

PACIFIC LUTHERAN UNIVERSITY
Tacoma, Washington

FINANCIAL STATEMENTS
Including Independent Auditors' Report

As of and for the Years Ended May 31, 2012 and 2011

PACIFIC LUTHERAN UNIVERSITY

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INDEPENDENT AUDITORS' REPORT

To the Board of Regents
Pacific Lutheran University
Tacoma, Washington

We have audited the accompanying statements of financial position of Pacific Lutheran University (the "University") as of May 31, 2012 and 2011 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 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 University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, 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 previously present fairly, in all material respects, the financial position of Pacific Lutheran University at May 31, 2012 and 2011, 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.

Baker Tilly Virchow Krause, LLP

Minneapolis, Minnesota
October 18, 2012

PACIFIC LUTHERAN UNIVERSITY

STATEMENTS OF FINANCIAL POSITION
As of May 31, 2012 and 2011

ASSETS		
	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 17,230,664	\$ 17,786,324
Student receivables, net of allowance for doubtful accounts of \$419,800 and \$387,600	1,186,441	1,348,887
Other receivables	1,073,068	596,315
Estate gift receivable	3,500,000	9,500,000
Real estate contracts receivable	175,551	814,833
Grants receivable	665,759	644,409
Contributions receivable, net	2,982,528	4,612,126
Inventories	826,605	844,983
Prepaid expenses and deposits	960,546	1,213,167
Real estate	2,902,920	2,814,256
Student loans receivables, net	7,542,098	7,586,966
Investments	11,227,605	11,873,076
Endowment investments	68,925,200	70,011,821
Deposits held by trustee		
Government obligations	4,739,300	4,708,904
Bond acquisition costs	1,365,387	1,420,002
Construction in progress	10,881,009	6,084,578
Property, plant and equipment, net	<u>103,282,462</u>	<u>106,592,289</u>
TOTAL ASSETS	<u>\$ 239,467,143</u>	<u>\$ 248,452,936</u>
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 2,322,210	\$ 1,720,955
Accrued liabilities	7,146,898	6,954,164
Student deposits	1,774,249	2,061,446
Asset retirement obligation	974,302	927,906
Long-term debt	57,072,107	58,228,531
Unamortized premium on long-term debt	997,659	1,037,566
Annuities payable	6,192,641	6,928,935
Deposits held in custody for others	1,224,339	1,280,038
Government grants refundable	<u>7,528,484</u>	<u>7,568,698</u>
Total Liabilities	<u>85,232,889</u>	<u>86,708,239</u>
NET ASSETS		
Unrestricted	60,523,280	66,509,799
Temporarily restricted	22,552,802	24,593,484
Permanently restricted	<u>71,158,172</u>	<u>70,641,414</u>
Total Net Assets	<u>154,234,254</u>	<u>161,744,697</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 239,467,143</u>	<u>\$ 248,452,936</u>

PACIFIC LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES
For the Year Ended May 31, 2012
With Comparative Totals for 2011

	2012			2011 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
REVENUES, GAINS AND OTHER SUPPORT				
Tuition and fees	\$ 102,408,334			\$ 97,340,275
Less: Scholarships and grants	(41,391,396)			(39,305,904)
Net tuition and fees	61,016,938			58,034,371
Government grants	2,305,315			2,630,412
Private gifts	2,981,836	\$ 9,548,300	\$ 1,733,759	31,030,595
Endowment income and gains (losses)	(2,112,717)	5,430	16,803	7,187,111
Gains (losses) in perpetual trusts			(955,309)	899,574
Other investment income	80,828			65,235
Sales and services of educational activities	142,706			147,521
Other sources	669,702			1,017,162
Sales and services of auxiliary enterprises	17,712,235			17,199,036
	82,796,843	9,553,730	795,253	118,211,017
Reclassification of net assets	(5,554)	(113,938)	119,492	
Net assets released from restrictions	11,429,290	(11,429,290)		
Total Revenues, Gains and Other Support	94,220,579	(1,989,498)	914,745	93,145,826
EXPENSES AND LOSSES				
Program expenses				
Instruction	40,301,960			38,928,664
Research	433,087			416,715
Public service	7,058,614			6,671,945
Academic support	5,878,958			5,686,712
Student services	11,226,259			10,721,792
Auxiliary enterprises	16,739,816			16,349,600
Support expenses				
Institutional support	18,673,740			17,638,068
Allocable expenses				
Operation and maintenance of plant	9,897,618			8,896,157
Interest expense	2,674,107			2,731,192
Depreciation expense	4,415,764			4,503,664
Amortization expense	137,439			137,439
Accretion expense	46,393			44,189
Less: Allocated expenses	(17,171,321)			(16,312,641)
Adjustment of actuarial liability for annuities payable	(139,227)	5,978	397,987	(142,214)
Loss on contributions receivable	33,891	45,206		668,731
Total Expenses and Losses	100,207,098	51,184	397,987	96,940,013
Change in Net Assets	(5,986,519)	(2,040,682)	516,758	21,271,004
NET ASSETS - Beginning of Year	66,509,799	24,593,484	70,641,414	140,473,693
NET ASSETS - END OF YEAR	\$ 60,523,280	\$ 22,552,802	\$ 71,158,172	\$ 161,744,697

