and 2012

Cash Equivalents

The University considers all highly liquid financial instruments with original maturities of three months or less from the date of purchase to be cash equivalents. Gallaudet has classified any cash or money market accounts held by external endowment managers as investments, as these amounts are not readily available for operations and are part of the long-term investment strategy of the University.

Fair Value of Financial Instruments

As required by U.S. generally accepted accounting principles for fair value measurements, Gallaudet uses a fair value hierarchy which maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The standard defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The three levels of inputs used by Gallaudet to measure fair value include:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the measurement date.
- Level 2: Observable inputs, other than quoted prices in active markets, which are either directly or indirectly observable as of the measurement date. The nature of these financial instruments include investments for which quoted prices are available but traded less frequently and investments that are fair valued using other securities, the parameters of which can be directly observed. Also included in Level 2 are investments measured using a net asset value (“NAV”) per share, or its equivalent, that may be redeemed at NAV at the statement of financial position date or in the near term, which the University has determined to be within 90 days.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. Also included in Level 3 are investments measured using a NAV per share, or its equivalent, that can never be redeemed at NAV at the statement of financial position date or in the near term or for which redemption at NAV is uncertain due to lock-up periods or other investment restrictions.

In certain instances, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, a financial instrument’s level within the hierarchy is based on the lowest level of input that is significant to the fair value measurement. The categorization within the hierarchy is based on the pricing transparency of the instrument and does not necessarily correspond to the perceived risk of that instrument. The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- Cash Equivalents - The carrying value of cash equivalents, such as money market funds approximates fair value because of the short maturity of these investments. These amounts are included in Level 1.

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- Fixed Income Securities - Gallaudet's investment in fixed income securities includes U.S. Treasury securities, mutual funds which invest in fixed income securities, and commingled funds with underlying investments in fixed income securities. The fair value estimates of the commingled funds are based on the fund manager's NAVs and determined using the underlying notes and bonds which are priced by the investment manager using a variety of pricing sources to determine market valuations. These investments are included in Level 2. The estimated fair values of U.S. Treasury securities are based on actively-traded market prices which are available on a daily basis. The fair value of fixed income mutual funds is based on the net asset value of the applicable funds, which are actively traded and priced daily. Therefore, U.S. Treasury securities and fixed income mutual funds are included in Level 1.
- Equity Securities - Gallaudet's investment in equity securities include direct investments in exchange-traded equity securities and equity mutual funds. Fair values of exchange-traded equity securities have been determined by Gallaudet from observable market quotations on major trade exchanges. Accordingly, such equity securities are included in Level 1. The fair value of equity mutual funds is estimated based on the NAV of the applicable funds. These instruments are traded daily in active markets and are included in Level 1.
- Natural Resources and Commodities - This class includes investments in natural resources and commodities through mutual funds and master limited partnerships (MLPs). Since both mutual funds and MLPs are valued at quoted prices in an active market, these investments are included in Level 1.
- Global Real Estate - This class includes investments in real estate mutual funds which are valued using quoted prices in an active market and are classified within Level 1 of the fair value hierarchy.
- Private Equity Funds, Private Real Asset Funds, and Hedge Funds - The fair value of these investments is based on the fund managers' NAVs. Valuations provided by investment fund managers include estimates, appraisals, assumptions and methods that are reviewed by management. When necessary, Gallaudet adjusts NAVs for contributions, distributions, or general market conditions subsequent to the latest NAV valuation date when determining fair value as of the measurement date. Since the most significant valuation inputs are not observable in the marketplace, the alternative investment valuations are disclosed in Level 2 or Level 3. Those funds which are available for redemption in the near-term at NAV, which the University has determined to be within 90 days of the statement of financial position date, are included in Level 2.
- Split-Interest Agreements - For charitable gift annuity investments in which Gallaudet acts as the trustee, the assets are held in debt and equity mutual funds with readily determinable fair values and therefore included in Level 1. For the beneficial interest in remainder and perpetual trusts which are held by a third-party, Gallaudet estimates the fair value of its beneficial interest based on a discounted cash flow methodology using a discount rate that is commensurate with risks of the underlying trust assets and other risks such as non-performance by the trustee. Since the most significant valuation inputs are not observable in the market place, the beneficial interests held by third-party trustees are included in Level 3.
- Deposits with Trustee - Funds held on deposit with a trustee are held in money market funds. Since money market funds approximate fair value due to the short maturity of these investments, these deposits are included in Level 1 of the fair value hierarchy.

GALLAUDET UNIVERSITY
Notes to Financial Statements
September 30, 2013 and 2012

During fiscal 2010, the University adopted new FASB guidance related to fair value measurements and disclosure of investments in certain entities that do not have a quoted market price but that calculate a NAV per share or its equivalent. As a practical expedient, the guidance permits, but does not require, an entity to measure fair value of an investment in an investee, within the scope of the amendments, based on the investee's NAV per share or its equivalent. As a result of applying the practical expedient, the fair value of certain of the University's investments have been determined based on the reported NAV beginning with the September 30, 2010 valuation. The adoption of this guidance did not have a material impact on the fair values of applicable investments; however, the use of the practical expedient required additional disclosures. See Note 5 for additional details.

