

The mission of Pacific Lutheran University is to educate students for lives of thoughtful inquiry, service, leadership and care – for other persons, for their communities and for the earth.

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Report of Independent Auditors

To the Board of Regents
Pacific Lutheran University

Report on the Financial Statements

We have audited the accompanying financial statements of Pacific Lutheran University (the University), which comprise the statement of financial position as of May 31, 2017, and the related statements of activities and cash flows for the year 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 auditor's 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, 2017, the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited the University's 2016 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 5, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended May 31, 2016 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Moss Adams LLP

Yakima, Washington
December 20, 2017

PACIFIC LUTHERAN UNIVERSITY

STATEMENTS OF FINANCIAL POSITION

As of May 31, 2017 and 2016

(in thousands)

ASSETS	2017	2016
Cash and cash equivalents	4,121	4,991
Student Receivables, net	1,008	1,090
Grants and other receivables	2,612	2,110
Inventories and prepaid expenses	1,422	1,273
Contributions receivables, net	1,238	1,641
Student loans receivable, net	6,670	6,468
Investments	95,880	82,433
Fair value of interest rate SWAP	1,112	-
Assets held under split-interest agreements	12,088	11,917
Bond proceeds restricted as reserves	1,441	5,876
Property, Plant and Equipment, net	122,485	125,204
TOTAL ASSETS	250,077	243,003
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued liabilities	9,219	9,042
Long-Term Debt	58,260	61,169
Student deposits	2,043	1,776
Liabilities under split-interest agreements	6,880	6,709
Government grants refundable	7,978	8,038
Other liabilities	1,464	1,424
TOTAL LIABILITIES	85,844	88,158
Net Assets		
Net assets without donor restrictions:		
Available for operations	2,577	6,503
Funds held for long-term investment held as endowment	12,507	4,517
Split-interest agreement funds	1,619	146
Invested in property, plant and equipment	58,044	60,864
Total net assets without donor restrictions	74,747	72,030
Net assets with donor restrictions:		
Unexpended funds received for educational expenses	2,844	1,290
Split-interest agreement funds	3,749	5,377
Student loan funds	165	165
Endowment funds	82,728	75,983
Total net assets with donor restrictions	89,486	82,815
TOTAL NET ASSETS	164,233	154,845
TOTAL LIABILITIES AND NET ASSETS	250,077	243,003

PACIFIC LUTHERAN UNIVERSITY

STATEMENTS OF ACTIVITIES

As of May 31, 2017 and 2016

(in thousands)

	Without donor restrictions	With donor restrictions	Totals	
			2017	2016
Revenues, gains, and other support:				
Tuition and fees	\$ 114,643	\$ -	\$ 114,643	\$ 114,173
Less student financial aid	(54,251)	-	(54,251)	(51,170)
Net tuition and fees	60,392	-	60,392	63,003
Sales and Service of auxiliary services	15,946		15,946	16,865
Grants	459	1,394	1,853	2,246
Contributions	3,728	4,584	8,312	9,845
Other investment income (loss)	2,949	7,226	10,175	3,239
Gain on Sale of KPLU	6,825	-	6,825	-
Change in split interest agreements	418	(604)	(186)	(339)
Other revenues	1,291	54	1,345	3,514
Total operating revenues and gains	92,008	12,654	104,662	98,373
Net assets released from restrictions	5,894	(5,894)	-	-
	97,902	6,760	104,662	98,373
Expenses:				
Instruction	33,494	-	33,494	32,625
Public service	1,493	-	1,493	7,578
Academic support	5,009	-	5,009	5,376
Student services	11,386	-	11,386	10,900
Institutional support	17,282	-	17,282	18,094
Auxiliary enterprises	9,802	-	9,802	11,456
Allocated expenses	17,920	-	17,920	17,221
Total operating expenses	96,386	-	96,386	103,250
Non-operating activity:				
Gain/Loss on interest rate SWAP	1,112	-	1,112	-
Reclassifications of net assets	89	(89)	-	-
	1,201	(89)	1,112	-
Change in net assets	2,717	6,671	9,388	(4,877)
Net assets, beginning of year	72,030	82,815	154,845	159,722
Net assets, end of year	<u>\$ 74,747</u>	<u>\$ 89,486</u>	<u>\$ 164,233</u>	<u>\$ 154,845</u>

