

AMERICAN UNIVERSITY OF BEIRUT

Financial Statements

September 30, 2003 and 2002

(With Independent Auditors' Report Thereon)



345 Park Avenue
New York, NY 10154

Independent Auditors' Report

The Board of Trustees
American University of Beirut:

We have audited the accompanying balance sheets of American University of Beirut (the University) as of September 30, 2003 and 2002, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our 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 American University of Beirut as of September 30, 2003 and 2002, 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

February 27, 2004



KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

AMERICAN UNIVERSITY OF BEIRUT

Balance Sheets

September 30, 2003 and 2002

Assets	2003	2002
Cash and cash equivalents	\$ 16,027,733	6,080,976
Accounts and grants receivable, net of allowances: 2003, \$10,612,000; 2002, \$10,894,000	48,908,393	41,416,425
Inventories and prepaid expenses	5,696,024	4,854,547
Contributions receivable, net of allowances: 2003, \$685,000; 2002, \$1,525,000	20,994,176	16,477,781
Investments	308,920,742	261,011,188
Property and equipment, net	185,252,191	175,309,232
Total assets	\$ 585,799,259	505,150,149
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 22,124,106	22,610,789
Deposits and deferred revenues	19,485,242	5,236,512
Term loan payable to bank	25,000,000	—
Accrued end-of-service benefits	44,900,000	46,400,000
Total liabilities	111,509,348	74,247,301
Net assets:		
Unrestricted – allocated to:		
Operations	2,021,566	(687,870)
Exchange differential	(15,964,385)	(15,964,385)
Investment:		
Net gains on endowment fund investments	37,788,860	32,633,591
Net gains on quasi-endowment fund investments	24,286,015	20,002,034
Other	107,556,709	99,792,623
Property and equipment acquisitions	17,460,416	20,945,812
Net investment in property and equipment	176,403,252	175,309,232
Total unrestricted	349,552,433	332,031,037
Temporarily restricted	76,502,369	58,266,753
Permanently restricted	48,235,109	40,605,058
Total net assets	474,289,911	430,902,848
Commitments and contingencies		
Total liabilities and net assets	\$ 585,799,259	505,150,149

See accompanying notes to financial statements.

AMERICAN UNIVERSITY OF BEIRUT

Statements of Activities

Years ended September 30, 2003 and 2002

	2003				2002			
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Unrestricted	Temporarily restricted	Permanently restricted	Total
Operating:								
Revenues:								
Contributions, grants, and contracts	\$ 4,639,322	11,982,386	—	16,621,708	5,791,944	10,065,185	—	15,857,129
Fees for services:								
Educational services	63,814,893	—	—	63,814,893	58,563,912	—	—	58,563,912
Health services	59,978,895	—	—	59,978,895	55,750,453	—	—	55,750,453
Auxiliary enterprises	3,302,283	—	—	3,302,283	3,211,103	—	—	3,211,103
Net investment return recognized in operations	13,518,363	6,668,189	—	20,186,552	8,069,064	2,050,766	—	10,119,830
	145,253,756	18,650,575	—	163,904,331	131,386,476	12,115,951	—	143,502,427
Net assets released from restrictions	16,153,850	(16,153,850)	—	—	14,829,517	(14,829,517)	—	—
Total operating revenues	161,407,606	2,496,725	—	163,904,331	146,215,993	(2,713,566)	—	143,502,427
Expenses:								
Educational services	70,788,484	—	—	70,788,484	63,055,320	—	—	63,055,320
Health services	65,164,936	—	—	65,164,936	54,524,380	—	—	54,524,380
Auxiliary enterprises	4,444,321	—	—	4,444,321	3,315,929	—	—	3,315,929
Management and general	16,419,772	—	—	16,419,772	19,083,673	—	—	19,083,673
Development and public relations	3,488,399	—	—	3,488,399	3,103,279	—	—	3,103,279
Total operating expenses	160,305,912	—	—	160,305,912	143,082,581	—	—	143,082,581
Excess (deficiency) of operating revenues over operating expenses	1,101,694	2,496,725	—	3,598,419	3,133,412	(2,713,566)	—	419,846
Nonoperating:								
Endowment and property and equipment acquisition contributions	—	12,048,535	7,262,804	19,311,339	—	3,952,874	1,289,898	5,242,772
Net investment return (loss) in excess of amounts recognized in operations	21,520,970	3,690,356	367,247	25,578,573	(55,529,694)	(5,718,849)	(310,246)	(61,558,789)
Early departure program	(5,101,268)	—	—	(5,101,268)	—	—	—	—
Total nonoperating revenues (losses)	16,419,702	15,738,891	7,630,051	39,788,644	(55,529,694)	(1,765,975)	979,652	(56,316,017)
Change in net assets before change in donor designation	17,521,396	18,235,616	7,630,051	43,387,063	(52,396,282)	(4,479,541)	979,652	(55,896,171)
Change in donor designation	—	—	—	—	(2,000,000)	—	2,000,000	—
Total change in net assets	17,521,396	18,235,616	7,630,051	43,387,063	(54,396,282)	(4,479,541)	2,979,652	(55,896,171)
Net assets:								
Beginning of year	332,031,037	58,266,753	40,605,058	430,902,848	386,427,319	62,746,294	37,625,406	486,799,019
End of year	\$ 349,552,433	76,502,369	48,235,109	474,289,911	332,031,037	58,266,753	40,605,058	430,902,848