Effective September 30, 2011, Gallaudet applied the guidance in FASB Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures – Improving Disclosures about Fair Value Measurements*, to its financial assets and liabilities disclosed at fair value. This guidance requires fair value measurement disclosures for each class of assets and liabilities and enhanced disclosures for transfers among the fair value hierarchy.

Land, Buildings, and Other Property

Land, buildings, and other property are reported at cost or estimated fair value, if acquired by gift, less accumulated depreciation and amortization. The University capitalizes buildings, building improvements, outside improvements, and software over \$25,000 and furniture and equipment over \$5,000 with depreciable lives greater than three years. Depreciation is computed using the straight-line method over the following estimated useful lives of the assets:

<u>Asset Class</u>	<u>Estimated Lives (years)</u>
Land improvements	60
Buildings	40 to 60
Building improvements	10 to 60
Outside improvements	10 to 40
Library books	10
Furniture and equipment	5
Software	3

New buildings are assigned an estimated life of 40 years. Improvements to certain historic structures have been assigned depreciable lives of 60 years.

During fiscal 2008, Gallaudet revised its policy regarding library books and elected to expense library books upon purchase. However, library books purchased prior to fiscal 2008 will continue to be depreciated consistent with the University's previously established policy.

Assets, consisting primarily of office equipment, acquired under capital leases are depreciated over the shorter of their economic useful life or the respective lease.

Inventories

Inventories, consisting of books, supplies, and clothing, are reported using the retail inventory method on a first in, first out basis.

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Income Taxes

Gallaudet has been recognized by the Internal Revenue Service (“IRS”) as exempt from federal income taxes, except on activities unrelated to its exempt purpose, under provisions of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. The IRS has determined that Gallaudet is a publicly supported educational institution and not a private foundation.

The income taxes topic number 740, “Income Taxes” of the FASB Accounting Standards Codification (“ASC”) establishes criterion that an individual tax position must meet for some or all the benefits of that position to be recognized in an entity’s financial statements. Upon initial application, this criterion is applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the “more-likely-than-not” recognition threshold at the adoption date will be recognized or continue to be recognized. This criterion was adopted by the University on October 1, 2009, and had no impact on the University’s financial statements. The tax years ended 2011, 2012 and 2013 are still open to audit for both federal and District of Columbia purposes. The University has processes presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; determine its filing and tax obligations in jurisdictions for which it has nexus; and to review other matters that may be considered tax positions.

Fundraising

Fundraising expenses include personnel and other direct costs associated with fundraising efforts. Fundraising expenses are included in institutional support and totaled approximately \$1,680,000 and \$1,920,000 for fiscal 2013 and 2012, respectively.

Refundable Advances

Funds provided by the U.S. government under the Federal Perkins Loan Program are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the U.S. government and are therefore reported as liabilities.

Use of Estimates

The preparation of 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 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. The most significant management estimates and assumptions relate to the determination of allowances for doubtful accounts for student accounts, loans, and contributions receivable; the determination of year-end operating accruals; the useful lives assigned to fixed assets; conditional asset retirement obligations; and the reported fair values of certain of the University’s financial instruments, particularly non-exchange traded alternative investments such as private equity, real asset and hedge fund investments. Actual results could differ from those estimates.

Conditional Asset Retirement Obligations

Costs related to legal obligations to perform certain activities in connection with the retirement, disposal, or abandonment of assets are required to be accrued. Gallaudet has identified asbestos abatement and other required disposals as conditional asset retirement obligations. Asbestos abatement costs were estimated using an external consulting firm’s walk-through inspection and observation of the presence of asbestos in campus buildings.

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Deferred Financing Charges

During fiscal 2011, Gallaudet capitalized bond financing costs incurred in connection with a bond issuance, from which the proceeds were used in support of certain capital improvement projects. Gallaudet is amortizing the deferred financing costs of the bond issuance over the life of the bonds using the effective interest method. Amortization expense for the years ended September 30, 2013 and 2012 totaled \$56,795 and \$58,952, respectively.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. Such reclassifications did not change total assets, liabilities, revenues, expenses or changes in net assets as reflected in the 2012 financial statements.

Subsequent Events

The University evaluated its subsequent events (events occurring after September 30, 2013) through December 19, 2013, which represents the date the financial statements were issued.