PACIFIC LUTHERAN UNIVERSITY

STATEMENTS OF CASH FLOWS

As of May 31, 2017 and 2016

(in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	2017	2016
Increase (decrease) in net assets	\$ 9,388	\$ (4,877)
Noncash operating adjustments:		
Depreciation and amortization	5,468	5,321
Accretion	51	48
Provision for doubtful student accounts and pledges	6	655
Net realized and unrealized gain on investments	(8,169)	(1,549)
Change in value of split interest agreements	134	767
Unrealized gain on interest rate swaps	(1,112)	-
Write-off of KPLU contribution receivables - net	233	-
Write-off of 2006 bond costs	309	-
Noncash investing and financing adjustments:		
Contributions to net assets with donor restrictions	(4,584)	(3,935)
Gain on disposal of plant assets	(7,600)	
Changes in operating assets and liabilities:		
Student accounts receivable	67	885
Grants and other receivables	487	301
Inventories and prepaid expenses	(150)	435
Contributions receivables	179	(899)
Accounts payable, accrued liabilities and other liabilities	164	(1,604)
Student deposits	267	(556)
Government grants refundable	(59)	448
Net cash from by operating activities	(4,921)	(4,560)
INVESTING ACTIVITIES		
Purchase of investments	(26,396)	(99,409)
Proceeds from sale of investments	21,118	101,169
Proceeds from sale of KPLU	7,000	-
Changes to bond proceeds restricted for capital projects, net	4,436	5,551
Purchase of land, buildings and equipment	(3,082)	(5,500)
Proceeds from matured trust	-	(146)
Net change in student loans receivable	(201)	218
Net cash from investing activities	2,875	1,883
FINANCING ACTIVITIES		
Payments on long-term debt	(51,783)	(1,416)
Issuance of long term debt	48,933	-
Bond issuance costs	(423)	-
Contributions of net assets with donor restrictions	4,584	3,935
Proceeds from issuance of split interest agreements	-	35
Annuity payments and other	(135)	(219)
Net cash from financing activities	1,176	2,335
Net decrease in cash and cash equivalents	(870)	(342)
CASH AND CASH EQUIVALENTS		
Beginning of year	4,991	5,333
End of year	<u>\$ 4,121</u>	<u>\$ 4,991</u>

Supplemental disclosure of cash flow information --

Interest Paid	\$ 2,651	\$ 2,901
Acquisition of property, plant and equipment through accounts payable	\$ 13	\$ 2
Underwriting received as consideration on sale of KPLU	\$ 1,000	\$ -

See accompanying notes to financial statements

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 1 – 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 3,100 students. The University offers 43 majors and 51 minors, as well as graduate and professional programs in business administration, creative writing, education, finance, marketing research, marriage and family therapy, and nursing.

Note 2 – Summary of Significant Accounting Policies

Basis of accounting – 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.

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.

Cash and cash equivalents – Cash and cash equivalents consist of short-term, highly liquid investments with an original maturity of three months or less, except for those held for long-term investment. Certain cash held by the University is restricted for the Federal Perkins and Nursing Loan Funds. The University's cash balances exceed Federal Deposit Insurance Corporation (FDIC) and Securities Investor Protection Corporation (SIPC) insured amounts at times. The University has not experienced any significant losses on its cash investments.

Student accounts receivable – Student accounts receivable are carried at the unpaid balance of the original amount billed to students less an allowance for doubtful accounts. Management determines the sufficiency of the allowance based on the length of time past due and historical experience. Student accounts are written off when all means of collection has been exhausted and collection is deemed unlikely.

Investments – Investments are stated at fair value (see note 3). Whenever available, quotations from organized securities exchanges are used as the basis for fair value. For investments not traded on organized exchanges, fair value estimates are provided by investment managers. Real estate held for investment is recorded at estimated fair value based on appraisals or other reliable documentation. During 2016, the University reclassified two properties that were held in property, plant and equipment to investments on the accompanying statement of financial position as the properties were considered to be investment properties and not used for the purpose of University operations. The real estate investments transferred through these transactions had a fair value of \$5,934 with a cost basis of \$1,839. The resulting gain of \$4,095 from the write-up to fair value is included in other investment income in the accompanying statement of activities.

Alternative investments are investments for which there is no readily determinable published value. The University has made a change in their investment strategy to liquidate the alternative investment portfolio as liquidity becomes available. It is our current strategy to have a balanced portfolio of equities, fixed assets and real estate.

Inventories – Bookstore and dining inventories are valued at a percentage of retail value, which approximates cost and is not in excess of market.

Bond proceeds restricted for capital projects – Bond proceeds held by trustee include amounts restricted for debt service as required by the trust indentures.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 2 – Summary of Significant Accounting Policies (continued)

Bond issuance costs – Costs of bond issuance are deferred and amortized over the term of the related indebtedness and recorded as a charge against long-term debt.

Property, 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; 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 asset additions in excess of \$5.

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.

Fair value measurements – The Fair Value Measurements and Disclosures Topic of the Financial Accounting Standards Board's (FASB) Accounting Standards Codification defines fair value, establishes a framework for measuring fair value, and expands disclosure of fair value measurements, which applies to all assets and liabilities that are measured and reported on a fair value basis. See Note 3 for additional information.

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.

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 reflected in other liabilities on the statement of financial position for the years ended May 31, 2017 and 2016 are as follows:

	2017	2016
Balance, Beginning of the year	\$ 1,012	\$ 964
Accretion expense	50	48
Balance, End of the year	<u>\$ 1,062</u>	<u>\$ 1,012</u>

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.

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.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 2 – Summary of Significant Accounting Policies (continued)

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, 2017 and 2016. The University's tax returns are subject to review and examination by federal authorities.

