

Cornell College

Financial Report
June 30, 2012

Contents

| | |
|-------------------------------------|---|
| Independent Auditor's Report | 1 |
|-------------------------------------|---|

| | |
|-------------------------------|--------|
| Financial Statements | |
| Balance sheets | 2 |
| Statements of activities | 3 – 4 |
| Statements of cash flows | 5 – 6 |
| Notes to financial statements | 7 – 31 |



Independent Auditor's Report

To the Board of Trustees
Cornell College
Mount Vernon, Iowa

We have audited the accompanying balance sheets of Cornell College as of June 30, 2012 and 2011, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cornell College as of June 30, 2012 and 2011 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

McGladrey LLP

Cedar Rapids, Iowa
October 29, 2012

Cornell College

Balance Sheets
June 30, 2012 and 2011

| Assets | 2012 | 2011 |
|---|-----------------------|-----------------------|
| Cash and cash equivalents | \$ 11,898,454 | \$ 6,124,712 |
| Accounts receivable, less allowance for doubtful accounts 2012 \$183,006; 2011 \$203,006 | 284,415 | 478,196 |
| Inventories and prepaid expenses | 411,542 | 325,111 |
| Contributions receivable, net (Note 2) | 8,407,273 | 14,070,693 |
| Student loans receivable, net (Note 3) | 2,037,810 | 2,090,679 |
| Investments (Notes 4 and 13) | 66,133,423 | 68,152,748 |
| Cash restricted for investment in land, buildings and equipment | 1,550,856 | 1,180,386 |
| Property, plant and equipment, net (Notes 5 and 7) | 58,595,784 | 58,312,107 |
| Total assets | \$ 149,319,557 | \$ 150,734,632 |

Liabilities and Net Assets

Liabilities:

| | | |
|---|-------------------|-------------------|
| Accounts payable, accrued expenses and deposits | \$ 3,304,434 | \$ 2,851,247 |
| Funds held on behalf of others | - | 65,045 |
| Student tuition paid in advance | 161,609 | 265,728 |
| Accrued severance plan liability (Note 6) | 2,818,741 | 2,988,560 |
| Asset retirement obligation (Note 11) | 999,697 | 985,775 |
| Long-term debt (Note 7) | 16,156,922 | 16,523,190 |
| Life-income payable (Note 9) | 2,330,756 | 2,477,435 |
| Due to U.S. government, refundable loan program | 901,607 | 1,054,027 |
| Total liabilities | 26,673,766 | 27,211,007 |

Commitments (Notes 4, 6 and 9)

Net Assets (Notes 8 and 12):

| | | |
|--|-----------------------|-----------------------|
| Unrestricted, including Board designated endowment 2012 \$2,819,661; 2011 \$2,824,501 | 37,447,823 | 36,734,584 |
| Temporarily restricted | 25,492,690 | 25,688,339 |
| Permanently restricted | 59,705,278 | 61,100,702 |
| Total net assets | 122,645,791 | 123,523,625 |
| Total liabilities and net assets | \$ 149,319,557 | \$ 150,734,632 |

See Notes to Financial Statements.

Cornell College

Statements of Activities

Years Ended June 30, 2012 and 2011

| | 2012 | | | Total |
|---|----------------------|---------------------------|---------------------------|-----------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Revenues: | | | | |
| Tuition and fees | \$ 37,857,012 | \$ - | \$ - | \$ 37,857,012 |
| Less scholarships and grants | 22,458,144 | - | - | 22,458,144 |
| Net tuition and fees | 15,398,868 | - | - | 15,398,868 |
| Contributions and grants | 1,707,856 | 6,385,595 | 745,905 | 8,839,356 |
| Investment income, net of investment expense | 1,064 | 168,253 | - | 169,317 |
| Miscellaneous revenues | 716,647 | 71,684 | - | 788,331 |
| Sales and services of auxiliary enterprises | 8,533,108 | - | - | 8,533,108 |
| Total revenues | 26,357,543 | 6,625,532 | 745,905 | 33,728,980 |
| Net assets released from restrictions (Note 8) | 7,549,653 | (7,549,653) | - | - |
| Total revenues and other support | 33,907,196 | (924,121) | 745,905 | 33,728,980 |
| Expenses (Note 10): | | | | |
| Instruction | 11,945,706 | - | - | 11,945,706 |
| Academic support and research | 2,381,464 | - | - | 2,381,464 |
| Student services | 7,032,688 | - | - | 7,032,688 |
| Institutional support | 3,443,368 | - | - | 3,443,368 |
| Institutional advancement | 1,798,120 | - | - | 1,798,120 |
| Auxiliary enterprises | 6,650,341 | - | - | 6,650,341 |
| Total expenses | 33,251,687 | - | - | 33,251,687 |
| Change in net assets before other adjustments | 655,509 | (924,121) | 745,905 | 477,293 |
| Investment returns (Note 4) | 76,313 | 1,616,091 | (912,693) | 779,711 |
| Write-off of contribution receivable (Note 2) | (68,500) | (1,672,620) | (471,161) | (2,212,281) |
| Actuarial adjustment on life income and annuity agreements | 49,917 | (276,030) | 303,556 | 77,443 |
| Change in donor intent | - | 1,061,031 | (1,061,031) | - |
| Change in net assets | 713,239 | (195,649) | (1,395,424) | (877,834) |
| Net assets, at beginning of year | 36,734,584 | 25,688,339 | 61,100,702 | 123,523,625 |
| Net assets, at ending of year | \$ 37,447,823 | \$ 25,492,690 | \$ 59,705,278 | \$ 122,645,791 |

See Notes to Financial Statements.

2011

| Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---------------|---------------------------|---------------------------|----------------|
| \$ 35,603,151 | \$ - | \$ - | \$ 35,603,151 |
| 21,029,059 | - | - | 21,029,059 |
| 14,574,092 | - | - | 14,574,092 |
| 2,480,154 | 3,342,108 | 628,942 | 6,451,204 |
| - | 144,725 | 37,639 | 182,364 |
| 527,049 | 80,745 | - | 607,794 |
| 8,406,423 | - | - | 8,406,423 |
| 25,987,718 | 3,567,578 | 666,581 | 30,221,877 |
| 4,733,365 | (4,733,365) | - | - |
| 30,721,083 | (1,165,787) | 666,581 | 30,221,877 |
| 12,519,059 | - | - | 12,519,059 |
| 2,720,051 | - | - | 2,720,051 |
| 7,343,325 | - | - | 7,343,325 |
| 2,953,175 | - | - | 2,953,175 |
| 1,771,020 | - | - | 1,771,020 |
| 6,031,637 | - | - | 6,031,637 |
| 33,338,267 | - | - | 33,338,267 |
| (2,617,184) | (1,165,787) | 666,581 | (3,116,390) |
| 2,485,165 | 5,100,168 | 140,169 | 7,725,502 |
| - | (250,000) | (750,000) | (1,000,000) |
| 195,109 | (104,305) | (80,275) | 10,529 |
| - | - | - | - |
| 63,090 | 3,580,076 | (23,525) | 3,619,641 |
| 36,671,494 | 22,108,263 | 61,124,227 | 119,903,984 |
| \$ 36,734,584 | \$ 25,688,339 | \$ 61,100,702 | \$ 123,523,625 |

