

**PACIFIC LUTHERAN UNIVERSITY**  
Tacoma, Washington

**FINANCIAL STATEMENTS**  
Including Independent Auditors' Report

As of and for the Years Ended May 31, 2014 and 2013

**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, 2014 and 2013, 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, 2014 and 2013, 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 Victor Krause, LLP*

Minneapolis, Minnesota  
December 16, 2014

**PACIFIC LUTHERAN UNIVERSITY**

**STATEMENTS OF FINANCIAL POSITION**

As of May 31, 2014 and 2013

<b>ASSETS</b>		
	2014	2013
Cash and cash equivalents	\$ 4,250,129	\$ 11,785,020
Student receivables, net of allowance for doubtful accounts of \$451,500 and \$417,600	1,285,627	1,213,791
Other receivables	1,674,502	1,524,000
Estate gift receivable	25,000	450,000
Real estate contracts receivable	116,551	146,051
Grants receivable	564,314	687,206
Contributions receivable, net	1,711,621	2,109,579
Inventories	864,658	875,750
Prepaid expenses and deposits	1,197,579	1,090,004
Real estate	1,967,020	2,005,020
Student loans receivables, net	7,186,738	7,422,861
Investments	12,697,622	12,099,247
Endowment investments	82,251,836	76,370,227
Deposits held by trustee - government obligations	4,801,810	4,769,609
Bond acquisition costs	1,256,156	1,310,771
Construction in progress	1,361,012	16,896,145
Property, plant and equipment, net	121,661,916	103,621,433
 <b>TOTAL ASSETS</b>	 <b>\$ 244,874,091</b>	 <b>\$ 244,376,714</b>
 <b>LIABILITIES AND NET ASSETS</b>		
<b>LIABILITIES</b>		
Accounts payable	\$ 1,855,632	\$ 3,565,138
Accrued liabilities	9,274,439	7,798,529
Student deposits	1,793,122	1,722,964
Asset retirement obligation	917,623	873,925
Long-term debt	54,575,944	55,854,612
Unamortized premium on long-term debt	917,846	957,753
Annuities payable	6,561,595	6,648,126
Deposits held in custody for others	1,111,053	1,153,418
Government grants refundable	7,391,775	7,430,820
Total Liabilities	84,399,029	86,005,285
 <b>NET ASSETS</b>		
Unrestricted	70,470,694	61,572,824
Temporarily restricted	11,330,335	21,582,023
Permanently restricted	78,674,033	75,216,582
Total Net Assets	160,475,062	158,371,429
 <b>TOTAL LIABILITIES AND NET ASSETS</b>	 <b>\$ 244,874,091</b>	 <b>\$ 244,376,714</b>

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2014  
With Comparative Totals for 2013

	2014			2013
	Unrestricted	Temporarily Restricted	Permanently Restricted	
<b>REVENUES, GAINS AND OTHER SUPPORT</b>				
Tuition and fees	\$ 112,878,069			\$ 112,878,069
Less: Scholarships and grants	(47,097,692)			(47,097,692)
Net tuition and fees	65,780,377			65,780,377
Government grants	3,057,376			3,057,376
Private gifts	1,259,798	\$ 9,027,659	\$ 2,278,065	12,565,522
Endowment income and gains	1,201,218	4,251,639	34,757	5,487,614
Gains in perpetual trusts			547,625	547,625
Other investment income (losses)	44,437		7	44,444
Sales and services of educational activities	141,886			141,886
Other sources	801,261			801,261
Sales and services of auxiliary enterprises	17,339,375			17,339,375
	89,625,728	13,279,298	2,860,454	105,765,480
Reclassification of net assets	2,170,729	(2,194,609)	23,880	
Net assets released from restrictions	21,332,334	(21,332,334)		
Total Revenues, Gains and Other Support	113,128,791	(10,247,645)	2,884,334	105,765,480
<b>EXPENSES AND LOSSES</b>				
Program expenses				
Instruction	42,199,062			42,199,062
Research	288,083			288,083
Public service	7,320,927			7,320,927
Academic support	6,506,802			6,506,802
Student services	11,977,605			11,977,605
Auxiliary enterprises	16,849,391			16,849,391
Support expenses				
Institutional support	19,018,244			19,018,244
Allocable expenses				
Operation and maintenance of plant	8,911,369			8,911,369
Interest expense	2,550,875			2,550,875
Depreciation expense	5,068,648			5,068,648
Amortization expense	137,439			137,439
Accretion expense	43,698			43,698
Less: Allocated expenses	(16,712,029)			(16,712,029)
Adjustment of actuarial liability for annuities payable	(63,159)	(5,957)	(582,117)	(651,233)
Loss on disposal of plant facilities	99,300			99,300
Loss on contributions receivable	34,666	10,000	9,000	53,666
Total Expenses and Losses	104,230,921	4,043	(573,117)	103,661,847
<b>Change in Net Assets</b>	8,897,870	(10,251,688)	3,457,451	2,103,633
NET ASSETS - Beginning of Year	61,572,824	21,582,023	75,216,582	158,371,429
<b>NET ASSETS - END OF YEAR</b>	\$ 70,470,694	\$ 11,330,335	\$ 78,674,033	\$ 160,475,062

