KPMG

HOBART AND WILLIAM SMITH COLLEGES

Financial Statements

May 31, 2014 and 2013

(With Independent Auditors’ Report Thereon)

HOBART AND WILLIAM SMITH COLLEGES

Financial Statements

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KPMG LLP
515 Broadway
Albany, NY 12207-2974

Independent Auditors' Report

The Board of Trustees
Hobart and William Smith Colleges:

We have audited the accompanying financial statements of Hobart and William Smith Colleges, which comprise the statements of financial position as of May 31, 2014 and 2013, the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hobart and William Smith Colleges as of May 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

October 30, 2014

HOBART AND WILLIAM SMITH COLLEGES

Statements of Financial Position

May 31, 2014 and 2013

Assets		2014	2013
Cash and cash equivalents	$	27,186,716	23,899,520
Short-term investments		6,537,010	6,234,403
Bond deposits for future construction		15,043,648	—
Accounts receivable, net		2,136,335	2,828,431
Notes receivable, net		2,457,033	2,452,155
Inventories		811,337	719,011
Contributions receivable, net		6,790,177	7,412,591
Other assets		2,410,705	2,092,317
Long-term investments		205,418,689	184,449,103
Land, buildings and equipment, net		134,547,644	136,220,512
Total assets	$	403,339,294	366,308,043
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued liabilities	$	8,385,361	7,012,326
Deferred revenue and deposits		5,055,323	4,214,693
Deferred giving liabilities		1,543,634	1,525,831
Refundable advances from government loan programs		1,938,143	1,963,838
Asset retirement obligations		2,354,260	2,338,834
Fair value of swap agreement		6,647,203	7,304,525
Bonds and note payable		72,821,272	59,257,428
Total liabilities		98,745,196	83,617,475
Net assets:			
Unrestricted		111,999,571	103,192,957
Temporarily restricted		67,606,026	58,347,063
Permanently restricted		124,988,501	121,150,548
Total net assets		304,594,098	282,690,568
Total liabilities and net assets	$	403,339,294	366,308,043

See accompanying notes to financial statements.

HOBART AND WILLIAM SMITH COLLEGES

Statement of Activities

Year ended May 31, 2014

(with summarized information for the year ended May 31, 2013)

	2014				
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**	**2013 Total**
Operating revenues:					
Tuition and fees	$ 106,386,932	—	—	106,386,932	99,695,121
Student aid	(43,774,550)	—	—	(43,774,550)	(41,597,251)
Net tuition and fees	62,612,382	—	—	62,612,382	58,097,870
Sales and services of auxiliaries	24,382,009	—	—	24,382,009	23,046,195
Government grants and contracts	1,934,615	—	—	1,934,615	2,932,506
Private gifts and grants	5,304,158	322,155	—	5,626,313	4,831,885
Endowment spending	7,469,076	306,509	—	7,775,585	7,824,651
Other investment income	239,554	365	—	239,919	429,163
Other	432,655	5,459	—	438,114	382,123
Net assets released from restrictions	885,229	(885,229)	—	—	—
Total operating revenues	103,259,678	(250,741)	—	103,008,937	97,544,393
Operating expenses:					
Instruction	34,209,693	—	—	34,209,693	32,431,870
Academic support	11,284,496	—	—	11,284,496	10,249,860
Student services	21,956,046	—	—	21,956,046	21,244,015
Institutional support	18,650,335	—	—	18,650,335	17,063,736
Auxiliaries operations	16,078,355	—	—	16,078,355	15,879,890
Total operating expenses	102,178,925	—	—	102,178,925	96,869,371
Change in net assets from operating activities	1,080,753	(250,741)	—	830,012	675,022
Nonoperating activities:					
Investment return, net of amounts designated for operations	176,436	8,103,594	308,774	8,588,804	17,924,298
Private gifts	7,305,597	1,723,291	3,127,479	12,156,367	5,051,762
Capital campaign expense	(425,753)	—	—	(425,753)	(812,587)
Loss on early extinguishment of debt	—	—	—	—	(300,857)
Other changes, net	21,954	14,395	200,746	237,095	(903,561)
Change in value of deferred giving arrangements	—	(190,319)	50,002	(140,317)	(67,859)
Change in fair value of swap agreement	657,322	—	—	657,322	1,868,627
Net assets released from restrictions or reclassified	(9,695)	(141,257)	150,952	—	—
Change in net assets from nonoperating activities	7,725,861	9,509,704	3,837,953	21,073,518	22,759,823
Increase in net assets	8,806,614	9,258,963	3,837,953	21,903,530	23,434,845
Net assets:					
Beginning of year	103,192,957	58,347,063	121,150,548	282,690,568	259,255,723
End of year	$ 111,999,571	67,606,026	124,988,501	304,594,098	282,690,568

See accompanying notes to financial statements.

