

# WILLIAM MARSH RICE UNIVERSITY



2 0 0 2   F I N A N C I A L   R E P O R T

**William Marsh Rice**  
**University**  
**Consolidated Financial Statements**  
**June 30, 2002**

## **Report of Independent Accountants**

To the Board of Trustees of  
William Marsh Rice University:

In our opinion, the accompanying consolidated statement of financial position and the related consolidated statements of activities and cash flows present fairly, in all material respects, the financial position of William Marsh Rice University (the University) at June 30, 2002, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. 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. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 13, the University has revised the classifications of its net assets as of June 30, 2001 from amounts previously reported to reflect the restrictions originally imposed by the donors on certain gifts. Other independent accountants who have ceased operations previously reported on the University's financial statements for the year ended June 30, 2001, prior to the revision.

PricewaterhouseCoopers LLP

October 18, 2002

**William Marsh Rice University**  
**Consolidated Statement of Financial Position**  
**June 30, 2002**

---

*(dollars in thousands)*

Assets:

Cash and cash equivalents	\$ 1,708
Accounts receivable and other assets	50,494
Pledges receivable, net	74,952
Investments	3,002,989
Property and equipment, net	<u>539,643</u>

Total assets \$ 3,669,786

Liabilities:

Accounts payable and accrued liabilities	\$ 54,847
Liabilities due under life-income agreements	86,797
Refundable advances and amounts held in trust for others	6,452
Notes and bonds payable	<u>189,200</u>

Total liabilities 337,296

Net assets:

Unrestricted net assets	2,533,330
Temporarily restricted net assets	202,704
Permanently restricted net assets	<u>596,456</u>

Total net assets 3,332,490

Total liabilities and net assets \$ 3,669,786

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

**William Marsh Rice University**  
**Consolidated Statement of Activities**  
**Year Ended June 30, 2002**

(dollars in thousands)

	<b>2002</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	
Operating revenues:				
Investment returns distributed for operations	\$ 137,440	\$ 7,697		\$ 145,137
Student tuition and fees, net	50,070			50,070
Grants and contracts	52,615	1,882		54,497
Gifts and pledges	15,089	5,100		20,189
Gifts and trusts released from restrictions	10,641	(10,641)		-
Auxiliary enterprises	22,792			22,792
Other revenues	7,146			7,146
	<u>295,793</u>	<u>4,038</u>	<u>-</u>	<u>299,831</u>
Operating expenses:				
Educational and general activities	249,119			249,119
Auxiliary enterprises expenditures	38,670			38,670
	<u>287,789</u>	<u>-</u>	<u>-</u>	<u>287,789</u>
Net operating income	<u>8,004</u>	<u>4,038</u>	<u>-</u>	<u>12,042</u>
Nonoperating changes:				
Gifts and pledges for property and endowment		12,700	\$ 20,552	33,252
Investment returns, reduced by operating distribution above	(293,122)	(23,463)	(1,324)	(317,909)
Net assets released from restrictions	5,958	(5,162)	(796)	-
Change in liabilities due under life-income agreements		1,100	2,377	3,477
Other nonoperating changes	(2,556)			(2,556)
	<u>(289,720)</u>	<u>(14,825)</u>	<u>20,809</u>	<u>(283,736)</u>
Net increase (decrease) in net assets	(281,716)	(10,787)	20,809	(271,694)
Net assets, beginning of year, as adjusted (Note 13)	<u>2,815,046</u>	<u>213,491</u>	<u>575,647</u>	<u>3,604,184</u>
Net assets, end of year	<u>\$ 2,533,330</u>	<u>\$ 202,704</u>	<u>\$ 596,456</u>	<u>\$ 3,332,490</u>