Financial statement presentation – The University reports information regarding its financial position and activities according to two classes of net assets: net assets without donor restrictions and net assets with donor restrictions. Net assets of the University and changes therein are classified and reported as follows:

Net assets without donor restrictions – Net assets that are not subject to donor-imposed stipulations.

Net assets with donor restrictions – Net assets subject to donor-imposed stipulations that will be met by action of the University and/or the passage of time, or in perpetuity. Generally, the donors of these assets permit the University to use all or part of the income and gains earned on related investment for general or specific purposes.

Prior year summarized information - The statement of activities includes comparative summarized information for the year ended May 31, 2016. Such information does not include sufficient detail by net asset class to constitute a presentation in conformity with U.S. GAAP. Accordingly, such information should be read in conjunction with the university's financial statements for the year ended May 31, 2016, from which the summarized information was derived.

Releases from restrictions - Expirations of 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.

Tuition and fees – Student tuition and fees are recorded as revenue on a ratable basis over the term of instruction. The majority of the University's students rely on funds received from various federal financial aid programs under Title IV of the Higher Education Act of 1965, as amended, to pay for a substantial portion of their tuition. These programs are subject to periodic review by the United States Department of Education (USDE). Disbursements under each program are subject to disallowance by the USDE and repayment by the University. In addition, as an educational institution, the University is subject to licensure from various accrediting and state authorities and other regulatory requirements of the USDE.

Auxiliary enterprises – Auxiliary enterprises consist of revenues and expenses relating to the operation of the residence halls, food services, bookstore, and the rental of facilities. Revenues from auxiliary enterprises are recorded at the time the related services are provided.

Other revenue and expenses – Revenues from sources other than contributions are generally reported as increases in net assets without donor restrictions. Expenses are reported as decreases in net assets without donor restrictions. Income earned on donor-restricted funds is initially classified as net assets with donor restrictions and is reclassified as net assets without donor restrictions when expenses are incurred for their intended purpose.

Contributions – 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.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 2 – Summary of Significant Accounting Policies (continued)

Expirations of restrictions on net assets are reported as net assets released from restrictions between the applicable classes of net assets. Conditional promises to give are recognized when the donor-imposed conditions are substantially met.

Unconditional promises to give, due after one year, are reported at the present value of net realizable value, using appropriate interest rates applicable to the years in which the promises were received. Amortization of discounts is recorded as an additional contribution, if any.

Contributions of property and equipment without donor stipulations concerning the use of such long-lived assets are reported as revenues without donor restrictions. Contributions of cash or other assets to be used to acquire property and equipment are reported as revenues with donor restrictions; the restrictions are considered to be released at the time such long-lived assets are placed in service.

Grant revenue – 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.

Investment gains and losses – Income from gains and losses are shown net of external and direct internal expenses on investments of endowment and similar funds and are reported as follows:

- Increases or decreases in net assets with donor restrictions if the terms of the gift or the University's interpretation of relevant state law requires they be added to the principal of a net asset with donor restrictions.
- Increases or decreases in net assets with donor restrictions if the terms of the gift impose restrictions on the use of the income.
- Increases or decreases in net assets without donor restrictions in all other cases.

Retirement plans – The University has a defined contribution retirement plan for academic and nonacademic personnel. Individual contributions are based on a percentage of compensation. The University's contribution rate was 7.5% as of May 31, 2017 and 2016, resulting in total contributions of approximately \$3,670 and \$3,740 for 2017 and 2016, 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.

Fundraising and advertising expenses – Fund-raising expenses totaled \$2,543 and \$2,696 for the years ended May 31, 2017 and 2016, respectively. Advertising costs are expensed when incurred.

Functional allocation of expenses – The costs of providing the various programs and other activities has been summarized on a functional basis in the statement of activities. The analysis of functional expenses present the natural classification detail of expense by function. Accordingly, certain expenses have been allocated among the programs and supporting services benefited. The expenses that are allocated include salaries, benefits, general and administrative tasks. Other costs are classified in each functional category based on the underlying purpose of each transaction.

Recent Accounting Pronouncements –

ASU 2014-15 – In August 2014, FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern*, which provides authoritative guidance about management's responsibility to evaluate whether there

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 2 – Summary of Significant Accounting Policies (continued)

is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. This standard is effective for fiscal years ending after December 15, 2016. The University has adopted ASU 2014-15 effective May 31, 2017.

ASU 2016-14 – In August 2016, FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, to improve the current net asset classification requirements and the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. This standard is effective for fiscal years beginning after December 15, 2017. Early application of the amendments is permitted. The University has early adopted ASU 2016-14 effective May 31, 2017.

As a result of the adoption of the ASU 2016-14 the University has applied the new standard retrospectively and restated the underwater endowments under net assets without restrictions to net assets with donor restrictions. Board designated investments held as endowments under net assets without donor restrictions as of May 31, 2016 have been reclassified as \$4,517, a change from the previous year's presentation of (\$1,545).