3. STUDENT ACCOUNTS, GRANTS, LOANS, AND OTHER RECEIVABLES, NET

Receivables (student, grants, loans and other), as of September 30, 2013 and 2012, consist of the following:

	<u>2013</u>	<u>2012</u>
Student accounts	\$ 6,428,853	\$ 6,895,711
Other	1,571,301	971,027
Grants and contracts	<u>362,457</u>	<u>312,004</u>
Total accounts receivable	8,362,611	8,178,742
Less: Allowance for doubtful accounts	<u>(2,839,592)</u>	<u>(2,816,468)</u>
Total accounts receivable, net	<u>\$ 5,523,019</u>	<u>\$ 5,362,274</u>
Student loans, gross	<u>\$ 1,148,570</u>	<u>\$ 1,205,507</u>

Amounts due under the Federal Perkins Loan Program are guaranteed by the government. At September 30, 2013 and 2012, the following amounts were past due under the Federal Perkins program:

<u>Fiscal year ending September 30:</u>	<u>1 - 119 days past due</u>	<u>120 - 719 days past due</u>	<u>720 + days past due</u>	<u>Total past due</u>
2013	\$ 46,558	\$ 30,828	\$ 174,106	\$ 251,492
2012	\$ 59,107	\$ 22,353	\$ 160,065	\$ 241,525

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4. CONTRIBUTIONS RECEIVABLE, NET

Contributions receivable as of September 30, 2013 and 2012 are expected to be received as follows:

	<u>2013</u>	<u>2012</u>
Within one year	\$ 1,472,957	\$ 3,925,755
Between one and five years	<u>344,846</u>	<u>1,289,577</u>
	1,817,803	5,215,332
Less: Unamortized discount (0.33% - 2.48%)	(14,393)	(20,268)
Allowance for uncollectibles	<u>(225,000)</u>	<u>(356,891)</u>
Total contributions receivable, net	<u>\$ 1,578,410</u>	<u>\$ 4,838,173</u>

5. INVESTMENTS

At September 30, 2013 and 2012, investments consist of the following:

	<u>2013</u>	<u>2012</u>
Money market funds	\$ 332,820	\$ 4,537,460
Equity securities:		
U.S. Large Cap	19,831,310	18,756,603
U.S. Small Cap	7,478,110	7,942,813
International (developed countries)	23,037,796	19,210,607
International (emerging markets)	14,350,302	9,029,170
Fixed income securities:		
U.S. bonds	937,368	-
Inflation protected bonds	3,227,630	8,050,275
High yield bond	9,578,656	8,206,644
World bonds	11,264,989	5,293,095
Multi-strategy bond funds	5,593,305	9,065,212
Natural resources and commodities	25,869,227	20,598,788
Global real estate	11,849,552	9,697,810
Private equity funds	7,186,141	6,819,851
Private real asset funds	4,663,966	4,557,795
Fund of hedge funds	<u>39,115,464</u>	<u>30,851,679</u>
Total investments	<u>\$ 184,316,636</u>	<u>\$ 162,617,802</u>

At September 30, 2013 and 2012, respectively, Gallaudet has committed to fund in future years, \$5,544,818 and \$6,308,713, respectively, to private equity and private real asset funds.

Gallaudet's investment policy for its pooled endowment emphasizes growth. The University follows the total return concept, which combines interest and dividends with market appreciation to measure investment return. The University's investment policy states that it will spend annually 5% of the three-year average fair value of the pooled funds.

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Interest and dividends are reported net of investment expenses. Investment expenses for fiscal 2013 and 2012 totaled approximately \$345,000 and \$487,000, respectively. For the years ended September 30, 2013 and 2012, return on investments, which primarily related to the University's endowment as discussed in Note 11, consists of the following:

	<u>2013</u>	<u>2012</u>
Net realized and unrealized return	\$ 11,783,005	\$ 16,588,450
Interest and dividends, net	<u>3,233,956</u>	<u>2,946,948</u>
Total return on investments	<u>\$ 15,016,961</u>	<u>\$ 19,535,398</u>
Unrestricted operating investment income	\$ 7,369,539	\$ 5,862,069
Unrestricted nonoperating investment income	1,506,374	4,070,735
Temporarily restricted operating investment income	330,990	234,571
Temporarily restricted nonoperating investment income	5,795,136	8,677,728
Permanently restricted investment income	<u>14,922</u>	<u>690,295</u>
Total return on investments	<u>\$ 15,016,961</u>	<u>\$ 19,535,398</u>

Interest earned on cash and cash equivalents for the years ended September 30, 2013 and 2012, which is included as part of operations in other revenue, totaled \$9,595 and \$17,346, respectively.

The following tables present Gallaudet's fair value hierarchy for those investment assets measured at fair value on a recurring basis at September 30, 2013 and 2012:

	2013			Total
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Investments:				
Money market funds	\$ 332,820	\$ -	\$ -	\$ 332,820
Equity securities:				
U.S. Large Cap	19,831,310	-	-	19,831,310
U.S. Small Cap	7,478,110	-	-	7,478,110
International (developed countries)	23,037,796	-	-	23,037,796
International (emerging markets)	14,350,302	-	-	14,350,302
Fixed income securities:				
U.S. bonds	937,368	-	-	937,368
Inflation protected bonds	3,227,630	-	-	3,227,630
High yield bond	9,578,656	-	-	9,578,656
World bonds	11,264,989	-	-	11,264,989
Multi-strategy bond funds	-	5,593,305	-	5,593,305
Natural resources and commodities	25,869,227	-	-	25,869,227
Global real estate	11,849,552	-	-	11,849,552
Private equity funds	-	-	7,186,141	7,186,141
Private real asset funds	-	-	4,663,966	4,663,966
Fund of hedge funds	-	<u>34,474,591</u>	<u>4,640,873</u>	<u>39,115,464</u>
Total investments	<u>127,757,760</u>	<u>40,067,896</u>	<u>16,490,980</u>	<u>184,316,636</u>
Deposits with trustee	6,719,887	-	-	6,719,887
Split-interest agreements	<u>168,797</u>	-	<u>527,262</u>	<u>696,059</u>
Total	<u>\$ 134,646,444</u>	<u>\$ 40,067,896</u>	<u>\$ 17,018,242</u>	<u>\$ 191,732,582</u>