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

**William Marsh Rice University**  
**Consolidated Statement of Cash Flows**  
**Year Ended June 30, 2002**

---

*(dollars in thousands)*

Cash flows from operating activities:	
Decrease in net assets	\$ (271,694)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:	
Depreciation	27,360
Loss on disposal of property and equipment	3,457
Net realized and unrealized investment losses	222,036
Equipment gifts in-kind	(5,071)
Contributions restricted for long-term purposes	(28,181)
Actuarial increase in life-income agreements	(3,477)
Changes in:	
Accounts receivable and other assets	617
Pledges receivable for current purposes	(421)
Accounts payable and accrued liabilities	<u>(1,747)</u>
Net cash used in operating activities	<u>(57,121)</u>
Cash flows from investing activities:	
Proceeds from sales of investments	1,268,187
Purchases of investments	(1,141,460)
Purchases of property and equipment	<u>(116,495)</u>
Net cash provided by investing activities	<u>10,232</u>
Cash flows from financing activities:	
Contributions restricted for long-term purposes:	
Endowment	14,964
Trusts and other	564
Property	2,101
Proceeds from commercial paper issuance	25,000
Net change in amounts held for others	<u>(458)</u>
Net cash provided by financing activities	<u>42,171</u>
Net decrease in cash and cash equivalents	(4,718)
Cash and cash equivalents:	
Beginning of year	<u>6,426</u>
End of year	<u>\$ 1,708</u>

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

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

**1. Basis of Presentation and Summary of Significant Accounting Policies**

**Basis of Presentation**

William Marsh Rice University (the University) is a Texas not-for-profit corporation that operates a private research university in Houston, Texas. The University is exempt from federal income tax to the extent provided under Section 501(c)(3) of the Internal Revenue Code. The consolidated financial statements of the University as of June 30, 2002, and for the year then ended, have been prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, the accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of the University and all wholly-owned subsidiaries. All material transactions between the University and its subsidiaries have been eliminated.

**Net Asset Categories**

Standards for external financial reporting by not-for-profit organizations require that resources be classified for reporting purposes into three net asset categories according to donor-imposed restrictions. A description of the University's three net asset categories follows:

- a. Unrestricted net assets and related activity include the following:
  - (1) All revenues traditionally classified as unrestricted resources of the University, including tuition and fees, unrestricted gifts and income on unrestricted endowments, recovery of facility and administrative costs from grants and contracts, and auxiliary enterprise revenues.
  - (2) Revenues related to sponsored research agreements, which are considered exchange transactions.
  - (3) Gifts and endowment income with donor-imposed restrictions if the restriction is anticipated to be met within the current fiscal year of the University.
  - (4) Investments in plant assets stated at cost or fair value at the date of gift, less accumulated depreciation, computed on a straight-line basis over the estimated useful lives of the assets. Equipment is removed from the records at the time of disposal.
  - (5) All expenses of the University.
- b. Temporarily restricted net assets include income from restricted endowments and gifts for which donor-imposed restrictions have not been met. The category also includes pledges receivable and life-income gifts for which the ultimate purpose of the proceeds is not permanently restricted.
- c. Permanently restricted net assets include gifts, trusts and pledges on which donors have imposed the restriction that the corpus be maintained in perpetuity and only the investment return be made available for program operations. Those gifts specified by donors to provide loans to students are also included in permanently restricted net assets.

Expirations of temporary restrictions on net assets or subsequent donor release of restrictions are reported as reclassifications between the applicable classes of net assets.

**Contributions**

Contributions, including unconditional promises to give and irrevocable trusts held by others under which the University is the beneficiary, are recognized as revenues in the period received or promised. Contributions restricted for the acquisition of land, buildings and equipment are

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

reported as temporarily restricted revenues. These contributions are reclassified to unrestricted net assets when the assets are placed in service. Promises to give that are subject to donor-imposed stipulations that the corpus be maintained in perpetuity are recognized as increases in permanently restricted net assets.

Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are reported at their estimated fair value at the date of gift. Contributions scheduled to be received after one year are discounted at a rate commensurate with the risk. Amortization of the discount is recorded as contribution revenue.

**Operating and Nonoperating Activities**

The consolidated statement of activities reports the change in net assets from the University's operating and nonoperating activities. Operating activities exclude (a) gifts and pledges for property and endowment (including annuity and life-income trusts), (b) release from restrictions of contributions restricted for the acquisition of property and equipment, (c) endowment return net of the University's operating needs as defined by University spending policy (see Note 4) and (d) actuarial adjustments on annuities payable.

**Cash and Cash Equivalents**

The University considers all highly liquid financial instruments with an original maturity of 90 days or less to be cash and cash equivalents, except those amounts assigned to its investment managers and unspent commercial paper proceeds, which are classified as investments.

**Investments**

Investments are made within guidelines authorized by the University's Board of Trustees. Investments are initially recorded at cost at date of acquisition or fair market value at date of donation in the case of gifts. Investments in marketable securities and private equities are stated at market value. All other investments are stated at cost or amortized cost. Ownership of investments is recognized as of the trade date. Transactions that have not settled are recognized as accounts receivable or accounts payable until the settlement date. Endowment return is calculated net of investment management expenses.