ASU 2015-03 – In April 2015, FASB issued Accounting Standards Update 2015-03 (Interest – Imputation of Interest (Subtopic 835-30) – Simplifying the Presentation of Debt Issuance Costs). The new guidance requires presentation of unamortized debt issuance costs as a debt reduction of the carrying amount of the associated debt liability. The University has adopted the standard effective May 31, 2017 and has retrospectively reclassified the asset, Bond Acquisition Costs to be presented as a net change to Long Term Debt.

Reclassification – Certain amounts from the prior year statement of activities and statement of financial position have been reclassified, in order to conform to the current year presentation.

Note 3 – Fair Value Measurements

U.S. GAAP defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. To increase consistency and comparability in fair value measurements, U.S. GAAP uses a fair value hierarchy that prioritizes the inputs to valuation approaches into three broad levels. The hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3).

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

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Prices or valuations that require using significant unobservable inputs in determining fair value. The inputs into the determination of fair value require significant judgement or estimation. The use of either the market approach, which generally consists of using comparable market transactions, or the income approach which generally consists of the net present value of estimated future cash flows, adjusted as appropriate for liquidity, credit, market and/or other risk factors.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 3 – Fair Value Measurements (continued)

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at May 31, 2017 and 2016.

Mutual and commodity funds: Valued at the daily closing price as reported by the fund. Mutual funds held by the University are open-end mutual funds that are registered with the U.S. Securities and Exchange Commission. These funds are required to publish their daily net asset value (NAV) and to transact at that price.

Short-term investments: Primarily consist 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 market that, are not active or are for the same or similar assets in active markets.

Government Obligations: These investments use other observable inputs to measure fair value such as dealer market prices for comparable investments based on interest rates, spreads, and trade activity in the market.

Investments in real estate: Determined using the market approach using appraised values, property tax assessments and other information for similar assets.

Hedge funds, private equity funds and funds of funds: Quoted prices are not readily available and funds cannot be redeemed within a short period of time. The University has estimated the fair value of these funds using the NAV provided by the investee as of the most recent date, adjusted for cash receipts, cash disbursements, and significant known valuation changes in market values of publicly held securities contained in the portfolio and security distributions through May 31, 2017 and 2016.

Perpetual trusts held by others: Estimate of fair value is based on fair value of underlying investments of the University's proportionate interest in the trusts based on level 3 information received from trustees. Trust assets consist of, but are not limited to, cash and cash equivalents, corporate and government bonds, mutual funds and equity securities. These assets are not subject to control or direction by the University.

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.

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.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 3 – Fair Value Measurements (continued)

Fair values of assets and liabilities measured on a recurring basis were as follows:

ASSETS	Fair Value Measurements at May 31, 2017			
	Level 1	Level 2	Level 3	Total
Short term investments	\$ -	\$ 2,474	\$ -	\$ 2,474
Mutual funds			-	
Domestic equity funds	3,809	-	-	3,809
International equity funds	2,307	-	-	2,307
Global fixed income funds	25,182	763	-	25,945
Index funds	36,544	-	-	36,544
U.S. government bond funds	-	1,169	-	1,169
Corporate bond funds	-	1,834	-	1,834
High yield bond funds	-	265	-	265
Real estate funds	1,587	-	-	1,587
Commodity funds	2,181	-	-	2,181
Investments in Real Estate	-	12,176	-	12,176
Perpetual Trusts Held by others	-	-	11,932	11,932
Government obligations	1,441	-	-	1,441
Interest rate swap agreement	-	1,112	-	1,112
Total assets in the fair value hierarchy	<u>\$ 73,051</u>	<u>\$ 19,793</u>	<u>\$ 11,932</u>	<u>\$ 104,776</u>
Investments Measured at NAV (Practical Expedient)				<u>2,195</u>
				<u>\$ 106,971</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, 2017:

Assets:	Balances May 31, 2016	Net Realized and Unrealized Gains (Losses)	Purchases	Sales	Transfers	Balances May 31, 2017
Perpetual Trusts Held by Endowment	\$ 11,451	\$ 481	\$ -	\$ -	\$ -	\$ 11,932
Investments in Real Estate	9,856	2,320	-	-	(12,176)	-
Total	<u>\$ 21,307</u>	<u>\$ 2,801</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (12,176)</u>	<u>\$ 11,932</u>

Total gains and losses are included in the Statement of Activities for the year ended May 31, 2017.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 3 – Fair Value Measurements (continued)

Fair values of assets and liabilities measured on a recurring basis were as follows:

ASSETS	Fair Value Measurements at May 31, 2016			
	Level 1	Level 2	Level 3	Total
Short term investments	\$ 1	\$ 3,485	\$ -	\$ 3,486
Mutual funds				
Domestic equity funds	3,722	-	-	3,722
International equity funds	2,110	-	-	2,110
Global fixed income funds	17,627	815	-	18,442
Index funds	30,056	-	-	30,056
U.S. government bond funds	-	1,156	-	1,156
Corporate bond funds	-	1,952	-	1,952
High yield bond funds	-	268	-	268
Real estate funds	1,548	-	-	1,548
Commodity funds	1,737	-	-	1,737
Investments in Real Estate	-	-	9,856	9,856
Perpetual Trusts Held by others	-	-	11,451	11,451
Government obligations	5,876	-	-	5,876
Total assets in the fair value hierarchy	\$ 62,677	\$ 7,676	\$ 21,307	\$ 91,660
Investments Measured at NAV (Practical Expedient)				4,871
				\$ 96,531