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<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			63,816,189
Government grants	2,193,127			2,193,127
Private gifts	1,957,723	\$ 7,968,196	\$ 2,590,468	12,516,387
Endowment income and gains	2,533,909	5,297,391	31,334	7,862,634
Gains in perpetual trusts			761,838	761,838
Other investment losses	(30,784)			(30,784)
Sales and services of educational activities	131,864			131,864
Other sources	453,668			453,668
Sales and services of auxiliary enterprises	17,615,009			17,615,009
	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	<u>102,740,284</u>	<u>(932,505)</u>	<u>3,512,153</u>	<u>105,319,932</u>
<b>EXPENSES AND LOSSES</b>				
Program expenses				
Instruction	41,413,178			41,413,178
Research	454,647			454,647
Public service	6,642,208			6,642,208
Academic support	6,088,339			6,088,339
Student services	12,110,651			12,110,651
Auxiliary enterprises	16,866,764			16,866,764
Support expenses				
Institutional support	18,603,144			18,603,144
Allocable expenses				
Operation and maintenance of plant	10,293,943			10,293,943
Interest expense	2,614,046			2,614,046
Depreciation expense	4,427,265			4,427,265
Amortization expense	137,439			137,439
Accretion expense	41,616			41,616
Less: Allocated expenses	(17,514,309)			(17,514,309)
Adjustment of actuarial liability for annuities payable	(493,278)	(14,326)	(572,653)	(1,080,257)
Loss on contributions receivable	5,087	52,600	26,396	84,083
Total Expenses and Losses	<u>101,690,740</u>	<u>38,274</u>	<u>(546,257)</u>	<u>101,182,757</u>
<b>Change in Net Assets</b>	1,049,544	(970,779)	4,058,410	4,137,175
NET ASSETS - Beginning of Year	<u>60,523,280</u>	<u>22,552,802</u>	<u>71,158,172</u>	<u>154,234,254</u>
<b>NET ASSETS - END OF YEAR</b>	<u>\$ 61,572,824</u>	<u>\$ 21,582,023</u>	<u>\$ 75,216,582</u>	<u>\$ 158,371,429</u>

See accompanying notes to financial statements.