**Property and Equipment**

Educational property is stated at cost for purchased assets and fair market value at the date of donation in the case of gifts. The University depreciates its educational property assets (excluding works of art) using the straight-line method over their estimated useful lives. Repairs and maintenance of property and equipment are expensed as incurred.

**Life-Income Agreements and Agency Arrangements**

Life-income agreements include charitable remainder trusts and gift annuities. Charitable remainder trusts hold donated assets for which the University's subsidiary generally acts as trustee and periodically pays specified amounts of the designated beneficiaries. Generally, beneficiary payments are a fixed amount for annuity trusts and a fixed percentage of the fair market value of the trust assets or based on income earned for other charitable remainder trusts. At a date specified in each gift instrument, usually the beneficiary's date of death, ownership of the trust assets will transfer to the University and the beneficiary payments will cease. The University also enters into gift annuity agreements, which require that the University take ownership of the assets at the date of gift with an obligation to periodically pay specified amounts to designated beneficiaries for their lifetimes. Assets held in life-income trusts and those assets associated with

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

gift annuities are included in investments. Contribution revenues are recognized at the date the trusts or gift annuities are established after recording liabilities, in accordance with actuarial tables established by the Internal Revenue Service, for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted annually for changes in the value for the assets and actuarial changes which impact the estimates of future payments.

The University has also received certain agency funds for which the University serves as custodian. Agency funds are recorded as investments with a corresponding liability (amounts held in trust for others) in the accompanying consolidated financial statements.

**Recent Accounting Pronouncements**

In September 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – a replacement of FASB Statement 125*. This Statement replaces SFAS No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. It revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of SFAS No. 125's provisions without reconsideration.

Certain provisions of SFAS No. 140 are effective for fiscal years beginning after December 15, 2000, while other provisions are effective for fiscal years beginning after March 31, 2001. SFAS No. 140 must be adopted at the beginning of a fiscal year. The impact of the adoption of this Statement did not have a material impact on the University's net increase (decrease) in net assets, cash flows, or financial position for the year ended June 30, 2002.

**Use of Estimates**

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

**2. Accounts Receivable and Other Assets**

Accounts receivable and other assets of the University at June 30, 2002 were as follows (in thousands):

Receivable under repurchase agreement	\$ 6,090
Unsettled investment sales	3,138
Investment income receivable	9,717
Loans receivable	6,776
Other accounts receivable	14,645
Inventory, deposits, and prepaid expenses	6,036
Other assets	4,092
	<hr/>
Total accounts receivable and other assets	\$ 50,494

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

**3. Pledges Receivable**

Unconditional promises to give are included in the consolidated financial statements as pledges receivable and revenue of the appropriate net asset category. Multiyear pledges are recorded after discounting to the present value of expected future cash flows. Unconditional promises to give at June 30, 2002 are expected to be realized in the following periods (in thousands):

In one year or less	\$ 23,926
Between one year and five years	40,393
More than five years	22,672
Less: Discount of \$10,440 and allowance of \$1,599	<u>(12,039)</u>
	<u>\$ 74,952</u>

Pledges receivable at June 30, 2002 had the following restrictions (in thousands):

Permanently invested	\$ 27,406
Buildings	29,056
Support of University programs and activities	30,529
Less: Discount of \$10,440 and allowance of \$1,599	<u>(12,039)</u>
	<u>\$ 74,952</u>

A discount rate of 3 percent was used to discount pledges made in the year ended June 30, 2002, and a discount rate of 6 percent was used to discount pledges made during and prior to 2001.

**4. Investments**

Investments at June 30, 2002 were as follows (in thousands):

Marketable securities (cost of \$2,457,914)	\$ 2,752,753
Private equity investments (cost of \$231,282)	207,780
Real estate investments*	38,878
Other*	<u>3,578</u>
	<u>\$ 3,002,989</u>

\* Stated at cost, net of accumulated amortization

Marketable securities in the table above included life-income funds securities of \$128,415,000 (cost of \$104,634,000).

Included in marketable securities were securities held as collateral under a repurchase agreement with a market value of \$6,712,000.