HOBART AND WILLIAM SMITH COLLEGES

Statement of Activities

Year ended May 31, 2013

	2013			
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**
Operating revenues:				
Tuition and fees	$ 99,695,121	—	—	99,695,121
Student aid	(41,597,251)	—	—	(41,597,251)
Net tuition and fees	58,097,870	—	—	58,097,870
Sales and services of auxiliaries	23,046,195	—	—	23,046,195
Government grants and contracts	2,932,506	—	—	2,932,506
Private gifts and grants	4,725,349	106,536	—	4,831,885
Endowment spending	7,305,480	519,171	—	7,824,651
Other investment income	428,980	183	—	429,163
Other	381,611	512	—	382,123
Net assets released from restrictions	555,640	(555,640)	—	—
Total operating revenues	97,473,631	70,762	—	97,544,393
Operating expenses:				
Instruction	32,431,870	—	—	32,431,870
Academic support	10,249,860	—	—	10,249,860
Student services	21,244,015	—	—	21,244,015
Institutional support	17,063,736	—	—	17,063,736
Auxiliaries operations	15,879,890	—	—	15,879,890
Total operating expenses	96,869,371	—	—	96,869,371
Change in net assets from operating activities	604,260	70,762	—	675,022
Nonoperating activities:				
Investment return, net of amounts designated for operations	6,840,046	10,927,461	156,791	17,924,298
Private gifts	40,712	2,882,963	2,128,087	5,051,762
Capital campaign expense	(812,587)	—	—	(812,587)
Loss on early extinguishment of debt	(300,857)	—	—	(300,857)
Other changes, net	(890,513)	(27,835)	14,787	(903,561)
Change in value of deferred giving arrangements	61,260	(201,767)	72,648	(67,859)
Change in fair value of swap agreement	1,868,627	—	—	1,868,627
Net assets released from restrictions or reclassified	297,188	(1,057,635)	760,447	—
Change in net assets from nonoperating activities	7,103,876	12,523,187	3,132,760	22,759,823
Increase in net assets	7,708,136	12,593,949	3,132,760	23,434,845
Net assets:				
Beginning of year	95,484,821	45,753,114	118,017,788	259,255,723
End of year	$ 103,192,957	58,347,063	121,150,548	282,690,568

See accompanying notes to financial statements.

HOBART AND WILLIAM SMITH COLLEGES

Statements of Cash Flows

Years ended May 31, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Change in net assets	$ 21,903,530	23,434,845
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion	7,842,072	7,667,220
Loss on early extinguishment of debt	—	300,857
Provision for uncollectible contributions receivable	160,220	217,085
Loss on disposal of land, buildings and equipment	81,386	387,500
Change in value of deferred giving arrangements	17,803	(8,484)
Change in fair value of swap agreement	(657,322)	(1,868,627)
Receipt of contributed securities	(1,099,231)	(918,599)
Contributions restricted for long-term investment	(12,841,967)	(2,868,537)
Noncash contributions for long-term purposes	(410,000)	—
Interest and dividends restricted for long-term investment	(166,001)	(182,961)
Net realized and unrealized gains on investments	(14,655,238)	(23,826,646)
Changes in operating assets and liabilities that provide (use) cash:		
Accounts receivable	692,096	(826,156)
Inventories	(92,326)	(164,823)
Contributions receivable	462,194	(2,078,442)
Other assets	44,522	(198,261)
Accounts payable and accrued liabilities	1,321,984	334,553
Asset retirement obligations	(92,339)	(17,985)
Deferred revenues and deposits	840,630	348,462
Net cash provided by (used in) operating activities	3,352,013	(268,999)
Cash flows from investing activities:		
Acquisition of land, buildings and equipment, net of construction related payable	(5,842,810)	(6,393,497)
Increase in bond deposits for future construction	(15,043,648)	—
Notes issued	(276,900)	(219,725)
Proceeds from note collections	272,022	279,561
Proceeds from sale and maturities of investments	125,383,834	108,147,397
Purchases of investments	(130,901,558)	(103,733,229)
Net cash used in investing activities	(26,409,060)	(1,919,493)
Cash flows from financing activities:		
Proceeds from contributions for:		
Investment in endowment	10,066,639	1,116,392
Investment in plant	2,677,125	1,681,119
Investment subject to deferred giving arrangements	98,203	71,026
Interest and dividends restricted for reinvestment	166,001	182,961
Bond issuance costs	(401,635)	(630,484)
Decrease in refundable advances from government loan programs	(25,695)	(27,174)
Proceeds from issuance of long-term debt	15,416,105	29,942,819
Payment of long-term debt	(1,652,500)	(30,002,000)
Net cash provided by financing activities	26,344,243	2,334,659
Net increase in cash and cash equivalents	3,287,196	146,167
Cash and cash equivalents:		
Beginning of year	23,899,520	23,753,353
End of year	$ 27,186,716	23,899,520
Supplemental data:		
Interest paid	$ 1,288,776	1,480,443
Noncash activities:		
Change in construction related payables	$ 51,051	(717,760)

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

Hobart and William Smith Colleges (the Colleges) are coordinate colleges located in the Finger Lakes Region of Central New York. Hobart College for men and William Smith College for women are selective, residential liberal arts institutions. The Colleges share a single curriculum, campus, faculty and central administration, but have separate deans, student governments, residences, and athletics organizations. The Colleges' coordinate structure provides men and women opportunities for independent learning and leadership in an environment of shared resources and objectives.