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES
For the Year Ended May 31, 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUES, GAINS AND OTHER SUPPORT				
Tuition and fees	\$ 97,340,275			\$ 97,340,275
Less: Scholarships and grants	<u>(39,305,904)</u>			<u>(39,305,904)</u>
Net tuition and fees	58,034,371			58,034,371
Government grants	2,630,412			2,630,412
Private gifts	19,161,081	\$ 9,629,244	\$ 2,240,270	31,030,595
Endowment income and gains	2,007,879	5,148,071	31,161	7,187,111
Gains in perpetual trusts			899,574	899,574
Other investment income	65,235			65,235
Sales and services of educational activities	147,521			147,521
Other sources	1,017,162			1,017,162
Sales and services of auxiliary enterprises	<u>17,199,036</u>			<u>17,199,036</u>
	100,262,697	14,777,315	3,171,005	118,211,017
Reclassification of net assets	66,608	(115,804)	49,196	
Net assets released from restrictions	<u>10,654,247</u>	<u>(10,654,247)</u>		
Total Revenues, Gains and Other Support	<u>110,983,552</u>	<u>4,007,264</u>	<u>3,220,201</u>	<u>118,211,017</u>
EXPENSES AND LOSSES				
Program expenses				
Instruction	38,928,664			38,928,664
Research	416,715			416,715
Public service	6,671,945			6,671,945
Academic support	5,686,712			5,686,712
Student services	10,721,792			10,721,792
Auxiliary enterprises	16,349,600			16,349,600
Support expenses				
Institutional support	17,638,068			17,638,068
Allocable expenses				
Operation and maintenance of plant	8,896,157			8,896,157
Interest expense	2,731,192			2,731,192
Depreciation expense	4,503,664			4,503,664
Amortization expense	137,439			137,439
Accretion expense	44,189			44,189
Less: Allocated expenses	<u>(16,312,641)</u>			<u>(16,312,641)</u>
Adjustment of actuarial liability for annuities payable	<u>(118,879)</u>	7,274	(30,609)	<u>(142,214)</u>
Loss on contributions receivable	<u>501,275</u>	<u>142,456</u>	<u>25,000</u>	<u>668,731</u>
Total Expenses and Losses	<u>96,795,892</u>	<u>149,730</u>	<u>(5,609)</u>	<u>96,940,013</u>
Change in Net Assets	14,187,660	3,857,534	3,225,810	21,271,004
NET ASSETS - Beginning of Year	<u>52,322,139</u>	<u>20,735,950</u>	<u>67,415,604</u>	<u>140,473,693</u>
NET ASSETS - END OF YEAR	<u>\$ 66,509,799</u>	<u>\$ 24,593,484</u>	<u>\$ 70,641,414</u>	<u>\$ 161,744,697</u>

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

STATEMENTS OF CASH FLOWS
For the Years Ended May 31, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ (7,510,443)	\$ 21,271,004
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	4,553,203	4,641,103
Accretion	46,396	44,189
Gifts of real property		(491,880)
Change in gifts of investments	65,679	(70,259)
(Gains) losses on endowment investments and perpetual trusts	3,837,198	(6,809,924)
Gains on investments	(15,676)	(1,557,859)
Actuarial adjustment on annuities payable	49,383	1,572,400
Loan cancellations, assignments and write-offs	134,689	126,318
Loss on default of real estate contract	108,266	
Losses on contributions receivable	79,097	668,731
Loss on sale of real estate	91,215	
Increase in allowance on student receivables	32,200	28,600
Decrease in allowance on student notes	(1,500)	(5,000)
Change in assets and liabilities		
Student receivables	130,246	34,141
Other receivables	(476,753)	277,765
Estate gift receivable	6,000,000	(9,500,000)
Grant receivables	(21,350)	(4,631)
Contributions receivable for operations	488,171	(85,373)
Inventories, prepaid expense and deposits	270,999	(272,232)
Real estate		35,151
Accounts payable and accrued liabilities	687,771	(1,159,997)
Student deposits	(287,197)	616,331
Deposits held in custody for others	(55,699)	(8,511)
Change in cash surrender value of life insurance held as endowment investment	(74,048)	10,938
Contributions restricted for long-term investment, loans and plant	(3,992,152)	(3,776,874)
Contributions under split-interest agreements	(1,867)	(587,843)
Interest and dividends restricted for reinvestment	(16,803)	(31,161)
Net Cash Flows From Operating Activities	<u>4,121,025</u>	<u>4,965,127</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of endowment investments	(9,123,786)	(25,826,928)
Sales of endowment investments	6,447,257	24,118,428
Purchases of investments	(18,257,681)	(2,879,377)
Sales of investments	18,853,149	2,889,717
Proceeds from sale of real estate	319,121	377,664
Additions to deposits held by trustee, net	(30,396)	(26,452)
Purchases of property, plant and equipment	(5,918,881)	(3,877,501)
Reductions of asset retirement obligation		(1,694)
Repayments of real estate contract receivables	32,016	7,806
Disbursements of loans to students	(1,303,400)	(1,103,850)
Repayments of loans from students	<u>1,215,079</u>	<u>1,080,948</u>
Net Cash Flows From Investing Activities	<u>(7,767,522)</u>	<u>(5,241,239)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of principal on indebtedness	(1,156,424)	(1,100,444)
Contributions received restricted for long-term investment, loans and plant	5,054,482	3,366,263
Proceeds from issuance of split-interest agreements	10,000	685,000
Receipts of interest and dividends restricted for reinvestment	16,803	31,161
Payments to annuitants	(793,810)	(787,079)
Decrease in government grants refundable	<u>(40,214)</u>	<u>(56,997)</u>
Net Cash Flows From Financing Activities	<u>3,090,837</u>	<u>2,137,904</u>
Net Change in Cash and Cash Equivalents	(555,660)	1,861,792
CASH AND CASH EQUIVALENTS - Beginning of year	<u>17,786,324</u>	<u>15,924,532</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 17,230,664</u>	<u>\$ 17,786,324</u>
Supplemental disclosure of cash flow statement		
Interest paid	\$ 2,678,764	\$ 2,735,619
Noncash investing and financing activities		
Property, plant and equipment acquired through accounts payable	557,645	451,427

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2012 and 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Organization - Pacific Lutheran University (the "University") is a private non-profit institution that offers a full range of liberal arts academic programs to undergraduate and graduate students. Affiliated with the Evangelical Lutheran Church in America, the University enrolls approximately 3,500 students. The University confers degrees and majors at the undergraduate level that include, but are not limited to, various majors of Bachelor of Arts, Bachelor of Science, and Bachelor of Music. At the Graduate level, the University confers degrees of Masters of Art in Education, Business Administration, Nursing and Fine Art.

Basis of Financial Statements - The accounting policies of the University reflect practices common to universities and colleges and conform to accounting principles generally accepted in the United States of America. The more significant accounting policies are summarized below:

Net Asset Classification - For the purposes of financial reporting, the University classifies resources into three net asset categories pursuant to any donor-imposed restrictions and applicable law. Accordingly, the net assets of the University are classified in the accompanying financial statements in the categories that follow:

Permanently Restricted Net Assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, the donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes.

Temporarily Restricted Net Assets - Net assets subject to donor-imposed stipulations that will be met by action of the University and/or the passage of time.

Unrestricted Net Assets - Net assets not subject to donor-imposed stipulations.

