

**PACIFIC LUTHERAN UNIVERSITY**  
Tacoma, Washington

FINANCIAL STATEMENTS  
Including Independent Auditors' Report

As of and for the Years Ended May 31, 2013 and 2012

**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 financial statements of Pacific Lutheran University (the "University"), which comprise the statements of financial position as of May 31, 2013 and 2012, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditors' Responsibility***

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

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

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

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Lutheran University as of May 31, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Baker Tilly Virchow Krause, LLP*

Minneapolis, Minnesota  
September 26, 2013

**PACIFIC LUTHERAN UNIVERSITY**  
**STATEMENTS OF FINANCIAL POSITION**  
As of May 31, 2013 and 2012

<b>ASSETS</b>		
	2013	2012
Cash and cash equivalents	\$ 11,785,020	\$ 17,230,664
Student receivables, net of allowance for doubtful accounts of \$417,600 and \$419,800	1,213,791	1,186,441
Other receivables	1,524,000	1,073,068
Estate gift receivable	450,000	3,500,000
Real estate contracts receivable	146,051	175,551
Grants receivable	687,206	665,759
Contributions receivable, net	2,109,579	2,982,528
Inventories	875,750	826,605
Prepaid expenses and deposits	1,090,004	960,546
Real estate	2,005,020	2,902,920
Student loans receivables, net	7,422,861	7,542,098
Investments	12,099,247	11,227,605
Endowment investments	76,370,227	68,925,200
Deposits held by trustee		
Government obligations	4,769,609	4,739,300
Bond acquisition costs	1,310,771	1,365,387
Construction in progress	16,896,145	10,881,009
Property, plant and equipment, net	103,621,433	103,282,462
<b>TOTAL ASSETS</b>	<b>\$ 244,376,714</b>	<b>\$ 239,467,143</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>LIABILITIES</b>		
Accounts payable	\$ 3,565,138	\$ 2,322,210
Accrued liabilities	7,798,529	7,146,898
Student deposits	1,722,964	1,774,249
Asset retirement obligation	873,925	974,302
Long-term debt	55,854,612	57,072,107
Unamortized premium on long-term debt	957,753	997,659
Annuities payable	6,648,126	6,192,641
Deposits held in custody for others	1,153,418	1,224,339
Government grants refundable	7,430,820	7,528,484
Total Liabilities	86,005,285	85,232,889
<b>NET ASSETS</b>		
Unrestricted	61,572,824	60,523,280
Temporarily restricted	21,582,023	22,552,802
Permanently restricted	75,216,582	71,158,172
Total Net Assets	158,371,429	154,234,254
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 244,376,714</b>	<b>\$ 239,467,143</b>

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2013  
With Comparative Totals for 2012

