



UNIVERSITY OF THE PACIFIC

Financial Statements

June 30, 2008

(With Independent Auditors' Report Thereon)

October 1, 2008

On behalf of the University of the Pacific, I am pleased to present the audited financial statements of the University for the fiscal year ending June 30, 2008. Overall, these statements summarize the financial transactions and health of the University during a year in which it was presented with challenges of the investment market and student enrollment market. By the year's end, however, the University saw a strongly positive result in operations, the highly successful completion of its Campaign for Excellence, and the successful completion of two of the most significant facility construction projects in the University's history.

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The operations for the University ended the year strong with net tuition revenue up over \$9 million or 5.9%, government grants increased \$3.7 million or 10.5% and private grants, gifts and bequests increased nearly \$6 million or 29.4%. Overall, operations continued its recent positive trend providing an increase in net assets of more than \$16.3 million including a \$9.8 million increase in permanently endowed net assets. However, the increase in net assets from operations was offset by market declines in investments and other activity totaling \$25.6 million.

While the University's endowment saw a decline in value of approximately \$12 million over the prior year's ending balance, it is important to note that this decline was *after* the endowment contributions of more than \$8.5 million to support programs throughout the University and a \$9 million unrestricted gift was transferred from quasi-endowment in accordance with the Board approved financing plan for new facilities.

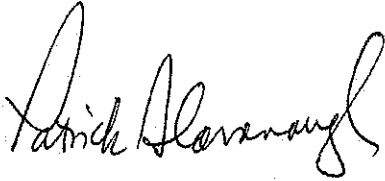
The University's Campaign for Excellence concluded in October of 2007 establishing a remarkable record of support for the University's programs and facilities. Beginning with what many believed to be a stretch goal of \$200 million, the University was, at the campaign's end, able to report to the Council of Advancement and Support of Education (CASE) a total in gifts and pledges of \$324 million, with \$151 million of deferred gifts to be recorded in the financial statements when they are realized. With the renewed energy from this remarkably successful campaign, the prospects for continued strong support in the future are most favorable.

During the year, two key facility projects that were part of the campaign projects were successfully concluded on the Stockton campus. While some of the reduction in investment assets is associated with the investment market, other invested assets were converted into plant in accordance with the financing plan approved by the Board. This is reflected in the large increase of over \$45 million in net fixed assets, as the buildings were completed.

October 1, 2008
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While the uncertainty in the investments markets during this year contributed to the challenges facing the University, we can be encouraged that despite these challenges we've continued to grow strong and prosper. This is possible because of the full participation and commitment of all members of the Pacific community. The continued generosity of our alumni, friends and supporters, the engagement of the University's leadership in critical decisions of resource allocation, and the wise and steady support of the Board of Regents have all been crucial to the successes Pacific enjoys now and will be crucial to the successes it enjoys in the future.

Very truly yours,

A handwritten signature in black ink, appearing to read "Patrick D. Cavanaugh". The signature is written in a cursive style with a large, prominent initial "P".

Patrick D. Cavanaugh

UNIVERSITY OF THE PACIFIC

June 30, 2008

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KPMG LLP
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Board of Regents
University of the Pacific:

We have audited the accompanying balance sheet of the University of the Pacific (the University) as of June 30, 2008, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University's 2007 financial statements and, in our report dated October 1, 2007, we expressed an unqualified opinion on those financial statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of the Pacific as of June 30, 2008, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 1, 2008

UNIVERSITY OF THE PACIFIC

Balance Sheet

June 30, 2008

(with comparative financial information
as of June 30, 2007)

(In thousands)

Assets	2008	2007
Cash and cash equivalents	\$ 12,671	10,534
Accounts receivable, net	26,126	21,704
Pledges receivable, net	13,093	19,634
Inventories, prepaid expenses, and other assets	8,058	6,696
Student loans receivable, net	33,901	32,155
Investments	313,884	368,459
Fixed assets, net	227,896	182,433
Total assets	\$ 635,629	641,615
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued liabilities	\$ 29,002	25,233
Asset retirement obligation	6,800	6,767
Advance deposits and deferred revenue	15,294	14,930
Self-insurance reserves	3,668	3,528
Early retirement reserves	2,191	2,191
Capital lease obligations	2,064	655
Notes and bonds payable	116,590	119,656
Trust and annuity obligations	9,728	9,522
Federal student loan funds	27,766	27,271
Total liabilities	213,103	209,753
Contingencies		
Net assets:		
Unrestricted	247,489	261,220
Temporarily restricted	33,957	39,378
Permanently restricted	141,080	131,264
Total net assets	422,526	431,862
Total liabilities and net assets	\$ 635,629	641,615

See accompanying notes to financial statements.