Releases from Restrictions - Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed and the law allows the release of the restriction) are reported on the statement of activities as net assets released from restrictions. Occasionally donor restrictions related to net assets may be clarified or changed, at which time they are reflected as reclassification of prior year net assets on the statement of activities.

Revenue Recognition - The timing and classification of revenue are summarized below:

Tuition and Fees and Auxiliary Revenue - Revenues from tuition and auxiliary enterprises are recognized in the period the services or goods are provided as increases in unrestricted net assets. Financial assistance in the form of scholarships and grants that cover a portion of tuition, living and other costs is reflected as a reduction of tuition and fees revenues.

Other Revenue and Expenses - Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Income earned on donor restricted funds is initially classified as temporarily restricted net assets and is reclassified as unrestricted net assets when expenses are incurred for their intended purpose.

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Contribution Revenue - Contributions, including unconditional promises to give, are recognized as revenues in the period received and are reported as increases in the appropriate categories of net assets in accordance with donor restrictions. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets. 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 property and equipment without donor stipulations concerning the use of such long-lived assets are reported as unrestricted revenues. Contributions of cash or other assets to be used to acquire property and equipment are reported as temporarily restricted revenues; the restrictions are considered to be released at the time such long-lived assets are placed in service.

Investment Gains and Losses - In the absence of donor stipulations or law to the contrary, gains or losses on the investments of a donor-restricted endowment funds adjust temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the funds have not been met before the change occurs. If losses reduce the assets of a donor-restricted endowment funds below the level required by the donor stipulations or law, gains that restore the fair value of the assets of the endowment funds to the required level are classified as increases in unrestricted net assets.

Gains and losses on investments of endowment funds created by a board designation of unrestricted funds are classified as changes in unrestricted net assets. Any other adjustments not subject to donor stipulations or law affect unrestricted net assets.

Cash and Cash Equivalents - The University considers all highly liquid investments, except for those held for long-term investment, with a maturity of three months or less when purchased to be cash equivalents. Certain cash held by the University is restricted for the Federal Perkins and Nursing Loan Funds.

Student Accounts Receivable - Student accounts receivable are carried at the unpaid balance of the original amount billed to students less an estimate made for doubtful accounts which is based on a review of all outstanding amounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Student accounts are written off when deemed uncollectible. Recoveries of student accounts previously written off are recorded when received.

Estate Gift Receivable - During the year ended May 31, 2011, the University received a gift of several properties and other assets from an estate. The amount recorded as estate gift receivable represents the non-liquidated portion of the estate as of May 31, 2012 and 2011 which was valued at the estimated fair value of assets at the date of the gift based on market appraisals, signed purchase agreements or other reliable expedients.

Inventories - Bookstore inventories are valued at a percentage of retail value, which approximates cost and is not in excess of market. All other inventories are valued at the lower of cost or market, determined on a first-in, first-out basis.

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Real Estate - Real estate consist of various properties and land held for resale. Such items are acquired at the discretion of the University or as contributions from donors. They are disposed of when management and the governing board believe a fair market price is available.

Deposits Held By Trustee - Deposits held by trustee include amounts restricted for debt service as required by the trust indentures.

Bond Acquisition Costs - Costs of bond issuance are deferred and amortized over the term of the related indebtedness.

Physical Plant and Equipment - Physical plant assets are stated at cost at date of acquisition less accumulated depreciation. The University depreciates its assets on the straight-line basis over estimated useful lives as follows: buildings and building improvements, 10 to 50 years; improvements other than buildings, 10 years; automobiles, 5 years; library books, 15 years; equipment, 10 years; and leasehold improvements, 15 years. Normal repair and maintenance expenses are charged to operations as incurred. The University capitalizes physical plant additions in excess of \$5,000.

Impairment of Long-Lived Assets - The University reviews long-lived assets, including property and equipment and intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be fully recoverable. An impairment loss would be recognized when the estimated future cash flows from the use of the asset are less than the carrying amount of that asset. To date, there have been no such losses.

Asset Retirement Obligations - The University recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, the cost of the retirement obligation is capitalized by increasing the carrying value of the related asset. Over time, the liability is accreted to its present value each year and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the statement of activities. The University reviews its estimates annually and adjusts the recorded liability as needed.

Substantially all of the University's asset retirement obligations relate to estimated costs to remove asbestos from campus facilities. The estimate of the losses that are probable for asbestos removal was calculated using the expected cash flow approach and based on an inventory of the University's long-lived assets combined with an estimate of the current market prices to remove the asbestos. The University utilized a credit-adjusted risk-free rate to discount the asset retirement obligation.

Changes in the accrual for asset retirement obligations during the years ended May 31, 2012 and 2011 are as follows:

	2012	2011
Balance, Beginning of the year	\$ 927,906	\$ 885,411
Abatements		(1,694)
Accretion expense	46,396	44,189
Balance, End of the year	<u>\$ 974,302</u>	<u>\$ 927,906</u>

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Government Grants Refundable - Funds provided by the United States Government under the Federal Perkins and Nursing Loan Programs are loaned to qualified students and may be reloaned after collections. These funds are ultimately refundable to the government and are included as liabilities in the statements of financial position. Revenues from other government grants are recognized as they are earned in accordance with the agreement. Any funding received before it is earned is recorded as a refundable advance. Expenses incurred before cash is received are recorded as receivables.

Retirement Plans - The University has certain contributory defined contribution retirement plans for academic and nonacademic personnel. Individual contributions are based on a percentage of compensation. The University pays the cost of the retirement plans currently. The contributions amounted to approximately \$3,444,000 and \$3,365,000 for the years ended May 31, 2012 and 2011, respectively.

Grants to Specified Students - Amounts received from state and federal agencies designated for the benefit of specified students are considered agency transactions and, therefore, are not reflected as revenues and expenses of the University.

Unemployment Compensation - The University has elected to pay unemployment compensation claims as they arise.

Income Tax Status - The Internal Revenue Service has determined that the University is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. However, any unrelated business income may be subject to taxation.

The University follows the accounting standards for contingencies in evaluating uncertain tax positions. This guidance prescribes recognition threshold principles for the financial statement recognition of tax positions taken or expected to be taken on a tax return that are not certain to be realized. No liability has been recognized by the University for uncertain tax positions as of May 31, 2012 and 2011. The University's tax returns are subject to review and examination by federal authorities. The tax returns for fiscal years 2009 and thereafter are open to examination by federal authorities.

