



FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Financial Statements

June 30, 2004 and 2003

(With Independent Auditors' Report Thereon)



KPMG LLP
99 High Street
Boston, MA 02110-2371

Telephone 617 988 1000
Fax 617 988 0800
Internet www.us.kpmg.com

Independent Auditors' Report

The Board of Trustees
Franklin W. Olin College of Engineering, Inc.:

We have audited the accompanying statements of financial position of Franklin W. Olin College of Engineering, Inc. (the College) as of June 30, 2004 and 2003, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the College as of June 30, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

August 6, 2004, except for the second paragraph of note 6,
as to which the date is September 21, 2004

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Statements of Financial Position

June 30, 2004 and 2003

(In thousands)

Assets	2004	2003
Cash	\$ 2,803	904
Short-term investments	131	3,497
Interest and dividends receivable	1,474	52
Other assets (note 7)	5,792	462
Loans receivable	599	200
Deposits with bond trustees	17,148	—
Contributions receivable from F. W. Olin Foundation, Inc. (note 6)	81,388	216,060
Long-term investments, at fair value (note 3)	310,529	29,848
Property and equipment, net (notes 4 and 7)	129,522	122,351
Total assets	\$ 549,386	373,374
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 3,519	5,232
Deferred revenue and deposits	311	470
Bonds payable, net (note 7)	157,788	—
Total liabilities	161,618	5,702
Net assets (deficit):		
Unrestricted	418	(511)
Temporarily restricted (note 8)	370,995	351,859
Permanently restricted (note 8)	16,355	16,324
Total net assets	387,768	367,672
Total liabilities and net assets	\$ 549,386	373,374

See accompanying notes to financial statements.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Statements of Activities

Years ended June 30, 2004 and 2003

(In thousands)

	2004				2003			
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues and other support:								
Contributions from the Foundation (note 6)	\$ —	—	—	—	5,804	257,827	—	263,631
Change in fair value of contributions receivable from the Foundation (note 6)	—	18,704	—	18,704	—	15,430	—	15,430
Other contributions	12	148	31	191	128	81	30	239
Grants	1,451	—	—	1,451	1,465	—	—	1,465
Student fees, net	822	—	—	822	484	—	—	484
Interest and dividend income	7	7,132	—	7,139	20	202	—	222
Net realized and unrealized gain on long-term investments	—	15,402	—	15,402	—	2,987	—	2,987
Other	175	—	—	175	91	—	—	91
Net assets released from restrictions (note 8)	22,250	(22,250)	—	—	10,046	(10,046)	—	—
Total revenues and other support	24,717	19,136	31	43,884	18,038	266,481	30	284,549
Expenses (note 5):								
Instruction	5,264	—	—	5,264	3,873	—	—	3,873
Academic support	2,804	—	—	2,804	2,712	—	—	2,712
Student services	4,740	—	—	4,740	3,991	—	—	3,991
Research	1,022	—	—	1,022	784	—	—	784
Sponsored programs	1,561	—	—	1,561	1,444	—	—	1,444
Development and fundraising	256	—	—	256	—	—	—	—
Institutional support	8,141	—	—	8,141	6,815	—	—	6,815
Total expenses	23,788	—	—	23,788	19,619	—	—	19,619
Change in net assets	929	19,136	31	20,096	(1,581)	266,481	30	264,930
Net (deficit) assets as of beginning of year	(511)	351,859	16,324	367,672	1,070	85,378	16,294	102,742
Net assets (deficit) as of end of year	\$ 418	370,995	16,355	387,768	(511)	351,859	16,324	367,672

See accompanying notes to financial statements.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Statements of Cash Flows

Years ended June 30, 2004 and 2003

(In thousands)