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, 2016:

Assets:	Balances May 31, 2015	Net Realized and Unrealized Gains (Losses)	Purchases	Sales	Transfers	Balances May 31, 2016
Perpetual Trusts Held by						
Endowment	\$ 11,258	\$ 193	\$ -	\$ -	\$ -	\$ 11,451
Investments in Real Estate	-	3,437	-	(74)	6,493	\$ 9,856
Total	\$ 11,258	\$ 3,630	\$ -	\$ (74)	\$ 6,493	\$ 21,307

Total gains and losses are included in the Statement of Activities for the year ended May 31, 2016.

The University has chosen to record its investments in real estate at fair value as a result of several properties reclassified as investments and the increase of assets shown as fair value are shown in the above table as transfers.

The University uses the 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.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 3 – Fair Value Measurements (continued)

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, 2017:

	Fair Value	Remaining Life	Unfunded Commitments	Redemption Terms	Redemption Restrictions
Hedge Funds	\$59	N/A	None	Monthly to annual, 45 to 90 days notice	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
Private Equity	\$1,400	1 to 12 years	\$778	3 to 5 years to draw	N/A
Funds of Funds	\$736	N/A	None	Annual with 120 days notice	1 year lockup. Upon full redemption, 90% is returned, with the remaining 10% heldback until the completion of the annual audit

Note 4 – Contributions Receivable

Contributions receivable at May 31 include the following:

	2017	2016
Contributions	\$ 2,161	\$ 3,105
Less allowance for uncollectable contributions	(108)	(659)
Less unamortized discount	(815)	(805)
Net unconditional promises to give	<u>\$ 1,238</u>	<u>\$ 1,641</u>
Amounts due in:		
Less than one year	\$ 617	
One to five years	415	
More than five years	1,129	
	<u>\$ 2,161</u>	

Contributions due in more than one year received on or before May 31, 2009 were discounted at an interest rate of 6%. Contributions due in more than one year received after May 31, 2009 are 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 contributions ranged from 1.57% to 2.34% at May 31, 2017 and 2016. Contributions due in less than one year were not discounted.

Note 5 – 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.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 5 – Student Loans Receivable (continued)

At both May 31, 2017 and 2016, student loans represented approximately 3% of total assets.

At May 31, 2017 and 2016, student loans consisted of the following:

	2017	2016
Federal government programs	\$ 7,135	\$ 6,934
Less allowance for doubtful accounts:		
Beginning of year	466	357
(Increases)/Decreases	1	(109)
End of year	465	466
Student loans receivable, net	<u>\$ 6,670</u>	<u>\$ 6,468</u>

Funds advanced by the Federal government of \$7,978 and \$8,038 at May 31, 2017 and 2016, 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 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, 2017 and 2016, the following amounts were past due under student loan programs:

May 31	Amounts Past Due				Total
	60-89 days	90-119 days	120+ days		
2017	\$ 3	\$ 3	\$ 736	\$	742
2016	5	2	761		768

Note 6 – Investments

The following summarizes the University's investments in funds at May 31:

	2017	2016
Stocks, included in ST investments	\$ 3	\$ 3
Endowment	88,826	76,801
Real estate, excluding Endowment assets	6,520	5,000
Other, at cost	531	629
	<u>\$ 95,880</u>	<u>\$ 82,433</u>

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 7 – Endowment Investments

The University's endowment consists of 537 and 511 individual funds at May 31, 2017 and 2016, respectively, 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 stipulations.

Interpretation of relevant law – The University has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) adopted by the 2009 Washington legislature as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the University classifies as net assets with donor restrictions: (a) the original value of gifts donated to the donor-restricted endowment, (b) the original value of subsequent gifts to the donor-restricted endowment, and (c) accumulations to the donor-restricted endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the Endowment Fund; (2) the purposes of the University and the donor-restricted 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; and (7) the investment policies of the University.