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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fund-Raising and Advertising Expenses - Fund-raising expenses totaled \$2,419,000 and \$2,548,000 for the years ended May 31, 2012 and 2011, respectively. Advertising costs are expensed when incurred.

Functional Allocation of Expenses - The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain expenses have been allocated among the programs and supporting services benefited.

Reclassifications - Certain amounts appearing in the 2011 financial statements have been reclassified to conform with the 2012 presentation. The reclassifications have no effect on reported amounts of total net assets or change in total net assets.

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 2 - FAIR VALUE MEASUREMENTS

Financial Instruments - The carrying amounts of cash and cash equivalents, student and other receivables, prepaid expenses and deposits, accounts payable, student deposits and deposits held in custody for others approximate fair value because of the short term maturity of these financial instruments. The carrying amounts of contributions receivable are recorded using the applicable discount rates in effect at the date of the gifts.

A reasonable estimate of the fair value of the receivables from students under government loan programs and grants refundable to the government for student loans could not be made because the notes receivable are not saleable and can only be assigned to the U.S. government or its designee. The fair value of receivables under institutional loan programs approximates carrying value.

Real estate is recorded at cost except those items received as gifts which are valued at fair market value at the date of the gift.

The carrying amounts of the actuarial liability for trusts and annuities payable are based on life expectancies, quoted market prices, and the applicable discount rates in effect at the time the agreements were received by the University. The fair value of bonds payable approximates \$64,600,000 and \$66,300,000 at May 31, 2012 and 2011, respectively.

Contributions of assets other than cash are recorded at their estimated fair value at the date of the gift. Estimates of fair value involve assumptions and estimation methods that are uncertain and, therefore, the estimates could differ from actual results.

The investment in the Garfield Commons LLC and Garfield North LLC are carried at cost.

Fair Value Hierarchy - Fair value is defined in the accounting guidance as the exchange price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the assets or liability in an orderly transaction between market participants at the measurement date. Under this guidance, a three-level hierarchy is used for fair value measurements which is based on the transparency of information, such as the pricing source, used in the valuation of an asset or liability as of the measurement date.

Financial instruments measured and reported at fair value are classified and disclosed in one of the following three categories.

Level 1 - Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data.

Level 3 - Inputs are unobservable for the asset or liability. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

Valuation Techniques and Inputs

Level 1 - Level 1 assets include:

- > Investments in certain mutual funds (domestic equity funds, international equity funds, global fixed income funds and real estate funds), certain commodity funds and government obligations for which quoted prices are readily available.

Level 2 - Level 2 assets include:

- > Short-term investments (consisting primarily of money market funds) for which quoted prices are not readily available. The fair values are estimated using Level 2 inputs based on multiple sources of information, which may include market data and/or quoted market prices from either markets that are not active or are for the same or similar assets in active markets.
- > Investments in certain mutual funds (global fixed income funds, U.S. government bond funds, corporate bond funds and high yield bond funds) for which quoted prices are not readily available. The fair values are estimated using Level 2 inputs based on multiple sources of information, which may include market data and/or quoted market prices from either markets that are not active or are for the same or similar assets in active markets.
- > Investments in certain commodity funds for which quoted prices are not readily available. The fair values are estimated using Level 2 inputs based on multiple sources of information, which may include market data and/or quoted market prices from either markets that are not active or are for the same or similar assets in active markets.

Level 3 - Level 3 assets include:

- > Investments in hedge funds, private equity funds and funds of funds for which quoted prices are not readily available and the funds cannot be redeemed within a short time. The University has estimated the fair value of these funds by using the net asset value ("NAV") provided by the investee as of December 31 or March 31, adjusted for cash receipts, cash disbursements, significant known valuation changes in market values of publicly held securities contained in the portfolio and security distributions through May 31.
- > Perpetual trusts held by others for which quoted prices are not readily available. The fair values are estimated using an income approach by calculating the present value of the future distributions expected to be received based on a combination of Level 2 inputs (interest rates and yield curves) and significant unobservable inputs (entity specific estimates of cash flows).

There have been no changes in the techniques and inputs used as of May 31, 2012 and 2011.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

While the University believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table presents information about the University's assets measured at fair value on a recurring basis as of May 31, 2012 based upon the three-tier hierarchy:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
ASSETS				
Short term investments	\$ 3,910,729		\$ 3,910,729	
Mutual funds				
Domestic equity funds	7,930,555	\$ 7,930,555		
International equity funds	12,489,723	12,489,723		
Global fixed income funds	10,754,953	9,960,201	794,752	
U.S. government bond funds	1,429,436		1,429,436	
Corporate bond funds	1,706,005		1,706,005	
High yield bond funds	266,116		266,116	
Real estate funds	1,445,834	1,445,834		
Alternative investments				
Hedge funds	9,323,345			\$ 9,323,345
Private equity funds	2,914,200			2,914,200
Funds of funds	4,840,306			4,840,306
Commodity funds	5,230,681	3,471,340	1,759,341	
Perpetual trusts held by others	8,831,510			8,831,510
Government obligations	4,739,300	4,739,300		
Total	\$ 75,812,693	\$ 40,036,953	\$ 9,866,379	\$ 25,909,361

The following table presents information about the University's assets measured at fair value on a recurring basis as of May 31, 2011 based upon the three-tier hierarchy:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
ASSETS				
Short term investments	\$ 2,315,275		\$ 2,315,275	
Mutual funds				
Domestic equity funds	9,425,734	\$ 9,425,734		
International equity funds	12,780,593	12,780,593		
Global fixed income funds	9,124,801	9,124,801		
U.S. fixed income funds	3,445,103		3,445,103	
Short term bond funds	210,341		210,341	
High yield bond funds	1,006,729		1,006,729	
Alternative investments				
Hedge funds	12,173,418			\$ 12,173,418
Private equity funds	2,530,665			2,530,665
Funds of funds	4,148,799			4,148,799
Commodity funds	6,067,914	3,893,034	2,174,880	
Perpetual trusts held by others	9,786,819			9,786,819
Government obligations	4,708,904	4,708,904		
Total	\$ 77,725,095	\$ 39,933,066	\$ 9,152,328	\$ 28,639,701