UNIVERSITY OF THE PACIFIC

Statement of Activities

Year ended June 30, 2008

(with summarized financial information
for the year ended June 30, 2007)

(In thousands)

	2008			Total	2007 Totals
	Unrestricted	Temporarily restricted	Permanently restricted		
Revenues, gains, and other support:					
Tuition and student fees	\$ 208,140	—	—	208,140	197,195
University-sponsored financial aid	(42,027)	—	—	(42,027)	(38,822)
Donor-sponsored financial aid	(2,735)	—	—	(2,735)	(4,106)
Net tuition and fees	163,378	—	—	163,378	154,267
Sales and services of auxiliary enterprises	26,128	—	—	26,128	26,327
Government grants and contracts	39,086	—	—	39,086	35,359
Private grants, gifts, and bequests	13,751	2,019	10,576	26,346	20,358
Investment return distributed	14,107	516	—	14,623	15,067
Dental clinic fees	12,483	—	—	12,483	11,446
Other	7,167	52	5	7,224	8,607
Actuarial gain (loss) on annuity and trust obligations	—	(1,576)	(1,269)	(2,845)	3,314
Net assets released from restrictions	2,488	(2,992)	504	—	—
Total revenues, gains, and other support	278,588	(1,981)	9,816	286,423	274,745
Expenses:					
Instructional and departmental research	113,114	—	—	113,114	105,578
Auxiliary enterprises	25,805	—	—	25,805	25,439
Sponsored programs	35,805	—	—	35,805	30,710
Academic support	20,761	—	—	20,761	18,621
Student services	16,246	—	—	16,246	15,075
Student aid	2,342	—	—	2,342	2,276
General administration	11,741	—	—	11,741	10,618
Fund-raising activities	8,747	—	—	8,747	8,538
Operations and maintenance at plant	17,085	—	—	17,085	15,566
Depreciation and amortization	12,468	—	—	12,468	11,923
Interest	5,997	—	—	5,997	6,009
Total expenses	270,111	—	—	270,111	250,353
Increase in net assets from operations	8,477	(1,981)	9,816	16,312	24,392
Other changes:					
Investment return net of distributions	(22,208)	—	—	(22,208)	22,415
Adjustments to pledges receivable	—	(3,440)	—	(3,440)	—
Change in net assets	(13,731)	(5,421)	9,816	(9,336)	46,807
Net assets, beginning of year	261,220	39,378	131,264	431,862	385,055
Net assets, end of year	\$ 247,489	33,957	141,080	422,526	431,862

See accompanying notes to financial statements.

UNIVERSITY OF THE PACIFIC

Statement of Cash Flows

Year ended June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

(In thousands)

	2008	2007
Cash flows from operating activities:		
Change in net assets	\$ (9,336)	46,807
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	12,468	11,923
Noncash contributions	(1,644)	(2,618)
Net realized and unrealized (gains) losses on investments	18,499	(25,810)
Contributions restricted for purchasing capital assets	(1,011)	(3,937)
Contributions restricted for long-term investment	(11,573)	(4,654)
Actuarial (gain) loss on annuity and trust obligations	2,845	(3,314)
Other noncash items	95	(29)
Changes in assets and liabilities:		
Accounts receivable	(4,422)	(2,876)
Pledges receivable	6,541	697
Inventories, prepaid expenses, and other assets	(1,362)	(63)
Accounts payable and accrued liabilities	3,769	4,108
Asset retirement obligation	33	262
Advance deposits and deferred revenue	364	409
Self-insurance reserves	140	(888)
Federal student loan funds	495	517
Net cash provided by operating activities	15,901	20,534
Cash flows from investing activities:		
Proceeds from sale of investments	479,516	235,222
Purchase of investments	(441,796)	(255,865)
Purchase of fixed assets	(56,117)	(14,920)
Proceeds from student loan collections	4,667	5,263
Student loans issued	(6,413)	(7,657)
Net cash used in investing activities	(20,143)	(37,957)
Cash flows from financing activities:		
Contributions restricted for purchasing capital assets	1,011	3,937
Contributions restricted for long-term investment	11,573	4,654
Trust and annuity obligations	(2,639)	1,170
Proceeds from issuance of bonds	—	4,250
Payment on notes payable, bonds payable, and capital leases	(3,566)	(2,933)
Net cash provided by financing activities	6,379	11,078
Net decrease in cash and cash equivalents	2,137	(6,345)
Cash and cash equivalents, beginning of year	10,534	16,879
Cash and cash equivalents, end of year	\$ 12,671	10,534
Supplemental disclosure of cash flow information:		
Interest paid	\$ 6,018	5,641
Supplemental disclosure of noncash investing and financing activities:		
Equipment acquired under capital leases	\$ 1,946	416