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	2012			
	Level 1	Level 2	Level 3	Total
Investments:				
Money market funds	\$ 4,537,460	\$ -	\$ -	\$ 4,537,460
Equity securities:				
U.S. Large Cap	18,756,603	-	-	18,756,603
U.S. Small Cap	7,942,813	-	-	7,942,813
International (developed countries)	19,210,607	-	-	19,210,607
International (emerging markets)	9,029,170	-	-	9,029,170
Fixed income securities:				
Inflation protected bonds	8,050,275	-	-	8,050,275
High yield bond	8,206,644	-	-	8,206,644
World bonds	5,293,095	-	-	5,293,095
Multi-strategy bond funds	-	9,065,212	-	9,065,212
Natural resources and commodities	20,598,788	-	-	20,598,788
Global real estate	9,697,810	-	-	9,697,810
Private equity funds	-	-	6,819,851	6,819,851
Private real asset funds	-	-	4,557,795	4,557,795
Fund of hedge funds	-	-	30,851,679	30,851,679
Total investments	<u>111,323,265</u>	<u>9,065,212</u>	<u>42,229,325</u>	<u>162,617,802</u>
Deposits with trustee	12,493,532	-	-	12,493,532
Split-interest agreements	183,490	-	579,439	762,929
Total	<u>\$ 124,000,287</u>	<u>\$ 9,065,212</u>	<u>\$ 42,808,764</u>	<u>\$ 175,874,263</u>

The following tables present the changes in Level 3 investment assets, by major category, measured at fair value on a recurring basis for the years ended September 30, 2013 and 2012:

	2013				
	Hedge funds	Private real asset funds	Private equity funds	Split-interest agreements	Total
Balance, beginning of year	\$ 30,851,679	\$ 4,557,795	\$ 6,819,851	\$ 579,439	\$ 42,808,764
Purchases	4,500,000	200,506	153,901	-	4,854,407
Sales/Maturities	-	(545,460)	(593,699)	-	(1,139,159)
Net gain (loss) on investments	3,763,785	451,125	806,088	(52,177)	4,968,821
Transfers out of Level 3	(34,474,591)	-	-	-	(34,474,591)
Balance, end of year	<u>\$ 4,640,873</u>	<u>\$ 4,663,966</u>	<u>\$ 7,186,141</u>	<u>\$ 527,262</u>	<u>\$ 17,018,242</u>

	2012				
	Hedge funds	Private real asset funds	Private equity funds	Split-interest agreements	Total
Balance, beginning of year	\$ -	\$ 3,775,403	\$ 6,252,865	\$ 516,991	\$ 10,545,259
Purchases	30,000,000	448,188	747,435	-	31,195,623
Sales/Maturities	-	(48,569)	(599,756)	-	(648,325)
Net gain on investments	851,679	382,773	419,307	62,448	1,716,207
Balance, end of year	<u>\$ 30,851,679</u>	<u>\$ 4,557,795</u>	<u>\$ 6,819,851</u>	<u>\$ 579,439</u>	<u>\$ 42,808,764</u>

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Annuities payable totaled \$113,051 and \$118,778 at September 30, 2013 and 2012, respectively, and are included in accounts payable and accrued expenses on the accompanying statements of financial position. The following table summarizes the changes in the annuities payable for the years ended September 30, 2013 and 2012:

	Payable to beneficiaries
Balance as of September 30, 2011	\$ 139,883
Payments	(28,036)
Present value adjustment	<u>6,931</u>
Balance as of September 30, 2012	118,778
Payments	(30,451)
Present value adjustment	<u>24,724</u>
Balance as of September 30, 2013	<u>\$ 113,051</u>

The following table presents the nature and risk of investment assets held at September 30, 2013 with fair values reported using a NAV:

Investment description	2013			2012 Fair value	Redemption frequency (if currently eligible)	Redemption notice period
	# of Funds	Fair value	Unfunded commitments			
Fund of hedge funds (a)	1	\$ 39,115,464	\$ -	\$ 30,851,679	Quarterly	65 days
Private equity funds (b)	4	7,186,141	3,674,982	6,819,851	N/A	N/A
Private real asset funds (c)	3	4,663,966	1,869,836	4,557,795	N/A	N/A
Commingled funds - multi- strategy bond funds (d)	<u>1</u>	<u>5,593,305</u>	-	<u>9,065,212</u>	Monthly	5 days
Total	<u>9</u>	<u>\$ 56,558,876</u>	<u>\$ 5,544,818</u>	<u>\$ 51,294,537</u>		

Redemption frequency and notice periods for each of the respective funds presented in the above chart are as of September 30, 2013 and 2012.