	2013			2012 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
<b>REVENUES, GAINS AND OTHER SUPPORT</b>				
Tuition and fees	\$ 107,806,144			\$ 107,806,144
Less: Scholarships and grants	(43,989,955)			(43,989,955)
Net tuition and fees	63,816,189			61,016,938
Government grants	2,193,127			2,305,315
Private gifts	1,957,723	\$ 7,968,196	\$ 2,590,468	14,263,895
Endowment income and gains (losses)	2,533,909	5,297,391	31,334	(2,090,484)
Gains (losses) in perpetual trusts			761,838	(955,309)
Other investment income (losses)	(30,784)			80,828
Sales and services of educational activities	131,864			142,706
Other sources	453,668			669,702
Sales and services of auxiliary enterprises	17,615,009			17,712,235
	88,670,705	13,265,587	3,383,640	105,319,932
Reclassification of net assets	(15,370)	(113,143)	128,513	
Net assets released from restrictions	14,084,949	(14,084,949)		
Total Revenues, Gains and Other Support	102,740,284	(932,505)	3,512,153	93,145,826
<b>EXPENSES AND LOSSES</b>				
Program expenses				
Instruction	41,413,178			40,301,960
Research	454,647			433,087
Public service	6,642,208			7,058,614
Academic support	6,088,339			5,878,958
Student services	12,110,651			11,226,259
Auxiliary enterprises	16,866,764			16,739,816
Support expenses				
Institutional support	18,603,144			18,673,740
Allocable expenses				
Operation and maintenance of plant	10,293,943			9,897,618
Interest expense	2,614,046			2,674,107
Depreciation expense	4,427,265			4,415,764
Amortization expense	137,439			137,439
Accretion expense	41,616			46,393
Less: Allocated expenses	(17,514,309)			(17,171,321)
Adjustment of actuarial liability for annuities payable	(493,278)	(14,326)	(572,653)	264,738
Loss on contributions receivable	5,087	52,600	26,396	79,097
Total Expenses and Losses	101,690,740	38,274	(546,257)	100,656,269
<b>Change in Net Assets</b>	1,049,544	(970,779)	4,058,410	(7,510,443)
NET ASSETS - Beginning of Year	60,523,280	22,552,802	71,158,172	161,744,697
<b>NET ASSETS - END OF YEAR</b>	\$ 61,572,824	\$ 21,582,023	\$ 75,216,582	\$ 154,234,254

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>REVENUES, GAINS AND OTHER SUPPORT</b>				
Tuition and fees	\$ 102,408,334			\$ 102,408,334
Less: Scholarships and grants	(41,391,396)			(41,391,396)
Net tuition and fees	61,016,938			61,016,938
Government grants	2,305,315			2,305,315
Private gifts	2,981,836	\$ 9,548,300	\$ 1,733,759	14,263,895
Endowment income and gains (losses)	(2,112,717)	5,430	16,803	(2,090,484)
Losses in perpetual trusts			(955,309)	(955,309)
Other investment income	80,828			80,828
Sales and services of educational activities	142,706			142,706
Other sources	669,702			669,702
Sales and services of auxiliary enterprises	17,712,235			17,712,235
	82,796,843	9,553,730	795,253	93,145,826
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	<u>94,220,579</u>	<u>(1,989,498)</u>	<u>914,745</u>	<u>93,145,826</u>
<b>EXPENSES AND LOSSES</b>				
Program expenses				
Instruction	40,301,960			40,301,960
Research	433,087			433,087
Public service	7,058,614			7,058,614
Academic support	5,878,958			5,878,958
Student services	11,226,259			11,226,259
Auxiliary enterprises	16,739,816			16,739,816
Support expenses				
Institutional support	18,673,740			18,673,740
Allocable expenses				
Operation and maintenance of plant	9,897,618			9,897,618
Interest expense	2,674,107			2,674,107
Depreciation expense	4,415,764			4,415,764
Amortization expense	137,439			137,439
Accretion expense	46,393			46,393
Less: Allocated expenses	(17,171,321)			(17,171,321)
Adjustment of actuarial liability for annuities payable	(139,227)	5,978	397,987	264,738
Loss on contributions receivable	33,891	45,206		79,097
Total Expenses and Losses	<u>100,207,098</u>	<u>51,184</u>	<u>397,987</u>	<u>100,656,269</u>
<b>Change in Net Assets</b>	(5,986,519)	(2,040,682)	516,758	(7,510,443)
NET ASSETS - Beginning of Year	<u>66,509,799</u>	<u>24,593,484</u>	<u>70,641,414</u>	<u>161,744,697</u>
<b>NET ASSETS - END OF YEAR</b>	<u>\$ 60,523,280</u>	<u>\$ 22,552,802</u>	<u>\$ 71,158,172</u>	<u>\$ 154,234,254</u>

See accompanying notes to financial statements.