(b) Basis of Presentation

The Colleges' financial statements have been prepared on the accrual basis of accounting and are presented in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*, which addresses the presentation of financial statements for not-for-profit entities. Accordingly, net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. The net assets of the Colleges are classified as follows:

Unrestricted net assets are not subject to donor stipulations restricting their use, but may be designated for specific purposes by the board of trustees or may otherwise be limited by contractual agreements with outside parties.

Temporarily restricted net assets are subject to donor-imposed stipulations that expire by the passage of time or can be fulfilled or removed by actions pursuant to the stipulations. Temporarily restricted net assets consist primarily of gifts restricted by donors for capital projects and other operating purposes.

Permanently restricted net assets are subject to donor-imposed stipulations that they be maintained in perpetuity. Generally, donors of these assets usually permit the use of all or part of the investment return on these assets.

Expenses are reported as decreases in unrestricted net assets. Expirations of donor-imposed stipulations that simultaneously increase one class of net assets and decrease another are reported as reclassifications between the applicable classes of net assets. It is the Colleges' policy to record temporarily restricted contributions received and expended in the same accounting period as unrestricted.

(c) 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 disclosures of contingent assets and liabilities at the dates of the financial statements. Estimates also affect the reported amount of revenues and expenses during the reporting periods. The Colleges' significant estimates made in the preparation of these financial statements include, but are not limited to, valuation of certain alternative investments, estimation of asset retirement obligation, useful lives of fixed assets and estimated net realizable value of accounts and contributions receivable. Actual results could differ from these estimates.

(d) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions or other highly liquid investments with a maturity of three months or less when purchased or other similar interest-bearing accounts. At certain points in time, the Colleges may maintain funds in excess of amounts insured by the Federal Depository Insurance Corporation.

(e) Short-term Investments

Short-term investments are recorded at fair value. The Colleges periodically invest excess operating cash generally in a select fixed-income fund on a short-term basis.

(f) Accounts and Notes Receivable

Accounts and notes receivable are reported net of reserves for doubtful accounts. The receivables are recorded at their current unpaid principal balance and associated interest income, if applicable, is accrued based on the principal amount outstanding and applicable interest rates. Allowances for doubtful accounts are recorded representing amounts that, in the opinion of management of the Colleges, are necessary to account for probable losses related to the receivables. These allowances are determined based upon numerous considerations, including economic conditions, the specific composition of the receivable balance, as well as trends of delinquencies and write offs. On a periodic basis, these factors are considered and the allowances for doubtful accounts are adjusted accordingly, with a corresponding adjustment to the provision for allowances for doubtful accounts.

Allowances of approximately $893,000 and $771,000 at May 31, 2014 and 2013, respectively, have been provided for accounts receivable estimated to be uncollectible.

Allowances of approximately $128,000 at May 31, 2014 and 2013 have been provided for notes receivable estimated to be uncollectible.

(g) Contributions

Contributions, including unconditional pledges, are recognized as revenue when donors' commitments are received. Conditional pledges are recognized as revenue when the conditions are substantially met. Unconditional pledges are recognized at their estimated net present value, net of an allowance for uncollectible amounts, and are classified as either permanently restricted or temporarily restricted net assets. Gifts whose restrictions are met in the same fiscal year as their receipt are combined with unrestricted gifts and reported as unrestricted contribution revenue. Contributions specified for the acquisition or construction of long lived assets are reported as unrestricted net assets when the assets are placed in service.

(h) Funds Held in Trust by Others

Contributions receivable includes funds held in trust by others which represent resources neither in the possession nor under the control of the Colleges, but paid and administered by outside trustees, with the Colleges deriving income or a residual interest from the assets of such funds. Funds held in trust by others are recognized at the estimated fair value of the assets which approximates the net present value of the future cash flows when the irrevocable trust is established or the Colleges are notified of its existence and are subsequently adjusted for changes in the fair value annually. Funds held in trust by others are categorized as Level 2 in the fair value hierarchy.

(i) Deferred Financing Costs

The Colleges have capitalized certain deferred financing costs and are amortizing them over the term of the related debt instruments. Deferred financing costs were approximately $1,149,000 and $786,000 at May 31, 2014 and 2013, respectively, and are included within other assets on the accompanying statements of financial position. Amortization expense was approximately $39,000 in 2014 and 2013.

(j) Long-term Investments

Long-term investments are recorded at fair value. If an investment is held directly by the Colleges and in an active market where quoted prices exists, the Colleges report the fair value as the market price of an identical security. Shares in mutual funds are based on share values reported by the funds as of the last business day of the fiscal year. The Colleges also hold shares or units in alternative investment funds involving real estate, hedge and private equity strategies. Such alternative investment funds may hold securities or other financial instruments for which a ready market exists and are priced accordingly. In addition, such funds may hold assets that require the estimation of fair values in the absence of readily determinable market values. Such valuations are determined by fund managers and generally consider variables such as operating results, comparable earnings multiples, projected cash flows, recent sales prices, and other pertinent information, and may reflect discounts for the illiquid nature of certain investments held.