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2012 and 2011

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

The following table presents a reconciliation of the statement of financial position amounts for assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the year ended May 31, 2012:

	Balance May 31, 2011	Net realized and unrealized gains (losses)	Purchases	Sales	Balance May 31, 2012
Assets					
Hedge funds	\$ 12,173,418	\$ (678,088)		\$ (2,171,985)	\$ 9,323,345
Private equity funds	2,530,665	230,716	\$ 459,913	(307,094)	2,914,200
Funds of funds	4,148,799	17,043	2,400,000	(1,725,536)	4,840,306
Perpetual trusts held by others	9,786,819	(955,309)			8,831,510
Total	\$ 28,639,701	\$ (1,385,638)	\$ 2,859,913	\$ (4,204,615)	\$ 25,909,361

The amount of total gains or losses for the period included in change in net assets attributable to the change in unrealized gains or losses relating to assets measured at fair value still held at May 31, 2012 \$ (231,524)

The following table presents a reconciliation of the statement of financial position amounts for assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the year ended May 31, 2011:

	Balance May 31, 2010	Net realized and unrealized gains (losses)	Purchases	Sales	Balance May 31, 2011
Assets					
Hedge funds	\$ 12,700,130	\$ 653,220	\$ 1,000,025	\$ (2,179,957)	\$ 12,173,418
Private equity funds	1,612,526	354,528	769,545	(205,934)	2,530,665
Real estate funds	699,976	124,467		(824,443)	-
Funds of funds	1,699,905	(51,106)	2,500,000		4,148,799
Perpetual trusts held by others	8,887,245	899,574			9,786,819
Total	\$ 25,599,782	\$ 1,980,683	\$ 4,269,570	\$ (3,210,334)	\$ 28,639,701

The amount of total gains for the period included in change in net assets attributable to the change in unrealized gains relating to assets measured at fair value still held at May 31, 2011 \$ 1,060,252

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

The University uses the net asset value ("NAV") as a practical expedient to determine fair value of all underlying investments which (a) do not have a readily determinable fair value; and (b) are in investment companies or similar entities that report their investment assets at fair values.

The following table lists the alternative investments in which NAV was utilized as the practical expedient for estimating fair value by major category as of May 31, 2012:

	<u>Hedge Funds</u>	<u>Private Equity Funds</u>	<u>Funds of Funds</u>
Fair value, May 31, 2012	\$9,323,345	\$2,914,200	\$4,840,306
Significant Investment Strategy	Long and short global equities, fixed income, and their derivatives	Venture and buyout investments in private companies globally	Long and short equities and their derivatives
Remaining Life	N.A.	1 to 12 years	N.A.
Dollar Amount of Unfunded Commitments	N.A.	\$1,125,678	N.A.
Timing to Draw Down Commitments	N.A.	3 to 5 years	N.A.
Redemption Terms	Range from monthly to annual, on 60 to 90 days' notice	N.A.	Annual with 100 days' notice
Redemption Restrictions	Currently there are no lock-ups in effect. Upon full redemption, 90% - 95% is returned, with the remaining 5% -10% held back until the completion of the annual audit	N.A.	Upon full redemption, 90% is returned, with the remaining 10% held back until completion of the annual audit
Redemption Restrictions in Place at Year End	Two funds have yet to return holdback positions following nearly-complete redemptions	N.A.	None

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 3 - RESTRICTIONS AND LIMITATIONS ON NET ASSET BALANCES

Permanently restricted net assets consist of the following at May 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Endowment funds	\$ 67,091,602	\$ 65,923,611
Contributions receivable	390,925	580,811
Student loan funds	252,602	247,711
Annuity, life income and similar funds	<u>3,423,043</u>	<u>3,889,281</u>
	<u>\$ 71,158,172</u>	<u>\$ 70,641,414</u>

Temporarily restricted net assets consist of the following at May 31, 2012 and 2011:

Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other departmental support - operating	\$ 2,850,090	\$ 3,530,588
Scholarships, instruction and other departmental support - endowment funds not yet appropriated for spending	3,978,303	6,962,644
Acquisition of buildings and equipment	<u>13,147,770</u>	<u>10,139,287</u>
	19,976,163	20,632,519
Contributions receivable for operations	531,642	1,054,365
Contributions receivable for acquisition of buildings and equipment	2,015,049	2,870,674
Annuity, life income and similar funds	<u>29,948</u>	<u>35,926</u>
	<u>\$ 22,552,802</u>	<u>\$ 24,593,484</u>

At May 31, 2012 and 2011, the University's unrestricted net assets were allocated as follows:

Operations	\$ 3,883,789	\$ 2,870,982
Endowment funds		
Donor restricted endowment funds (underwater)	(3,680,950)	(1,454,906)
Board designated endowment	<u>4,413,621</u>	<u>3,222,203</u>
Total Endowment	732,671	1,767,297
Annuity, life income and similar funds	1,173,147	1,112,412
Loans to students	838,043	838,808
Plant	<u>53,895,630</u>	<u>59,920,300</u>
	<u>\$ 60,523,280</u>	<u>\$ 66,509,799</u>

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 4 - NET ASSETS RELEASED FROM RESTRICTIONS

Net assets released from temporary donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors during the years ended May 31, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Expended for plant facilities	\$ 6,749	\$ 37,960
Scholarships, instruction and other departmental support	<u>11,422,541</u>	<u>10,616,287</u>
	<u>\$ 11,429,290</u>	<u>\$ 10,654,247</u>

These assets were reclassified to unrestricted net assets.