See accompanying notes to financial statements.

UNIVERSITY OF THE PACIFIC

Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

(1) Organization and Summary of Significant Accounting Policies

(a) *Nature of Operations*

The University of the Pacific (University) was founded in 1851 and offers undergraduate and graduate programs of higher education through three campuses located in Northern California. Funding sources generally include tuition and fees charged to students, income of auxiliary enterprises, grants, contracts, gifts, and bequests.

(b) *Basis of Presentation*

The financial statements of the University have been prepared on the accrual basis of accounting.

The University classifies net assets and revenues, gains and losses into three categories, based on the existence or absence of donor-imposed restrictions. The categories are permanently restricted, temporarily restricted, and unrestricted net assets.

- Permanently restricted net assets (endowments) are comprised of the historical dollar amount of gifts, including pledges, trusts, and remainder interests, which are required by donors to be permanently retained. Pledges, trusts, and remainder interests designated for permanently restricted purposes are reported at their estimated present values. Endowments are reported at the original amount of the gift plus the portion, if any, of earnings explicitly stipulated by the donor to be added to corpus.
- Temporarily restricted net assets include gifts, pledges, trusts, remainder interests, and income and gains on restricted contributions which can be expended but for which restrictions have not yet been met. Such restrictions include purpose restrictions where donors have specified the purpose for which the net assets are to be spent, or time restrictions imposed by donors or implied by the nature of the gift (capital projects, pledges to be paid in the future, life income funds, etc.)
- Unrestricted net assets are all the remaining net assets of the University. Unrestricted net assets are, in part, designated for specific purposes by action of the board of regents and may otherwise be limited by contractual agreements with outside parties.

In accordance with the American Institute of Certified Public Accountants Audit and Accounting Guide, (i) tuition and fees are reflected net of financial aid provided in the form of institutional scholarships; (ii) expenses include vested benefits of employees for future compensated absences; and (iii) funds administered as an intermediary for others, including student loan funds provided by federal agencies, are accounted for as liabilities rather than as net assets of the University.

(c) *Net Assets Released from Restrictions*

Net assets released from restrictions as reported in current operations are comprised of expenditures, funded by gifts and endowment earnings, for scholarships, capital improvements and other purposes designated by the donors. Plant related items, funded by gifts, include expenditures for University building and remodeling projects.

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Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

(d) Cash and Cash Equivalents

Cash and cash equivalents include all cash balances and highly liquid investments with a maturity of three months or less other than cash equivalents included in the University's investment pool which are accounted for as investments.

The University maintains its operating cash accounts in several commercial banks in amounts that are generally in excess of insured levels. The accounts at the banks are guaranteed by the Federal Deposit Insurance Corporation up to \$100,000 for each financial institution. The University has not experienced losses on these deposits to date.

(e) Inventory

Inventories are valued at the lower of average cost or market.

(f) Investments

The University's investments are recorded at fair value. The fair value of publicly traded equity and fixed income securities is based on quoted market prices. The fair value of direct real estate investments is determined from periodic valuation prepared by independent appraisers. Hedge funds and private equity investments held through limited partnerships or commingled trusts consist primarily of investments that are not readily marketable. Investments in these categories, which are managed externally, are estimated by management based upon the most current information provided by the general partner. Net appreciation (depreciation) in investments, including realized gains or losses and unrealized appreciation or (depreciation) on those investments, as well as all dividends, interest, and other investment income, is shown in the statement of activities.

These investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect total net assets and the amounts reported in the balance sheet.