**PACIFIC LUTHERAN UNIVERSITY**  
**STATEMENTS OF CASH FLOWS**  
For the Years Ended May 31, 2013 and 2012

	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 4,137,175	\$ (7,510,443)
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	4,564,704	4,553,203
Accretion	41,616	46,396
Change in gifts of investments	4,579	65,679
(Gains) losses on endowment investments and perpetual trusts	(7,750,874)	3,837,198
Gains on investments	(1,366,631)	(15,676)
Actuarial adjustment on annuities payable	673,207	49,383
Loan cancellations, assignments and write-offs	114,548	134,689
Loss on default of real estate contract		108,266
Losses on contributions receivable	84,082	79,097
Loss on sale of real estate	162,674	91,215
Increase (decrease) in allowance on student receivables	(2,200)	32,200
Decrease in allowance on student notes	(6,000)	(1,500)
Change in assets and liabilities		
Student receivables	(25,150)	130,246
Other receivables	(450,932)	(476,753)
Estate gift receivable	3,050,000	6,000,000
Grants receivable	(21,447)	(21,350)
Contributions receivable for operations	374,323	488,171
Inventories, prepaid expense and deposits	(178,603)	270,999
Accounts payable and accrued liabilities	(117,930)	687,771
Student deposits	(51,285)	(287,197)
Deposits held in custody for others	(70,921)	(55,699)
Change in cash surrender value of life insurance held as endowment investment	(57,159)	(74,048)
Contributions restricted for long-term investment, loans and plant	(2,684,079)	(3,992,152)
Contributions under split-interest agreements	(459,507)	(1,867)
Interest and dividends restricted for reinvestment	(31,334)	(16,803)
Net Cash Flows From Operating Activities	(67,144)	4,121,025
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of endowment investments	(18,707,179)	(9,123,786)
Sales of endowment investments	19,070,185	6,447,257
Purchases of investments	(1,924,866)	(18,257,681)
Sales of investments	2,003,881	18,853,149
Proceeds from partial redemption of life insurance policy	411,395	
Proceeds from sale of real estate	735,226	319,121
Additions to deposits held by trustee, net	(30,309)	(30,396)
Purchases of property, plant and equipment	(8,891,612)	(5,918,881)
Reductions of asset retirement obligation	(141,993)	
Repayments of real estate contract receivables	29,500	32,016
Disbursements of loans to students	(1,218,873)	(1,303,400)
Repayments of loans from students	1,229,562	1,215,079
Net Cash Flows From Investing Activities	(7,435,083)	(7,767,522)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayments of principal on indebtedness	(1,217,495)	(1,156,424)
Contributions received restricted for long-term investment, loans and plant	3,098,623	5,054,482
Proceeds from issuance of split-interest agreements	1,059,560	10,000
Receipts of interest and dividends restricted for reinvestment	31,334	16,803
Payments to annuitants	(817,775)	(793,810)
Decrease in government grants refundable	(97,664)	(40,214)
Net Cash Flows From Financing Activities	2,056,583	3,090,837
Net Change in Cash and Cash Equivalents	(5,445,644)	(555,660)
CASH AND CASH EQUIVALENTS - Beginning of year	17,230,664	17,786,324
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 11,785,020	\$ 17,230,664
Supplemental disclosure of cash flow statement		
Interest paid	\$ 2,618,942	\$ 2,678,764
Noncash investing and financing activities		
Property, plant and equipment acquired through accounts payable	2,570,134	557,645

## PACIFIC LUTHERAN UNIVERSITY

### NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2013 and 2012

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#### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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**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, 2013 and 2012

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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**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 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. Receivables are generally unsecured. Past due balances are subject to a 1.5% monthly interest charge.