PACIFIC LUTHERAN UNIVERSITY

STATEMENTS OF CASH FLOWS  
For the Years Ended May 31, 2014 and 2013

	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 2,103,633	\$ 4,137,175
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	5,206,087	4,564,704
Accretion	43,698	41,616
Change in gifts of investments	577	4,579
Gains on endowment investments and perpetual trusts	(4,802,551)	(7,750,874)
Gains on investments	(964,395)	(1,366,631)
Actuarial adjustment on annuities payable	704,960	673,207
Loan cancellations, assignments and write-offs	73,961	114,548
Losses on contributions receivable	53,666	84,083
Loss on sale of real estate		162,674
Unrealized loss on real estate	38,000	
Increase (decrease) in allowance on student receivables	33,900	(2,200)
Decrease in allowance on student notes	(14,000)	(6,000)
Change in assets and liabilities		
Student receivables	(105,736)	(25,150)
Other receivables	(150,502)	(450,932)
Estate gift receivable	425,000	3,050,000
Grant receivables	122,892	(21,447)
Contributions receivable for operations	56,193	374,323
Inventories, prepaid expense and deposits	(96,483)	(178,603)
Accounts payable and accrued liabilities	1,727,100	(117,930)
Student deposits	70,158	(51,285)
Deposits held in custody for others	(42,365)	(70,921)
Change in cash surrender value of life insurance held as endowment investment	(210,407)	(57,159)
Contributions restricted for long-term investment, loans and plant	(3,551,017)	(2,684,080)
Contributions under split-interest agreements	(13,811)	(459,507)
Interest and dividends restricted for reinvestment	(32,227)	(31,334)
Net Cash Flows From Operating Activities	<u>676,331</u>	<u>(67,144)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of endowment investments	(9,275,646)	(18,707,179)
Sales of endowment investments	8,406,995	19,070,185
Purchases of investments	(960,934)	(1,924,866)
Sales of investments	1,212,297	2,003,881
Proceeds from partial redemption of life insurance policy	114,080	411,395
Proceeds from sale of real estate		735,226
Additions to deposits held by trustee, net	(32,201)	(30,309)
Purchases of property, plant and equipment	(9,657,425)	(8,891,612)
Reductions of asset retirement obligation		(141,993)
Repayments of real estate contract receivables	29,500	29,500
Disbursements of loans to students	(1,037,091)	(1,218,873)
Repayments of loans from students	<u>1,213,253</u>	<u>1,229,562</u>
Net Cash Flows From Investing Activities	<u>(9,987,172)</u>	<u>(7,435,083)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayments of principal on indebtedness	(1,278,668)	(1,217,495)
Contributions received restricted for long-term investment, loans and plant	3,839,116	3,098,623
Proceeds from issuance of split-interest agreements	45,000	1,059,560
Receipts of interest and dividends restricted for reinvestment	32,227	31,334
Payments to annuitants	(822,680)	(817,775)
Decrease in government grants refundable	(39,045)	(97,664)
Net Cash Flows From Financing Activities	<u>1,775,950</u>	<u>2,056,583</u>
Net Change in Cash and Cash Equivalents	<u>(7,534,891)</u>	<u>(5,445,644)</u>
CASH AND CASH EQUIVALENTS - Beginning of year	<u>11,785,020</u>	<u>17,230,664</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 4,250,129</u>	<u>\$ 11,785,020</u>
Supplemental disclosure of cash flow statement		
Interest paid	\$ 2,556,020	\$ 2,618,942
Noncash investing and financing activities		
Property, plant and equipment acquired through accounts payable	609,438	2,570,134

See accompanying notes to financial statements.

# PACIFIC LUTHERAN UNIVERSITY

## NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2014 and 2013

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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, 2014 and 2013

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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, 2014 and 2013, 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, 2014 and 2013

**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, 2014 and 2013 are as follows:

	2014	2013
Balance, Beginning of the year	\$ 873,925	\$ 974,302
Abatements		(141,993)
Accretion expense	43,698	41,616
Balance, End of the year	\$ 917,623	\$ 873,925

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended May 31, 2014 and 2013

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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 \$3,659,000 and \$3,568,000 for the years ended May 31, 2014 and 2013, 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, 2014 and 2013. The University's tax returns are subject to review and examination by federal authorities. The tax returns for fiscal years 2011 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 \$2,450,000 and \$2,304,000 for the years ended May 31, 2014 and 2013, 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, 2014 and 2013

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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 \$59,574,000 and \$61,244,000 as of May 31, 2014 and 2013, 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 that the reporting entity can access at the measurement date.

Level 2 - Inputs other than quoted prices included in Level 1 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 market-corroborated inputs.

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2014 and 2013

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

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Level 3 - Inputs are unobservable for the asset or liability. Unobservable inputs reflect the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk) using the best information available in the circumstances, which may include using the reporting entity's own data.