Cornell College

**Statements of Cash Flows
Years Ended June 30, 2012 and 2011**

| | 2012 | 2011 |
|--|---------------------|---------------------|
| Cash Flows from Operating Activities: | | |
| Change in net assets | \$ (877,834) | \$ 3,619,641 |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities: | | |
| Depreciation | 3,424,049 | 3,403,184 |
| Write-off of contribution receivable | 2,212,281 | 1,000,000 |
| Actuarial adjustment of annuities and life income payable | (77,443) | (10,529) |
| Net (appreciation) on investments | (779,711) | (7,725,502) |
| Donations of investments and equipment | (681,268) | (1,800,557) |
| Contributions restricted for long-term investment and property, plant and equipment | (3,379,659) | (628,942) |
| Change in operating assets and liabilities: | | |
| Decrease in accounts receivable | 193,781 | 428,035 |
| Decrease in contributions receivable | 1,296,026 | 596,497 |
| Increase in accounts payable and accrued expenses | 453,187 | 274,906 |
| Increase in asset retirement obligation | 13,922 | 46,942 |
| Increase (decrease) in early retirement liability | (169,819) | 173,962 |
| Other, net | (255,595) | 20,999 |
| Net cash provided by (used in) operating activities | 1,371,917 | (601,364) |
| Cash Flows from Investing Activities: | | |
| Purchases of investments | (23,984,508) | (29,724,645) |
| Proceeds from sales and maturities of investments | 27,464,812 | 31,318,997 |
| Disbursements of student loans | (279,146) | (57,328) |
| Repayments of student loans | 332,015 | 350,337 |
| Proceeds from sales of property and equipment | - | 125,374 |
| Purchase of property and equipment | (3,707,726) | (1,854,861) |
| Change in cash restricted for land, buildings and equipment | (370,470) | (507,649) |
| Net cash (used in) investing activities | (545,023) | (349,775) |
| Cash Flows from Financing Activities: | | |
| Proceeds from issuance of indebtedness | 700,000 | 28,406 |
| Repayments of principal on indebtedness | (1,066,268) | (2,345,546) |
| Cash received from contributions restricted for long-term investment and property, plant and equipment | 5,534,772 | 1,646,103 |
| (Decrease) in U.S. government grants refundable, net | (152,420) | (628) |
| Increase in annuities payable resulting from new annuities | 85,000 | - |
| Investment income restricted for life income agreements | 37,630 | 77,512 |
| Payments to annuitants and life income recipients | (191,866) | (323,716) |
| Net cash provided by (used in) financing activities | \$ 4,946,848 | \$ (917,869) |

(Continued)

Cornell College

Statements of Cash Flows (Continued)
Years Ended June 30, 2012 and 2011

| | 2012 | 2011 |
|---|-----------------------------|---------------------|
| Net increase (decrease) in cash and cash equivalents | \$ 5,773,742 | \$ (1,869,008) |
| Cash and cash equivalents: | | |
| Beginning | <u>6,124,712</u> | 7,993,720 |
| Ending | <u>\$ 11,898,454</u> | <u>\$ 6,124,712</u> |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash payments for interest | \$ 427,998 | \$ 529,379 |
| Accounts payable incurred for purchase of property and equipment | 354,235 | - |

See Notes to Financial Statements.

Cornell College

Notes to Financial Statements

Note 1. Significant Accounting Policies

Operations: Cornell College (College) is a liberal arts institution located in Mount Vernon, Iowa. The College is accredited as a baccalaureate degree granting institution by the North Central Association of Colleges and Universities.

Accounting 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. Actual results could differ from those estimates.

Basis of presentation: Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the College 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 College and/or the passage of time and accumulated earnings for restricted endowment fund assets. Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the temporarily restricted net asset class, and a reclassification to unrestricted net assets is made to reflect the expiration of such restrictions.
- Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be retained permanently by the College. Generally, the donors of these assets permit the College 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, other than endowment and similar funds, are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets; net assets released from restrictions.

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 property, plant and equipment without donor restrictions concerning the use of such long-lived assets are reported as revenue of the unrestricted net asset class. Contributions of cash or other assets to be used to acquire property, plant and equipment are reported as revenue of the temporarily restricted net asset class; the restrictions are considered to be released at the time of acquisition of such long-lived assets. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. 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 including such factors as prior collection history, type of contribution and nature of fundraising activity.

Cornell College

Notes to Financial Statements

Note 1. Significant Accounting Policies (Continued)

Income, realized gains and losses, and unrealized gains and losses on investments of endowment and similar funds are reported as follows:

- As increases in permanently restricted net assets if the terms of the gift or the College'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 in all other cases unless the individual endowment is underwater; and
- As increases in unrestricted net assets if the individual endowment is underwater.

The Board of Trustees designates a portion of the College's cumulative unrestricted investment return for support of current operations; the remainder is retained to support operations of future years and to offset potential market declines.

Cash and cash equivalents: The College considers all highly liquid debt instruments purchased with a maturity date of less than three months to be cash equivalents except for money market funds held for long-term investment and deposits with bond trustees.

Cash in excess of daily requirements is invested in interest bearing accounts and money market funds of qualified financial institutions in amounts that frequently exceed insured limits. The College has not experienced any losses in these investments.

Student accounts receivable and student loans receivable: Student accounts receivable are carried at the unpaid balance of the original amount billed to students and student loans receivable are carried at the amount of unpaid principal. Both receivables are less an estimate made for doubtful accounts based on a review of all outstanding amounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience. Student accounts and loans receivable are written off when deemed uncollectible and student loans receivable may be assigned to the U.S. Department of Education. Recoveries of student accounts and loans receivable previously written off are recorded when received. The provision for bad debts charged to expense, net of recoveries, was a net expense of \$14,150 and \$167,143 for the years ended June 30, 2012 and 2011, respectively.

Interest is charged on student accounts receivable that are past due and is recognized as it is charged. A student account receivable is considered to be past due if any portion of the receivable balance is outstanding at the beginning of the term to which the charges relate. Once a student is no longer enrolled, accrual of interest is suspended.

Interest is charged and recognized on student loans receivable after a student is no longer enrolled in an institution of higher education and after a grace period. Interest is recognized as charged. Late charges are charged if payments are not paid by the payment due date and are recognized as they are received. Students may be granted a deferment, forbearance or cancellation of their student loan receivable based on eligibility requirements defined by the U.S. Department of Education or in the case of loan funds of the College, based on the respective loan program.

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

Cornell College

Notes to Financial Statements

Note 1. Significant Accounting Policies (Continued)

Investments: Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value with unrealized gains and losses included in the statement of activities. Donated investments are recorded at fair value on the date received.

Alternative investments, such as private equity, absolute return hedge funds, real estate investment trusts, and natural resource funds consist primarily of investments that are not readily marketable. Investments in these categories are valued utilizing the most current information provided by the general partner or manager of the fund. Because these alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material.

Farms and city real estate are carried at cost or, if received as a donation, at the fair market value at the date received less applicable accumulated depreciation.

Realized gains are calculated using the average cost method.

Property, plant and equipment: Land and campus improvements, buildings, rental properties, equipment and library books are stated at cost at date of acquisition or fair value at date of gift, less accumulated depreciation computed on a straight-line basis over the following estimated useful lives. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

| | |
|---------------------------------|--------------|
| Campus land improvements | 20 Years |
| Buildings and rental properties | 50 Years |
| Equipment | 5 – 10 Years |
| Library books | 10 Years |

Pension plan: The College has a pension plan covering substantially all of its employees. The total pension expense for the years ended June 30, 2012 and 2011 was \$566,746 and \$527,389, respectively. The Plan is of the defined-contribution type whereby the College contributes a specified percentage of the employee's salary and the employee's benefit is whatever amount the accumulated contributions will buy. There is no unfunded prior service cost.

Self insurance: The College is self-insured with respect to its health insurance coverage. The College maintains reinsurance that carries a specific stop-loss of \$50,000 per participant covered for the period January 1, 2012 to December 31, 2012 and an aggregate stop-loss of 125% of total expected claims. Expected claims are estimated to be approximately \$1,811,220. For the years ended June 30, 2012 and 2011, the amount of health insurance expense, including administrative costs and reinsurance costs, net of stop loss recoveries received or receivable, was \$1,725,004 and \$1,566,225, respectively.

Severance plan: The College provides certain retirement, health care and life insurance benefits for all employees who meet eligibility requirements. The College's estimated costs of benefits that will be paid after retirement is generally being accrued by charges to expenses over the employees' service periods to the dates they are fully eligible for benefits.

Cornell College

Notes to Financial Statements

Note 1. Significant Accounting Policies (Continued)

Asset retirement obligations: The College recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, the cost of the retirement obligation is capitalized by increasing the carrying value of the related asset. Over time, the liability is accreted to its present value each year and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the statement of activities. The College reviews its estimates annually and adjusts the recorded liability as needed. (Note 11)

Due to U.S. government: Amounts due to the U.S. Government include advances under the Perkins Loan Program and the program's cumulative net income as these funds are ultimately refundable to the U.S. Government.