See accompanying notes to financial statements.

AMERICAN UNIVERSITY OF BEIRUT

Statements of Cash Flows

Years ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Total change in net assets	\$ 43,387,063	(55,896,171)
Adjustments to reconcile total change in net assets to net cash used in operating activities:		
Depreciation	9,419,005	8,689,719
Recovery of doubtful accounts	(282,000)	(2,203,000)
Contributions restricted for endowment and property and equipment acquisitions	(19,311,339)	(5,242,772)
Net (appreciation) depreciation in fair value of investments	(40,788,395)	57,901,220
Contributions of property and equipment	(313,750)	(1,692,000)
(Increase) decrease in accounts and grants receivable	(7,209,968)	6,880,494
(Increase) decrease in inventories and prepaid expenses	(841,477)	597,321
(Increase) decrease in contributions receivable, excluding amounts restricted for endowment and property and equipment acquisitions	(362,666)	1,121,807
Decrease in accounts payable and accrued expenses	(486,683)	(1,600,723)
Increase (decrease) in deposits and deferred revenues	14,248,730	(8,026,979)
Decrease in accrued end-of-service benefits	(1,500,000)	(6,600,000)
Net cash used in operating activities	<u>(4,041,480)</u>	<u>(6,071,084)</u>
Cash flows from investing activities:		
Proceeds from sales of investments	201,362,164	1,005,077,861
Purchases of investments	(208,666,242)	(986,131,344)
Purchases of property and equipment	(19,048,214)	(20,122,038)
Net cash used in investing activities	<u>(26,352,292)</u>	<u>(1,175,521)</u>
Cash flows from financing activities:		
Proceeds from contributions restricted for:		
Investment in endowment	7,206,075	1,302,823
Investment in property and equipment	7,951,535	2,430,874
Income and net gains restricted for investment	182,919	56,653
Proceeds from term loan payable to bank	25,000,000	—
Principal payments under capital lease obligations	—	(618,761)
Net cash provided by financing activities	<u>40,340,529</u>	<u>3,171,589</u>
Net increase (decrease) in cash and cash equivalents	9,946,757	(4,075,016)
Cash and cash equivalents:		
Beginning of year	<u>6,080,976</u>	<u>10,155,992</u>
End of year	\$ <u><u>16,027,733</u></u>	\$ <u><u>6,080,976</u></u>
Supplemental data:		
Cash paid for interest	\$ 679,055	181,327

See accompanying notes to financial statements.

AMERICAN UNIVERSITY OF BEIRUT

Notes to Financial Statements

September 30, 2003 and 2002

(1) Nature of Operations

American University of Beirut (the University) is an independent, not-for-profit, coeducational, nonsectarian institution of higher learning located in Beirut, Lebanon, where it also operates a 421-bed medical center. The University was granted its charter in 1863 by the State of New York and was founded in 1866. It is exempt from Federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

The purpose of the University, as an institution of higher learning, is to share in the education of the youth of the Middle East, in service of its people, and in the advancement of knowledge.

The University presently serves approximately 6,000 undergraduate students and 1,100 graduate and professional students in the faculties of Arts and Sciences, Agriculture and Food Sciences, Engineering and Architecture, Medicine, and Public Health and in the schools of Business and Nursing.

At September 30, 2003, approximately 43% of the University's assets are located in the Republic of Lebanon. Approximately 71% of those assets are property and equipment.