- (a) This class includes investments in a fund of hedge funds across several strategies. The objective of the fund is to achieve long-term returns commensurate with long-term returns from an investment in the general equity market, while experiencing volatility more like that of an investment in the general debt markets. Many of the underlying funds seek to achieve their investment objectives with minimal correlation with traditional equity or fixed income indices. The fair values of the investments in this class have been estimated using the net asset value per share of the investments. Currently, all of these investments are not redeemable, because the fund restricts redemption in the first year after acquisition with subsequent redemption quarterly. During fiscal 2013, certain lock-up provisions pertaining to the fund of hedge funds lapsed, causing a transfer of approximately \$34 million between Levels 2 and 3. The remaining restrictions on these investments are 6 to 9 months at September 30, 2013.
- (b) This class includes several private equity funds that invest in either domestic or international limited partnerships. These investments are geographically diversified among the United States, Europe, Latin America and Asia. Allocations consist of leveraged buy-outs, venture capital expansion opportunities, recapitalization, distressed and special situation investments. The fair values of these investments have been estimated using the net asset value of Gallaudet's ownership interest in partners' capital. These investments can never be redeemed with the funds. Instead, the nature of the investments in this class

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is that distributions are received through liquidation of the underlying assets of the funds. It is estimated that the underlying assets of the funds would be liquidated over 3 to 10 years.

- (c) This class includes investments in limited partnerships with several underlying holdings in private investment partnerships, limited liability companies, or similar entities that invest in real assets, also known as inflation hedging investments. Real asset allocations are primarily in natural resources, power, infrastructure and to a smaller extent, real estate. The fair values of these investments have been estimated using the net asset value of Gallaudet's ownership interest in partners' capital. These investments can never be redeemed with the funds. Instead, distributions are received through liquidation of the underlying assets of the funds. It is estimated that the underlying assets of the funds would be liquidated over 3 to 10 years.
- (d) This class includes investments in a multi-manager, multi-strategy commingled fund. The objective of this fund is to allocate assets across a broad spectrum of fixed income sectors to achieve a fully diversified fixed income portfolio. The fund invests in fixed income securities and strategies, including but not limited to global bonds, inflation-indexed bonds, high yield bonds, emerging markets debt and opportunistic credit strategies. The fair values of the investments in this class have been estimated using the net asset value per share of the investments.

6. LAND, BUILDINGS, AND OTHER PROPERTY, NET

At September 30, 2013 and 2012, land, buildings, and other property consist of the following:

	2013			2012
	University	Clerc Center	Total	
Buildings and improvements	\$ 221,807,257	\$ 38,533,401	\$ 260,340,658	\$ 253,427,655
Outside improvements	30,089,459	3,072,748	33,162,207	31,884,692
Furniture, equipment, and library books	30,227,246	2,758,422	32,985,668	30,277,493
Land stabilization improvements	6,190,017	-	6,190,017	6,190,017
Software	4,214,981	-	4,214,981	4,168,621
	<u>292,528,960</u>	<u>44,364,571</u>	<u>336,893,531</u>	<u>325,948,478</u>
Less: Accumulated depreciation and amortization	<u>(128,454,238)</u>	<u>(26,412,103)</u>	<u>(154,866,341)</u>	<u>(142,899,855)</u>
	164,074,722	17,952,468	182,027,190	183,048,623
Land	1,468,119	-	1,468,119	1,468,119
Construction in progress	<u>7,820,603</u>	<u>-</u>	<u>7,820,603</u>	<u>4,461,166</u>
Land, buildings, and other property, net	<u>\$ 173,363,444</u>	<u>\$ 17,952,468</u>	<u>\$ 191,315,912</u>	<u>\$ 188,977,908</u>

Included in furniture, equipment, and library books, is copier equipment acquired under capital lease arrangements for five years with a cost of \$2,811,070 and \$2,795,973 and accumulated depreciation of \$817,318 and \$381,543 as of September 30, 2013 and 2012, respectively.

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Gallaudet recognized net gains of \$6,246 and \$22,091 in fiscal 2013 and 2012, respectively, related to the replacement of existing leased copiers. Included in construction in progress at September 30, 2013 are costs associated with the renovation of University student housing and an University academic building. These projects are expected to be completed in fiscal 2014. The following table represents the activity for the conditional asset retirement obligations for the years ended September 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Balance, beginning of year	\$ 535,117	\$ 589,399
Obligations settled in current period	-	(76,965)
Accretion expense	<u>23,228</u>	<u>22,683</u>
Balance, end of year	<u>\$ 558,345</u>	<u>\$ 535,117</u>

During fiscal 2012, Gallaudet remediated three buildings located on campus. This activity included previously recognized asset retirement obligations. The cost of the abatement totaled \$98,360, of which \$76,965 was previously accrued for by the University. The additional cost of the abatement project of \$21,395 has been shown as part of nonoperating activities in the accompanying 2012 statement of activities.