The Colleges utilize the net asset value (NAV) reported by each of the alternative investment funds as a practical expedient for determining the fair value of the investment. These investments are redeemable at NAV under the original terms of the subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the underlying fund agreements. Due to the nature of the investments held by these funds, changes in market conditions and the economic environment may significantly impact the NAV of the funds and, consequently, the fair value of the Colleges' interests in the funds. Furthermore, changes to the liquidity provisions of the funds may significantly impact the fair value of the Colleges' interest in the funds.

Endowment and investment return includes interest and dividends, realized gains and losses, and the change in unrealized appreciation (depreciation) on the associated investments. The average cost of investment securities sold is used to determine the basis for computing realized gains or losses, and the Colleges account for investment sales and purchases on a trade date basis.

(k) Land, Buildings and Equipment

Grounds, site improvements, buildings, equipment and library books are recorded at cost at the date of acquisition or their fair value at the date of donation, less accumulated depreciation, computed on a straight line basis over the estimated useful lives of the site improvements (20 years), buildings (15

(Continued)

– 45 years), equipment (5 – 20 years) and library books (20 years). Expenditures for maintenance, repairs, and renewals of relatively minor items are not capitalized.

(l) Deferred Giving Arrangements

The Colleges' deferred giving arrangements consist primarily of gift annuities, pooled life income funds and charitable remainder trusts. Deferred giving assets of approximately $4,210,000 and $3,914,000 are included in long-term investments at their fair value as of May 31, 2014 and 2013, respectively. Contribution revenues are recognized at the date the arrangements are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or beneficiaries. The liabilities are adjusted during the term of the arrangements for changes in the value of the assets and changes in the estimated present value of future cash outflows and other changes in the estimates of future benefits. The deferred giving liabilities represent the net present value of future cash outflows over the beneficiary's life expectancy as required by the deferred gift agreements. Discount rates are used to calculate the net present value of the obligations, and are based on market rates commensurate with the beneficiary life expectancy.

(m) Refundable Advances from Government Loan Programs

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

(n) Asset Retirement Obligations

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, the Colleges will record period-to-period changes in the ARO liability resulting from the passage of time as other changes, net. Accretion expense was approximately $108,000 and $104,000 during 2014 and 2013, respectively. Upon settlement of the obligation, any difference between the actual cost to settle the ARO and the liability recorded is recognized as a gain or loss in the statement of activities.

(o) Derivative Instruments

A derivative instrument related to the Colleges' long-term debt is included in the fair value of the swap agreement on the statements of financial position. The change in the fair value of the derivative instrument is included in nonoperating activities in the statements of activities. The Colleges selected the combination of a variable rate bond issue and an interest rate swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The Colleges are exposed to credit loss in the event of nonperformance by the counterparty to its long term rate swap. The interest rate swap does not qualify for cash flow hedge accounting.

(p) Taxation

The Colleges are a not-for-profit organization as described in Section 501(c)(3) of the Internal Revenue Code and are generally exempt from income tax on related income.

The Colleges recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Colleges believe they have taken no significant uncertain tax positions.

(q) Revenue Recognition

Tuition, fees, room, and board revenue is recognized over the academic year as services are provided. Funds received in advance of services provided are included in deferred revenue.

(r) Operations

The statement of activities reflects a subtotal for the change in net assets from operations. This subtotal reflects revenues the Colleges received for operating purposes, including investment return used for operations and all expenses. Nonoperating activity reflects all other activity, including but not limited to the investment to return in excess of the amount appropriated under the Board of Trustees' approved spending formula, contributions for endowment and plant purposes, and the change in present value of annuity and life income funds.

(s) Allocation of Certain Expenses

The statements of activities present expenses by functional classification. Operation and maintenance of plant, depreciation and interest expense are allocated based on square footage.

(t) 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 practical to estimate that value:

Cash and cash equivalents, short-term and long-term investments, accounts receivable, notes receivables, accounts payable and accrued liabilities – The carrying amounts approximate fair value because of the short-term maturity of these instruments or their carrying values approximate their estimated fair values.

Bonds and note payable – The carrying value of the variable rate long-term debt approximates fair value within the statement of financial position. The fair value of fixed rate long-term debt is based on quoted market prices for the Colleges' outstanding bonds. The fair value of the Colleges' borrowings is approximately $73,053,000 and $59,826,000 at May 31, 2014 and 2013, respectively, and has been determined using significant observable inputs that would be considered to be Level 2 in the fair value hierarchy.

Fair value of swap agreement – Interest rate swap agreements are recorded at fair value within the accompanying financial statements based on dealer quotes of the estimated settlement amounts required of the College if the agreement was terminated, taking into consideration current interest rates. The interest rate swaps are categorized as Level 2 in the fair value hierarchy.