(2) Summary of Significant Accounting Policies

Basis of Presentation

The financial statements are prepared on the accrual basis of accounting. The University reports its net assets in one of the following three classes:

Unrestricted net assets – Net assets not subject to donor-imposed restrictions.

Temporarily restricted net assets – Net assets subject to donor-imposed restrictions that will be met by actions of the University or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed restrictions that stipulate they be maintained permanently, but permit the use of part or all of the income derived from them.

Substantially all gains, both realized and unrealized, arising from investment of the University's endowment resources and expendable resources designated by the Board for investment purposes (quasi-endowment) are classified as either unrestricted or temporarily restricted net assets in the accompanying financial statements. The University, however, intends to continue its management of endowment and similar resources in the manner employed in prior years, which considers gains as part of the original contribution and unexpendable except as permitted by the University's spending policy, based on total return. Such policy allows expenditure of 4.75% of the average of the prior 20 quarters' market value. Expendable amounts exceeding current yield (i.e., interest and dividends) are charged against accumulated gains.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by explicit donor-imposed restrictions or by law. When such restrictions expire, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of activities as net assets released from restrictions. Expenses are reported as decreases in unrestricted net assets.

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Contributions, including unconditional promises to give (pledges and grants), are reported as revenues in the appropriate net asset class in the period received at the estimated present value of future cash flows, net of an allowance for estimated uncollectible promises. Amortization of the present value discount is recorded as additional contribution revenue in the appropriate net asset class.

Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions of assets other than cash, including property and equipment, are recorded at their estimated fair value as increases in unrestricted net assets unless the donor restricts their use.

Health services revenues are recorded at the University's established rates, with provisions for third-party contractual adjustments, charity care, and bad debts deducted to arrive at net patient service revenues. Estimated contractual adjustments, including prospective rate adjustments arising under third-party agreements, are accrued in the period services are rendered. Differences between estimated retroactive third-party settlements for prior periods and subsequent final settlements are recorded as current period adjustments to revenues. The estimated settlements at September 30, 2003 relate to the years ended September 30, 2002 and 2003. Final settlements have been made for all other prior years.

Contracts are reported as revenues when earned in accordance with the terms of the agreements. Amounts received in advance are recognized as deferred revenues.

Expenses are charged to the functions incurring or benefiting from their occurrence. Certain expenses are allocated between medical educational services and health services based on actual levels of effort of the faculty members providing services to each function. Other expenses are allocated among functions on the basis of direct salary cost, metered usage, or other appropriate measures of the expenses incurred.

Operations

Operations include all revenues earned and expenses incurred by the University except for net appreciation and depreciation in fair value of long-term investments, contributions for property and equipment acquisitions or for permanently restricted purposes, exchange gains and losses on translation of assets and liabilities denominated in Lebanese pounds, and other nonrecurring transactions.

Cash Equivalents

Cash equivalents include all investments with maturities of three months or less at time of purchase, except for such assets held by the University's investment managers as part of their long-term investment strategies.

Property and Equipment

Land, buildings, and improvements are stated at values from an appraisal made in 1965 by the University, plus subsequent additions at cost. Equipment and construction in progress are stated at cost. Library books are valued at \$1 per volume, except for 1,233 volumes of rare books valued at a total amount of \$41,820, based on appraisals made in 1967 and 1968.

Depreciation is determined on the straight-line method over the estimated useful lives of the assets. Depreciation is not computed in the year of acquisition of assets, but a full year's depreciation is reflected

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September 30, 2003 and 2002

as expense in the year of asset disposal. Depreciable lives for land improvements and buildings and building improvements range from 20 to 50 years, and estimated useful lives of equipment range from three to 20 years.

Inventories

Inventories are stated at the lower of cost (stated at average cost) or market.

Currency Exchange

As indicated in note 1, the University conducts its educational, health, and auxiliary activities from facilities located in the Republic of Lebanon. The local currency is the Lebanese pound, and many of the University's transactions are denominated in that currency. Other transactions occur in U.S. dollars. Assets, liabilities, and related net assets are recorded in the currency in which they are denominated (i.e., Lebanese pounds or U.S. dollars). To provide for reporting of revenue and expense transactions in U.S. dollars at the time of their occurrence, the University establishes exchange rates between the pound and the dollar at the beginning of each month and translates assets and liabilities at the month-end rate. Exchange gains or losses are recognized as revenue or expense.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could be different from those estimates.

Other Significant Accounting Policies

Other significant accounting policies are set forth in the financial statements and the following notes.