7. RETIREMENT PLANS

Although Gallaudet is a private institution, legislation enacted by the U.S. Congress permits regular status employees to be covered by federal pension programs. Under these arrangements, employees contribute a percentage of their salaries to one of two retirement systems, and Gallaudet matches a certain percentage of each employee's contributions. The University contributed \$10,621,254 and \$10,389,223 for the years ended September 30, 2013 and 2012, respectively, to these retirement programs. Employee and matching contributions are paid to the U.S. Office of Personnel Management, the administrator of the plans. Gallaudet has no unfunded pension costs under these plans.

8. LINE OF CREDIT

Gallaudet has a \$15 million unsecured line of credit with PNC Bank, National Association which expires in April 2014. There was no outstanding balance on this line of credit at September 30, 2013 and 2012.

9. TAX-EXEMPT REVENUE BONDS

In May 2011, the District of Columbia issued Series 2011 tax-exempt revenue bonds in the amount of \$40,000,000 on behalf of Gallaudet. These bonds were sold to finance the costs of (i) building a new student housing facility, (ii) renovating and improving heating and lighting systems and controls in campus buildings, (iii) upgrading technology infrastructure and (iv) renovating resident halls, classroom buildings, and other campus facilities. The new student housing facility was completed during fiscal 2012 with the remaining projects to be completed between December 2013 and September 2014.

The bond proceeds are held by a trustee and invested in U.S. government obligations or funds of U.S. government obligations. The trustee reimburses Gallaudet for qualifying expenditures paid to third-party vendors relating to the capital projects.

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Gallaudet is obligated under the revenue bonds as follows:

	<u>2013</u>	<u>2012</u>
Series 2011 revenue bonds, serial, with interest rates ranging from 3.000% to 4.875%, maturing at various dates from April 1, 2013 to April 1, 2026	\$ 11,900,000	\$ 12,605,000
Series 2011 revenue bonds, term		
Interest rate 5.5%, maturing April 1, 2034	11,885,000	11,885,000
Interest rate 5.5%, maturing April 1, 2041	<u>15,510,000</u>	<u>15,510,000</u>
Total bonds, at face value	39,295,000	40,000,000
Less: unamortized discount and premium	<u>(596,912)</u>	<u>(592,040)</u>
Total bonds payable	<u>\$ 38,698,088</u>	<u>\$ 39,407,960</u>

The serial and term bonds represent unsecured general obligations of Gallaudet.

Interest on the bonds is payable semi-annually every April 1st and October 1st. For the period ending September 30, 2013 and 2012, respectively, Gallaudet capitalized interest, net of earnings, of \$640,579 and \$1,938,804, relating to the projects described above.

The fair value of Gallaudet's bonds payable approximates \$40,900,000 and \$45,100,000 as of September 30, 2013 and 2012, respectively. The fair value of the bonds is estimated based on quoted market prices for the same or similar issues. The market prices utilized reflect the rate that Gallaudet would have to pay to a creditworthy third-party to assume its obligation and do not reflect an additional liability of Gallaudet.

The term bonds maturing on April 1, 2034 and April 1, 2041, are subject to mandatory redemption by operation of sinking fund installments. The installment payments for the term bonds maturing April 1, 2034, begin on April 1, 2027, and range from \$1.2 to \$1.8 million per year through the maturity date. Installment payments for the term bond maturing April 2041, begin on April 1, 2035, and range from \$1.9 to \$2.6 million per year through the maturity date.

Required principal and interest payments due on all debt obligations during the next five fiscal years and in total thereafter are as follows:

<u>Fiscal year ending September 30:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
2014	\$ 730,000	\$ 2,001,081	\$ 2,731,081
2015	750,000	1,979,181	2,729,181
2016	770,000	1,956,681	2,726,681
2017	800,000	1,931,656	2,731,656
2018	830,000	1,899,656	2,729,656
Thereafter	<u>35,415,000</u>	<u>27,358,888</u>	<u>62,773,888</u>
	<u>\$ 39,295,000</u>	<u>\$ 37,127,143</u>	<u>\$ 76,422,143</u>

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10. NET ASSETS

The nature of temporary restrictions on net assets at September 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Instruction	\$ 532,795	\$ 515,200
Research	1,059,288	1,044,244
Public service	174,364	135,330
Academic support	1,827,565	357,442
Student services	8,919,866	8,666,718
Plant operations and maintenance	49,310	24,632
General operations	<u>14,855,407</u>	<u>12,757,375</u>
Total temporarily restricted net assets	<u>\$ 27,418,595</u>	<u>\$ 23,500,941</u>

Permanently restricted net assets are invested in perpetuity. The income and net gains generated by these assets are used to support donor-specified programs or the general activities of Gallaudet. At September 30, 2013 and 2012, Gallaudet held the following permanently restricted net assets, the income and net gains from which support the activities indicated below:

	<u>2013</u>	<u>2012</u>
Instruction	\$ 2,816,691	\$ 2,807,443
Research	2,087,127	2,061,962
Public service	2,147,257	2,135,186
Academic support	1,225,040	1,224,988
Student services	37,830,457	37,457,158
Plant operations and maintenance	524,570	524,272
General operations	<u>74,534,893</u>	<u>74,516,132</u>
Total permanently restricted net assets	<u>\$ 121,166,035</u>	<u>\$ 120,727,141</u>

The preceding table includes the Gallaudet University Federal Endowment Fund (see Note 11) of \$73,388,400 and \$73,409,184 as of September 2013 and 2012, respectively. Of this amount, \$53,499,333 and \$53,520,117 is included in general operations with the balance reflected as part of the other captions comprising the total.