**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, 2013 and 2012, 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, 2013 and 2012

**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, 2013 and 2012 are as follows:

	2013	2012
Balance, Beginning of the year	\$ 974,302	\$ 927,906
Abatements	(141,993)	
Accretion expense	41,616	46,396
	\$ 873,925	\$ 974,302
Balance, End of the year		

# PACIFIC LUTHERAN UNIVERSITY

## NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended May 31, 2013 and 2012

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### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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**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 \$3,568,000 and \$3,444,000 for the years ended May 31, 2013 and 2012, 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, 2013 and 2012. The University's tax returns are subject to review and examination by federal authorities. The tax returns for fiscal years 2010 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 \$2,304,000 and \$2,419,000 for the years ended May 31, 2013 and 2012, 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.

## PACIFIC LUTHERAN UNIVERSITY

### NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2013 and 2012

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#### NOTE 2 - FAIR VALUE MEASUREMENTS

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**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 fair value of contributions receivable (pledges) is based on a discounted cash flow methodology using discount rates consistent with the expected maturities of the pledges, adjusted for consideration of the donor's credit. The fair value of the contributions receivable approximates carrying value and would be considered Level 3 in the fair value hierarchy.

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 annuities payable related to split interest agreements is based on a discounted cash flow methodology using assumptions about estimated return on invested assets during the term of the agreement, the contractual payment obligations of the agreement, discount rates that are commensurate with the risks involved, and life expectancies published in the mortality tables. The fair value of the annuities payable approximates carrying value. The fair value for annuities payable related to gift annuities would be considered Level 2 in the fair value hierarchy. The fair value of annuities payable related to unitrusts would be considered Level 3 in the fair value hierarchy.

The approximate fair value of fixed rate debt was \$61,244,000 and \$64,600,000 as of May 31, 2013 and 2012, respectively. The estimated fair value for the fixed rate debt was estimated using the rates currently offered for comparable debt instruments with similar remaining maturities. Based on these inputs, the fair value of the fixed rate long-term debt would be classified as a Level 2 liability.

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

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.

**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, 2013 and 2012

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**NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)**

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***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, 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 at May 31, 2013 and 2012.

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, 2013 and 2012

**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, 2013 based upon the three-tier hierarchy:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>ASSETS</b>				
Short term investments	\$ 2,174,652		\$ 2,174,652	
Mutual funds				
Domestic equity funds	9,983,914	\$ 9,983,914		
International equity funds	22,675,407	22,675,407		
Global fixed income funds	6,768,244	6,012,881	755,363	
U.S. government bond funds	1,499,321		1,499,321	
Corporate bond funds	1,613,146		1,613,146	
High yield bond funds	270,959		270,959	
Real estate funds	1,476,775	1,476,775		
Alternative investments				
Hedge funds	11,353,379			\$ 11,353,379
Private equity funds	3,129,757			3,129,757
Funds of hedge funds	4,321,997			4,321,997
Commodity funds	4,803,852	3,066,098	1,737,754	
Perpetual trusts held by others	9,593,347			9,593,347
Government obligations	<u>4,769,609</u>	<u>4,769,609</u>		
 Total	 <u>\$ 84,434,359</u>	 <u>\$ 47,984,684</u>	 <u>\$ 8,051,195</u>	 <u>\$ 28,398,480</u>

**PACIFIC LUTHERAN UNIVERSITY**

NOTES TO FINANCIAL STATEMENTS  
As of and for the Years Ended May 31, 2013 and 2012

**NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)**

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>
<b>ASSETS</b>				
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 hedge 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	<u>4,739,300</u>	<u>4,739,300</u>		
 Total	 <u>\$ 75,812,693</u>	 <u>\$ 40,036,953</u>	 <u>\$ 9,866,379</u>	 <u>\$ 25,909,361</u>

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, 2013:

	<u>Balance May 31, 2012</u>	<u>Net realized and unrealized gains</u>	<u>Purchases</u>	<u>Sales</u>	<u>Balance May 31, 2013</u>
<b>Assets</b>					
Hedge funds	\$ 9,323,345	\$ 2,187,659	\$ 3,207,078	\$ (3,364,703)	\$ 11,353,379
Private equity funds	2,914,200	396,319	164,998	(345,760)	3,129,757
Funds of hedge funds	4,840,306	337,417		(855,726)	4,321,997
Perpetual trusts held by others	<u>8,831,510</u>	<u>761,837</u>			<u>9,593,347</u>
 Total	 <u>\$ 25,909,361</u>	 <u>\$ 3,683,232</u>	 <u>\$ 3,372,076</u>	 <u>\$ (4,566,189)</u>	 <u>\$ 28,398,480</u>