(u) Reclassifications

Certain reclassifications have been made to 2013 information to conform with the 2014 presentation.

(2) Contributions Receivable

Unconditional contributions receivable at May 31, 2014 and 2013 are restricted by donors predominantly for scholarships and capital projects. They are expected to be realized in the following periods:

		2014	2013
Less than one year	$	7,776,201	8,129,475
One year to five years		6,594,004	7,191,246
More than five years		671,429	587,500
		15,041,634	15,908,221
Less present value discount		(308,842)	(336,673)
Allowance for uncollectible receivables		(8,581,008)	(8,797,350)
		6,151,784	6,774,198
Charitable remainder and perpetual trusts		638,393	638,393
	$	6,790,177	7,412,591

(3) Investments

The investment objective of the Colleges is to invest assets in a prudent manner to achieve a long term rate of return sufficient to fund a portion of its spending and to increase investment value after inflation. The Colleges' investment strategy incorporates a diversified asset allocation approach that maintains, within defined limits, exposure to domestic and international equities, fixed income, real estate, commodities, and private equity markets. The majority of the Colleges' investments are managed in a pooled fund that consists primarily of endowment assets.

Fair value represents the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants as of the measurement date. Financial instruments measured and reported at fair value are classified and disclosed in one of the following categories:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Colleges have the ability to access at the measurement date. Assets and liabilities classified as Level 1 generally include listed equities. Level 1 also includes cash and cash equivalents given the short maturity of these investments.

- Level 2 inputs are quoted market prices for markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly. Assets and liabilities classified as Level 2 generally include fixed income securities or investments in common collective trusts that hold Level 1 assets and derivative instruments.
- Level 3 inputs include pricing inputs that are unobservable for the assets and reflect certain assumptions to determine fair value. Assets classified as Level 3 include the Colleges' alternative investments (private equities and hedge funds). The Colleges utilized the NAV reported by the alternative investments as a practical expedient for measuring and reporting their fair values in the accompanying financial statements. The investments in these partnerships and funds may include certain private instruments, which do not trade in public markets and, therefore, may be subject to greater liquidity risk.

With respect to those investments reported at NAV as a practical expedient, classification in Level 2 or 3 is based on the Colleges' ability to redeem its interest at or near the date of the statements of financial position, and if the interest can be redeemed in the near term, the investment is classified in Level 2. As of May 31, 2014 and 2013, the Colleges had no specific plans or intentions to sell investments of amounts different than NAV.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes is not necessarily an indication of the risk associated with investing in those investments or a reflection on the liquidity of each fund's underlying assets and liabilities.

The Colleges' short-term and long-term investments at May 31, 2014 are summarized in the following table by their fair value hierarchy classification:

	May 31, 2014	Level 1	Level 2	Level 3	Redemption frequency	Days' notice
Investments:						
Cash and cash equivalents	$ 12,162,230	1,243,886	10,918,344	—	Daily	Same day
Fixed income and government securities	10,732,031	9,087,320	1,644,711	—	Daily – Monthly	Same day – 10 days
Common and preferred stocks	87,116,083	42,859,493	44,256,590	—	Daily – Monthly	Same day – 30 days
Real estate (a)	7,116,637	—	—	7,116,637	Illiquid	Illiquid
Private equity (b)	11,035,013	—	—	11,035,013	Illiquid	Illiquid
Hedge (c)	81,671,809	—	49,367,089	32,304,720	Monthly – Illiquid	24 days – Illiquid
Other	2,121,896	—	2,121,896	—	Illiquid	Illiquid
Total investments	$ 211,955,699	53,190,699	108,308,630	50,456,370		

The College's short-term and long-term investments at May 31, 2013 are summarized in the following table by their fair value hierarchy classification:

	May 31, 2013	Level 1	Level 2	Level 3	Redemption frequency	Days notice
Investments:						
Cash and cash equivalents	$ 6,810,366	148,589	6,661,777	—	Daily	Same day
Fixed income and government securities	16,974,169	13,946,302	3,027,867	—	Daily – Monthly	Same day – 10 days
Common and preferred stocks	72,466,484	55,668,911	16,797,573	—	Daily – Monthly	Same day – 28 days
Real estate (a)	6,677,986	—	—	6,677,986	Illiquid	Illiquid
Private equity (b)	11,899,655	—	—	11,899,655	Illiquid	Illiquid
Hedge (c)	73,882,172	—	41,970,128	31,912,044	Monthly – Illiquid	7 days – Illiquid
Other	1,972,674	—	1,972,674	—	Illiquid	Illiquid
Total investments	$ 190,683,506	69,763,802	70,430,019	50,489,685		

(a) This category includes investments with limited partnerships or limited liability companies in commercial, residential improved and unimproved real estate primarily in the United States. The Colleges do not have redemption rights in these investments and the investments remaining lives are between one and ten years.