Gains and investment income that are limited to specific uses by donor-imposed restrictions are reported as increases in unrestricted net assets if the restrictions are met in the same reporting period that the gains and income are recognized. Losses on investments related to gifts that the donor required to be invested in perpetuity (i.e., endowment funds) are classified as decreases in unrestricted net assets; subsequent gains that restore the fair value of the assets of the endowment funds to the required level are classified as increases in unrestricted net assets.

(g) Endowment Investment Return Spending Policy

The University invests certain assets on a pooled basis under a methodology wherein the investment returns of the pool are allocated proportionately among the individual funds and activities participating in the pool. Board policy allows the board of regents to appropriate portions of the net appreciation resulting from investment of endowment corpus and from investment of amounts set aside by the board of regents as quasi-endowment investments as is prudent considering the

UNIVERSITY OF THE PACIFIC

Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

University's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends and general economic conditions. Under the University's endowment pool spending policy, a percentage of the average fair value at the end of the previous three years of endowment and quasi-endowment investments is appropriated to support current operations. The spending rate was 4.50% and 4.75% for the years ended June 30, 2008 and 2007, respectively.

(h) Fixed Assets

Fixed assets are recorded at cost, if purchased or at fair market value at the date of gift, if acquired by donation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 40 years.

Repairs and maintenance are expensed as incurred. Assets with a cost of over \$5,000 are capitalized. The cost and accumulated depreciation of assets retired or sold are removed from the accounts and a gain or loss is recognized in the year of disposal.

(i) Contributions

Unconditional contributions received, including unconditional promises or pledges, are recognized as revenue when the donors' unconditional commitment is received. Conditional promises and gifts are recorded as revenue when the donor's conditions are substantially met. Pledges in excess of \$5,000 are recorded at the estimated present value of the future cash flows, net of an allowance for nonfulfillment. Promises made that are designated for future periods or are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support, depending on the nature of the restriction. Donor-restricted gifts, including investment return on endowments, which are received and either spent or deemed spent within the same year are reported as unrestricted revenues. Gifts specified for the acquisition or construction of long-lived assets are reported as temporarily restricted net assets until the related expense has been incurred, at which time the restrictions are released and the net asset amount is reclassified to the unrestricted category.

(j) Split Interest Trusts

Split interest trusts are established by gifts that require payments to be made to the donor or the donor's designee(s) from assets of the trust and which name the University as a beneficiary of all or a portion of the assets remaining at the termination of the trust. Split interest trusts for which the University is the trustee are recorded as contribution income at the fair value of the assets received less a liability, computed using actuarial methods, for the present value of the estimated payouts under the agreement. An annual adjustment is made for the actuarial gain or loss on annuity obligations representing differences between assumed and actual experience as to earnings, payouts and life expectancies used in the computation of the liability for distributions. If the use of the assets remaining at the termination of the trust is restricted by the donor, the net amount of the split interest trusts are included in temporarily or permanently restricted net assets, depending on the terms of the donor's restriction.

UNIVERSITY OF THE PACIFIC

Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

(k) *Assets Held by Other Trustees*

Funds held in trust by others represent assets irrevocably held and administered by trustees other than the University with the University named as a beneficiary to derive income or a residual interest from the assets of such funds after the passage of time or occurrence of specified events. When the University is notified that funds have been put in a trust held by others with the University designated as beneficiary, contribution income is recognized as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction imposed by the donor, at the estimated present value of the future cash flows to be received by the University.

(l) *Self-Insurance Reserves*

The University is self-insured for workers' compensation, unemployment, dental and disability benefits. Annual provisions to adjust the reserve for unpaid claims are recorded as an expense of unrestricted net assets. The reserve for unpaid claims related to workers' compensation is estimated using actuarial methods. It is possible that the amounts paid in connection with self-insured risks will vary from the amount recorded as self-insurance reserves as of June 30, 2008.

(m) *Asset Retirement Obligations*

In accordance with Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143*, the University has recorded an estimated liability for the fair value of its conditional asset retirement obligations resulting from statutory and/or regulatory requirements to apply special handling and disposal to asbestos upon retirement of certain buildings. The estimated liability is determined annually on June 30 to reflect remediation efforts and updated costs for abatement.

(n) *Undistributed Estates*

Bequests are recorded as contribution income when the court orders distribution.

(o) *Expenses*

Expenses are reported as decreases in unrestricted net assets.