Funds held on behalf of others: The College maintains a bank account for the funds of various student activities connected with the College; however, the College's function is limited to bookkeeping only. As of June 30, 2012, the funds are now reflected as College funds due to a change in the College's function.

Revenue recognition: Tuition, fees and room and board revenue is recognized in the year the services are performed. Net tuition and fees are computed after deducting financial aid awarded to students. In order to assist students in meeting tuition and other costs of attendance, the College administers a variety of federal, state, institutional and private programs. Financial aid packages to students may include direct grants, loans and employment during the academic year.

Investment income is recognized as it is earned.

Income tax status: The College is recognized as exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The College may be subject to federal and state income taxes on any net income from unrelated business activities. The College files a Form 990 (Return of Organization Exempt from Income Tax) annually and unrelated business income (UBI) is reported on Form 990-T, as appropriate. Management has evaluated their material tax positions, which include such matters as the tax exempt status and various positions relative to potential sources of UBI. As of June 30, 2012 and 2011, there were no uncertain tax benefits identified and recorded as a liability. Forms 990 and 990-T filed by the College are no longer subject to examination by the Internal Revenue Service for the fiscal years ended June 30, 2008 and prior.

Cornell College

Notes to Financial Statements

Note 1. Significant Accounting Policies (Continued)

Advertising: The College follows the policy of charging advertising costs to expense as incurred. Total advertising expense is not material to the College's financial statements.

Fundraising: The College incurred fundraising costs of approximately \$1,242,000 and \$1,102,000 for the years ended June 30, 2012 and 2011, respectively. These expenses are included with institutional advancement on the statement of activities.

Financial instruments: The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, accounts receivable and accounts payable: The carrying amount approximates fair value because of the short maturity of those instruments.

Contributions receivable: The carrying amount approximates fair value as they are discounted to present value based on rates commensurate with the risks involved.

Student loans receivable: The fair value of the student loans receivable and liability for U.S. Government loans refundable, in which the College acts as an agent for the U.S. Government Perkins Loan Program, are not practical to determine. These loans are subject to restrictions on interest rates and transferability.

Investments: Debt and equity securities are carried at fair values which are based on quoted market prices on the last day of the year for those or similar investments. Alternative investments are based on fair value as determined by management based on information provided by the general partner or manager of the fund.

Long-term debt and life-income payable: The carrying amount of notes, bonds and life-income payable approximates fair value, as borrowing rates currently available to the College for similar instruments are consistent with existing terms, except for the 2006 IHELA bonds, whose fair value was approximately \$8,550,000 and \$7,400,000 at June 30, 2012 and 2011, respectively.

New accounting pronouncement: In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This ASU was issued to clarify FASB's intent on application of certain aspects of existing fair value measurement requirements and to change certain requirements for measuring fair value and for disclosing information about fair value measurements. These changes include guidance on measuring the fair value of financial instruments that are managed within a portfolio, application of premiums and discounts, and additional disclosures about fair value measurements. FASB has concluded that this ASU will achieve the objective of developing common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. This ASU is effective for the College for annual reporting periods beginning after December 15, 2011. Management is in the process of evaluating the potential impact this standard will have on its financial statements.

Cornell College

Notes to Financial Statements

Note 1. Significant Accounting Policies (Continued)

Subsequent events: The College has considered subsequent events through October 29, 2012, the date of issuance. Through this date, there were no significant events requiring disclosure other than the commitments to renovate the Thomas Commons and the Garner President's House for approximately \$2,300,000.

Reclassification: Certain amounts included in prior year financial statements have been reclassified with no effect on change in net assets or net assets to conform with the current presentation.

Note 2. Contributions Receivable

Contributions receivable are summarized as follows as of June 30, 2012 and 2011:

| | 2012 | 2011 |
|---|---------------------|----------------------|
| Contributions receivable expected to be collected in: | | |
| Less than one year | \$ 3,239,538 | \$ 4,102,725 |
| One year to five years | 5,935,720 | 11,537,242 |
| Over five years | 330,238 | 122,349 |
| Gross contributions receivable | 9,505,496 | 15,762,316 |
| Less: | | |
| Allowance for uncollectibles | (200,000) | (200,000) |
| Unamortized discount for time value of money * | (898,223) | (1,491,623) |
| Net contributions receivable | \$ 8,407,273 | \$ 14,070,693 |

* The discount rate used ranged from 2% to 6%.

The above contributions receivable have been included in the following net asset categories as of June 30, 2012 and 2011:

| | 2012 | 2011 |
|------------------------|---------------------|----------------------|
| Temporarily restricted | \$ 7,530,453 | \$ 12,620,666 |
| Permanently restricted | 876,820 | 1,450,027 |
| | \$ 8,407,273 | \$ 14,070,693 |

Of total gross contributions receivable as of June 30, 2012 and 2011, approximately \$6,580,000 and \$6,400,000, respectively, are due from current and life members of the Board of Trustees of the College.

The College had \$2,212,281 in contributions receivable that were written off during the year ended June 30, 2012.

Cornell College

Notes to Financial Statements

Note 3. Student Loans Receivable

The College's student loans receivable consist of a revolving loan fund for Federal Perkins Loans for which the College acts as an agent for the federal government in administering the loan program and an institutional loan fund created by the College to assist students in funding their education.

The College determined their allowance for doubtful accounts on these student loans by looking at historical default rates and analyzing the aging of the past due loans. During the year ended June 30, 2012, the College has not significantly changed its methodology for the allowance for doubtful accounts on student loans.

The aging of the student loan portfolio by classes of loans as of June 30, 2012 and 2011 is presented as follows:

| Classes of Loans | 2012 | | | | | | Total |
|--|---------------------|-------------------|-----------------------------------|---|---|-------------------------------------|---------------------|
| | Not in Repayment | Current | Less Than 240 Days Past Due | Greater Than 240 Days, but Less Than 2 Years Past Due | Greater Than 2 Years, Less Than 5 Years Past Due | Greater Than 5 Years Past Due | |
| Federal Perkins Loans | \$ 363,507 | \$ 627,551 | \$ 86,060 | \$ 40,026 | \$ 26,927 | \$ 87,545 | \$ 1,231,616 |
| Institutional Loans | 389,731 | 354,467 | 49,947 | 32,960 | 30,395 | 77,694 | 935,194 |
| | <u>\$ 753,238</u> | <u>\$ 982,018</u> | <u>\$ 136,007</u> | <u>\$ 72,986</u> | <u>\$ 57,322</u> | <u>\$ 165,239</u> | <u>\$ 2,166,810</u> |
| As a percentage of total loan portfolio | 34.76% | 45.32% | 6.28% | 3.37% | 2.65% | 7.62% | 100.00% |

| Classes of Loans | 2011 | | | | | | Total |
|--|---------------------|-------------------|-----------------------------------|---|---|-------------------------------------|---------------------|
| | Not in Repayment | Current | Less Than 240 Days Past Due | Greater Than 240 Days, but Less Than 2 Years Past Due | Greater Than 2 Years, Less Than 5 Years Past Due | Greater Than 5 Years Past Due | |
| Federal Perkins Loans | \$ 415,574 | \$ 610,859 | \$ 146,362 | \$ 27,997 | \$ 19,881 | \$ 79,580 | \$ 1,300,253 |
| Institutional Loans | 411,942 | 356,488 | 40,579 | 13,745 | 25,897 | 70,775 | 919,426 |
| | <u>\$ 827,516</u> | <u>\$ 967,347</u> | <u>\$ 186,941</u> | <u>\$ 41,742</u> | <u>\$ 45,778</u> | <u>\$ 150,355</u> | <u>\$ 2,219,679</u> |
| As a percentage of total loan portfolio | 37.28% | 43.58% | 8.42% | 1.88% | 2.06% | 6.78% | 100.00% |

The allowance for doubtful accounts on student loans in aggregate is \$129,000 for the years ended June 30, 2012 and 2011.