(b) This category includes investments with limited partnerships or limited liability companies in domestic and international private sector businesses, and similar equity securities. The Colleges do not have redemption rights in these investments and the investments remaining lives are between one and six years.

(c) This category includes investments with limited partnerships or limited liability companies in funds of funds and private investment companies that employ a multi-strategy approach. The Colleges may redeem the majority these investments on a monthly, quarterly or annual basis with notice ranging from 24 to 95 days, however the Colleges do not have redemption rights in certain investments in this category.

The Colleges' policy is to recognize transfers in and transfers out of different levels as of the actual date of the event or circumstance that caused the transfer. The following is a reconciliation of Level 3 assets for which significant unobservable inputs were used to determine fair value. One transfer occurred between Level 2 and Level 3 for the year ended May 31, 2014 and no significant transfers occurred for the year ended May 31, 2013. The following table represents the activity of Level 3 securities held during the years ended May 31, 2014 and 2013:

	Real estate	Private equity	Hedge	Total
Fair value, May 31, 2012	$ 6,827,504	10,540,735	27,269,387	44,637,626
Realized gains	220,100	601,676	5,101,297	5,923,073
Unrealized gains (losses)	239,206	265,797	(63,612)	441,391
Purchases	163,189	1,453,115	20,705,281	22,321,585
Sales	772,013	961,668	21,100,309	22,833,990
Fair value, May 31, 2013	6,677,986	11,899,655	31,912,044	50,489,685
Realized gains (losses)	12,945	652,934	(82,103)	583,776
Unrealized gains (losses)	187,250	(1,110,963)	5,003,205	4,079,492
Purchases	451,928	1,344,889	8,342,430	10,139,247
Sales	213,472	1,751,502	5,314,640	7,279,614
Transfers out of level 3	—	—	(7,556,216)	(7,556,216)
Fair value, May 31, 2014	$ 7,116,637	11,035,013	32,304,720	50,456,370

Liquidity

The following presents the fair value of the Colleges' investments as of May 31, 2014 and 2013 by redemption period:

	2014	2013
Investments redemption period:		
Daily	$ 66,844,656	76,436,828
Monthly	68,892,931	46,022,114
Quarterly	23,639,846	21,678,276
Annual	8,693,282	8,418,223
Illiquid (locked-up)	43,884,984	38,128,065
Total	$ 211,955,699	190,683,506

Investments that are in the Illiquid (locked-up) category are primarily related to real estate, private equity and hedge investments. The period of time until liquidation is not necessarily determinable by management, as liquidation terms are at the discretion of the applicable fund's investment manager subject to market conditions and the underlying complexities of the individual investments. These liquidity restrictions have been in effect since the initial purchase of the applicable funds.

The Colleges participate in certain limited partnership arrangements as part of the endowment portfolio. Outstanding unfunded capital commitments on these investments approximate $13,607,000 as of May 31, 2014. The Colleges maintain sufficient liquidity in the investment portfolio to cover such commitments.

The Colleges pool investments on a fair value basis. The unit fair value for the investment pool is used to account for pool transactions, with each individual fund subscribing to or disposing of units on the basis of the unit fair value. The per unit fair value of the endowment investment pool at May 31, 2014 and 2013 was $3.32 and $3.11, respectively.

In accordance with its spending policy on endowment and other investments the Colleges' return on investments was as follows:

		2014	2013
Dividends and interest income	$	1,949,070	2,351,466
Net realized and unrealized gains		14,655,238	23,826,646
Total return on investments		16,604,308	26,178,112
Investment return designated for current operations (endowment spending and other investment income)		8,015,504	8,253,814
Investment return more than amounts designated for current operations	$	8,588,804	17,924,298

(4) Endowment

Endowment funds are long-term assets of the Colleges created either by donor gifts or by actions of the Board of Trustees. Their purpose is to generate, in perpetuity, operating revenue for specific activities or for the use of the Colleges'. Endowment funds are invested under direction of the Board of Trustees to achieve maximum long-term total return with prudent concern for the preservation of investment capital. All investments of endowment funds are recorded in the statement of financial position as long-term investments, including cash balances held by external investment managers. Unless otherwise directed in the gift instrument or required by applicable law, both donor-restricted and board-designated endowment funds are pooled for efficient investment purposes. These pooled funds are invested in a broadly diversified portfolio designed to produce long-term returns that equal or exceed the Board-approved spending rates plus the impacts of inflation. The fair value of endowment investments (separately invested and pooled) was $202,413,144 and $181,787,616 as of May 31, 2014 and 2013, respectively.

The Colleges follow New York Prudent Management of Institutional Funds Act (NYPMIFA) in the management of its endowments. Absent donor stipulations to the contrary, the statutory guidelines contained in NYPMIFA relate to the prudent management, investment and expenditure of donor-restricted endowment funds without regard to the original value of the gifts. However, NYPMIFA contains specific factors that must be considered prior to making investment decisions or appropriating funds for expenditure. In accordance with NYPMIFA, the Board of Trustees considers the following factors in making a determination to appropriate or accumulate endowment funds: the duration and preservation of the fund; the purposes of the Colleges and the endowment fund; general economic conditions; the possible effect of inflation and deflation; the expected total return from income and the appreciation of investments; other resources of the Colleges; where appropriate and where circumstances would otherwise warrant, alternatives to expenditure of an endowment fund, giving due consideration to the effect that such alternatives may have on the Colleges; the investment policies of the Colleges.