(p) *Measure of Operations*

The change in net assets from operations reported in the statement of activities represents the excess of revenues, gains and support over expenses and losses exclusive of the portion of investment return designated by the University's Board of Regents for future years' operations and exclusive of revenues or expenses related to unusual or nonrecurring items. As to investment return, the board of regents designates only a portion of the University's cumulative investment return for support of current operations; the remainder is retained to function as funds functioning as endowments (i.e., quasi-endowment funds) in support of operations in future years and to offset potential market declines. Investment return, net of distributions, consisting of the excess of investment return on endowment and quasi-endowment funds over the spending rate, is reported in other changes in net

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Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

assets. All other realized and unrealized investment returns are reported as a component of the change in net assets from operations.

(q) *Income Taxes*

The University is tax exempt under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the Revenue and Taxation Code of the State of California and, generally, is not subject to state or federal taxes on income. However, the University remains subject to income taxes on any net income that is derived from a trade or business, regularly carried on and not in furtherance of the purpose for which it was granted exemption. No income tax provision has been recorded as net income, if any, from any unrelated trade or business and, in the opinion of management, is not material to the financial statements taken as a whole.

In July 2006, the Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109 (the Interpretation)*. The Interpretation establishes a minimum threshold for financial statement recognition of the benefit of positions taken in filing tax returns (including whether an entity is taxable in a particular jurisdiction), and requires certain expanded tax disclosures. This standard was implemented in the current year.

(r) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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.

(s) *Comparative Totals*

The statement of activities includes certain prior-year summarized information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2007 from which the summarized information was derived.

UNIVERSITY OF THE PACIFIC

Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

(2) Receivables

(a) *Accounts Receivable*

Accounts receivable as of June 30, 2008 and 2007 are without collateral and consist of (in thousands):

	2008	2007
Student accounts	\$ 2,591	2,025
Clinic	3,565	3,526
Government contracts and other	21,398	17,656
Total	27,554	23,207
Less allowance for doubtful accounts	(1,428)	(1,503)
Accounts receivable, net	\$ 26,126	21,704

(b) *Student Loans Receivable*

Student loans receivable as of June 30, 2008 and 2007 are without collateral and consist of (in thousands):

	2008	2007
Federal government programs	\$ 32,571	31,278
Institutional programs	1,930	1,677
	34,501	32,955
Less allowance for doubtful loans	(600)	(800)
Student loans receivable, net	\$ 33,901	32,155

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Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

(c) Pledges Receivable

Pledges receivable as of June 30, 2008 and 2007 are without collateral and consist of (in thousands):

	2008	2007
Pledges to be collected:		
In one year or less	\$ 6,762	9,771
Between one year and five years	7,972	12,821
In more than five years	818	1,025
Total pledges	15,552	23,617
Less allowance for nonfulfillment	(1,384)	(2,037)
Less discount to present value at 2.27% to 6.05%	(1,075)	(1,946)
Pledges receivable, net	\$ 13,093	19,634

Pledges receivable as of June 30, 2008 and 2007 will, when collected, have the following restrictions (in thousands):

	2008	2007
Endowment with earnings expendable for departmental programs and activities	\$ 4,377	6,425
Endowments with earnings expendable for scholarships	1,573	794
Building construction	4,069	7,325
Departmental programs and activities	3,074	5,090
	\$ 13,093	19,634

(3) Investments

Investments as of June 30, 2008 and 2007 consist of (in thousands):

	2008	2007
Cash and cash equivalents	\$ 92,831	76,011
Long-term government and corporate bonds	53,141	104,685
Corporate stocks and mutual funds	91,991	127,626
Hedge funds and private equity	39,932	24,424
International stocks and mutual funds	34,067	33,680
Assets held by other trustees	1,652	1,764
Real and personal properties	269	269
Total	\$ 313,883	368,459

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Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

Investments include \$17,050,920 and \$22,985,000 held under split-interest trust agreements as of June 30, 2008 and 2007, respectively. Bond proceeds included in investments and restricted for construction were \$1,834,000 and \$21,948,000 as of June 30, 2008 and 2007, respectively.

Hedge funds and private equity investments include hedge funds of \$31,007,000 and private equity investments of \$8,905,000. The University is obliged under certain investment contracts to periodically advance additional funding up to contractual levels. At June 30, 2008, the commitment to make such additional investments approximated \$14,532,000.