11. ENDOWMENTS

Federal Endowment Fund

The Education of the Deaf Act of 1986 (the "Act") established a Matching Endowment Program known as the Gallaudet University Federal Endowment Fund (the "Fund"). The original Act authorized annual appropriations to match (on a dollar-for-dollar basis for federal contributions up to \$1,000,000 and on a two-dollar-for-one-dollar basis for federal contributions over \$1,000,000) contributions received from non-federal sources. The amendments to the Act of 1998 removed the two-for-one provision and made the matches one-for-one for all non-federal contributions up to the federal contribution ceiling of \$1,000,000.

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Both federal and matching cash contributions are placed in the Fund and, under the Act, are permanently restricted and unavailable for expenditure.

Under amendments to the Act in 1992, all annual federal and matching contributions to the Fund, as well as all realized and unrealized gains and losses, plus 50% of interest and dividends for a period of ten years following the fiscal year in which the appropriation was made, are all permanently restricted. The remaining 50% of interest and dividends earned annually from the Fund may be withdrawn and expended for general operations according to limitations set forth in the 1992 amendments. After this ten-year period has elapsed for each year's contributions, all future investment income attributable to that year's contributions, including realized and unrealized gains and losses, is available for general operations.

Reinvested income including interest, dividends, and realized and unrealized investment gains for 2013 and 2012 totaled \$14,922 and \$690,295, respectively. As of September 30, 2013 and 2012, permanently restricted net assets related to the Federal Endowment Fund consists of the following:

	<u>2013</u>	<u>2012</u>
Federal appropriations	\$ 19,389,067	\$ 19,389,067
Matching contributions	19,889,067	19,889,067
Permanently reinvested income:		
Interest and dividends	10,164,187	10,044,695
Realized and unrealized investment gains	<u>23,946,079</u>	<u>24,086,355</u>
Cumulative additions to the Fund	<u>\$ 73,388,400</u>	<u>\$ 73,409,184</u>

Endowments

The University's endowment consists of 365 individual funds which have been established primarily to support the operations of the University and to provide for scholarships. The University's endowment includes certain permanently restricted, temporarily restricted and unrestricted net assets. The permanently restricted portion includes the University's Federal Endowment Fund and other donor restricted funds that the University must hold in perpetuity, pursuant to express donor stipulations.

Excluded from the permanently restricted portion of the University's endowment are contributions receivable and split-interest agreements. The temporarily restricted portion of the endowment includes accumulated unspent earnings from the permanently restricted portion of the endowment and is available for expenditure in subsequent years following appropriation by the University's Board of Trustees. The unrestricted portion of the endowment includes certain funds which have been designated by the University's Board of Trustees to function as a fund of permanent duration (quasi-endowment) as well as any accumulated losses on any individual permanently restricted endowments funds.

Interpretation of Relevant Law

The University's Board of Trustees has interpreted the District of Columbia Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the University, absent explicit donor stipulations to the contrary, to act in good faith and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances in making determinations to appropriate or accumulate endowment funds, taking into account both its obligation to preserve the value of the endowment and its obligation to use the endowment to achieve the purposes for which it was donated. The University classifies as permanently restricted net assets: (a) the original value of gifts donated to the permanent endowment, (b) the original

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value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment required by the applicable donor gift instrument. The remaining portion of donor-restricted endowment funds that is not classified as permanently restricted is classified as temporarily restricted net assets until such amounts are appropriated for expenditure by the University's Board of Trustees.

The University defines the appropriation of endowment net assets for expenditure as the authorization of its investment spending rate as approved annually by its Board of Trustees. In making a determination to appropriate or accumulate, the University adheres to the standard of prudence prescribed by UPMIFA and considers the following factors:

- (1) The duration and preservation of the endowment fund;
- (2) The purposes of the University and the endowment fund;
- (3) General economic conditions;
- (4) The possible effect of inflation or deflation;
- (5) The expected total return from income and appreciation of endowment investments;
- (6) Other resources of the institution; and,
- (7) The investment policy of the University.

Return Objectives and Strategies

The University has adopted investment and spending policies for endowment assets that support the objective of providing a sustainable and increasing level of endowment income distribution to support the University's activities while preserving the real purchasing power of the endowment. The University's primary investment objective is to maximize total return within reasonable and prudent levels of risk while maintaining sufficient liquidity to meet disbursement needs and ensure preservation of capital. To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy, the objective of which is to achieve a return consisting of a combination of current income and capital appreciation recognizing that changes in market conditions and interest rates will result in varying strategies in an attempt to optimize results. The endowment portfolio is diversified among various asset classes and utilizes various strategies to manage risk.