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, 2013 \$ 2,618,879

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**

As of and for the Years Ended May 31, 2013 and 2012

**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:

	<u>Balance May 31, 2011</u>	<u>Net realized and unrealized gains (losses)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Balance May 31, 2012</u>
<b>Assets</b>					
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 hedge funds	4,148,799	17,043	2,400,000	(1,725,536)	4,840,306
Perpetual trusts held by others	<u>9,786,819</u>	<u>(955,309)</u>			<u>8,831,510</u>
Total	<u>\$ 28,639,701</u>	<u>\$ (1,385,638)</u>	<u>\$ 2,859,913</u>	<u>\$ (4,204,615)</u>	<u>\$ 25,909,361</u>

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)

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**

As of and for the Years Ended May 31, 2013 and 2012

**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, 2013:

	Hedge Funds	Private Equity Funds	Funds of Funds
Fair value, May 31, 2013	\$11,353,379	\$3,129,757	\$4,321,997
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.	\$924,000	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, 2013 and 2012

**NOTE 3 - RESTRICTIONS AND LIMITATIONS ON NET ASSET BALANCES**

Permanently restricted net assets consist of the following at May 31, 2013 and 2012:

	2013	2012
Endowment funds	\$ 70,387,873	\$ 67,091,602
Contributions receivable	250,913	390,925
Student loan funds	257,331	252,602
Annuity, life income and similar funds	4,320,465	3,423,043
	\$ 75,216,582	\$ 71,158,172

Temporarily restricted net assets consist of the following at May 31, 2013 and 2012:

Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other departmental support - operating	\$ 2,683,299	\$ 2,850,090
Scholarships, instruction and other departmental support - endowment funds not yet appropriated for spending	6,256,854	3,978,303
Acquisition of buildings and equipment	10,764,931	13,147,770
	19,705,084	19,976,163
Contributions receivable for operations	187,322	531,642
Contributions receivable for acquisition of buildings and equipment	1,645,343	2,015,049
Annuity, life income and similar funds	44,274	29,948
	\$ 21,582,023	\$ 22,552,802

At May 31, 2013 and 2012, the University's unrestricted net assets were allocated as follows:

Operations	\$ 3,189,449	\$ 3,883,789
Endowment funds		
Donor restricted endowment funds (underwater)	(1,989,553)	(3,680,950)
Board designated endowment	4,930,532	4,413,621
Total Endowment	2,940,979	732,671
Annuity, life income and similar funds	646,143	1,173,147
Loans to students	824,743	838,043
Plant	53,971,510	53,895,630
	\$ 61,572,824	\$ 60,523,280

**PACIFIC LUTHERAN UNIVERSITY**

NOTES TO FINANCIAL STATEMENTS  
As of and for the Years Ended May 31, 2013 and 2012

**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, 2013 and 2012 were as follows:

	2013	2012
Expended for plant facilities	\$ 3,106,458	\$ 6,749
Scholarships, instruction and other departmental support	10,978,491	11,422,541
	\$ 14,084,949	\$ 11,429,290

These assets were reclassified to unrestricted net assets.