The following summarizes the investment return during the year ended June 30, 2008 and its classification in the statement of activities (in thousands):

	<u>Total</u>	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>
Dividends and interest	\$ 10,914	10,449	465	—
Realized and unrealized gain on investments	<u>(18,499)</u>	<u>(18,550)</u>	<u>51</u>	<u>—</u>
Total investment return, net	<u>\$ (7,585)</u>	<u>(8,101)</u>	<u>516</u>	<u>—</u>
Investment return distributed	\$ 14,623	14,107	516	—
Investment return, net of distributions	<u>(22,208)</u>	<u>(22,208)</u>	<u>—</u>	<u>—</u>
Total investment return, net	<u>\$ (7,585)</u>	<u>(8,101)</u>	<u>516</u>	<u>—</u>

UNIVERSITY OF THE PACIFIC

Notes to Financial Statements

June 30, 2008

(with comparative financial information
for the year ended June 30, 2007)

The following summarizes the investment return during the year ended June 30, 2007 and its classification in the statement of activities (in thousands):

	<u>Total</u>	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>
Dividends and interest	\$ 11,672	10,624	1,048	—
Realized and unrealized gain on investments	<u>25,810</u>	<u>25,742</u>	<u>68</u>	<u>—</u>
Total investment return, net	<u>\$ 37,482</u>	<u>36,366</u>	<u>1,116</u>	<u>—</u>
Investment return distributed	\$ 15,067	13,951	1,116	—
Investment return, net of distributions	<u>22,415</u>	<u>22,415</u>	<u>—</u>	<u>—</u>
Total investment return, net	<u>\$ 37,482</u>	<u>36,366</u>	<u>1,116</u>	<u>—</u>

Pooled Funds

Endowment and similar funds assets are generally pooled on a unit-fair-value basis. Funds are added to the pool at the unit fair value at the beginning of the three-month period after which the transaction takes place. Funds withdrawn are valued at the unit-fair value at the end of the most recent three-month period. Pooled funds as of June 30, 2008 and 2007 consisted of:

	<u>2008</u>	<u>2007</u>
Investments in pooled funds, at fair value	\$ 200,950,986	210,813,000
Total number of units	92,854	88,388
Fair value per unit	\$ 2,164	2,385

Professional fees for management of the pooled investments are recorded against investment returns and amounted to approximately \$808,713 and \$1,062,000 for the years ended June 30, 2008 and 2007, respectively.

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(4) Fixed Assets

Fixed assets as of June 30, 2008 and 2007 consist of (in thousands):

	2008	2007
Land	\$ 6,247	6,247
Buildings	239,233	233,137
Equipment	52,368	48,013
Library books and collections	30,755	29,028
Construction in progress	60,292	16,070
Improvements other than buildings	2,723	1,192
	391,618	333,687
Less accumulated depreciation	(163,722)	(151,254)
	\$ 227,896	182,433

(5) Long-Term Debt

Long term debt as of June 30, 2008 and 2007 consist of (in thousands):

	2008	2007
Bonds payable:		
California Educational Facilities Authority (CEFA)		
Project Revenue Bonds:		
Series 1997A, 4.350-5.450%, due in 2013	\$ 2,380	3,270
Series 1998, 3.650-5.000%, due 2018 to 2023	10,330	10,755
Series 2000, 5.750-5.875%, due 2020 to 2030	12,710	12,710
Series 2004, 3.500-5.250%, due 2005 to 2034	9,830	10,445
Series 2006, 4.750-5.000%, due 2007 to 2036	76,205	76,515
	111,455	113,695
Unamortized premium on bonds	1,296	1,333
Total bonds payable	112,751	115,028
Notes payable:		
California Educational Facilities Authority (CEFA)		
Master Lease with Option to Purchase Agreements:		
Series 2003, 2.87%, due in 2009	128	378
Series 2007, 3.95%, due in 2014	3,711	4,250
	3,839	4,628
	\$ 116,590	119,656

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Scheduled maturities of long-term debt are (in thousands):

	Bonds	Notes	Total
Year ending June 30:			
2009	\$ 2,350	688	3,038
2010	2,470	582	3,052
2011	2,610	605	3,215
2012	2,190	629	2,819
2013	2,310	654	2,964
Thereafter	99,525	681	100,206
	\$ 111,455	3,839	115,294
Plus net unamortized premium			1,296
			\$ 116,590