Cornell College

Notes to Financial Statements

Note 3. Student Loans Receivable (Continued)

The allowance for doubtful accounts on loans by portfolio segment as of June 30, 2012 and 2011 is presented as follows:

| | Federal Perkins Loans | Institutional Loans | Total |
|---|-----------------------------|------------------------|------------|
| <u>2012</u> | | | |
| Allowance for loans collectively evaluated for impairment | \$ 85,680 | \$ 43,320 | \$ 129,000 |
| Loans collectively evaluated for impairment | 1,231,616 | 935,194 | 2,166,810 |
| Allowance as a percentage of loans collectively evaluated for impairment | 6.96% | 4.71% | 5.95% |
| <u>2011</u> | | | |
| Allowance for loans collectively evaluated for impairment | \$ 85,680 | \$ 43,320 | \$ 129,000 |
| Loans collectively evaluated for impairment | 1,300,253 | 919,426 | 2,219,679 |
| Allowance as a percentage of loans collectively evaluated for impairment | 6.59% | 4.71% | 5.81% |

For each class of financing receivable, the following presents the recorded investment by credit quality indicator as of June 30, 2012 and 2011:

| | Federal Perkins Loans | Institutional Loans | Total |
|---------------|-----------------------------|------------------------|---------------------|
| <u>2012</u> | | | |
| Performing | \$ 1,077,118 | \$ 794,145 | \$ 1,871,263 |
| Nonperforming | 154,498 | 141,049 | 295,547 |
| | <u>\$ 1,231,616</u> | <u>\$ 935,194</u> | <u>\$ 2,166,810</u> |
| <u>2011</u> | | | |
| Performing | \$ 1,172,795 | \$ 809,009 | \$ 1,981,804 |
| Nonperforming | 127,458 | 110,417 | 237,875 |
| | <u>\$ 1,300,253</u> | <u>\$ 919,426</u> | <u>\$ 2,219,679</u> |

Performing loans are those which are less than 240 days past due. Nonperforming loans are those which are greater than or equal to 240 days past due.

For student loans, the credit quality indicator is performance determined by delinquency status and, for Federal Perkins Loans, origination and servicing of the loan. Delinquency status is updated monthly by the College's loan servicer. Federal Perkins Loans that are originated and serviced properly under Department of Education regulations can be assigned to the Department of Education when deemed no longer collectible. The College is not aware of any material amount of loans not properly originated or serviced under Department of Education regulations.

Cornell College

Notes to Financial Statements

Note 4. Long-Term Investments

The long-term investments include funds traditionally considered the endowment of the College (including quasi-endowment) as well as other assets. As of June 30, 2012 and 2011, the carrying value of long-term investments are as follows:

| | 2012 | 2011 |
|--|----------------------|----------------------|
| Endowment: | | |
| Money market funds | \$ 4,592,336 | \$ 4,058,063 |
| Common stock | 152,998 | 152,998 |
| Bond funds | 23,574,604 | 23,298,064 |
| Cash value of life insurance | 2,717,507 | 3,631,938 |
| Equity securities | 12,807,484 | 15,843,212 |
| Real estate investment trusts ** | 3,383,749 | 1,073,125 |
| Private equity ** | 5,115,646 | 4,820,560 |
| Hedge funds ** | 6,709,977 | 7,859,088 |
| Natural resource funds ** | 778,814 | 913,891 |
| Contracts and miscellaneous | 23,042 | 25,542 |
| Trusts held by others * | 3,281,806 | 3,414,999 |
| Unitrusts *** | 1,953,225 | 1,928,334 |
| | <u>65,091,188</u> | <u>67,019,814</u> |
| Other: | | |
| Stocks | 6,122 | 6,564 |
| Land held for resale, farms and city real estate | 100,000 | 100,000 |
| Cash value of life insurance | 492,933 | 583,190 |
| Money market funds | 438,056 | 438,056 |
| Other | 5,124 | 5,124 |
| | <u>1,042,235</u> | <u>1,132,934</u> |
| | <u>\$ 66,133,423</u> | <u>\$ 68,152,748</u> |

* Trusts held in trust by others are assets neither in the possession of nor under control of the College, but held and administered by outside fiscal agents, with the College deriving income from such funds. The value of such assets is supported by annual trust statements, and consists of publicly traded stocks and bonds.

** The College has the ability to liquidate these investments periodically in accordance with the provisions of the respective investment fund agreements. Under terms of certain limited partnership agreements, the College is obligated periodically to advance additional funding for private equity and real estate investments. As of June 30, 2012, the College had commitments of approximately \$1,618,000 for which capital calls had not been exercised. Such commitments generally have fixed expiration dates or other termination clauses. The College anticipates that it will maintain sufficient liquidity in its investment portfolio to cover such calls.

*** Assets held under charitable remainder trusts primarily consist of equity securities and bonds.

Cornell College

Notes to Financial Statements

Note 4. Long-Term Investments (Continued)

The investments of the College are exposed to various risks such as interest rate, market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to the changes in the value of such investments, it is at least reasonably possible that changes in risks in the near-term would materially affect investment balances and the amounts reported in the financial statements. Investment gains were reduced by \$967,463 due to a large life insurance policy that was re-written by the donor, extending the life of the policy but reducing the cash surrender value substantially.

Investment return consists of the following for the years ended June 30, 2012 and 2011:

| | 2012 | 2011 |
|--|-------------------|---------------------|
| Net realized gains on investments | \$ 2,159,271 | \$ 2,357,752 |
| Net unrealized gains (losses) on investments | (1,379,560) | 5,367,750 |
| Total investment gains | \$ 779,711 | \$ 7,725,502 |

Note 5. Property, Plant and Equipment

Property, plant and equipment as of June 30, 2012 and 2011 is as follows:

| | 2012 | 2011 |
|-----------------------------------|----------------------|----------------------|
| Land and real estate improvements | \$ 3,376,702 | \$ 3,193,850 |
| Buildings | 81,928,781 | 80,668,345 |
| Equipment and library books | 15,891,363 | 16,728,317 |
| Rental properties | 1,824,906 | 1,775,051 |
| Construction in progress | 2,017,857 | 238,815 |
| | 105,039,609 | 102,604,378 |
| Less accumulated depreciation | 46,443,825 | 44,292,271 |
| | \$ 58,595,784 | \$ 58,312,107 |

Note 6. Accrued Severance Plan Liability

The College has an unfunded retirement arrangement that covers full-time faculty and salaried administrative personnel who began service prior to April 14, 1991. To be eligible, the employee must complete at least 15 years of service and have accumulated at least 75 "points" (a combination of age and years of service). The arrangement provides a benefit equal to 110% of the participant's final year's compensation in a lump-sum payment. The arrangement also added health care benefits, which will be provided for the lesser of five years or Medicare eligibility and life insurance, which will be provided for up to five years.

Cornell College

Notes to Financial Statements

Note 6. Accrued Severance Plan Liability (Continued)

The following table sets forth information related to the plan as of June 30, 2012 and 2011:

| | 2012 | 2011 |
|---|------------------------------|------------------------------|
| Benefit obligation at beginning of period | \$ 2,988,560 | \$ 2,814,598 |
| Service cost | 49,187 | 49,089 |
| Interest cost | 189,698 | 177,454 |
| Actuarial loss (gain) | 93,198 | 87,683 |
| Benefits paid | (167,404) | (140,264) |
| Adjustment | (334,498) | - |
| Benefit obligation at end of period | <u>2,818,741</u> | <u>2,988,560</u> |
| Plan assets in deficit of projected benefit obligation | <u>\$ (2,818,741)</u> | <u>\$ (2,988,560)</u> |
| Rollforward of accrued benefit: | | |
| Accrued benefit on balance sheet, beginning of year | \$ 2,988,560 | \$ 2,814,598 |
| Change in plan liability | (169,819) | 173,962 |
| Accrued benefit on balance sheet, end of year | <u>\$ 2,818,741</u> | <u>\$ 2,988,560</u> |
| Benefits cost | \$ 308,672 | \$ 296,330 |
| Benefits paid | 167,404 | 140,264 |

Weighted-average assumptions used to determine benefit obligations for the year ended June 30, 2012 were as follows: discount rate was 3.0% and rate of compensation increase was 3.0% for administrative employees and faculty. Weighted-average assumptions used to determine benefit obligations for the year ended June 30, 2011 were as follows: discount rate was 6.5% and rate of compensation increase was 3.0% for administrative employees and 4.5% for faculty.