Reclassifications

Certain amounts for 2002 have been reclassified to conform to the current year's presentation.

(3) Currency Rate

During 2003 and 2002, established monthly exchange rates between the Lebanese pound and the U.S. dollar were L£1,508 = \$1. The rate at September 30, 2003 and 2002 was L£1,508 = \$1.

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Notes to Financial Statements

September 30, 2003 and 2002

(4) Investments

The University reports its investments at fair value based on the values provided by its external investment managers or upon quoted market values. The following tabulation summarizes the composition of investments at September 30, 2003 and 2002:

	2003		2002	
	Cost	Fair value	Cost	Fair value
Uninvested cash	\$ 1,399,957	1,399,957	216,490	216,155
Due to brokers	(364,880)	(364,880)	(180,188)	(180,188)
Forward contracts – buy/sell:				
U.S. dollars	—	—	—	(7,153)
Accrued income	243,932	243,932	399,891	400,226
Money market funds	120,000	120,000	17,448,273	17,445,420
U.S. Government obligations	5,375,173	5,481,994	7,957,032	8,293,201
Mortgage-backed securities	3,111,931	3,086,732	2,231,473	2,378,192
Corporate bonds	1,989,133	2,059,690	26,781,258	27,285,452
Mutual funds – fixed income	24,332,211	24,269,721	—	—
Alternative investments	52,951,512	60,593,881	50,851,455	51,731,447
Mutual funds – equities	96,708,663	110,471,566	60,000,000	53,931,863
Corporate stocks	90,682,368	101,558,149	116,477,368	99,516,573
	<u>\$ 276,550,000</u>	<u>308,920,742</u>	<u>282,183,052</u>	<u>261,011,188</u>

Although the University does not directly employ investment-related derivatives, it does approve strategic use of derivatives by external investment managers. The uses of such strategies by the investment managers are limited to future contracts against currency translation risk for investments denominated in other-than-U.S. dollars.

At June 30, 2003, the University had funding commitments outstanding of approximately \$5.2 million under the terms of certain alternative investment agreements. The University maintains sufficient liquidity in its investment portfolio to cover such commitments.

Certain securities are pledged as collateral for the term loan payable to bank outstanding at September 30, 2003 (see note 11).

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Notes to Financial Statements

September 30, 2003 and 2002

The following table summarizes the University's total investment return and its classification in the financial statements for years ended September 30, 2003 and 2002:

<u>2003</u>	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Dividends and interest on investments, net of expenses of \$850,813	\$ 265,867	3,757,381	74,796	4,098,044
Net appreciation in fair value of investments	<u>33,963,320</u>	<u>6,584,232</u>	<u>240,843</u>	<u>40,788,395</u>
Net gain on investments	34,229,187	10,341,613	315,639	44,886,439
Interest on cash equivalents	<u>810,146</u>	<u>16,932</u>	<u>51,608</u>	<u>878,686</u>
Total return on investments and cash equivalents	35,039,333	10,358,545	367,247	45,765,125
Investment return recognized in operations	<u>13,518,363</u>	<u>6,668,189</u>	<u>—</u>	<u>20,186,552</u>
Net investment gain in excess of amounts recognized in operations	<u>\$ 21,520,970</u>	<u>3,690,356</u>	<u>367,247</u>	<u>25,578,573</u>

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Notes to Financial Statements

September 30, 2003 and 2002

<u>2002</u>	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Dividends and interest on investments, net of expenses of \$843,516	\$ 3,330,770	2,049,550	34,123	5,414,443
Net depreciation in fair value of investments	<u>(51,379,887)</u>	<u>(5,718,849)</u>	<u>(366,899)</u>	<u>(57,465,635)</u>
Net loss on investments	(48,049,117)	(3,669,299)	(332,776)	(52,051,192)
Interest on cash equivalents	<u>588,487</u>	<u>1,216</u>	<u>22,530</u>	<u>612,233</u>
Total return on investments and cash equivalents	(47,460,630)	(3,668,083)	(310,246)	(51,438,959)
Investment return recognized in operations	<u>8,069,064</u>	<u>2,050,766</u>	<u>—</u>	<u>10,119,830</u>
Net investment loss in excess of amounts recognized in operations	<u>\$ (55,529,694)</u>	<u>(5,718,849)</u>	<u>(310,246)</u>	<u>(61,558,789)</u>