***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, 2014 and 2013.

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, 2014 and 2013

**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, 2014 based upon the three-level hierarchy:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>ASSETS</b>				
Short term investments	\$ 2,353,510		\$ 2,353,510	
Mutual funds				
Domestic equity funds	13,938,292	\$ 13,938,292		
International equity funds	26,884,956	26,884,956		
Global fixed income funds	7,619,516	6,707,579	911,937	
U.S. government bond funds	1,254,639		1,254,639	
Corporate bond funds	2,064,731		2,064,731	
High yield bond funds	289,018		289,018	
Real estate funds	1,708,830	1,708,830		
Alternative investments				
Hedge funds	8,780,894			\$ 8,780,894
Private equity funds	3,037,506			3,037,506
Funds of hedge funds	4,761,055			4,761,055
Commodity funds	3,635,294	1,801,994	1,833,300	
Perpetual trusts held by others	10,140,973			10,140,973
Government obligations	4,801,810	4,801,810		
	<u>\$ 91,271,024</u>	<u>\$ 55,843,461</u>	<u>\$ 8,707,135</u>	<u>\$ 26,720,428</u>

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**

As of and for the Years Ended May 31, 2014 and 2013

**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, 2013 based upon the three-level 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	4,769,609	4,769,609		
Total	<u>\$ 84,434,359</u>	<u>\$ 47,984,684</u>	<u>\$ 8,051,195</u>	<u>\$ 28,398,480</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, 2014:

	<u>Balance</u>	<u>Net realized</u>			<u>Balance</u>
	<u>May 31, 2013</u>	<u>and</u>	<u>Purchases</u>	<u>Sales</u>	<u>May 31, 2014</u>
		<u>unrealized</u>			
		<u>gains</u>			
<b>Assets</b>					
Hedge funds	\$ 11,353,379	\$ 509,000		\$ (3,081,485)	\$ 8,780,894
Private equity funds	3,129,757	547,462	\$ 39,548	(679,261)	3,037,506
Funds of hedge funds	4,321,997	439,058			4,761,055
Perpetual trusts held by others	9,593,347	547,626			10,140,973
Total	<u>\$ 28,398,480</u>	<u>\$ 2,043,146</u>	<u>\$ 39,548</u>	<u>\$ (3,760,746)</u>	<u>\$ 26,720,428</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, 2014

\$ 212,922

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2014 and 2013

**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, 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>
<b>Total</b>	<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, 2014 and 2013

**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, 2014:

	Hedge Funds	Private Equity Funds	Funds of Funds
Fair value, May 31, 2014	\$8,780,894	\$3,037,506	\$4,761,055
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.	\$888,000	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**  
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**NOTE 3 - RESTRICTIONS AND LIMITATIONS ON NET ASSET BALANCES**

Permanently restricted net assets consist of the following at May 31, 2014 and 2013:

	2014	2013
Endowment funds	\$ 73,378,427	\$ 70,387,873
Contributions receivable	238,961	250,913
Student loan funds	164,604	257,331
Annuity, life income and similar funds	4,892,041	4,320,465
	\$ 78,674,033	\$ 75,216,582

Temporarily restricted net assets consist of the following at May 31, 2014 and 2013:

Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other departmental support - operating	\$ 2,852,219	\$ 2,683,299
Scholarships, instruction and other departmental support - endowment funds not yet appropriated for spending	7,368,650	6,256,854
Acquisition of buildings and equipment	788,154	10,764,931
	11,009,023	19,705,084
Contributions receivable for operations	131,128	187,322
Contributions receivable for acquisition of buildings and equipment	131,202	1,645,343
Annuity, life income and similar funds	58,982	44,274
	\$ 11,330,335	\$ 21,582,023

At May 31, 2014 and 2013, the University's unrestricted net assets were allocated as follows:

Operations	\$ 1,928,984	\$ 3,189,449
Endowment funds		
Donor restricted endowment funds (underwater)	(1,460,337)	(1,989,553)
Board designated endowment	5,078,336	4,930,532
Total Endowment	3,617,999	2,940,979
Annuity, life income and similar funds	677,973	646,143
Loans to students	804,598	824,743
Plant	63,441,140	53,971,510
	\$ 70,470,694	\$ 61,572,824

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS  
As of and for the Years Ended May 31, 2014 and 2013

**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, 2014 and 2013 were as follows:

	<u>2014</u>	<u>2013</u>
Expended for plant facilities	\$ 10,552,682	\$ 3,106,458
Scholarships, instruction and other departmental support	<u>10,779,652</u>	<u>10,978,491</u>
	<u>\$ 21,332,334</u>	<u>\$ 14,084,949</u>

These assets were reclassified to unrestricted net assets.