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Change in net assets	\$ 20,096	264,930
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	3,189	3,782
Net realized and unrealized gain on long-term investments	(15,402)	(2,987)
Contributions from the Foundation restricted for acquisition and construction of property and equipment	—	(22,235)
Increase in interest and dividends receivable	(1,422)	(52)
Increase in other assets	(183)	(152)
Net change in contributions receivable from the Foundation	(9,358)	(242,805)
Decrease in accounts payable and accrued expenses	(2,807)	(2,371)
Change in deferred revenue and deposits	(159)	51
Net cash used in operating activities	<u>(6,046)</u>	<u>(1,839)</u>
Cash flows from investing activities:		
Purchases of investments	(731,734)	—
Sales and maturities of investments	610,484	—
Acquisition and construction of property and equipment	(9,056)	(20,170)
Increase in deposits with bond trustees	(17,148)	—
Change in short-term investments	3,366	(417)
Increase in loans receivable	(399)	(200)
Net cash used in investing activities	<u>(144,487)</u>	<u>(20,787)</u>
Cash flows from financing activities:		
Proceeds from borrowings, net of discount	157,776	—
Payment of bond issuance costs	(5,344)	—
Contributions from the Foundation restricted for acquisition and construction of property and equipment	—	22,235
Net cash provided by financing activities	<u>152,432</u>	<u>22,235</u>
Net change in cash	1,899	(391)
Cash as of beginning of year	<u>904</u>	<u>1,295</u>
Cash as of end of year	<u>\$ 2,803</u>	<u>904</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 957	—
Securities received from the Foundation	144,029	26,745

See accompanying notes to financial statements.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

(1) Description of the College

Franklin W. Olin College of Engineering, Inc. (the College) was founded by the F. W. Olin Foundation, Inc. (the Foundation) in 1997 in response to a national agenda for the advancement of engineering education in the 21st century. The College officially opened in fall 2002 and welcomed the inaugural freshman class of 75 students. In fall 2004, there will be approximately 225 students, with the ultimate total enrollment expected to be approximately 600. The College offers undergraduate programs in engineering, electrical and computer engineering, and mechanical engineering.

While the College maintains its own independent financial resources, governance, identity, and style, a collaborative relationship exists between the College and the adjacent Babson College. The two colleges cooperate in academic programming and share certain facilities and services. The College pays Babson College a fee for certain administrative and programmatic services, and other associated expenses. For the years ended June 30, 2004 and 2003, such fees were \$2,893 and \$1,937, respectively, of which approximately \$229 and \$169 were included in accounts payable and accrued expenses, respectively. Those fees have been included in institutional support in the accompanying statements of activities.

(2) Summary of Significant Accounting Policies

(a) Basis of Financial Statement Presentation

The accompanying financial statements are presented on the accrual basis of accounting and have been prepared to focus on the College as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified as follows:

Unrestricted net assets represent those assets that the College may use at its discretion.

Temporarily restricted net assets result from contributions and other inflows of assets whose use by the College is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the College pursuant to those stipulations. Net appreciation (depreciation) of permanently restricted long-term investments is recognized within the temporarily restricted net asset category until such monies are available for expenditure and a qualifying expenditure is incurred.

Permanently restricted net assets result from contributions and other inflows of assets whose use by the College is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the College.

Revenues are reported as increases in unrestricted net assets unless use of the related net assets is limited by donor-imposed restriction, including time restrictions. Expenses are reported as decreases in unrestricted net assets. The College reports all temporarily restricted contributions as increases to that net asset class and reclassifies them to unrestricted net assets when the restrictions are met, regardless of when the contribution is received. Expirations of temporary restrictions on net assets are reported as releases between the applicable classes of net assets. Expirations of temporary restrictions occur when donor-imposed stipulated purposes have been accomplished and/or the

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

stipulated time period has elapsed. Contributions restricted for the purchase of land are reported as permanently or temporarily restricted net assets depending on the donor's intent. To the extent such contributions are temporarily restricted, the restrictions are released when the amounts are expended for land. Contributions restricted for the acquisition or construction of buildings and equipment are reported as increases in temporarily restricted net assets and are reclassified to unrestricted net assets over the useful lives of the related assets. If an expense is incurred for a purpose for which both unrestricted and temporarily restricted net assets are available, a donor-imposed restriction is fulfilled to the extent of the expense incurred unless the expense is for a purpose that is directly attributable to another specific external source of revenue.

Dividends, interest, and net gain (loss) on investments are reported as follows:

- as increases in permanently restricted net assets if the terms of the contribution require that they be added to the principal of a permanent endowment fund;
- as increases (decreases) in temporarily restricted net assets if the terms of the contribution impose restrictions on the current use of the income or net gains; and
- as increases (decreases) in unrestricted net assets in all other cases.

Contributions, including unconditional promises to give, are recognized as revenues in the period received and generally increase temporarily restricted net assets. Promises to give 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.

