



FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Financial Statements

June 30, 2005 and 2004

(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, 2005 and 2004, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control over financial reporting. Accordingly, we express no such opinion. 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, 2005 and 2004, 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 8, 2005

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Statements of Financial Position

June 30, 2005 and 2004

(In thousands)

Assets	2005	2004
Cash and cash equivalents	\$ 2,041	2,934
Interest and dividends receivable	846	1,474
Other assets (note 7)	5,683	5,792
Loans receivable	620	599
Deposits with bond trustees	3,849	17,148
Contributions receivable from F. W. Olin Foundation, Inc. (note 6)	5,000	81,388
Long-term investments, at fair value (note 3)	418,732	310,529
Property and equipment, net (notes 4 and 7)	138,132	129,522
Total assets	<u>\$ 574,903</u>	<u>549,386</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 3,297	3,519
Deferred revenue and deposits	170	311
Bonds payable, net (note 7)	157,836	157,788
Total liabilities	<u>161,303</u>	<u>161,618</u>
Net assets:		
Unrestricted	15,023	418
Temporarily restricted (note 8)	396,750	370,995
Permanently restricted (note 8)	1,827	16,355
Total net assets	<u>413,600</u>	<u>387,768</u>
Total liabilities and net assets	<u>\$ 574,903</u>	<u>549,386</u>

See accompanying notes to financial statements.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Statements of Activities

Years ended June 30, 2005 and 2004

(In thousands)

	2005				2004			
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues and other support:								
Contributions from the Foundation (note 6)	\$ —	34,796	—	34,796	—	—	—	—
Change in fair value of contributions receivable from the Foundation (note 6)	—	(1,718)	—	(1,718)	—	18,704	—	18,704
Other contributions	80	123	77	280	12	148	31	191
Grants	1,309	—	—	1,309	1,451	—	—	1,451
Student fees, net	1,442	—	—	1,442	822	—	—	822
Interest and dividend income	66	7,685	—	7,751	7	7,132	—	7,139
Net realized and unrealized gain on long-term investments	—	11,068	—	11,068	—	15,402	—	15,402
Other	105	213	—	318	175	—	—	175
Net assets released from restrictions (note 8)	41,017	(26,412)	(14,605)	—	22,250	(22,250)	—	—
Total revenues and other support	44,019	25,755	(14,528)	55,246	24,717	19,136	31	43,884
Expenses (note 5):								
Instruction	7,086	—	—	7,086	5,264	—	—	5,264
Academic support	3,434	—	—	3,434	2,804	—	—	2,804
Student services	6,812	—	—	6,812	4,740	—	—	4,740
Research	1,125	—	—	1,125	1,022	—	—	1,022
Sponsored programs	1,469	—	—	1,469	1,561	—	—	1,561
Development and fundraising	393	—	—	393	256	—	—	256
Institutional support	9,095	—	—	9,095	8,141	—	—	8,141
Total expenses	29,414	—	—	29,414	23,788	—	—	23,788
Change in net assets	14,605	25,755	(14,528)	25,832	929	19,136	31	20,096
Net assets (deficit) as of beginning of year	418	370,995	16,355	387,768	(511)	351,859	16,324	367,672
Net assets as of end of year	\$ 15,023	396,750	1,827	413,600	418	370,995	16,355	387,768

See accompanying notes to financial statements.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Statements of Cash Flows

Years ended June 30, 2005 and 2004

(In thousands)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Change in net assets	\$ 25,832	20,096
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	4,820	3,189
Net realized and unrealized gain on long-term investments	(11,068)	(15,402)
Gift of securities	(27,065)	—
Contributions restricted for long-term investment	(2,731)	—
Change in interest and dividends receivable	628	(1,422)
Increase in other assets	(72)	(183)
Net change in contributions receivable from the Foundation	718	(9,358)
Decrease in accounts payable and accrued expenses	(241)	(2,807)
Decrease in deferred revenue and deposits	(141)	(159)
Net cash used in operating activities	<u>(9,320)</u>	<u>(6,046)</u>
Cash flows from investing activities:		
Purchases of investments	(954,937)	(731,734)
Sales and maturities of investments	960,538	610,484
Acquisition and construction of property and equipment	(13,191)	(9,056)
Sales of property and equipment	8	—
Change in deposits with bond trustees	13,299	(17,148)
Increase in loans receivable	(21)	(399)
Net cash used in investing activities	<u>5,696</u>	<u>(147,853)</u>
Cash flows from financing activities:		
Proceeds from borrowings, net of discount	—	157,776
Payment of bond issuance costs	—	(5,344)
Contributions restricted for long-term investment	2,731	—
Net cash provided by financing activities	<u>2,731</u>	<u>152,432</u>
Net change in cash	(893)	(1,467)
Cash and cash equivalents as of beginning of year	<u>2,934</u>	<u>4,401</u>
Cash and cash equivalents as of end of year	\$ <u><u>2,041</u></u>	\$ <u><u>2,934</u></u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 7,230	957
Securities received from the Foundation	102,736	144,029

See accompanying notes to financial statements.

FRANKLIN W. OLIN COLLEGE OF ENGINEERING, INC.

Notes to Financial Statements

June 30, 2005 and 2004

(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 2005, there will be approximately 300 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, 2005 and 2004, such fees were \$2,525 and \$2,893, respectively, of which \$218 and \$229 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

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stipulated time period has elapsed. 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) *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash in banks and short-term investments with a maturity date from purchase of three months or less.

(c) *Long-Term Investments*

Long-term investments are carried at fair value based on quoted market prices as provided by the fund managers.

(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 each 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.