The Colleges' Board of Trustees has interpreted New York State's Not-for-Profit Corporation Law, including NYPMIFA, 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 Colleges classify 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. Unspent appropriations related to the donor restricted endowment fund are classified as temporarily restricted net assets until the amounts are expended by the Colleges in a manner consistent with the donor's intent. The remaining portion of the donor-restricted endowment fund that is not classified as permanently or temporarily restricted net assets is classified as unrestricted net assets.

Spending Policy

The Board of Trustees determines the appropriate amount to withdraw from endowment funds on an annual basis, to provide support for operations with prudent concern for the long-term growth in the underlying assets. The Colleges employ a total return spending policy which recognizes for spending purposes income equal to a percentage of a multi-year moving average of the unit value of pooled investments. The percentage was 5% in 2014 and 2013. In any given year, the amount availed from the pooled investments may, therefore, be greater or less than the dividend or interest yield for that year. Investment returns earned in excess of the spending policy are classified as nonoperating revenue; any shortfall is made up from historically earned capital appreciation.

The following tables provide the net asset composition of the endowment as of May 31, 2014 and a rollforward of the net assets in from June 1, 2013 to May 31, 2014.

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted funds	$ (145,101)	43,773,375	123,357,770	166,986,044
Funds functioning as endowment	35,427,100	—	—	35,427,100
	$ 35,281,999	43,773,375	123,357,770	202,413,144

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets at beginning of year	$ 26,106,308	35,865,600	119,815,708	181,787,616
Investment return	3,170,190	14,622,861	157,172	17,950,223
Change in funds with deficiencies	519,344	(519,344)	—	—
Private gifts	7,010,000	—	3,430,768	10,440,768
Other changes	56,000	—	(45,878)	10,122
Endowment spending	(1,579,843)	(6,195,742)	—	(7,775,585)
Endowment net assets at end of year	$ 35,281,999	43,773,375	123,357,770	202,413,144

The following tables provide the net asset composition of the endowment as of May 31, 2013 and a rollforward of the net assets in from June 1, 2012 to May 31, 2013.

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted funds	$ (664,445)	35,865,600	119,815,708	155,016,863
Funds functioning as endowment	26,770,753	—	—	26,770,753
	$ 26,106,308	35,865,600	119,815,708	181,787,616

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets at beginning of year	$ 19,936,015	24,611,568	116,691,230	161,238,813
Investment return	2,286,239	24,121,533	174,495	26,582,267
Change in funds with deficiencies	5,131,968	(5,131,968)	—	—
Private gifts	55,031	—	2,101,154	2,156,185
Other changes	(75,238)	(1,138,589)	848,829	(364,998)
Endowment spending	(1,227,707)	(6,596,944)	—	(7,824,651)
Endowment net assets at end of year	$ 26,106,308	35,865,600	119,815,708	181,787,616

Funds with Deficiencies

As a result of market declines, the fair market value of certain donor-restricted endowments was less than the historical cost value of such funds by $145,101 and $664,445 at May 31, 2014 and 2013, respectively. To support spending from these endowment funds the Colleges utilized unrestricted accumulated gains of approximately $89,000 and $487,000, in 2014 and 2013, respectively.

The unrealized losses for these endowment funds have been recorded as reductions in unrestricted net assets. Future market gains will be used to restore this deficiency in unrestricted net assets before any net appreciation above the historical cost value of such funds increases temporarily restricted net assets. While it is the intent of the Colleges to restore this deficiency from future gains, there is no legal obligation to do so.

(5) Land, Buildings and Equipment

The components of land, buildings and equipment, as of May 31, 2014 and 2013 were as follows:

	2014	2013
Grounds	$ 3,566,191	3,407,792
Site improvements	13,306,196	13,181,967
Buildings	158,423,589	155,090,068
Equipment	48,120,999	46,346,339
Library books	18,483,025	17,886,416
Construction in progress	3,855,074	3,634,479
	245,755,074	239,547,061
Accumulated depreciation	(111,207,430)	(103,326,549)
	$ 134,547,644	136,220,512

Depreciation expense amounted to $7,895,343 and $7,687,068 in 2014 and 2013, respectively.