California Educational Facilities Authority (CEFA) Project Revenue Bonds

In June 2006, the University issued CEFA Revenue Bonds, Series 2006 in the amount of \$77,180,000. Such bonds are payable in varying annual installments through 2036 with interest paid semiannually at rates ranging from 4.75% – 5.00%. After original issue premium and costs of issuance, net proceeds of \$29,470,335 were deposited into an irrevocable trust for the purpose of funding payments of principal and interest on the University’s Series 2000 Bonds; \$24,059,525 were deposited into an irrevocable trust for the purpose of funding payments of principal and interest on the University’s Series 2002 Bonds and \$24,000,000 to be utilized for various construction projects.

In August 2004, the University issued CEFA Revenue Bonds, Series 2004 amounting to \$11,500,000. Such bonds are payable in varying annual installments through 2034 with interest paid semiannually at rates ranging from 3.500% – 5.250%. After original issue premium, underwriters discount, and other costs of issuance, net proceeds of \$11,470,000 to be utilized for facility and equipment upgrades and renovations.

In June 2000, the University issued CEFA Revenue Bonds, Series 2000 amounting to \$41,000,000. Such bonds are payable in varying annual installments through 2030 with interest paid semiannually at rates ranging from 5.750% – 5.875%. Net proceeds of \$14,723,000 were placed in an irrevocable trust for the sole purpose of funding payments of principal and interest on the Series 1993 B Bonds.

In June 1998, the University issued CEFA Revenue Bonds, Series 1998 amounting to \$12,500,000. Such bonds are payable in varying annual installments through 2023 with interest paid semiannually at rates ranging from 3.65% to 5.00%. The net proceeds, after deducting issuance costs, amounted to approximately \$11,926,000.

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In April 1997, the University participated in the issuance of CEFA Revenue Bonds, 1997 Series A and B. The University's portion of the bonds amounted to \$9,570,000 of Series A bonds. Upon issuance of the CEFA 1997 Series A bonds, the net proceeds were used to purchase U.S. government securities, which securities were placed into an irrevocable trust for the sole purpose of funding payments of principal and interest on the University's CEFA Series 1986 and 1987 bonds.

The University must maintain a ratio of unrestricted and temporarily restricted assets (as defined in the loan agreements) to debt outstanding (as defined in the loan agreements) of at least 2:0 under the Series 1997A and 1998 bonds. The applicable agreements place certain other restrictions on the University, including cash reserve requirements for sinking funds.

The University has pledged as collateral a portion of its gross revenues equal to the annual payments on its CEFA bonds as they become due. Obligations under the 1997 Series A (Series B and A) loan agreements are several with other Series B and A borrowers, and no Series B and A borrower will be responsible for the default of another Series B and A borrower except to the extent of amounts in a borrowers Bond Reserve Fund (approximately \$476,000 for the University as of June 30, 2008). The University is not aware of any default by any Series B or A borrower.

California Educational Facilities Authority (CEFA) Master Lease with Option to Purchase Agreements

In June 2007, the University completed equipment acquisition financing through CEFA. The amount of this commitment, secured by the equipment, is payable in semi-annual installments through 2014 at an interest rate of 3.94% per annum. Under the terms of the financing agreement, the University may borrow up to \$4,250,000 to finance the purchase of capital equipment.

In September 2003, the University completed equipment acquisition financing through CEFA. The amount of this commitment, secured by the equipment, is payable in semi-annual installments through 2009 at an interest rate of 2.87% per annum. Proceeds of \$1,200,000 were used to finance the purchase of capital equipment.

(6) Retirement Benefits

Defined contribution retirement benefits are provided for University employees principally through the Teachers Insurance and Annuity Association (TIAA-CREF), a national organization used to fund retirement benefits for educational institutions. Under this arrangement, the University and plan participants make monthly contributions to TIAA-CREF to fund retirement benefits, which are immediately vested with the employee. The University's share of the cost of these benefits for the years ended June 30, 2008 and 2007 was approximately \$9,732,000 and \$8,765,000, respectively.

(7) Contingencies

The University is involved in various items of litigation, most of which involve employment matters. Management believes each of these matters has meritorious defenses and intends to defend these cases vigorously and believes the ultimate liability, if any, will not be material to the financial position of the University.