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

The following table summarizes investment income and net gains (losses) for the year ended June 30, 2002 by source (in thousands):

	<b>Year ended June 30, 2002</b>			<b>Total</b>
	<b>Investment income</b>	<b>Net gains (losses)</b>		
		<b>Realized</b>	<b>Unrealized</b>	
Marketable securities and private equity investments	\$ 39,775	\$ 55,399	\$ (277,723)	\$ (182,549)
Oil and gas properties	3,506			3,506
Real estate and other investments	5,983	288		6,271
	<u>\$ 49,264</u>	<u>\$ 55,687</u>	<u>\$ (277,723)</u>	<u>\$ (172,772)</u>

The following table summarizes investment income and net gains (losses) for the year ended June 30, 2002 by net asset classification (in thousands):

	<b>Year ended June 30, 2002</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	
Investment earnings	\$ 42,959	\$ 2,853	\$ 3,452	\$ 49,264
Net gains (losses) on investments	<u>(198,641)</u>	<u>(18,619)</u>	<u>(4,776)</u>	<u>(222,036)</u>
Total endowment gains (losses) and earnings	(155,682)	(15,766)	(1,324)	(172,772)
Less: investment returns distributed for operations	<u>(137,440)</u>	<u>(7,697)</u>		<u>(145,137)</u>
Investment return, reduced by operating distribution	<u>\$ (293,122)</u>	<u>\$ (23,463)</u>	<u>\$ (1,324)</u>	<u>\$ (317,909)</u>

The University has adopted an endowment earnings distribution policy based on total investment returns, as permitted by the Texas Uniform Management of Institutional Funds Act. Under this policy, the Board of Trustees approves an endowment earnings distribution, which is based on the earnings distribution of the preceding year and the market value of the endowment assets. Sources of this distribution for each restricted endowment, in the order utilized, are (a) earned income as traditionally defined (interest, dividends and rents), (b) reinvested earned income from prior years and (c) capital gains where not prohibited by the gift document. Sources of this distribution for the unrestricted general endowment, in the order utilized, are (a) earned income as traditionally defined (interest, dividends and rents) and (b) capital gains.

Endowment return, net of operating distributions, is reinvested under the University's endowment earnings distribution policy in the investment pool as net assets functioning as endowment.

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

**5. Educational Plant**

Property and equipment of educational plant at June 30, 2002, were as follows (in thousands):

	<b>Estimated useful lives (years)</b>	
Land	—	\$ 15,542
Buildings and improvements	20 - 50	426,939
Equipment, furniture and library books	2 - 20	237,922
Construction in progress	—	72,843
Less: accumulated depreciation	—	<u>(213,603)</u>
		<u>\$ 539,643</u>

Effective July 1, 2001, the University changed the depreciable life of library books from an indefinite life to 15 years to better reflect the estimated useful life of these assets. The University is accounting for this change in estimate on a prospective basis beginning July 1, 2001, which increased the reported net decrease in net assets by approximately \$5,691,000 for the year ended June 30, 2002.

**6. Accounts Payable And Accrued Liabilities**

Accounts payable and accrued liabilities of the University at June 30, 2002 were as follows (in thousands):

Liability for collateral held under repurchase agreement	\$ 6,712
Unsettled investment purchases	4,785
Accounts payable	23,524
Unearned income	9,861
Other	<u>9,965</u>
Total accounts payable and accrued liabilities	<u>\$ 54,847</u>

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

**7. Notes And Bonds Payable**

Notes and bonds payable of the University at June 30, 2002, were as follows (in thousands):

City of Houston Higher Education Finance Corporation (CHHEFC):

Tax-exempt revenue bonds, Series 1999A, maturing 2023  
through 2029, with fixed interest at 5.375% per annum  
payable semiannually \$ 120,000

Commercial paper notes, Series A, with interest ranging from  
1.4% to 1.75% per annum at June 30, 2002 payable upon maturity 69,200

\$ 189,200

The University incurred and paid interest expense of approximately \$7,457,000 and \$7,545,000, respectively, in 2002. Interest expense of \$2,992,000 was charged to operations. During 2002, \$2,186,000, net of interest earned on unspent proceeds, was capitalized as a cost of construction.

**Tax-Exempt Revenue Bonds**

Scheduled interest payments on the bonds are \$6,450,000 per year. Principal payments commence on November 15, 2023. No collateral is pledged on these bonds.

Unspent bond proceeds amounting to \$6,090,000 at June 30, 2002, were invested in a flexible repurchase agreement under which the University loaned cash to a financial institution and received investment securities as collateral. The collateral is required to be returned as the agreement matures.

The estimated fair value of the CHHEFC Series 1999A bonds is 102.4% of face value at June 30, 2002. The fair value is estimated based on the average price of trades nearest to June 30.