Weighted-average assumptions used to determine net cost for the year ended June 30, 2012 were as follows: discount rate was 3.0% and rate of compensation increase was 3.0% for administrative employees and faculty. Weighted-average assumptions used to determine net cost for the year ended June 30, 2011 were as follows: discount rate was 6.5% and rate of compensation increase was 3.0% for administrative employees and 4.5% for faculty.

Cash flows: The benefits expected to be paid in each year 2013 – 2022 are as follows:

| | |
|----------------------|--------------|
| Year ending June 30: | |
| 2013 | \$ 1,458,267 |
| 2014 | 199,125 |
| 2015 | 410,386 |
| 2016 | 340,779 |
| 2017 | 207,388 |
| 2018 - 2022 | 861,581 |

Cornell College

Notes to Financial Statements

Note 6. Accrued Severance Plan Liability (Continued)

The expected benefits are based on the same assumptions used to measure the College's benefit obligation as of June 30 and include estimated future employee service.

Subsequent to June 30, 2012, the plan was changed as follows: Employees 62 and older will receive 60% of their current salary if they elect to retire by December 31, 2012 or 40% if they elect after that date but before December 31, 2013. After December 31, 2013, the plan will no longer be available. For employees under age 62, no benefits will be paid out under the plan. The liability under these new terms is anticipated to be significantly reduced.

Note 7. Pledged Assets and Related Debt

Long-term debt as of June 30, 2012 and 2011 is summarized as follows:

| | 2012 | 2011 |
|--|----------------------|----------------------|
| Iowa Higher Education Loan Authority (IHELA) - Series 2006. Interest is payable semi-annually on April 1 and October 1 through maturity on October 1, 2036, at fixed rates ranging from 4.1% to 4.875% (current effective rate is 4.72% as of June 30, 2012). Annual principal payments are due beginning in 2011. The remaining bond discount of \$45,305 is being amortized over the bond term using the interest method. The College is required to maintain certain financial ratios including a liquidity ratio and a debt service ratio as well as nonfinancial covenants. The bonds are collateralized by a building with a net book value of approximately \$4,990,000. The College is also required to maintain a bond reserve fund (balance as of June 30, 2012 is approximately \$438,000) to handle the repayment of bond principal and interest. | \$ 6,759,694 | \$ 6,891,809 |
| Iowa Higher Education Loan Authority (IHELA) - Series 2008. Interest is payable monthly through maturity on October 1, 2038, at a variable rate determined by the remarketing agent not to exceed 10% (current effective rate is 1.75% as of June 30, 2012). The entire principal balance is due at maturity in 2038. The remaining bond discount of \$40,483 is being amortized over the bond term using the interest method. The bonds are collateralized by an irrevocable letter of credit in the amount of \$8,897,112. The letter of credit expires on June 20, 2014. The letter of credit agreement requires the College to maintain certain financial ratios including a cash, investments and pledges to debt ratio and a debt service ratio as well as nonfinancial covenants. The letter of credit is collateralized by buildings with a net book value of approximately \$5,520,000. The letter of credit agreement contains a covenant requiring the College to supply audited financial statements within a certain time period after the College's fiscal year-end. | 8,774,517 | 9,352,975 |
| Subtotal forward | \$ 15,534,211 | \$ 16,244,784 |

Cornell College

Notes to Financial Statements

Note 7. Pledged Assets and Related Debt (Continued)

| | 2012 | 2011 |
|---|---------------|---------------|
| Subtotal forwarded | \$ 15,534,211 | \$ 16,244,784 |
| <p>JPMorgan Chase Bank, NA - Original loan of \$700,000 with principal payments due in quarterly installments of \$50,000 starting January 1, 2012 with final payment on or before December 31, 2014. Interest is payable quarterly on the first day of January, April, July and October, at a floating rate based on LIBOR plus 190 basis points (effective interest rate is 2.145% as of June 30, 2012). The loan is collateralized by contributions receivable related to the McLennan Center property. The College is required to maintain certain financial ratios including cash, investments and pledges to debt ratio and a debt service ratio as well as nonfinancial covenants.</p> | | |
| | 600,000 | - |
| Other | 22,711 | 278,406 |
| | \$ 16,156,922 | \$ 16,523,190 |

The College is authorized to draw \$1,300,000 from JPMorgan Chase Bank, NA to be used to finance renovations to the President's House. The loan would bear interest at a rate of LIBOR plus 190 basis points. The maturity date of the loan is December 1, 2016. The College has the ability to draw these funds until December 31, 2012. Payments would commence January 1, 2013. The College is required to maintain certain financial ratios including cash, investments and pledges to debt ratio and a debt service ratio as well as nonfinancial covenants. There are no outstanding amounts as of June 30, 2012 and 2011.

The following is a schedule of maturities for the above debt:

| | IHELA Series 2006 | IHELA Series 2008 | McLennan Center | Other | Total |
|----------------------|----------------------|----------------------|--------------------|-----------|---------------|
| Year ending June 30: | | | | | |
| 2013 | \$ 137,164 | \$ - | \$ 200,000 | \$ 5,681 | \$ 342,845 |
| 2014 | 142,217 | - | 200,000 | 5,681 | 347,898 |
| 2015 | 152,273 | - | 200,000 | 5,681 | 357,954 |
| 2016 | 157,332 | - | - | 5,668 | 163,000 |
| 2017 | 162,394 | - | - | - | 162,394 |
| 2018-2022 | 943,037 | - | - | - | 943,037 |
| 2023-2027 | 1,190,235 | - | - | - | 1,190,235 |
| 2028-2032 | 1,508,108 | - | - | - | 1,508,108 |
| 2033-2037 | 2,366,934 | - | - | - | 2,366,934 |
| 2038-2040 | - | 8,774,517 | - | - | 8,774,517 |
| | \$ 6,759,694 | \$ 8,774,517 | \$ 600,000 | \$ 22,711 | \$ 16,156,922 |

Cornell College

Notes to Financial Statements

Note 8. Restrictions and Limitations on Net Asset Balances

As of June 30, 2012 and 2011, the College's restricted net assets were allocated as follows:

| | 2012 | 2011 |
|--|----------------------|----------------------|
| Temporarily restricted net assets: | | |
| Instruction and other departmental support | \$ 3,538,247 | \$ 5,118,093 |
| Accumulated earnings on endowment funds | 6,914,786 | 7,842,978 |
| Acquisition of buildings and equipment | 13,255,066 | 12,266,174 |
| Life income, annuities and cash surrender value of life insurance policies | 414,176 | 340,036 |
| Student loan funds | 1,370,415 | 121,058 |
| | <u>\$ 25,492,690</u> | <u>\$ 25,688,339</u> |
| Permanently restricted net assets: | | |
| Invested in perpetuity, the income from which is expendable for: | | |
| Scholarships | \$ 25,742,475 | \$ 25,618,728 |
| Unrestricted | 10,742,640 | 10,469,596 |
| Professorships | 10,980,363 | 10,520,660 |
| Library | 1,044,184 | 1,036,484 |
| Other instructional support | 7,630,677 | 7,467,022 |
| Student loan funds | 83,418 | 1,199,597 |
| Annuity, life income and cash surrender value of life insurance policies and restricted pledges | 3,481,521 | 4,788,615 |
| | <u>\$ 59,705,278</u> | <u>\$ 61,100,702</u> |

Net assets during the years ended June 30, 2012 and 2011 were released from donor restrictions for the following purposes:

| | 2012 | 2011 |
|--|---------------------|---------------------|
| Scholarships and other endowment funds | \$ 1,353,350 | \$ 2,014,313 |
| Instruction and other departmental support | 3,169,708 | 2,459,038 |
| Capital projects | 3,026,595 | 260,014 |
| | <u>\$ 7,549,653</u> | <u>\$ 4,733,365</u> |

Note 9. Liability to Life Tenants Under Charitable Remainder Trusts and Annuities Payable

The College has several charitable remainder trust agreements whereby the College is required to pay certain amounts to the income beneficiary during their lifetime. The present value of these payments discounted using a rate of 6% is \$1,057,006 and \$1,074,801 as of June 30, 2012 and 2011, respectively. In addition, the College has received amounts from various individuals under annuity agreements that require the College to pay to the donors varying amounts during their lifetime. The present value of these payments using specified discount rate ranging from 3% to 14% totaled \$1,273,750 and \$1,402,634 as of June 30, 2012 and 2011, respectively.