NOTE 5 - CONTRIBUTIONS RECEIVABLE

Contributions receivable at May 31, 2012 and 2011 include the following unconditional promises to give:

	<u>2012</u>	<u>2011</u>
Unrestricted - completed construction projects	\$ 100,092	\$ 166,913
Temporarily restricted - operations	595,443	1,218,248
Temporarily restricted - plant projects	2,955,712	3,460,168
Permanently restricted - endowment	<u>450,571</u>	<u>683,016</u>
Gross unconditional promises to give	4,101,818	5,528,345
Less: Allowance for uncollectable promises	(331,392)	(512,459)
Less: Unamortized discount	<u>(787,898)</u>	<u>(403,760)</u>
Net Unconditional Promises to Give	<u>\$ 2,982,528</u>	<u>\$ 4,612,126</u>
Amounts due in:		
Less than one year	\$ 1,319,115	
One to five years	1,554,191	
More than five years	<u>1,228,512</u>	
	<u>\$ 4,101,818</u>	

Promises due in more than one year received on or before May 31, 2009 were discounted at an interest rate of 6%. Promises due in more than one year received after May 31, 2009 were discounted at interest rates that approximate the U.S. Daily Treasury Yield Curve at the date of the gift adjusted for a risk premium. The discount rates for these promises ranged from 1.57% to 2.34% at May 31, 2012 and 2011. Promises due in less than one year were not discounted.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2012 and 2011

NOTE 6 - ENDOWMENT INVESTMENTS

The University's endowment consists of 453 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the governing board to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the governing board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law - The University's governing board has interpreted the State of Washington enacted version of UPMIFA as allowing the University to appropriate for expenditure or accumulate so much of an endowment fund as the University determines is prudent for the uses, benefits, purposes and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. Unless stated otherwise in the gift instrument, the assets in an endowment fund shall be donor-restricted assets until appropriated for expenditure by the Board of Regents. See Note 2 for further information on net asset classifications.

The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate endowment funds:

1. The duration and preservation of the fund
2. The purpose of the University and the endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the University
7. The investment policies of the University

Endowment net asset composition by type of fund consists of the following as of May 31, 2012:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (3,680,950)	\$ 3,978,303	\$ 67,091,602	\$ 67,388,955
Board-designated endowment funds	4,413,621			4,413,621
Total endowment net assets	<u>\$ 732,671</u>	<u>\$ 3,978,303</u>	<u>\$ 67,091,602</u>	<u>\$ 71,802,576</u>

Endowment net asset composition by type of fund consists of the following as of May 31, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (1,454,906)	\$ 6,962,644	\$ 65,923,611	\$ 71,431,349
Board-designated endowment funds	3,222,203			3,222,203
Total endowment net assets	<u>\$ 1,767,297</u>	<u>\$ 6,962,644</u>	<u>\$ 65,923,611</u>	<u>\$ 74,653,552</u>

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 6 - ENDOWMENT INVESTMENTS (Continued)

Changes in endowment net assets for the year ended May 31, 2012 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2011	\$ 1,767,297	\$ 6,962,644	\$ 65,923,611	\$ 74,653,552
Investment return:				
Investment income, net of fees of \$213,378	578,840	251,666	31,828	862,334
Net depreciation, perpetual trusts - unrealized			(955,309)	(955,309)
Net depreciation - realized and unrealized	(2,635,652)	(246,237)		(2,881,889)
Total investment return	(2,056,812)	5,429	(923,481)	(2,974,864)
Contributions	1,026	26,945	2,011,780	2,039,751
Appropriation of endowment net assets for expenditure	(578,840)	(3,016,715)		(3,595,555)
Transfer to loan fund			(4,884)	(4,884)
Transfers to/from endowment	1,600,000		84,576	1,684,576
Endowment net assets, May 31, 2012	<u>\$ 732,671</u>	<u>\$ 3,978,303</u>	<u>\$ 67,091,602</u>	<u>\$ 71,802,576</u>

Changes in endowment net assets for the year ended May 31, 2011 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2010	\$ 418,964	\$ 4,825,504	\$ 62,300,955	\$ 67,545,423
Investment return:				
Investment income, net of fees of \$215,041	576,324	715,020	31,161	1,322,505
Net appreciation, perpetual trusts - unrealized			899,574	899,574
Net appreciation - realized and unrealized	1,477,299	4,433,051		5,910,350
Total investment return	2,053,623	5,148,071	930,735	8,132,429
Contributions	50		2,040,414	2,040,464
Appropriation of endowment net assets for expenditure	(576,324)	(3,036,828)		(3,613,152)
Net asset reclassifications	(273,256)	25,897	273,256	25,897
Matured deferred gifts			383,515	383,515
Transfer to loan fund			(5,264)	(5,264)
Transfers to/from endowment	144,240			144,240
Endowment net assets, May 31, 2011	<u>\$ 1,767,297</u>	<u>\$ 6,962,644</u>	<u>\$ 65,923,611</u>	<u>\$ 74,653,552</u>

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 6 - ENDOWMENT INVESTMENTS (Continued)

Funds with Deficiencies - From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UMIFA requires the University to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$3,680,950 and \$1,454,906 as of May 31, 2012 and 2011, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the governing board. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

Return Objectives and Risk Parameters - The University has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the University must hold in perpetuity or for a donor-specified period as well as board-designated funds. Under this policy, as approved by the governing board, the endowment assets are invested in a manner that is intended to produce an acceptable level of return while assuming a moderate level of investment risk. The University expects its endowment funds, over time, to provide an average annual rate of approximately 10%. Actual returns in any year may vary from this amount.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The University targets a diversified asset allocation that places a greater emphasis on alternative investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy - The University has a policy that limits the amount the endowment shall distribute annually to 5% of a three-year average market value of the principal, on a unit value basis. The average computation is to include the November 30 quarter end preceding the beginning of the fiscal year. In establishing this policy, the University considered the long-term expected return on its endowment. Accordingly, over the long term, the University expects to achieve a total return, over a three-year moving average basis, at least equal to the spending rate plus the rate of inflation as measured by the Consumer Price Index (CPI) for urban customers. This is consistent with the University's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 6 - ENDOWMENT INVESTMENTS (Continued)

The following summarizes the University's endowment investments at May 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Cash and short term investments	\$ 6,173,821	\$ 5,861,458
Commodity funds	5,230,681	6,067,914
Domestic equity mutual funds	4,773,244	5,008,768
Fixed income mutual funds	9,960,202	9,124,801
International equity mutual funds	10,876,266	11,138,106
Alternative investments		
Hedge funds	9,323,345	12,173,418
Funds of hedge funds	4,840,306	4,148,799
Real estate	6,943,160	6,931,870
Real estate contracts	539,242	563,382
Private equity funds	2,914,200	2,530,665
	<u>61,547,467</u>	<u>63,549,181</u>
Perpetual trusts held by others	8,831,510	9,786,819
Life insurance	1,396,599	1,322,552
	<u>71,802,576</u>	<u>74,658,552</u>
Less Interfund Amounts:		
Cash and short term investments	(2,338,134)	(4,083,349)
Real estate contracts	<u>(539,242)</u>	<u>(563,382)</u>
	<u>\$ 68,925,200</u>	<u>\$ 70,011,821</u>

Endowment investments include interfund amounts which have been eliminated in the financial statements.