**Commercial Paper Notes**

The University has a commercial paper credit facility that provides for borrowings in the form of individual notes up to an aggregate of \$100,000,000. The notes bear a fixed rate of interest, established on the borrowing date, over their individual terms, not to exceed 270 days. The outstanding balance under the facility was \$69,200,000 with an average interest rate of 1.46 percent and an average maturity of 63 days as of June 30, 2002.

The estimated fair value of the Series A Notes is considered to be the same as the face value in view of their maturity dates.

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

**8. Net Assets**

The University's unrestricted, temporarily restricted and permanently restricted net assets are summarized as follows (in thousands):

	<b>Year ended June 30, 2002</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	
Undesignated	\$ 7,716			\$ 7,716
Designated or restricted by donor, including pledges	39,862	\$ 56,716		96,578
Internally designated for specific programs	44,890			44,890
Net investment in plant	328,353	18,915		347,268
Endowment and designated for long-term investment including pledges	2,110,288	114,097	\$ 560,901	2,785,286
Life-income trusts		12,976	33,621	46,597
Loans	2,221		1,934	4,155
	<u>\$ 2,533,330</u>	<u>\$ 202,704</u>	<u>\$ 596,456</u>	<u>\$ 3,332,490</u>

The Board of Trustees has designated certain unrestricted and temporarily restricted net assets for long-term investment. Substantially all net assets designated for long-term investment and endowment assets participate in one common investment pool of marketable securities (see Note 4).

**9. Student Financial Aid**

Gross student tuition and fees of \$74,954,000 are presented in the consolidated financial statements net of scholarship and fellowship awards of \$24,884,000. Auxiliary enterprises revenue was reduced by scholarship awards applied to room and board charges of \$904,000. In addition, stipends and other direct payments to students totaled \$9,035,000.

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

**10. Functional Expenses**

Educational and general expenses of the University by major functional category for the year ended June 30, 2002 were as follows (in thousands):

Instruction and department research	\$ 131,076
Sponsored research	45,637
Library	18,238
Scholarships and fellowships	9,035
Student services	11,505
General administration	19,606
Institutional development and other activities	<u>14,022</u>
 Total educational and general	 <u>\$ 249,119</u>

The above table includes depreciation expense of \$14,154,000 and operations and maintenance expense of \$22,456,000 which were allocated to the major functional categories based on space usage. Depreciation of library books of \$5,691,000 was recognized as library expense. In addition, depreciation expense of \$7,515,000 was allocated to auxiliary enterprises.

**11. Retirement Plans**

Substantially all employees are eligible to participate in defined contribution retirement plans, which are administered by outside agencies. The contributions of the University and the plan participants are applied to annuity contracts. The University's contributions to these plans of \$10,913,000 were recorded as expenses in the appropriate functional categories.

**12. Commitments and Contingencies**

There are several suits and claims pending against the University, the effect of which cannot be estimated at this time. However, officials of the University and legal counsel believe that the ultimate uninsured liability, if any, will not be material to the University's financial position and activities.

The University receives funding from federal government agencies for research conducted under government grants and contracts. The grants and contracts provide for reimbursement of direct and indirect costs. The costs recovered by the University in support of sponsored research are subject to audit and adjustment.

In connection with its private equity investment program (see Note 4), the University is obligated under certain limited partnership agreements to advance additional funding up to specified levels upon the request of the general partner. At June 30, 2002, the University had unfunded commitments of \$288,188,000, which are expected to be called primarily over the next five to seven years.

Additionally, the University was committed under contracts at June 30, 2002, for capital construction and improvements and major maintenance of approximately \$27,223,000 to be

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2002**

---

financed primarily from gifts and net assets designated for long-term investments. Other commitments of \$5,228,000 were also outstanding at June 30, 2002.

**13. Revision of Beginning Net Assets Balances (Unaudited)**

The University has revised the classification of certain gifts from the amounts previously reported to reflect the restrictions originally imposed by the donors. The revision had the following effect on net assets (in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Balance, June 30, 2001:				
As previously reported	\$ 2,867,757	\$ 202,224	\$ 534,203	\$ 3,604,184
Adjustments	<u>(52,711)</u>	<u>11,267</u>	<u>41,444</u>	<u>-</u>
As adjusted	<u>\$ 2,815,046</u>	<u>\$ 213,491</u>	<u>\$ 575,647</u>	<u>\$ 3,604,184</u>