Cornell College

Notes to Financial Statements

Note 10. Allocation of Functional Expenses

The College is required to allocate the operations and maintenance of the physical plant, depreciation expense and interest to the various programs of the College. The allocations for the years ended June 30, 2012 and 2011 are as follows:

| | Expenses as Reported on the Statement of Activities | Allocations to Programs | Program Expenses Prior to Allocations |
|------------------------------------|--|----------------------------|--|
| Year Ended June 30, 2012 | | | |
| Operating expenses: | | | |
| Instruction | \$ 11,945,706 | \$ (2,187,717) | \$ 9,757,989 |
| Academic support and research | 2,381,464 | (477,850) | 1,903,614 |
| Student services | 7,032,688 | (1,120,895) | 5,911,793 |
| Institutional support | 3,443,368 | (601,402) | 2,841,966 |
| Institutional advancement | 1,798,120 | (92,050) | 1,706,070 |
| Auxiliary enterprises | 6,650,341 | (2,905,210) | 3,745,131 |
| Operation and maintenance of plant | - | 3,533,077 | 3,533,077 |
| Depreciation | - | 3,424,049 | 3,424,049 |
| Interest | - | 427,998 | 427,998 |
| | <u>\$ 33,251,687</u> | <u>\$ -</u> | <u>\$ 33,251,687</u> |
| Year Ended June 30, 2011 | | | |
| Operating expenses: | | | |
| Instruction | \$ 12,519,059 | \$ (2,554,121) | \$ 9,964,938 |
| Academic support and research | 2,720,051 | (664,849) | 2,055,202 |
| Student services | 7,343,325 | (1,227,049) | 6,116,276 |
| Institutional support | 2,953,175 | (399,590) | 2,553,585 |
| Institutional advancement | 1,771,020 | (71,947) | 1,699,073 |
| Auxiliary enterprises | 6,031,637 | (994,987) | 5,036,650 |
| Operation and maintenance of plant | - | 1,979,980 | 1,979,980 |
| Depreciation | - | 3,403,184 | 3,403,184 |
| Interest | - | 529,379 | 529,379 |
| | <u>\$ 33,338,267</u> | <u>\$ -</u> | <u>\$ 33,338,267</u> |

Cornell College

Notes to Financial Statements

Note 11. Asset Retirement Obligation

Under current accounting standards guidance, the College must accrue for costs related to legal obligations to perform certain activities in connection with the retirement, disposal or abandonment of assets. The obligation to perform the asset retirement activity is not conditional even though the timing or method may be conditional. The fair value of a liability for a legal obligation associated with an asset retirement is required to be recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized.

Substantially all of the College's conditional asset retirement obligation relates to the estimated cost to remove certain materials from campus facilities. The future value of the asset retirement obligation as of June 30, 2012 is estimated to be approximately \$1,309,000. The liability was estimated using an inflation rate of 4%. Because accounting standards required retrospective application to the inception of the liability, the initial asset retirement obligation was calculated using a discount rate of 5%.

Changes in the accrual for asset retirement obligation during the years ended June 30, 2012 and 2011 are as follows:

| | 2012 | 2011 |
|---|-------------------|-------------------|
| Balance beginning | \$ 985,775 | \$ 938,833 |
| Accretion of asset retirement liability | 35,772 | 46,942 |
| Settlement of asset retirement obligation | (21,850) | - |
| Balance ending | <u>\$ 999,697</u> | <u>\$ 985,775</u> |

Note 12. Endowment Fund and Net Asset Classifications

The College's Endowment Fund consists of various donor restricted endowment funds and funds designated as quasi-endowment by the Board of Trustees. Net assets associated with endowment funds, including funds designated to function as endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

The College has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) adopted by the 2008 Iowa legislature as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the College classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund, (d) the original net present value of permanently restricted annuities, and (e) subsequent changes in amounts due under permanently restricted annuities. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the College in a manner consistent with the standard of prudence prescribed by the State of Iowa in its enacted version of UPMIFA. In accordance with UPMIFA, the College considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the Endowment Fund; (2) the purposes of the College and the donor-restricted Endowment Fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the College; and (7) the investment policies of the College.

Cornell College

Notes to Financial Statements

Note 12. Endowment Fund and Net Asset Classifications (Continued)

The College has adopted investment and spending policies for its Endowment Fund. The objective of these policies is to provide the College a predictable funding stream for its programs while achieving an investment return greater than the combination of the current spending formula and the current rate of inflation in order to protect the purchasing power of the Endowment Fund. The College, through its investment policy, has established a target (inflation-adjusted) annualized rate of return over the long-term of at least 8%; the total return during any single measurement period may deviate from the long-term return objective. To satisfy its long-term rate-of-return objective, the College expects to maintain appropriate diversification among equity, fixed income and alternative investment allocations. The purpose is to moderate the overall investment risk of the Endowment Fund.

The Board of Trustees of the College may appropriate for expenditure or accumulate so much of the Endowment Fund as the College determines is prudent for the uses, benefits, purposes and duration for which the Endowment Fund is established. The amount appropriated, per the spending policy, is a Board approved percentage applied to the average fair value of the endowment fund assets during the eight quarters ending December 31st of the prior calendar year. The Board approved spending percentage was 5% and 6% for the fiscal years ended June 30, 2012 and 2011, respectively.

Endowment net assets as of June 30, 2012 and 2011 were as follows:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|--|-----------------------|---------------------------|---------------------------|----------------------|
| 2012 | | | | |
| Donor-restricted endowment funds | \$ (6,103,848) | \$ 7,328,963 | \$ 59,621,860 | \$ 60,846,975 |
| Board-designated quasi-endowment funds | 2,819,661 | - | - | 2,819,661 |
| Total endowment funds | \$ (3,284,187) | \$ 7,328,963 | \$ 59,621,860 | \$ 63,666,636 |
| 2011 | | | | |
| Donor-restricted endowment funds | \$ (5,862,124) | \$ 8,183,012 | \$ 59,901,105 | \$ 62,221,993 |
| Board-designated quasi-endowment funds | 2,824,501 | - | - | 2,824,501 |
| Total endowment funds | \$ (3,037,623) | \$ 8,183,012 | \$ 59,901,105 | \$ 65,046,494 |

Cornell College

Notes to Financial Statements

Note 12. Endowment Fund and Net Asset Classifications (Continued)

The changes in endowment net assets for the years ended June 30, 2012 and 2011 were as follows:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|--|------------------|---------------------------|---------------------------|------------------|
| 2012 | | | | |
| Endowment net assets, beginning of year | \$ (3,037,623) | \$ 8,183,012 | \$ 59,901,105 | \$ 65,046,494 |
| Investment return: | | | | |
| Investment income allocated to operations | - | 64,725 | - | 64,725 |
| Net appreciation/(depreciation) (realized and unrealized) | (6,958) | 1,616,091 | (912,693) | 696,440 |
| Total investment return | (6,958) | 1,680,816 | (912,693) | 761,165 |
| Contributions | - | - | 716,259 | 716,259 |
| Write-off of contribution receivable | - | - | (471,161) | (471,161) |
| Appropriation of endowment funds for expenditure | (289,523) | (2,174,040) | - | (2,463,563) |
| Other changes | 49,917 | (360,825) | 388,350 | 77,442 |
| Endowment net assets, end of year | \$ (3,284,187) | \$ 7,328,963 | \$ 59,621,860 | \$ 63,666,636 |
| 2011 | | | | |
| Endowment net assets, beginning of year | \$ (6,119,913) | \$ 5,773,413 | \$ 60,015,119 | \$ 59,668,619 |
| Investment return: | | | | |
| Investment income | - | 143,486 | - | 143,486 |
| Net appreciation/(depreciation) (realized and unrealized) | 2,485,165 | 5,100,168 | 140,169 | 7,725,502 |
| Total investment return | 2,485,165 | 5,243,654 | 140,169 | 7,868,988 |
| Contributions | - | - | 618,190 | 618,190 |
| Write-off of contribution receivable | - | - | (750,000) | (750,000) |
| Appropriation of endowment funds for expenditure | - | (2,974,515) | - | (2,974,515) |
| Other changes | 597,125 | 140,460 | (122,373) | 615,212 |
| Endowment net assets, end of year | \$ (3,037,623) | \$ 8,183,012 | \$ 59,901,105 | \$ 65,046,494 |

From time to time, the fair value of endowment funds associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the College to retain as a fund of perpetual duration, underwater endowments. As of June 30, 2012 and 2011, donor restricted endowment funds were underwater by \$6,103,848 and \$5,862,124, respectively. This amount is reported in unrestricted net assets. These deficiencies, which the College believes are temporary, resulted from unfavorable market fluctuations. The Board determined that continued appropriation during fiscal years ended June 30, 2012 and 2011 for certain programs was prudent.