Investments, in general, are subject to various risks, including credit, interest and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

Through the University's investments in alternative investments, the University is indirectly involved in investment activities such as securities lending, trading in futures and forward contracts and other derivative products. Derivatives are used to adjust portfolio risk exposure or enhance returns. While these instruments may contain varying degrees of risk, the University's risk with respect to such transactions is limited to its capital balance in each investment. These interests have varying degrees of liquidity.

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 7 - INVESTMENTS

The following summarizes the University's investments in funds other than endowment funds at May 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Cash and short term investments	\$ 238,061	\$ 537,166
Mutual funds		
Equity funds	4,770,767	6,059,453
Fixed income funds	4,196,309	4,662,173
Stocks	7,771	73,450
Real estate funds	1,445,834	
Other	<u>568,863</u>	<u>540,834</u>
	<u>\$ 11,227,605</u>	<u>\$ 11,873,076</u>

NOTE 8 - CONSTRUCTION IN PROGRESS

At May 31, 2012, the following major building projects were in progress:

	<u>Cost To Date</u>	<u>Funding Source</u>
Eastvold	\$ 9,311,774	Private Grants
Campus Entrance	171,306	Private Grants
Olson Auditorium	286,463	Private Grants
Athletic Fields	<u>1,111,466</u>	Private Grants
	<u>\$ 10,881,009</u>	

NOTE 9 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following at May 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Land	\$ 2,037,723	\$ 2,037,723
Buildings and building improvements	133,652,263	133,652,262
Improvements other than buildings	5,104,025	5,104,025
Equipment and automobiles	33,444,692	32,757,476
Library books	12,506,788	12,811,417
Leasehold improvements	1,840,955	1,840,955
Non depreciated assets	<u>1,235,950</u>	<u>1,235,950</u>
	189,822,396	189,439,808
Less: Accumulated depreciation and amortization	<u>(86,539,934)</u>	<u>(82,847,519)</u>
	<u>\$ 103,282,462</u>	<u>\$ 106,592,289</u>

PACIFIC LUTHERAN UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2012 and 2011

NOTE 10 - LONG-TERM DEBT

Long-term debt at May 31, 2012 and 2011 consisted of the following:

	<u>2012</u>	<u>2011</u>
Loan payable to Washington Higher Education Facilities Authority, Series 2006	\$ 56,965,000	\$ 58,110,000
Note payable to an individual	<u>107,107</u>	<u>118,531</u>
	<u>\$ 57,072,107</u>	<u>\$ 58,228,531</u>

In December 2006, the University entered into a loan and security agreement with the Washington Higher Education Facilities Authority for the Authority to sell Series 2006 Revenue and Refunding Bonds in the amount of \$62,160,000. Interest is payable semi-annually on each November 1 and May 1 at rates ranging from 4.25% to 5.00%. Serial bonds are payable in amounts ranging from \$1,205,000 to \$2,300,000 on November 1, 2012 through November 1, 2025. Term bonds in the amounts of \$16,085,000 and \$17,080,000 are due November 1, 2031 and 2036, respectively. The term bonds are subject to annual sinking fund payments on November 1, in the years 2026 to 2036, in amounts varying from \$2,400,000 to \$3,730,000. The bonds were issued for the purposes of refinancing the series 1996 and series 1999 loans and for construction and plant improvement projects to the extent that proceeds are available. These projects include the renovation and improvement of various residence halls on the University campus, including energy improvements, security system enhancement, utility system replacement and improvements, and space improvements to add additional bathrooms and enhance the efficiency of the residence halls. The University renovated and upgraded the dining facilities located in the University Center. The University Center expanded the commons area, relocated a number of offices and expanded meeting room space and student organization office space. The University has pledged its unrestricted revenues to the repayment of its obligations under the loan agreement.

The loan agreements with the Washington Higher Education Facilities Authority require the University to comply with certain financial and other covenants, as amended in May 2012. As of May 31, 2012, the University is in compliance with these covenants.

The note payable to an individual, dated January 20, 1995, was issued to purchase land adjacent to the University and is secured by the land. The note bears interest at a rate of 9.0%, with monthly installments of \$1,800, including interest, due through February 1, 2018.

The approximate principal and sinking fund payment requirements for all long-term debt for the five years subsequent to May 31, 2012 are:

<u>Year Ended May 31</u>	<u>Principal</u>
2013	\$ 1,217,000
2014	1,279,000
2015	1,345,000
2016	1,416,000
2017	1,488,000

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NOTE 11 - OPERATING LEASES

The University has an operating lease for equipment which expires in 2015. The University also has two building facility leases, an existing one that expires in 2022 and which after 15 years, the University has the option to renew for up to seven five-year lease terms and one that was obtained under assignment and assumption dated June 1, 2010, which expires June, 2012. Rental expense under these leases and a previously expired lease totaled \$743,000 and \$695,000, respectively, for the years ended May 31, 2012 and 2011.

KPLU-FM Pacific Lutheran University, a noncommercial radio station owned and operated by the University, has two operating leases for communications equipment and facilities. Rental expense associated with these leases totaled \$256,671 and \$212,239 for the years ended May 31, 2012 and 2011, respectively. One of the leases was renegotiated extending the lease term through June 2020, and an option was exercised renewing the other lease for an additional 10 years commencing January 2011.

Future minimum lease payments under operating leases as of May 31, 2012 are:

<u>Year Ended May 31</u>	<u>Amount</u>
2013	\$ 780,500
2014	735,500
2015	738,500
2016	533,000
2017	545,900

NOTE 12 - DEFERRED GIFT AGREEMENTS

The University has arrangements with donors classified as charitable lead trusts, charitable remainder trusts and charitable gift annuities. In general, under these arrangements the University receives a gift from a donor in which it has a remainder interest and agrees to pay the donor stipulated amounts over the life of the donor. The arrangement may cover one or more lives. The University invests and administers the related assets and makes distributions to the beneficiaries as required. When the agreement reaches the end of its term, remaining assets are retained by the University as unrestricted, temporarily restricted or permanently restricted net assets, or in some instances, distributed to third-party beneficiaries.