Endowment net assets consisted of the following at May 31:

May 31, 2017				
	Without donor Restrictions	With Donor Restrictions		Total
		Original Gift	Accumulated gains (losses)	
Board designated funds - purpose	\$ 12,507	\$ -	\$ -	\$ 12,507
Donor restricted funds				
Underwater funds	-	42,633	(4,136)	38,497
Other funds	-	26,321	4,325	30,646
Funds Held by Others	-	7,160	6,425	13,585
Total endowment funds	<u>\$ 12,507</u>	<u>76,114</u>	<u>6,614</u>	<u>95,235</u>
May 31, 2016				
	Without donor Restrictions	With Donor Restrictions		Total
		Original Gift	Accumulated gains (losses)	
Board designated funds - purpose	\$ 4,517	\$ -	\$ -	\$ 4,517
Donor restricted funds				
Underwater funds	-	47,812	(6,062)	41,750
Other funds	-	18,224	2,950	21,174
Funds Held by Others	-	7,160	5,899	13,059
Total endowment funds	<u>\$ 4,517</u>	<u>73,196</u>	<u>2,787</u>	<u>80,500</u>

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 7 – Endowment Investments (continued)

Changes to the endowment net assets for the years ended May 31, 2017 and 2016:

	Without donor restrictions	With donor restrictions	Total
Endowment net assets, May 31 2015	\$ 2,759	\$ 82,822	\$ 85,581
Investment return:			
Investment income, net of fees - \$329	1,789	(1,073)	\$ 716
Net appreciation - realized and unrealized	1,657	(4,949)	\$ (3,292)
Net appreciation - perpetual trusts - unrealized	-	193	\$ 193
Total investment return	3,446	(5,829)	\$ (2,383)
Contributions	100	1,973	2,073
Appropriation of endowment net assets for expenditure	(1,788)	(3,284)	(5,072)
Transfers from other funds	-	301	301
Endowment net assets, May 31 2016	4,517	75,983	80,500
Investment return:			
Investment income, net of fees - \$231	217	1,198	1,415
Net appreciation - realized and unrealized	952	5,255	6,207
Net appreciation - perpetual trusts - unrealized		544	544
Total investment return	1,169	6,997	8,166
Contributions	1	2,929	2,930
Appropriation of endowment net assets for expenditure	(482)	(3,190)	(3,672)
Transfers from other funds	7,302	9	7,311
Endowment net assets, May 31, 2017	\$ 12,507	\$ 82,728	\$ 95,235

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 UPMIFA requires the University to retain as a fund of perpetual duration. UPMIFA allows an institution to continue to spend on an endowment that is below the level of the original contributions and the University does not have a policy to suspend distributions on such endowments. In accordance with GAAP, deficiencies of this nature that are reported in net assets with donor restrictions were \$4,136 and \$6,062 as of May 31, 2017 and 2016, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of new donor-restricted contributions and continued appropriation for certain programs that was deemed prudent by the governing board.

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

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 7 – Endowment Investments (continued)

diversified asset allocation 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.

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

	2017	2016
Cash and short term investments	\$ 8,121	\$ 6,178
Commodity funds	2,181	1,772
Mutual Funds	61,726	47,683
Alternative investments:		
Hedge funds	59	1,948
Funds of hedge funds	736	1,174
Real estate contracts, at cost	387	422
Real estate	7,042	6,335
Private equity funds	1,400	1,930
	<u>81,652</u>	<u>67,442</u>
Perpetual trusts held by others	11,932	11,451
Life insurance, at cost	<u>1,652</u>	<u>1,607</u>
	95,236	80,500
Less Interfund Amounts:		
Cash and short term investments, at cost	(6,004)	(3,277)
Real estate contracts, at cost	<u>(406)</u>	<u>(422)</u>
	<u>(6,410)</u>	<u>(3,699)</u>
	<u>\$ 88,826</u>	<u>\$ 76,801</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 those changes could materially affect the amounts reported in the financial statements.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 8 – Net Assets Released from Restrictions

Net assets with donor restrictions released are by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors during the years ended May 31 were as follows:

	2017	2016
Expended for plant facilities	\$ 4	\$ 1,557
Scholarships, instruction and other departmental support	5,890	4,821
	<u>\$ 5,894</u>	<u>\$ 6,378</u>

These assets were reclassified to net assets without donor restrictions.

Note 9 – Long-Term Debt

Long-term debt at May 31 to Washington Higher Education Facilities Authority (WHEFA) consisted of the following:

	Interest Rate			May 31,	
	Mode	Interest Rate	Maturity Date	2017	2016
Bonds paid off in 2017	Fixed	4.25-5.00%	2025-2036	\$ -	\$ 51,765
Series 2014 Bonds - Term	Fixed	4.63%	11/1/2041	5,800	5,800
Series 2014 Bonds - Serial	Fixed	5.25%	11/1/2044	4,200	4,200
Series 2016 Bonds	Variable Rate*	2.70%	11/1/2041	48,933	-
Note payable to an individual	Fixed	9.00%	2/1/2019	32	50
				<u>58,965</u>	<u>61,815</u>
Less unamortized discount, premium, and debt issuance costs				(705)	(646)
				<u>\$ 58,260</u>	<u>\$ 61,169</u>

*LIBOR x 70% + 2% (applicable margin) is the effective interest rate as of May 31, 2017.

Series 2014 – In June 2014, the WHEFA issued Revenue Bonds (Pacific Lutheran University) Series 2014 on behalf of the University totaling \$10,000. The bond proceeds were used to provide a portion of the funds to finance the renovations, additions and improvements to University residence halls, including Stuen Hall, Ordal Hall and South Hall, and to other University facilities located on its campus and to pay the costs of issuing the bonds. Principle payments begin on November 1, 2037.