**NOTE 5 - CONTRIBUTIONS RECEIVABLE**

Contributions receivable at May 31, 2013 and 2012 include the following unconditional promises to give:

	2013	2012
Unrestricted - completed construction projects	\$ 77,255	\$ 100,092
Temporarily restricted - operations	209,068	595,443
Temporarily restricted - plant projects	2,454,642	2,955,712
Permanently restricted - endowment	288,082	450,571
Gross unconditional promises to give	3,029,047	4,101,818
Less: Allowance for uncollectable promises	(234,398)	(331,392)
Less: Unamortized discount	(685,070)	(787,898)
Net Unconditional Promises to Give	\$ 2,109,579	\$ 2,982,528
Amounts due in:		
Less than one year	\$ 839,283	
One to five years	1,061,252	
More than five years	1,128,512	
	\$ 3,029,047	

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, 2013 and 2012. 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, 2013 and 2012

**NOTE 6 - ENDOWMENT INVESTMENTS**

The University's endowment consists of 482 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, 2013:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (1,989,553)	\$ 6,256,854	\$ 70,387,873	\$ 74,655,174
Board-designated endowment funds	4,930,532			4,930,532
Total endowment net assets	\$ 2,940,979	\$ 6,256,854	\$ 70,387,873	\$ 79,585,706

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	\$ 732,671	\$ 3,978,303	\$ 67,091,602	\$ 71,802,576

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2013 and 2012

**NOTE 6 - ENDOWMENT INVESTMENTS (Continued)**

Changes in endowment net assets for the year ended May 31, 2013 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2012	\$ 732,671	\$ 3,978,303	\$ 67,091,602	\$ 71,802,576
Investment return:				
Investment income, net of fees of \$356,502	574,838	282,925	31,326	889,089
Net appreciation, perpetual trusts - unrealized			761,838	761,838
Net appreciation - realized and unrealized	2,001,175	5,014,466		7,015,641
Total investment return	2,576,013	5,297,391	793,164	8,666,568
Contributions	150,050		2,334,576	2,484,626
Appropriation of endowment net assets for expenditure	(574,838)	(3,018,840)		(3,593,678)
Matured deferred gifts	7,083		167,956	175,039
Transfer from other funds	50,000		575	50,575
Endowment net assets, May 31, 2013	\$ 2,940,979	\$ 6,256,854	\$ 70,387,873	\$ 79,585,706

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	251,667	31,828	862,335
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)	5,430	(923,481)	(2,974,863)
Contributions	1,026	26,944	2,011,780	2,039,750
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 endowment	1,600,000		84,576	1,684,576
Endowment net assets, May 31, 2012	\$ 732,671	\$ 3,978,303	\$ 67,091,602	\$ 71,802,576

**PACIFIC LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2013 and 2012

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**NOTE 6 - ENDOWMENT INVESTMENTS (Continued)**

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**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 \$1,989,553 and \$3,680,950 as of May 31, 2013 and 2012, 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, 2013 and 2012

**NOTE 6 - ENDOWMENT INVESTMENTS (Continued)**

The following summarizes the University's endowment investments, which are recorded at fair value unless otherwise noted, at May 31, 2013 and 2012:

	2013	2012
Cash and short term investments	\$ 4,191,071	\$ 6,173,821
Commodity funds	4,803,852	5,230,681
Domestic equity mutual funds	6,301,432	4,773,244
Fixed income mutual funds	6,012,881	9,960,202
International equity mutual funds	20,738,235	10,876,266
Alternative investments		
Hedge funds	11,353,379	9,323,345
Funds of hedge funds	4,321,997	4,840,306
Real estate (at cost)	7,172,787	6,943,160
Real estate contracts (at cost)	513,212	539,242
Private equity funds	<u>3,129,757</u>	<u>2,914,200</u>
	68,538,603	61,547,467
Perpetual trusts held by others	9,593,347	8,831,510
Life insurance (at cost)	<u>1,453,757</u>	<u>1,396,599</u>
	<u>79,585,707</u>	<u>71,802,576</u>
Less Interfund Amounts:		
Cash and short term investments (at cost)	(2,702,268)	(2,338,134)
Real estate contracts (at cost)	<u>(513,212)</u>	<u>(539,242)</u>
	<u>\$ 76,370,227</u>	<u>\$ 68,925,200</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, 2013 and 2012