When a gift is received under one of these arrangements, it is split into the amount representing the actuarial present value of future distributions back to the donor and the remaining gift value to be retained for the benefit of the University or third-party beneficiaries. The actuarial liability is adjusted annually using actuarial tables appropriate for the type of arrangement, number of lives covered and age of the donor. The University used interest rates ranging from of 1.8% to 11.6% in making the calculations at May 31, 2012 and 2011.

The University received \$1,867 and \$587,843 of gift value relating to deferred gift agreements for the years ended May 31, 2012 and 2011, respectively. Total assets held by the University under deferred gift agreements totaled \$11,538,522 and \$12,696,960 at May 31, 2012 and 2011, respectively. The University maintains separate reserve funds adequate to meet future payments under its charitable gift annuity contracts as required by governing states' law. The total amount held in separate reserve funds was \$3,230,546 and \$3,799,317, respectively, as of May 31, 2012 and 2011.

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NOTE 13 - CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the University to concentrations of credit risk consist principally of cash, investments, accounts receivable, notes receivable, real estate contracts receivable and other receivables. Cash and cash equivalents in excess of federally insured limits are subject to the usual risks of balances in excess of those limits. The majority of the University's cash and cash equivalents are on deposit with a single bank. Investments are diversified in order to limit credit risk. Investments are generally placed in a variety of managed funds administered by different investment managers in order to limit credit risk. Concentrations of credit risk with respect to the real estate contracts receivable are limited due to the University holding a secured position in these agreements. Student notes and receivables and other receivables are due from a variety of sources concentrated primarily in the northwestern United States. In addition, the University's students receive a substantial amount of support from state and federal student financial assistance programs which are subject to audit by governmental agencies. A significant reduction in the level of this support, if this were to occur, could have an adverse effect on the University's programs and activities.

NOTE 14 - RELATED PARTY TRANSACTIONS

During the year ending May 31, 2011, the University had a signed contract with a construction company owned by the spouse of a member of the Board of Regents to renovate Eastvold in the amount of \$2,989,658. The contract was approved in accordance with the Board of Regents' conflict of interest policy. As of May 31, 2012, the University owed \$158,267 on the contract which was included in accounts payable on the statements of financial position.

The University entered into a partnership agreement, effective April 20, 2006, to form Garfield Commons LLC, a commercial retail project located in Parkland two blocks from the University's main entrance. The University has a 49% ownership interest in Garfield Commons, and applies the equity method of accounting for its investment. The other investee, Lorig/Garfield Commons, LLC, a Washington limited liability company, has a 51% ownership in the partnership. The property upon which the commercial building was constructed constituted the University's capital contribution in Garfield Commons. As part of the agreement, the University's bookstore became a tenant of the building in the summer of 2007. Terms of a separate lease agreement between the University, as a lessee and Garfield Commons, as the lessor, commenced at that time (see Note 11).

The University entered into a partnership agreement, effective October 17, 2011, to form Garfield North, LLC, a retail, commercial and residential project located in Parkland two blocks from the University's main entrance. As provided for in the partnership agreement, and as amended on April 5, 2012, the parties agree to make specified capital contributions to Garfield North on or before October 31, 2012. Following its capital contribution to Garfield North, a portion of which is University owned real property, the University will have a 40% ownership interest, and will apply the equity method of accounting for its investment. The other investee, Garfield Partners, LLC, a Washington limited liability company, will have a 60% ownership interest in the partnership. A spouse of a member of the University's Board of Regents (the "related party") is a partner in Garfield Partners, LLC. Under the terms of the agreement, the University will provide financing to Garfield North in the form of a loan in the amount of \$1,000,000. The loan will be jointly and severally guaranteed by Garfield Partners, the related party and another entity in an amount equal to 60% of the loan. In addition, the related party's construction company is specified in the partnership agreement to act as the general contractor on a construction contract that is yet to be signed.

Contributions receivable from non-compensated board members at May 31, 2012 and 2011 were \$443,108 and \$770,158, respectively. Gifts from non-compensated board members totaled \$239,330 and \$651,244 at May 31, 2012 and 2011, respectively.

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NOTE 15 - STUDENT LOANS RECEIVABLE

The University issues uncollateralized loans to students based on financial need. Student loans are funded through Federal government loan programs or institutional resources. Student loans receivable are carried at the amount of unpaid principal less an estimate for doubtful accounts. Allowances for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. At May 31, 2012 and 2011, student loans represented 3.15% and 3.05% of total assets, respectively.

At May 31, 2012 and 2011 student loans consisted of the following:

	<u>2012</u>	<u>2011</u>
Federal government programs	\$ 7,939,098	\$ 7,985,466
Less allowance for doubtful accounts:		
Beginning of year	398,500	403,500
Increase	<u>1,500</u>	<u>5,000</u>
End of year	<u>397,000</u>	<u>398,500</u>
Student loans receivable, net	<u>\$ 7,542,098</u>	<u>\$ 7,586,966</u>

Funds advanced by the Federal government of \$7,453,618 and \$7,453,143 at May 31, 2012 and 2011, respectively, are ultimately refundable to the government and are classified as liabilities in the statement of financial position.

After a student is no longer enrolled in an institution of higher education and after a grace period, interest is charged on student loans receivable and is recognized as it is charged. Student loans receivable through the loan programs are considered to be past due if a payment is not made within 30 days of the payment due date, at which time, late charges are charged and recognized. The Federal Perkins and Nursing Loan Program receivables may be assigned to the U.S. Department of Education and U.S. Department of Health and Human Services, respectively. Students may be granted a deferment, forbearance, or cancellation of their student loan receivable based on eligibility requirements defined by the U.S. Department of Education and U.S. Department of Health and Human Services.

A student loan receivable is considered to be delinquent if any portion of the receivable balance is outstanding for more than 60 days after the billing date. At May 31, 2012 and 2011, the following amounts were past due under student loan programs:

	<u>Amounts Past Due</u>			
	<u>60-89 days</u>	<u>90-119 days</u>	<u>120+ days</u>	<u>Total</u>
May 31,				
2012	\$ 4,162	\$ 7,005	\$ 1,045,626	\$ 1,056,793
2011	5,159	5,900	1,034,233	1,045,292

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NOTE 16 - SUBSEQUENT EVENTS

The University has evaluated subsequent events through October 18, 2012, which is the date that the financial statements were issued.