(5) Contributions Receivable

Contributions receivable consist of the following at September 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Amounts expected to be collected in:		
Less than one year	\$ 5,782,247	5,052,812
One to five years	<u>17,524,599</u>	<u>14,384,509</u>
	23,306,846	19,437,321
Less:		
Discount to present value at 3%	1,628,158	1,435,028
Allowance for doubtful collection	<u>684,512</u>	<u>1,524,512</u>
	<u>\$ 20,994,176</u>	<u>16,477,781</u>

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Notes to Financial Statements

September 30, 2003 and 2002

(6) Property and Equipment

Property and equipment at September 30, 2003 and 2002 consist of the following:

	2003	2002
Land and land improvements	\$ 65,325,674	65,159,096
Buildings and building improvements	98,409,127	80,568,484
Equipment	88,762,131	86,603,957
Library books	646,254	636,366
Construction in progress	21,961,030	24,612,968
Total	275,104,216	257,580,871
Less accumulated depreciation	89,852,025	82,271,639
	\$ 185,252,191	175,309,232

(7) Employee Benefit Plans

The University has contributory and noncontributory employee benefit plans designed to provide pension benefits and, in accordance with Lebanese law, end-of-service indemnities. Total expense under these plans for the years ended September 30, 2003 and 2002 was \$11,439,000 and \$4,057,000, respectively.

Accumulated benefits for non-U.S. citizen academic employees under a separate plan are included in the accrued end-of-service benefits.

(8) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets at September 30, 2003 and 2002 are available for the following purposes:

	2003	2002
Educational services:		
Instruction	\$ 19,340,363	17,535,893
Research	6,390,319	3,147,756
Academic support	1,038,455	1,087,433
Student aid	20,183,792	17,023,232
Health services	1,385,914	1,378,019
Property and equipment	25,074,071	15,246,677
College Hall Fund	2,747,457	2,283,888
Other	341,998	563,855
	\$ 76,502,369	58,266,753

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September 30, 2003 and 2002

Permanently restricted net assets at September 30, 2003 and 2002 are restricted for investment in perpetuity, with investment return available to support the following activities:

	<u>2003</u>	<u>2002</u>
Educational services:		
Instruction	\$ 28,343,374	22,275,440
Research	96,495	96,495
Academic support	1,219,624	1,231,103
Student aid	13,076,747	11,804,784
Health services	2,672,043	2,448,641
Other	2,826,826	2,748,595
	<u>\$ 48,235,109</u>	<u>40,605,058</u>

(9) Fair Value of Financial Information

The fair value of the University's investments is discussed in note 4. The fair value of the University's other financial instruments approximates their carrying value because of the short maturity of these instruments.

(10) Medical Malpractice Insurance and Litigation

The University has obtained medical malpractice liability coverage, under public liability insurance coverage from a commercial carrier, for claims made during the policy period with coverage limits dependent on the time of occurrence of the alleged event and subject to deductibles dependent on the jurisdiction in which the claim arises. The cost for providing the public liability coverage, including that for medical malpractice, was \$390,000 and \$311,000 for the years ended September 30, 2003 and 2002, respectively.

The University is a defendant to various claims alleging medical malpractice or arising out of the operations of its educational programs at its Beirut campus. The outcome of these actions, seeking damages potentially in excess of the University's insurance coverage, cannot be determined at this time. University management believes that the University has good and meritorious defenses against these claims, and does not expect the ultimate resolution of these actions to have a material adverse effect on the University's financial position.

(11) Term Loan Payable to Bank

In connection with the purchase of an office condominium in September 2002 and in anticipation of commencing construction of a student activity center on the Beirut campus, on January 15, 2003, the University obtained a ten-year term loan from a commercial bank in the amount of \$25 million at an interest rate of 3.74% for the first five years; thereafter, the University has an option to change to a rate of the London InterBank Offered Rate plus .25%. Monthly principal payments of \$416,677 commence in 2008, with final payment due January 2013. The term loan is secured by a pledge of certain securities of the University's investment portfolio. Interest expense for the year ended September 30, 2003 was \$755,904, of which \$611,734 was capitalized in property and equipment.

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September 30, 2003 and 2002

(12) Early Departure Program

During 2003, in connection with a reorganization plan of medical and support units, the University instituted a voluntary early departure program for nonacademic employees. Accordingly, the University recorded a nonoperating charge of \$5,101,268 for severance and related costs for those individuals who elected to take early departure by June 30, 2003. Such charge related primarily to health services and management and general expenses.