(b) *Short-Term Investments*

Short-term investments are stated at fair value and consist solely of holdings in the Common Fund Short-Term Fund.

(c) *Long-Term Investments*

Long-term investments are carried at fair value based on quoted market prices.

(d) *Bond Discount and Issue Costs*

Unamortized bond discount and issue costs are being amortized on a straight-line basis through the final maturity date of the respective bond issue.

(e) *Property and Equipment*

Land, buildings, and equipment are reported at cost at the date of acquisition or at fair value at the date of donation in the case of gifts. For assets placed in service, depreciation is provided using the straight-line method over the estimated useful lives of the assets. The cost of normal maintenance and repairs that does not add to the value of the asset or materially extend the asset's life is not capitalized.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

Depreciation is provided on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Buildings and improvements	15 to 40
Land improvements	10 to 35
Equipment	3 to 20

(f) *Deferred Revenue and Deposits*

The College recognizes revenue on grants and contracts for research as related costs are incurred. Payments received in advance of expenditures are recorded as deferred revenue. Advance payments received for student-related activities are recorded as deposits.

(g) *Use of Estimates*

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

(h) *Functional Reporting of Expenses*

The cost of providing the College's activities has been summarized on a functional basis in the accompanying statements of activities. For the years ended June 30, 2004 and 2003, expenses associated with the College's property and equipment, including depreciation, operations, and maintenance expenses, are functionally allocated based on estimated space utilized.

(i) *Income Tax Status*

The College is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is generally exempt from income taxes pursuant to Section 501(a) of the Code.

(j) *Reclassifications*

Certain 2003 balances have been reclassified to conform to 2004 recording practices.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

(3) Long-Term Investments

Long-term investments consisted of the following as of June 30:

	<u>2004</u>	<u>2003</u>
Equity securities	\$ 190,585	29,461
Preferred equity securities	1,500	269
Short-term mutual funds	3,025	118
Fixed-income securities	<u>115,419</u>	<u>—</u>
Long-term investments, at fair value	<u>\$ 310,529</u>	<u>29,848</u>

Investments by net asset class as of June 30 are as follows:

	<u>2004</u>	<u>2003</u>
Permanently restricted	\$ 1,745	—
Temporarily restricted	<u>308,784</u>	<u>29,848</u>
Total	<u>\$ 310,529</u>	<u>29,848</u>

Total investment management and advisory fees were approximately \$525 and \$22 for the years ended June 30, 2004 and 2003, respectively.

(4) Property and Equipment

Property and equipment consisted of the following as of June 30:

	<u>2004</u>	<u>2003</u>
Land	\$ 14,610	14,610
Buildings and improvements	102,475	102,475
Equipment	6,813	6,397
Construction in progress	<u>12,757</u>	<u>3,021</u>
	136,655	126,503
Less accumulated depreciation	<u>(7,133)</u>	<u>(4,152)</u>
Property and equipment, net	<u>\$ 129,522</u>	<u>122,351</u>

Included in construction in progress at June 30, 2004 is \$2,455 of net capitalized interest associated with the construction of the second residence hall.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

(5) Expenses

Expenses by their natural classification were as follows for the years ended June 30:

	<u>2004</u>	<u>2003</u>
Salaries	\$ 7,334	5,884
Benefits	1,476	1,277
Interest and other financing	1,197	—
Depreciation and amortization	3,189	3,782
Information and communications	2,023	2,034
Facility services	1,464	2,021
Babson College services	2,893	1,937
Training, travel and entertainment	1,287	1,102
Professional services	1,836	1,003
Program and other	106	72
Materials and supplies	344	250
Insurance	133	145
Consumable equipment	506	112
	<u>\$ 23,788</u>	<u>19,619</u>

The College has established a contributory retirement plan (the Plan) for eligible personnel. The Plan is designed in accordance with the provisions of Section 403(b) of the Code. The College's expenses under the Plan were \$641 and \$564 for the years ended June 30, 2004 and 2003, respectively.