Note 13. Fair Value Measurements

The Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification defines fair value, establishes a framework for measuring fair value and requires disclosure of fair value measurements. The fair value hierarchy set forth in the Topic is as follows:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. Investments measured using the practical expedient, that do not have any significant redemption restrictions, lock-up periods, gates or other characteristics that would cause report and liquidation date net asset value (NAV) to be significantly different, if redemption were requested at the report date.
- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability. The College reports the fair value of certain Level 3 investments using the practical expedient. The practical expedient allows for the use of net asset value (NAV), either as reported by the investee fund or as adjusted by the College based on various factors, to be used to determine fair value, under certain conditions. The fair value of the investment is based on a combination of audited financial statements of the investees and monthly or quarterly statements received from the investees. These investments would have significant redemption and other restrictions that would limit the Funds' ability to redeem out of the fund at report date NAV.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Investments: Where quoted prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation including alternative investments, securities are classified within level 3 of the valuation hierarchy. Level 3 securities include investments in limited partnerships, life insurance policies, real estate, land and mineral rights. Investments in limited partnerships are fund-of-funds that take custody of the assets and use partnership accounting to determine the unit value of each member's interest in the partnership. Annual audits are performed each year on the partnerships. The College obtains the fair value from the fund managers. The fund managers use various models, comparisons and assumptions to estimate fair value. Consideration is given to the type of investment, risks, marketability, restrictions on dispositions and quotations from other market participants. Life insurance policies are valued at cash surrender values determined by the life insurance companies. The value of real estate, land and mineral rights is determined through third party appraisals. The value of charitable lead/remainder unitrusts is derived from the underlying investments of the unitrusts. The value of those investments is determined in the same manner as investments described above. Future expected cash flows are discounted using a risk adjusted discount rate.

There have been no changes in valuation techniques used for any assets measured at fair value during the years ended June 30, 2012 and 2011.

Cornell College

Notes to Financial Statements

Note 13. Fair Value Measurements (Continued)

The following tables summarize assets measured at fair value on a recurring basis as of June 30, 2012 and 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|-------------------------------|----------------------|--|--|--|
| | 2012 | | | |
| Assets: | | | | |
| Investments: | | | | |
| Common Stocks: | | | | |
| Miscellaneous | \$ 152,998 | \$ - | \$ - | \$ 152,998 |
| Equity Mutual Funds: | | | | |
| International funds | 2,725,259 | 2,725,259 | - | - |
| Multi strategy funds | 10,666,748 | 6,274,932 | 4,391,816 | - |
| Fixed Income Mutual Funds: | | | | |
| Total return funds | 24,697,325 | 19,436,640 | 5,260,685 | - |
| Tax exempt funds | 245,981 | 245,981 | - | - |
| Cash value of life insurance | 3,210,440 | - | - | 3,210,440 |
| Real estate investment trust | 3,383,749 | - | - | 3,383,749 |
| Natural resource funds | 778,814 | - | - | 778,814 |
| Hedge funds | 6,709,977 | - | - | 6,709,977 |
| Private equity | 5,115,646 | - | - | 5,115,646 |
| Funds held in trust by others | 3,281,806 | - | - | 3,281,806 |
| Other | 34,288 | - | - | 34,288 |
| | <u>\$ 61,003,031</u> | <u>\$ 28,682,812</u> | <u>\$ 9,652,501</u> | <u>\$ 22,667,718</u> |

Cornell College

Notes to Financial Statements

Note 13. Fair Value Measurements (Continued)

| | Fair Value | Quoted Prices | Significant Other | Significant |
|-------------------------------|----------------------|---|-----------------------------------|-------------------------------------|
| | | in Active Markets for Identical Assets (Level 1) | Observable Inputs (Level 2) | Unobservable Inputs (Level 3) |
| 2011 | | | | |
| Assets: | | | | |
| Investments: | | | | |
| Common Stocks: | | | | |
| Miscellaneous | \$ 152,998 | \$ - | \$ - | \$ 152,998 |
| Equity Mutual Funds: | | | | |
| International funds | 3,927,356 | 3,927,356 | - | - |
| Multi strategy funds | 12,523,886 | 9,602,354 | 2,921,532 | - |
| Fixed Income Mutual Funds: | | | | |
| Total return funds | 24,383,749 | 19,295,932 | 5,087,817 | - |
| Tax exempt funds | 234,620 | 234,620 | - | - |
| Cash value of life insurance | 4,215,128 | - | - | 4,215,128 |
| Real estate investment trust | 1,073,125 | - | - | 1,073,125 |
| Natural resource funds | 913,891 | - | - | 913,891 |
| Hedge funds | 7,859,087 | 1,958,713 | - | 5,900,374 |
| Private equity | 4,820,560 | - | - | 4,820,560 |
| Funds held in trust by others | 3,414,999 | - | - | 3,414,999 |
| Other | 37,230 | - | - | 37,230 |
| | <u>\$ 63,556,629</u> | <u>\$ 35,018,975</u> | <u>\$ 8,009,349</u> | <u>\$ 20,528,305</u> |

Included in investments on the balance sheets are money markets that are cash and cash equivalents and land which are recorded at a cost basis of \$5,130,392 and \$4,596,119 as of June 30, 2012 and 2011, respectively, and are excluded from the above table as they are not subject to fair value measurement guidance.

There were no transfers between levels 1, 2 or 3 of the fair value hierarchy during the years ended June 30, 2012 and 2011.

Cornell College

Notes to Financial Statements

Note 13. Fair Value Measurements (Continued)

The following tables present additional information about assets measured at fair value on a recurring basis for which the College has utilized level 3 inputs to determine fair value.

| | Common Stocks Miscellaneous | Cash Value of Life Insurance | Real Estate Investment Trust | Natural Resource Funds | Hedge Funds | Private Equity | Funds Held in Trust by Others | Other | Total |
|---|-----------------------------------|------------------------------------|------------------------------------|------------------------------|----------------|-------------------|-------------------------------------|-----------|---------------|
| June 30, 2012 | | | | | | | | | |
| Balance, beginning | \$ 152,998 | \$ 4,215,128 | \$ 1,073,125 | \$ 913,891 | \$ 5,900,374 | \$ 4,820,560 | \$ 3,414,999 | \$ 37,230 | \$ 20,528,305 |
| Total gains or losses (realized/unrealized) included in change in net assets | - | (1,004,440) | 310,624 | (62,817) | (41,931) | 279,070 | (133,193) | 1,063 | (651,624) |
| Purchases | - | - | 2,000,000 | 2,500 | 900,000 | 480,326 | - | - | 3,382,826 |
| Sales | - | - | - | (74,760) | (48,466) | (464,310) | - | (4,005) | (591,541) |
| Settlements | - | (248) | - | - | - | - | - | - | (248) |
| Balance, ending | \$ 152,998 | \$ 3,210,440 | \$ 3,383,749 | \$ 778,814 | \$ 6,709,977 | \$ 5,115,646 | \$ 3,281,806 | \$ 34,288 | \$ 22,667,718 |
| June 30, 2011 | | | | | | | | | |
| Balance, beginning | \$ 153,026 | \$ 4,110,763 | \$ 852,122 | \$ 871,007 | \$ 5,806,137 | \$ 3,775,986 | \$ 2,998,474 | \$ 26,581 | \$ 18,594,096 |
| Total gains or losses (realized/unrealized) included in change in net assets | (28) | 124,515 | 183,052 | 236,558 | 95,690 | 1,019,507 | 416,525 | 10,649 | 2,086,468 |
| Purchases | - | - | 37,951 | 10,000 | 3,135,964 | 604,500 | - | - | 3,788,415 |
| Sales | - | - | - | (203,674) | (3,137,417) | (579,433) | - | - | (3,920,524) |
| Settlements | - | (20,150) | - | - | - | - | - | - | (20,150) |
| Balance, ending | \$ 152,998 | \$ 4,215,128 | \$ 1,073,125 | \$ 913,891 | \$ 5,900,374 | \$ 4,820,560 | \$ 3,414,999 | \$ 37,230 | \$ 20,528,305 |
| Total gains or losses included in change in net assets attributable to the change in unrealized gains or losses relating to financial instrument still held at fiscal year-end | \$ (28) | \$ 124,515 | \$ 201,100 | \$ 236,558 | \$ 178,528 | \$ 1,019,507 | \$ 416,525 | \$ 10,649 | \$ 2,187,354 |

Gains and losses included in change in net assets for the period above are reported as realized and unrealized gains (losses) on investments.