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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, 2005 and 2004, 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 2004 balances have been reclassified to conform to the 2005 presentation.

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(Dollars in thousands)

(3) Long-Term Investments

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

	<u>2005</u>	<u>2004</u>
Equity securities	\$ 268,457	190,585
Preferred equity securities	162	1,500
Short-term mutual funds	3,098	3,025
Forward contracts	142	—
Fixed-income securities	<u>146,873</u>	<u>115,419</u>
Long-term investments, at fair value	<u>\$ 418,732</u>	<u>310,529</u>

Total investment management and advisory fees were approximately \$1,641 and \$525 for the years ended June 30, 2005 and 2004, respectively.

(4) Property and Equipment

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

	<u>2005</u>	<u>2004</u>
Land	\$ 14,610	14,610
Buildings and improvements	106,905	102,475
Equipment	7,164	6,813
Construction in progress	<u>21,170</u>	<u>12,757</u>
	149,849	136,655
Less accumulated depreciation	<u>(11,717)</u>	<u>(7,133)</u>
Property and equipment, net	<u>\$ 138,132</u>	<u>129,522</u>

The College capitalized interest associated with the construction of the second residence hall in the amount of \$1,160 and \$2,455 for the years ended June 30, 2005 and 2004, respectively.

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(Dollars in thousands)

(5) Expenses

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

	<u>2005</u>	<u>2004</u>
Salaries	\$ 7,993	7,334
Benefits	1,786	1,476
Interest and other fees	4,933	1,197
Depreciation and amortization	4,820	3,189
Information and communications	2,102	2,023
Facility services	1,681	1,464
Babson College services	2,525	2,893
Training, travel and entertainment	1,471	1,287
Professional services	1,238	1,836
Program and other	109	106
Materials and supplies	320	344
Insurance	140	133
Consumable equipment	296	506
	<u>\$ 29,414</u>	<u>23,788</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 \$676 and \$641 for the years ended June 30, 2005 and 2004, 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% general limitation 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. Through June 30, 2004, the Foundation transferred cash and securities initially valued at \$191,644 in support of this agreement.

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

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August 2004) to the College to be added to the Olin Endowment. In conjunction therewith, a decrease in fair market value adjustment of \$1,718 was made to reflect the completion of contribution receivables from the Foundation.

On September 17, 2004, the College and the Foundation entered into a Surplus Funds Agreement whereby the Foundation committed to transfer substantially all its remaining assets to the College. Thereafter, from September to November 2004, the Foundation transferred \$27,065 in securities and \$2,731 in cash to the College under the terms of the Surplus Funds Agreement. The College has recorded a receivable of \$5,000 under this agreement at June 30, 2005. The remaining balance of the Foundation's available assets, after payment of all its debts and expenses, will be transferred to the College upon settlement of the Foundation. In return, the College committed to add these funds to the Olin Endowment and also agreed to certain other covenants including the payments of any debts or expenses which might arise after the reserve has been transferred to the College.

(7) Bonds Payable

Debt consisted of the following as of June 30:

	<u>2005</u>	<u>2004</u>
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	93,200
Tax-Exempt Revenue Bonds Series B, at a rate of 5.25%, maturing serially from 2028 to 2033	<u>65,910</u>	<u>65,910</u>
	159,110	159,110
Less unamortized bond discount	<u>(1,274)</u>	<u>(1,322)</u>
Bonds payable, net	<u>\$ 157,836</u>	<u>157,788</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, with which the College is in compliance at June 30, 2005.

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.

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(Dollars in thousands)

Included in other assets on the statements of financial position are unamortized bond issuance costs of \$4,967 and \$5,148 as of June 30, 2005.

Interest expense was \$4,668 and \$969 for the years ended June 30, 2005 and 2004, respectively.

The College leases office equipment and construction trailers under noncancelable agreements that expire on various dates through 2008. Rental expense under these agreements aggregated \$70 and \$85 for the years ended June 30, 2005 and 2004, respectively.

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

	<u>Amount</u>
Years ending June 30:	
2006	\$ 17
2007	10
2008	10
2009	2
	<u>39</u>
	<u>\$ 39</u>

(8) Restricted Net Assets and Releases

(a) Temporarily Restricted Net Assets

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

	<u>2005</u>	<u>2004</u>
Contributions receivable from the Foundation	\$ 5,000	81,388
Olin Endowment	292,855	187,046
Purpose restrictions	690	301
Investment in property and equipment (to be released over time)	98,205	102,260
	<u>\$ 396,750</u>	<u>370,995</u>

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(Dollars in thousands)

(b) Permanently Restricted Net Assets

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

	<u>2005</u>	<u>2004</u>
Land	\$ —	14,605
Bioengineering chair	1,633	1,633
Milas Library Fund	125	100
Olin Endowment	19	17
Samuel & Rae Eckman Endowment	50	—
	<u>\$ 1,827</u>	<u>16,355</u>

On August 29, 2005, effective as of June 30, 2005, the Board of Directors of the Foundation released all restrictions on a previous contribution of \$14,605 to the College, which was originally restricted in perpetuity.

(c) Net Assets Released from Restrictions

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

	<u>2005</u>	<u>2004</u>
Depreciation	\$ 4,590	2,981
Olin Endowment	21,709	19,231
Scholarships	103	17
Other	10	21
	<u>\$ 26,412</u>	<u>22,250</u>

Included in the Olin Endowment release for the year ended June 30, 2005 is \$809 of accrued expenses for which the cash has not been transferred to the operating account. The Olin Endowment cash draw amounted to \$20,900 and \$19,321 for the years ended June 30, 2005 and 2004, respectively.