(6) Contributions from the Foundation

On December 26, 2002, the Foundation entered into an Endowment Grant Agreement (the Agreement) with the College. The Agreement provides that the Foundation will contribute a significant portion of its remaining investment assets to the College to establish the Olin Endowment and to subsidize as necessary the College's operating and capital requirements. All such amounts constituting the Olin Endowment are available for the College's use in certain specified circumstances, including debt repayment in the event that unrestricted net assets are insufficient for that purpose. However, the Agreement also stipulates that the Endowment Take, that is, the annual amount appropriated by the College to fund its operating needs, may generally not exceed 6% of the Olin Endowment. Endowment Take sought beyond this 6% limit requires affirmative Board appropriation. There are also certain restrictions regarding permissible uses of the Endowment Take and any operating surpluses generated by the College. Because of these various use and time restrictions, the Olin Endowment, including interest, dividends and net investment gain (loss) thereon, is recorded as an increase (decrease) in temporarily restricted net assets.

On September 15, 2004, the Foundation and the College signed an amendment to the Agreement that accelerated the remaining pledge commitment to the College. The Foundation transferred securities with a fair market value of \$75,671 (in addition to a regularly scheduled payment of \$4,000 made in August 2004) to the College to be added to the Olin Endowment. In addition, on September 17, 2004, the College and the Foundation entered into a Surplus Funds Agreement whereby the Foundation committed to transfer

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

substantially all its remaining assets to the College. In return, the College committed to add these funds to the Olin Endowment and also agreed to certain other covenants. On September 21, 2004, the Foundation transferred \$27,065 in securities to the College under the terms of the Surplus Funds Agreement.

(7) Bonds Payable

Debt consisted of the following as of June 30, 2004:

Taxable Revenue Bonds Series A-1 and A-2 Auction Variable Rate Securities, maturing serially from 2030 to 2033, at a rate of 1.4%	\$ 93,200
Tax-Exempt Revenue Bonds Series B, at a rate of 5.25%, maturing serially from 2028 to 2033	<u>65,910</u>
	159,110
Less unamortized bond discount	<u>(1,322)</u>
Bonds payable, net	<u><u>\$ 157,788</u></u>

The College issued multiple series of bonds in September 2003. A portion of the proceeds from these bonds was used to reimburse the College for construction of Phase I of the main campus, and the remaining balance is to be used for construction of a second residence hall. The bonds are secured by approximately 42.6 acres of the College's land, along with the associated buildings, facilities and improvements.

The terms of the Bonds include debt covenants such as maintaining certain values of net assets available for debt service.

Repayments of Series A-1 are as follows: \$10,000 in 2030, \$10,000 in 2031, \$10,000 in 2032 and \$10,000 in 2033. The lump-sum repayment of the \$53,200 Series A-2 bonds is due in 2033.

Sinking fund payments on the Series B bonds are as follows: \$1,025 in 2028, \$10,315 in 2029, \$11,545 in 2030, \$12,870 in 2031, \$14,305 in 2032, and \$15,850 in 2033.

Included in other assets on the statements of financial position are unamortized bond issuance costs of \$5,148 as of June 30, 2004.

Interest expense was \$969 for the year ended June 30, 2004.

The College leases office equipment and construction trailers under noncancelable agreements that expire on various dates through 2006. Rental expense under these agreements aggregated \$85 and \$507 for the years ended June 30, 2004 and 2003, respectively.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

Future minimum annual lease payments required under these leases are as follows:

	Amount
Years ending June 30:	
2005	\$ 369
2006	34
Thereafter	—
	\$ 403

(8) Restricted Net Assets and Releases

(a) Temporarily Restricted Net Assets

Temporarily restricted net assets consisted of the following as of June 30:

	2004	2003
Contributions receivable from the Foundation	\$ 81,388	216,060
Olin Endowment	187,046	29,901
Purpose restrictions	301	256
Investment in property and equipment (to be released over time)	102,260	105,642
	\$ 370,995	351,859

(b) Permanently Restricted Net Assets

Permanently restricted net assets consisted of the following as of June 30:

	2004	2003
Land purchased with Foundation contributions	\$ 14,610	14,610
Bioengineering chair	1,633	1,633
Milas Library Fund	100	76
Olin Endowment	12	5
	\$ 16,355	16,324

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

(c) *Net Assets Released from Restrictions*

Net assets released from restrictions consisted of the following as of June 30:

	<u>2004</u>	<u>2003</u>
Depreciation	\$ 2,981	3,782
Collections of Foundation contributions receivable utilized for operations	19,231	6,253
Scholarship	17	11
Other	21	—
	<u>\$ 22,250</u>	<u>10,046</u>