The University's investment policy states that it will spend annually 5% of the three-year average fair value of the endowment, exclusive of the portion relating to the federal endowment. However, when donors have expressly stipulated the payout percentage of earnings on endowments, which differs from University policy, it is followed. In fiscal 2013, the University's Board of Trustees approved the use of an additional 5% payout from a Board-designated endowment fund. This payout of \$1,021,976 was used to fund operational expenses of the University. This is consistent with the University's objective as addressed above.

Endowment net asset composition by type of fund as of September 30, 2013 follows:

Endowment net asset composition by type of fund as of September 30, 2013	Unrestricted	Temporarily restricted	Permanently restricted	Total
Board-designated endowment funds	\$ 38,780,336	\$ -	\$ -	\$ 38,780,336
Donor-restricted endowment funds	<u>(970,710)</u>	<u>23,796,797</u>	<u>120,641,774</u>	<u>143,467,861</u>
Total endowment funds	<u>\$ 37,809,626</u>	<u>\$ 23,796,797</u>	<u>\$ 120,641,774</u>	<u>\$ 182,248,197</u>

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Endowment net asset composition by type of fund as of September 30, 2012 follows:

Endowment net asset composition by type of fund as of September 30, 2012	Unrestricted	Temporarily restricted	Permanently restricted	Total
Board-designated endowment funds	\$ 23,322,915	\$ -	\$ -	\$ 23,322,915
Donor-restricted endowment funds	<u>(2,011,636)</u>	<u>18,050,075</u>	<u>120,144,165</u>	<u>136,182,604</u>
Total endowment funds	<u>\$ 21,311,279</u>	<u>\$ 18,050,075</u>	<u>\$ 120,144,165</u>	<u>\$ 159,505,519</u>

Changes in endowment assets for the year ended September 30, 2013 follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, October 1, 2012	\$ 21,311,279	\$ 18,050,075	\$ 120,144,165	\$ 159,505,519
Investment return	8,757,347	6,126,126	14,922	14,898,395
Contributions	15,000,000	-	482,370	15,482,370
Amounts appropriated for expenditure	(7,259,000)	(379,404)	-	(7,638,404)
Other changes:				
Reclassification of net assets due to clarification of donor intent	<u>-</u>	<u>-</u>	<u>317</u>	<u>317</u>
Endowment net assets, September 30, 2013	<u>\$ 37,809,626</u>	<u>\$ 23,796,797</u>	<u>\$ 120,641,774</u>	<u>\$ 182,248,197</u>

Changes in endowment assets for the year ended September 30, 2012 follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, October 1, 2011	\$ 17,265,630	\$ 9,602,529	\$ 118,536,702	\$ 145,404,861
Investment return	9,759,061	8,912,299	690,295	19,361,655
Contributions	-	-	593,870	593,870
Amounts appropriated for expenditure	(5,715,094)	(407,055)	-	(6,122,149)
Other changes:				
Reclassification of net assets due to clarification of donor intent	<u>1,682</u>	<u>(57,698)</u>	<u>323,298</u>	<u>267,282</u>
Endowment net assets, September 30, 2012	<u>\$ 21,311,279</u>	<u>\$ 18,050,075</u>	<u>\$ 120,144,165</u>	<u>\$ 159,505,519</u>

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the original value of the gift donated to the permanent endowment. In accordance with U.S. generally accepted accounting principles, deficiencies of this nature are reported in unrestricted net assets. These deficiencies resulted from unfavorable market fluctuations that eroded the accumulated gains of the permanently restricted endowments as well as the continued appropriation for certain programs which were deemed prudent by the University's Board of Trustees. Future gains will continue to be classified as increases in unrestricted net assets until the shortfalls previously charged to unrestricted net assets have been eliminated and the individual endowment funds are returned to their required levels as stipulated by donors.

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As of September 30, 2013 and 2012, there were a total of 63 and 90 individual endowment funds, respectively, within the permanently restricted net asset category with a fair value less than their historical corpus value. The aggregate deficit at September 30, 2013 and 2012 totaled approximately \$1 million and \$2 million, respectively.

12. COMMITMENTS AND CONTINGENCIES

Gallaudet receives significant amounts of federal funding in the form of appropriations, grants, and contracts. These awards are subject to audit by federal agencies. Management is of the opinion that disallowances, if any, would not have a significant effect on the financial position, change in net assets or cash flows of the University.

The University is a party to litigation and other claims in the ordinary course of business. In the opinion of management, the ultimate resolution of these matters will not have a significant effect on the financial position, change in net assets or cash flows of the University.

From time to time, the University enters into capital leases for office, technology, or other equipment. Remaining future minimum rental payments under such leases, which extend through 2018, totaled \$2,447,912 at September 30, 2013 and are payable as follows:

<u>Fiscal year ending September 30:</u>	
2014	\$ 675,033
2015	650,861
2016	629,950
2017	456,015
2018	<u>36,053</u>
	2,447,912
Less: Interest	<u>(384,146)</u>
Total obligations under capital leases	<u>\$ 2,063,766</u>