**NOTE 7 - INVESTMENTS**

The following summarizes the University's investments in funds other than endowment funds at May 31, 2013 and 2012:

	2013	2012
Cash and short term investments	\$ 685,849	\$ 238,061
Mutual funds		
Equity funds	5,619,654	4,770,767
Fixed income funds	4,138,789	4,196,309
Stocks (at cost)	3,192	7,771
Real estate funds	1,476,775	1,445,834
Other (at cost)	174,988	568,863
	<u>\$ 12,099,247</u>	<u>\$ 11,227,605</u>

**NOTE 8 - CONSTRUCTION IN PROGRESS**

At May 31, 2013, the following major building projects were in progress:

	Cost To Date	Funding Source
Karen Hille Phillips Center for the Performing Arts	\$ 16,593,575	Private Grants
Campus Entrance	302,570	Private Grants
	<u>\$ 16,896,145</u>	

**NOTE 9 - PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consisted of the following at May 31, 2013 and 2012:

	2013	2012
Land	\$ 2,037,723	\$ 2,037,723
Buildings and building improvements	133,652,263	133,652,263
Improvements other than buildings	8,722,013	5,104,025
Equipment and automobiles	34,221,463	33,444,692
Library books	12,449,286	12,506,788
Leasehold improvements	1,840,955	1,840,955
Non depreciated assets	1,235,950	1,235,950
	<u>194,159,653</u>	<u>189,822,396</u>
Less: Accumulated depreciation and amortization	(90,538,220)	(86,539,934)
	<u>\$ 103,621,433</u>	<u>\$ 103,282,462</u>

**PACIFIC LUTHERAN UNIVERSITY**

NOTES TO FINANCIAL STATEMENTS  
As of and for the Years Ended May 31, 2013 and 2012

**NOTE 10 - LONG-TERM DEBT**

Long-term debt at May 31, 2013 and 2012 consisted of the following:

	2013	2012
Loan payable to Washington Higher Education Facilities Authority, Series 2006	\$ 55,760,000	\$ 56,965,000
Note payable to an individual	94,612	107,107
	\$ 55,854,612	\$ 57,072,107

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 \$1,265,000 to \$2,300,000 on November 1, 2013 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 were available. 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, 2013, 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, 2013 are:

Year Ended May 31	Principal
2014	\$ 1,279,000
2015	1,345,000
2016	1,416,000
2017	1,488,000
2018	1,564,000

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**

As of and for the Years Ended May 31, 2013 and 2012

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**NOTE 11 - OPERATING LEASES**

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The University has an operating lease for equipment, which expires in June 2015. The University also has two building facility leases. One lease term expires in January 2022 with an option to renew for up to seven five-year lease terms. The other lease term expires in October 2017. Rental expense under these leases totaled \$787,000 and \$743,000, respectively, for the years ended May 31, 2013 and 2012.

KPLU-FM Pacific Lutheran University, a noncommercial radio station owned and operated by the University, has two operating leases for communications equipment and facilities through June 2020 and January 2021, respectively. Rental expense associated with these leases totaled \$276,800 and \$256,700 for the years ended May 31, 2013 and 2012, respectively.

Future minimum lease payments under operating leases as of May 31, 2013 are:

<u>Year Ended May 31</u>	<u>Amount</u>
2014	\$ 777,750
2015	780,750
2016	575,250
2017	588,150
2018	607,950

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**NOTE 12 - DEFERRED GIFT AGREEMENTS**

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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 1.2% to 11.6% in making the calculations at May 31, 2013 and 2012.

The University received \$459,507 and \$1,867 of gift value relating to deferred gift agreements for the years ended May 31, 2013 and 2012, respectively. Total assets held by the University under deferred gift agreements totaled \$12,280,118 and \$11,538,522 at May 31, 2013 and 2012, 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 \$2,901,474 and \$3,230,546, respectively, as of May 31, 2013 and 2012.