Cornell College

Notes to Financial Statements

Note 13. Fair Value Measurements (Continued)

The following table sets forth additional disclosure of the College's investments whose fair value is estimated using net asset value (NAV) per share (or its equivalent) as of June 30, 2012 and 2011:

| | Fair Value | | Unfunded Commitment | Redemption Frequency | Redemption Notice Period |
|----------------------------------|--------------|--------------|------------------------|-------------------------|-----------------------------|
| | 2012 | 2011 | | | |
| Fixed Income Mutual Funds: | | | | | |
| Total return funds (A) | \$ 5,260,685 | \$ 3,484,455 | \$ - | Daily | 10 days |
| Total return funds (B) | - | 1,603,362 | - | Daily | 1 day |
| Real estate investment trust (C) | 3,383,749 | 1,073,125 | - | Quarterly | 90 days |
| Natural resource funds (D) | 778,814 | 913,891 | 37,500 | N/A | N/A |
| Hedge funds: | | | | | |
| (E) | 3,230,893 | 2,945,662 | - | Quarterly | 90 days |
| (F) | 2,806,684 | 2,744,647 | - | Quarterly | 100 days |
| (G) | 500,000 | - | - | Monthly | 5 days |
| Private Equity: | | | | | |
| (H) | 1,536,907 | 1,156,951 | 566,000 | N/A | N/A |
| (I) | 1,092,963 | 1,108,185 | 349,034 | N/A | N/A |
| (J) | 1,019,544 | 1,016,136 | 180,000 | N/A | N/A |
| (K) | 763,517 | 808,945 | 120,000 | N/A | N/A |
| (L) | 297,862 | 375,539 | 257,044 | N/A | N/A |
| (M) | 404,853 | 354,804 | 108,750 | N/A | N/A |

- (A) This fund invests in a globally diversified portfolio of primarily debt or debt-like securities. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (B) The fund invests primarily in government and investment grade corporate bonds. It may invest more than 10% of the value of the Fund in another common trust fund or in stocks bonds or other obligations issued or guaranteed by one issuer. Financial futures may be used to provide liquidity for cash flows, to obtain exposure, to hedge or for other purposes that facilitate meeting the Fund's objective. Futures are capped to 5% notional value of the Fund. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (C) The fund invests in both publicly-owned real estate securities and privately owned real estate investments. Investors may request quarterly redemptions of 1% with written notice from the date of investment inception. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.

Note 13. Fair Value Measurements (Continued)

- (D) The fund invests in a select group of investment funds in the natural resource sector, with an emphasis on depleting resources. These funds are valued on a regular basis; however, these investments cannot be redeemed during the life of the partnership. Distributions will be received as the underlying funds of the investment are liquidated over time. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (E) The fund invests the majority of its assets in related commodity pools, all of which engage in various investing and trading activities including investing in other funds and the speculative trading of futures contracts, forward currency contracts, securities and other financial instruments. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (F) The Fund is a "feeder" fund in a "master-feeder" structure whereby the Fund invests substantially all of its assets in the Master Fund. The Master Fund pursues its investment objectives by allocating its capital among various portfolio managers (the "Portfolio Managers") through investments in collective investment vehicles (the "Investee Funds") and individually managed accounts. The Investee Funds may engage in the trading of equity and debt securities of U.S. and non U.S. corporations, U.S. government securities, non U.S. government securities, futures contracts, options, options on futures, other derivatives including swaps, forward contracts, currencies and physical commodities, partnership interests, money market instruments and derivatives on securities. The Master Fund may also make investments directly rather than, or in addition to investing in Investee Fund including without limitation, for purposes of hedging certain exposures. This fund has a 25% quarterly investor-level redemption restriction. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by the investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (G) The Fund is a "feeder" fund in a "master-feeder" structure whereby the Fund invests substantially all of its assets in the Master Fund. The Master Fund pursues its investment objectives by allocating its capital among various portfolio managers (the "Managers") through investments in pooled investment vehicles and individually managed accounts. Distributions are made to the members in cash pro rata in proportion to their capital accounts.
- (H) The limited partnership was created with the purpose of investing in the Master Fund which holds private equity and venture capital partnerships which invest in equity, equity-related, and debt securities. The limited partners have made commitments to classes of investments in the Partnership which include Developed Markets-Private Equity (the "PE Class"), Developed Markets-Venture Capital (the "VC Class"), and Emerging Markets-Private Equity and Venture Capital (the "EM Class"), (collectively, the "Classes" and, individually, a "Class"). These funds are valued on a regular basis; however, these investments cannot be redeemed during the life of the partnership. Distributions will be received as the underlying funds of the investment are liquidated over time. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator.

Note 13. Fair Value Measurements (Continued)

- (I) This limited partnership, was formed for the purpose of investing substantially all of its assets in the Offshore Holdings Partnership. The Offshore Holdings Partnership was formed for the purpose of investing in pooled investment vehicles purchased from the existing owners of such pooled vehicles and not from the issuers of such investments or transactions structured to share many of the characteristics and economics of such purchases (“Secondary Investments”). The Secondary Investments are generally held by Private Equity Opportunities (“PEO”). PEO may receive distributions-in-kind from the Secondary Investments representing securities of the Secondary Investments’ underlying portfolio companies (“Security Investments” and together with Secondary Investments, “Portfolio Investments”). PEO may make investments directly or indirectly related to the Secondary Investments, including underlying portfolio companies owned by Secondary Investments, swaps, options and forward currency contracts. The Offshore Holdings Partnership may also make investments in swaps, options, forward currency contracts, and other alternative transactions. The Offshore Holdings Partnership is permitted to invest both domestically and internationally across all sectors of the private equity market directly and through PEO. These funds are valued on a regular basis; however, these investments cannot be redeemed during the life of the partnership. Distributions will be received as the underlying funds of the investment are liquidated over time. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (J) The fund invests in following private equity industry sectors: Buyout, Venture Capital and Special Situations. These funds are valued on a regular basis; however, these investments cannot be redeemed during the life of the partnership. Distributions will be received as the underlying funds of the investment are liquidated over time. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (K) The fund invests in securities in secondary market transactions primarily in leveraged buyout, growth equity, mezzanine and venture capital investment funds. In addition, the fund may make primary investments in Investment Partnerships, direct investments in companies alongside Investment Partnerships, and Secondary Investments in companies. These funds are valued on a regular basis; however, these investments cannot be redeemed during the life of the partnership. Distributions will be received as the underlying funds of the investment are liquidated over time. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (L) This fund invests primarily in secondary transactions in privately offered direct investment funds and portfolio companies established by a select number of experienced and well established sponsors. These funds are valued on a regular basis; however, these investments cannot be redeemed during the life of the partnership. Distributions will be received as the underlying funds of the investment are liquidated over time. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.
- (M) The fund invests in a select group of private equity funds in the venture capital, buyout and capital restructuring sectors. These funds are valued on a regular basis; however, these investments cannot be redeemed during the life of the partnership. Distributions will be received as the underlying funds of the investment are liquidated over time. The fair values of the investments in this category have been estimated using the College's Partner capital balance as provided by each investment's fund administrator. The capital balance is based on their percentage ownership of the overall fund.