(6) Bonds and Notes Payable

Bonds and notes payable consist of the following at May 31:

	Maturity date	Interest rate	Original issue	2014	2013
City of Geneva Industrial Development Agency Revenue Bonds:					
Series 2007 (a)	2037	Variable	$ 31,250,000	27,700,000	28,350,000
City of Geneva Development Corporation Refunding Bonds:					
Series 2012 (b)	2032	1.0 - 5.0%	26,695,000	24,715,000	25,530,000
Revenue Bonds:					
Series 2014 (c)	2044	3.0 - 5.25%	14,295,000	14,295,000	—
Net bond premium				4,006,772	3,085,428
				70,716,772	56,965,428
Manufacturers and Traders Trust Company:					
Term note (d)	2023	Variable	3,420,000	2,104,500	2,292,000
				$ 72,821,272	59,257,428

(a) Series 2007 City of Geneva Industrial Development Agency Multi-Modal Civic Facility Revenue Bonds are Variable Rate Demand bonds enhanced by a letter of credit with a financial institution. The interest rate is determined every 7 days. Interest is payable monthly and the rates paid during the fiscal year ended May 31, 2014 ranged from .03% to .12%. The bonds mature in 2037.

The letter of credit was issued in the amount of $31,599,316 and will remain in effect until notice that the outstanding bonds have been repaid, the related bonds have been converted to an interest rate other than a Daily Rate or Weekly Rate, or a substitute Credit Agreement or Liquidity Facility has been put in place. The letter of credit will expire on September 3, 2014.

(b) In June 2012, the Colleges issued $26,695,000 of Series 2012 City of Geneva Development Corporation Refunding Bonds. The proceeds of the bonds were used for the legal defeasance of the Series 2001, 2003A and 2003B bonds. The refunding was accounted for as an early extinguishment of debt resulting in a loss recorded in the statement of activities of approximately $301,000.

(c) In March 2014, the Colleges issued $14,295,000 of Series 2014 City of Geneva Development Corporation Revenue Bonds. The proceeds will partially fund the construction of an academic building for the performing arts program.

(d) Interest on the note is variable at LIBOR plus 2% until maturity in 2023. Rates during the fiscal year ended May 31, 2014 ranged from 2.162% to 2.195%.

The scheduled principal payments on bonds payable and term note for the next five years and thereafter is reflected in the following table:

Fiscal year		Amount
2015	$	1,727,500
2016		2,032,500
2017		2,142,500
2018		2,247,500
2019		2,428,500
Thereafter		58,236,000
		68,814,500
Net bond premium		4,006,772
	$	72,821,272

As noted in letter (a) above the Colleges have a letter of credit agreement with a financial institution. In the event that the Series 2007 Bond covered by this agreement is not remarketable and the agreements were not otherwise renewed, the principal amounts due in the principal debt service payments table would be as follows:

Fiscal year		Amount
2015	$	10,285,833
2016		10,565,833
2017		10,625,834
2018		1,472,500
2019		1,628,500
Thereafter		34,236,000
	$	68,814,500

(a) Interest Rate Swap

On June 18, 2007, the Colleges entered into an interest rate swap agreement with an effective date of December 4, 2007 and a maturity date of December 1, 2037. Neither the Colleges nor the counterparty, which is a prominent financial investment institution, are required to collateralize their respective obligations under this swap. At May 31, 2014, the notional amount of the swap was $27,700,000. Under the agreement, the Colleges will pay the counterparty interest at a fixed rate of 4.0% until maturity. The notional amount does not represent an amount exchanged by the parties, and is thus not a measure of exposure of the Colleges. The amounts exchanged are based on the notional amounts and other terms of the swap. At May 31, 2014 and 2013, the Colleges have recognized $1,179,509 and $1,105,320, respectively, in nonoperating expenses in the statement of activities which represent the net cash payment for the difference between the Colleges' and the counterparty's payments under the swap. At May 31, 2014 and 2013, the Colleges recognized an increase in net assets of $657,322 and $1,868,627, respectively, and related change in liabilities on the statement of financial position.

(b) Line of Credit

The Colleges maintain a line of credit for $1,000,000 which was unused during 2014 and 2013. The line of credit is renewed on an annual basis.

(7) Net Assets

Temporarily restricted net assets at May 31, 2014 and 2013 are available for the following purposes:

		2014	2013
Endowment earnings	$	44,036,011	36,137,064
Acquisition of buildings and equipment		23,122,748	21,758,800
Planned giving arrangements		289,290	293,777
Program and student support		157,977	157,422
	$	67,606,026	58,347,063

Permanently restricted net assets at May 31, 2014 and 2013 are available for the following purposes:

		2014	2013
Program and student support	$	63,641,126	61,422,829
Scholarship support		42,301,302	41,217,286
Faculty support		15,540,856	15,400,152
Planned giving arrangements		2,382,830	2,094,408
Library support		1,122,387	1,015,874
	$	124,988,501	121,150,549

(8) Retirement Plan

The Colleges participate in contributory retirement plans administered by the Teachers Insurance Annuity Association of America (TIAA) and College Retirement Equities Fund (CREF) for full-time employees. The Colleges' policy is to accrue the costs of these defined contribution plans currently. Total expense charged to operations relating to these plans was approximately $3,420,000 and $3,151,000 for 2014 and 2013, respectively.

(9) Subsequent Events

The Colleges have performed an evaluation of subsequent events through October 30, 2014, the date on which the financial statements were issued. There were no subsequent events having a material effect on the financial statements.