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The University receives funding or reimbursement from governmental agencies for various activities which are subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to government review and interpretation, as well as regulatory actions. Recently, government activity has increased with respect to investigations and allegations concerning possible violations by university healthcare providers of regulations which could result in the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The University is subject to such regulatory reviews and, while these reviews may result in repayments and/or civil remedies, management believes based on its current knowledge and information, that such repayments and/or civil remedies would not have a material effect on the University's financial position,

(8) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

(a) Cash and Cash Equivalents

The carrying amount approximates fair value, based on the short maturity of those instruments.

(b) Loans Receivable

The fair value of student loans receivable approximates their carrying value, based on current comparable loan rates.

(c) Investments

The fair value of investments is estimated based on quoted market prices for those investments that are invested in actively traded securities. For other investments for which there are no quoted market prices, an estimate of the amount that could be realized in a sale is made by management. As of June 30, 2008, management believes the fair value of all investments for which there are no quoted market prices approximates the carrying value.

(d) Long-Term Debt

The fair value of the University's long-term debt is estimated based on the current rates available to the University for debt of the same remaining maturities. As of June 30, 2008, the fair value of the University's notes and bonds approximates \$117,000,000.

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(9) Leases

The University is obligated under various capital leases for equipment that expire at various dates during the next five years. As of June 30, 2008 and 2007, the gross amount of equipment recorded under capital leases was as follows (in thousands):

	2008	2007
Equipment	\$ 4,421	2,475
Less accumulated amortization	(2,485)	(1,716)
	\$ 1,936	759

Future minimum capital lease payments as of June 30, 2008 are as follows (in thousands):

	Capital leases
Fiscal year ending June 30:	
2009	\$ 1,061
2010	772
2011	348
2012	86
Total minimum lease payments	2,267
Less amounts representing interest	(203)
Present value of net minimum capital lease payments	\$ 2,064

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(10) Composition of Net Assets

The composition of the categories of net asset as of June 30, 2008 and 2007 consists of (in thousands):

	2008	2007
Unrestricted net assets:		
Undesignated net assets	\$ 6,359	11,857
Designated for specific purposes	64,327	94,128
Quasi-endowment and accumulated gains on permanent endowments whose income is unrestricted	67,561	88,717
Investment in fixed assets, net of long-term debt	109,242	66,518
	247,489	261,220
Temporarily restricted net assets:		
Amounts restricted by donors for programs	12,737	13,818
Amounts restricted by donors for investment in plant	14,077	13,145
Pledges receivable for programs	3,074	5,090
Pledges receivable for investment in plant	4,069	7,325
	33,957	39,378
Permanently restricted net assets:		
Permanent endowment and similar funds	135,130	124,045
Pledges receivable for permanent endowment	5,950	7,219
	141,080	131,264
	\$ 422,526	431,862

(11) Expenses by Function

Expenses by functional classification after allocating operations and maintenance of plant, depreciation expense, and interest expense are as follows for the years ended June 30, 2008 and 2007 (in thousands):

	2008	2007
Instruction and departmental research	\$ 132,594	124,277
Auxiliary enterprises	25,805	25,439
Sponsored programs	41,972	36,149
Academic support	24,336	21,919
Student services	19,045	17,745
Student aid	2,342	2,276
General administration	13,764	12,498
Fundraising activities	10,253	10,050
	\$ 270,111	250,353

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(12) Related Party Transactions

Included in revenues for the years ended June 30, 2008 and 2007, are contributions from board of regents members totaling \$4,949,000 and \$1,207,000, respectively.

Included in pledges receivable for the years ended June 30, 2008 and 2007, are pledges from members of the board of regents totaling approximately \$3,097,000 and \$4,085,000, respectively, net of time value discount.

A member of the University's Board of Regents is also an officer of a bank that provides the University general banking services. Additionally, the trust department of the bank is an investment custodian of invested assets of approximately \$246,500,000 and \$250,000,000, respectively. The invested assets include assets of the University and of trusts for which the University serves as trustee.

(13) Subsequent Event

Since year-end, major U.S. stock indices, including the Dow Jones, the S&P 500, and the Nasdaq, have declined significantly. Management is monitoring market conditions and related unrealized losses on investments. Due to the volatility of the U.S. economy and the financial markets as of the date of this report, there is uncertainty regarding the long-term impact of market conditions on the University's investment portfolio.