## PACIFIC LUTHERAN UNIVERSITY

### NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2013 and 2012

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#### NOTE 13 - CONCENTRATION OF CREDIT RISK

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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.

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#### NOTE 14 - RELATED PARTY TRANSACTIONS

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**Garfield Commons, LLC** - The University entered into an 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).

**Garfield North, LLC** - The University entered into an operating agreement with Garfield Partners, LLC ("GP"), a Washington limited liability company, 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 (Garfield Station). The original agreement was amended on April 5, 2012 and July 18, 2013. As provided for in the operating agreement, as amended, the parties agreed to make specified capital contributions to Garfield North on or before July 26, 2013. In April 2012, the agreed upon value of the property to be contributed by the University was determined to be \$1,080,000 and the agreed upon value for the property to be contributed by GP was determined to be \$1,023,000.

The University will contribute an additional \$500,000 in cash as part of its capital contributions and GP will contribute at least an additional \$4,220,000 in cash as part of its capital contributions.

Following its capital contributions to Garfield North, the University will have a 22% ownership interest, and will apply the equity method of accounting for its investment. GP will have a 78% ownership. A spouse of a member of the University's Board of Regents (the "related party") is a partner in GP. In addition, five members of the University's Board of Regents are personally invested in GP.

Under the terms of the agreement, as amended, the University provided financing to Garfield North in the form of a loan in the amount of \$1,000,000. Interest is at 3%. Principal payments of \$150,000 shall be made annually until the loan is paid in full, unless sufficient funds are not available to pay the full \$150,000, in which case the balance shall be added to the amount to be paid in the next year. The loan will be jointly and severally guaranteed by GP, the related party and another entity in an amount equal to their 78% 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.

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2013 and 2012

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**NOTE 14 - RELATED PARTY TRANSACTIONS (Continued)**

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The University has contracts totaling approximately \$12,882,000 with a construction company owned by the spouse of a member of the Board of Regents to renovate Eastvold (which has been renamed the Karen Hille Phillips Center for the Performing Arts). The contracts were approved in accordance with the Board of Regents' conflict of interest policy. At May 31, 2013, the University owed \$2,541,000 on the contracts, which was included in accounts payable on the statements of financial position.

Contributions receivable from non-compensated board members at May 31, 2013 and 2012 were \$185,810 and \$443,108, respectively. Gifts from non-compensated board members totaled \$1,219,492 and \$239,330 at May 31, 2013 and 2012, respectively.

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**NOTE 15 - STUDENT LOANS RECEIVABLE**

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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 both May 31, 2013 and 2012, student loans represented approximately 3% of total assets.

At May 31, 2013 and 2012, student loans consisted of the following:

	<u>2013</u>	<u>2012</u>
Federal government programs	\$ 7,813,861	\$ 7,939,098
Less allowance for doubtful accounts:		
Beginning of year	397,000	398,500
Increase	6,000	1,500
End of year	<u>391,000</u>	<u>397,000</u>
Student loans receivable, net	<u>\$ 7,422,861</u>	<u>\$ 7,542,098</u>

Funds advanced by the Federal government of \$7,430,278 and \$7,453,618 at May 31, 2013 and 2012, 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.

**PACIFIC LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2013 and 2012

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**NOTE 15 - STUDENT LOANS RECEIVABLE (Continued)**

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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, 2013 and 2012, the following amounts were past due under student loan programs:

	Amounts Past Due			
	60-89 days	90-119 days	120+ days	Total
May 31,				
2013	\$ 4,366	\$ 4,841	\$ 1,032,487	\$ 1,041,694
2012	4,162	7,005	1,045,626	1,056,793

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**NOTE 16 - SUBSEQUENT EVENTS**

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The University has evaluated subsequent events through September 26, 2013, which is the date that the financial statements were issued.