Series 2016 – In August 2016, WHEFA issued Refunding Revenue Bonds (Pacific Lutheran University Project) Series 2016 on behalf of the University totaling \$48,933. The bond proceeds were used to refund the Series 2006 WHEFA bonds. The structure of the bonds moved from fixed rate term and serial bonds to variable rate direct placement bonds.

The bonds are secured by a pledge of all unrestricted revenues as defined by the security agreement and the University's interest, if any in the Debt Service Fund.

The University maintains an unsecured \$2,000,000 line of credit, which it could draw upon in the event of an unanticipated liquidity need. No funds were borrowed under this agreement during the fiscal year ended May 31, 2017.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 9 – Long-Term Debt (continued)

The loan agreements with the Washington Higher Education Facilities Authority require the University to comply with certain financial and other covenants described in those agreements. As of May 31, 2017 the University has received a first year waiver for non-compliance with the liquidity ratio.

Other – 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 \$2, including interest, due through February 1, 2019.

The approximate payment obligation requirements for all long-term debt for the five years subsequent to May 31, 2017 are:

Year Ended May 31	Principal
2018	1,300
2019	1,337
2020	1,368
2021	1,413
2022	1,461
Thereafter	52,086
	\$ 58,965

Note 10 – Property, Plant, and Equipment

	2017	2016
Land	\$ 762	\$ 762
Buildings	167,588	165,687
Improvements other than buildings	9,029	8,722
Equipment & vehicles	14,867	14,338
Library books	5,259	5,823
Leasehold improvements	3,162	3,152
Nondepreciated assets	1,194	1,236
Construction In Progress	-	398
	201,861	200,118
Less accumulated depreciation and amortization	(79,376)	(74,914)
	\$ 122,485	\$ 125,204

The University has written off library assets that are fully depreciated and obsolete in the amount of \$600 during 2017.

Note 11 – 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 net assets without donor restrictions or net assets with donor restrictions, or in some instances, distributed to third-party beneficiaries.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 11 – Deferred Gift Agreements (continued)

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 and sex characteristics of the donor. The University used interest rates ranging from 1.20% to 11.60% in making the calculations at May 31, 2017 and 2016, respectively.

The University received \$0 and \$20 of gift value relating to deferred gift agreements for the years ended May 31, 2017 and 2016, respectively. Total assets held by the University under deferred gift agreements totaled \$12,248 and \$12,232 at May 31, 2017 and 2016 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 under liabilities as split-interest agreement on the statement of financial position was \$2,015 and \$2,244 respectively, as of May 31, 2017 and 2016.

Note 12 – Operating Leases

The University has three 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 \$863 and \$785 for the years ended May 31, 2017 and 2016, respectively.

Thereafter, future minimum lease payments under operating leases as of May 31, 2017 are:

<u>Year</u>	<u>Amount</u>
2018	\$ 753
2019	718
2020	641
2021	550
2022	448

Note 13 – Interest Rate Swap

The University uses variable-rate debt to finance the acquisition of land, buildings, and equipment as indicated in Note 9. The variable rate at May 31, 2017 was 2.7% (70% of LIBOR plus 2%). These debt obligations expose the University to variability in interest payments due to changes in interest rates. The University believes it is prudent to limit the variability of a portion of its interest payments and has entered into an interest rate swap to manage fluctuation in cash flows resulting from interest rate risk.

Under the interest rate swap, the University receives variable interest rate payments and makes fixed interest rate payments, thereby creating the equivalent of fixed-rate debt. In August 2016, the University acquired a 10-year amortizing swap from Washington Federal at a fixed rate of 1.016%. The notional amount of this swap fluctuates over time per the underlying amortization schedule as principal payments are made on the bonds. The amortizing swap had a notional amount of \$40,000 at May 31, 2017. There was no cash exchange at the time of acquisition of this swap due to the relationship between the variable rates and the swap rate at that time.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 13 – Interest Rate Swap (continued)

Change in the fair value of the interest rate swap is reported as unrealized gains or losses on interest rate swap related to bonds on the consolidated Statements of Activities. Providing that the University holds the swap to maturity, the value of the derivative will be zero. This swapping transaction can be terminated at the market rates at any time during the term of the swap.

The University does not enter into derivative instruments for any purpose other than interest payment hedging purposes and does not speculate for investment purposes using derivative instruments.

Note 14 – Liquidity and Availability

The following table reflects the University's financial assets as of May 31, 2017, reduced by amounts not available for general expenditures within one year. Financial assets are considered unavailable when illiquid or not convertible to cash within one year. Other considerations of non-liquid assets are state required annuity reserves, assets held for others, perpetual endowments and accumulated earnings net of appropriations within one year, trust assets or governing board designations for long-term investment. These investments include quasi-endowments and trusts.

	<u>2017</u>
Financial assets:	
Cash and cash equivalents	\$ 4,121
Accounts receivable	1,008
Contribution receivables	1,238
Grants and other receivables	2,612
Investments	95,880
Assets held under split-interest agreements	12,088
Bond reserves restricted	<u>1,441</u>
Financial Assets, at year-end	118,388
Less those unavailable for general expenditure within one year:	
Accounts and contributions receivable collectible beyond one year	1,427
Grants and other receivables unavailable beyond one year	2,359
Bond reserves required for issued bonds	1,441
Funds with donor restrictions for educational expenses	2,844
Investments and other financial assets held for others	6,880
Perpetual and term endowments, and accumulated earnings subject to appropriation beyond one year	79,098
Investments held in trusts and various state required annuity reserves	5,533
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 18,806</u>

As of May 31, 2017, the University has liquid assets on hand to cover 71 days of operating expenses. The University's practice is to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 15 – Analysis of expense by functional and natural categories

	Program Services			Supporting Activities		Total
	Instruction & Research	Student Services	Public Service	Administration	Fundraising	Expenses
Compensation	25,660	9,734	911	9,743	1,678	47,726
Employee benefits	6,703	2,186	222	4,108	512	13,731
Service, supplies and other expenses	6,095	9,069	352	5,789	353	21,658
Facility operations and maintenance	3,534	839	12	717	-	5,102
Depreciation & accretion	3,822	908	13	776	-	5,519
Interest	1,836	436	6	372	-	2,650
	47,650	23,172	1,516	21,505	2,543	96,386

The financial statements reports compensation, benefits, and services to the appropriate direct program. The table above has certain categories of expenses that are attributable to one or more program or supporting functions of the University allocated to these functional programs. These expenses include facility operations and maintenance, depreciation and accretion, and interest. These costs are allocated based on square footage methodology.

Note 16 – Related Party Transactions

Garfield Commons, LLC –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 and expires on January 31, 2022. At May 31, 2017 and 2016 the University's investment in Garfield Commons, LLC, totaled \$1,437 and \$1,437, respectively, and is included as real estate in Investments.

Garfield North, LLC –The University has a 29% ownership interest, and is applying the equity method of accounting for its investment. Garfield Partners, LLC (GP) has a 71% ownership. A spouse of a member of the University's Board of Regents (the related party) is a partner in GP. In addition, four members of the University's Board of Regents are personally invested in GP. At May 31, 2017 and 2016, the University's investment in Garfield North, LLC, totaled \$461 and \$987, respectively and is included as real estate in Investments.

Under the terms of the partnership agreement, as amended, the University provided financing to Garfield North, LLC in the form of a loan in the amount of \$1,000. Interest is at 3%. Principal payments of \$150 shall be made annually until the loan is paid in full, unless sufficient funds are not available to pay the full \$150, in which case the balance shall be added to the amount to be paid in the next year. The loan is jointly and severally guaranteed by GP, the related party and another entity in an amount equal to their 71% of the loan. In addition, and as specified in the partnership agreement, the related party's construction company is acting as the general contractor on the construction contract. Construction on Garfield Station was completed during fiscal year ended May 31, 2015. At May 31, 2017 and 2016, the amount due from Garfield North, LLC, totaled \$850 and \$850, respectively and is included as other receivables on the statements of financial position.

Contributions receivable from board members at May 31, 2017 and 2016 were \$55 and \$93, respectively. Gifts from board members totaled \$52 and \$102 at May 31, 2017 and 2016, respectively.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of May 31, 2017 and 2016

(in thousands)

Note 17 – 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 18 – Sale of KPLU (Radio Station)

On August 30, 2016 PLU sold KPLU's (University radio station) broadcasting rights and its assets to Friends of 88.5 FM for \$8 million, comprised of \$7 million in cash and \$1 million in underwriting announcements over 10 years. The sale excluded a number of assets including, but not limited to, equipment and facilities located on the University's campus in Parkland, Washington. The University wrote off the remaining contributions receivable of \$233, net of the uncollectable allowance and recorded a receivable of \$1 million for the in-kind underwriting announcements agreed upon in the asset purchase agreement.

Note 19 – Commitments and Contingencies

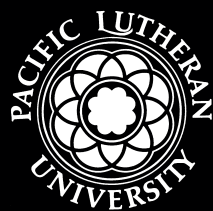
Regulation and litigation – The University receives funding or reimbursement from governmental agencies for various activities which are subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to government review and interpretation, as well as regulatory actions. The University is subject to such regulatory reviews and, while these reviews may result in repayments and/or civil remedies, management believes, based on its current knowledge and information, that such repayments and/or civil remedies, if any, would not have a material effect on the University's financial position.

The University is subject to legal proceedings and claims that arise in the ordinary course of its business. In the opinion of management, there are no matters that will materially affect the University's financial position.

Note 20 – Subsequent Events

Subsequent events are events or transactions that occur after the statement of financial position date but before financial statements are issued. The University recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of financial position, including the estimates inherent in the process of preparing the financial statements. The University's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of financial position but arose after the statement of financial position date and before financial statements are available to be issued.

The University has evaluated subsequent events through December 20, 2017 which is the date the financial statements are available to be issued.



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