**NOTE 5 - CONTRIBUTIONS RECEIVABLE**

Contributions receivable at May 31, 2014 and 2013 include the following unconditional promises to give:

	<u>2014</u>	<u>2013</u>
Unrestricted - completed construction projects	\$ 1,908,857	\$ 77,255
Temporarily restricted - operations	145,851	209,068
Temporarily restricted - plant projects	147,749	2,454,642
Permanently restricted - endowment	<u>272,035</u>	<u>288,082</u>
Gross unconditional promises to give	2,474,492	3,029,047
Less: Allowance for uncollectable promises	(190,180)	(234,398)
Less: Unamortized discount	<u>(572,691)</u>	<u>(685,070)</u>
Net Unconditional Promises to Give	<u>\$ 1,711,621</u>	<u>\$ 2,109,579</u>
Amounts due in:		
Less than one year	\$ 753,350	
One to five years	742,131	
More than five years	<u>979,011</u>	
	<u>\$ 2,474,492</u>	

Promises due in more than one year received on or before May 31, 2009 were discounted at an interest rate of 6%. Promises due in more than one year received after May 31, 2009 were discounted at interest rates that approximate the U.S. Daily Treasury Yield Curve at the date of the gift adjusted for a risk premium. The discount rates for these promises ranged from 1.57% to 2.34% at May 31, 2014 and 2013. Promises due in less than one year were not discounted.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS  
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**NOTE 6 - ENDOWMENT INVESTMENTS**

The University's endowment consists of 497 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 the Uniform Prudent Management of Institutional Funds Act (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 1 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, 2014:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (1,460,337)	\$ 7,368,650	\$ 73,378,427	\$ 79,286,740
Board-designated endowment funds	5,078,336			5,078,336
<b>Total endowment net assets</b>	<b>\$ 3,617,999</b>	<b>\$ 7,368,650</b>	<b>\$ 73,378,427</b>	<b>\$ 84,365,076</b>

Endowment net asset composition by type of fund consists of the following as of May 31, 2013:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
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
<b>Total endowment net assets</b>	<b>\$ 2,940,979</b>	<b>\$ 6,256,854</b>	<b>\$ 70,387,873</b>	<b>\$ 79,585,706</b>

**PACIFIC LUTHERAN UNIVERSITY**

NOTES TO FINANCIAL STATEMENTS  
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**NOTE 6 - ENDOWMENT INVESTMENTS (Continued)**

Changes in endowment net assets for the year ended May 31, 2014 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2013	\$ 2,940,979	\$ 6,256,854	\$ 70,387,873	\$ 79,585,706
Investment return:				
Investment income, net of fees of \$242,845	588,297	658,626		1,246,923
Net appreciation, perpetual trusts - unrealized			547,625	547,625
Net appreciation - realized and unrealized	652,988	3,601,938		4,254,926
Total investment return	1,241,285	4,260,564	547,625	6,049,474
Contributions	24,032		2,308,470	2,332,502
Appropriation of endowment net assets for expenditure	(588,297)	(3,174,181)		(3,762,478)
Transfer from other funds		25,413	134,459	159,872
Endowment net assets, May 31, 2014	<u>\$ 3,617,999</u>	<u>\$ 7,368,650</u>	<u>\$ 73,378,427</u>	<u>\$ 84,365,076</u>

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

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
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	<u>\$ 2,940,979</u>	<u>\$ 6,256,854</u>	<u>\$ 70,387,873</u>	<u>\$ 79,585,706</u>

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS  
As of and for the Years Ended May 31, 2014 and 2013

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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 UPMIFA 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 \$1,460,337 and \$1,989,553 as of May 31, 2014 and 2013, 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  
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**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, 2014 and 2013:

	2014	2013
Cash and short term investments	\$ 3,600,162	\$ 4,191,071
Commodity funds	3,635,294	4,803,852
Domestic equity mutual funds	10,153,929	6,301,432
Fixed income mutual funds	6,707,579	6,012,881
International equity mutual funds	24,725,120	20,738,235
Alternative investments		
Hedge funds	8,780,894	11,353,379
Funds of hedge funds	4,761,055	4,321,997
Real estate (at cost)	6,673,254	7,172,787
Real estate contracts (at cost)	485,146	513,212
Private equity funds	<u>3,037,506</u>	<u>3,129,757</u>
	72,559,939	68,538,603
Perpetual trusts held by others	10,140,973	9,593,347
Life insurance (at cost)	<u>1,664,164</u>	<u>1,453,757</u>
	84,365,076	79,585,707
Less Interfund Amounts:		
Cash and short term investments (at cost)	(1,628,094)	(2,702,268)
Real estate contracts (at cost)	<u>(485,146)</u>	<u>(513,212)</u>
	<u>\$ 82,251,836</u>	<u>\$ 76,370,227</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**  
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**NOTE 7 - INVESTMENTS**

The following summarizes the University's investments in funds other than endowment funds at May 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Cash and short term investments	\$ 381,442	\$ 685,849
Mutual funds		
Equity funds	5,944,199	5,619,654
Fixed income funds	4,520,325	4,138,789
Stocks (at cost)	2,600	3,192
Real estate funds	1,708,830	1,476,775
Other (at cost)	<u>140,226</u>	<u>174,988</u>
	<u>\$ 12,697,622</u>	<u>\$ 12,099,247</u>

**NOTE 8 - CONSTRUCTION IN PROGRESS**

At May 31, 2014, the following major building projects were in progress:

	<u>Cost To Date</u>	<u>Funding Source</u>
Campus Entrance	\$ 302,570	Private Grants
Stuen	962,709	Private Grants
Rieke Greenhouse	<u>95,733</u>	
	<u>\$ 1,361,012</u>	

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

Property, plant and equipment consisted of the following at May 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Land	\$ 1,938,422	\$ 2,037,723
Buildings and building improvements	155,364,148	133,652,263
Improvements other than buildings	8,722,013	8,722,013
Equipment and automobiles	34,757,084	34,221,463
Library books	12,473,844	12,449,286
Leasehold improvements	1,840,955	1,840,955
Non depreciated assets	<u>1,235,950</u>	<u>1,235,950</u>
	216,332,416	194,159,653
Less: Accumulated depreciation and amortization	<u>(94,670,500)</u>	<u>(90,538,220)</u>
	<u>\$ 121,661,916</u>	<u>\$ 103,621,433</u>

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2014 and 2013

**NOTE 10 - LONG-TERM DEBT**

Long-term debt at May 31, 2014 and 2013 consisted of the following:

	2014	2013
Loan payable to Washington Higher Education Facilities Authority, Series 2006	\$ 54,495,000	\$ 55,760,000
Note payable to an individual	80,944	94,612
	\$ 54,575,944	\$ 55,854,612

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 \$1,330,000 to \$2,300,000 on November 1, 2014 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. The University was not in compliance with the liquidity ratio at May 31, 2014.

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, 2014 are:

Year Ended May 31	Principal
2015	\$ 1,345,000
2016	1,416,000
2017	1,488,000
2018	1,564,000
2019	1,638,000

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2014 and 2013

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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 \$574,000 and \$787,000, respectively, for the years ended May 31, 2014 and 2013.

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 \$269,200 and \$276,800 for the years ended May 31, 2014 and 2013, respectively.

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

<u>Year Ended May 31</u>	<u>Amount</u>
2015	\$ 834,270
2016	628,770
2017	641,670
2018	661,470
2019	625,790

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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, 2014 and 2013.

The University received \$13,811 and \$459,507 of gift value relating to deferred gift agreements for the years ended May 31, 2014 and 2013, respectively. Total assets held by the University under deferred gift agreements totaled \$12,846,347 and \$12,280,118 at May 31, 2014 and 2013, 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 \$2,832,968 and \$2,901,474, respectively, as of May 31, 2014 and 2013.

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS  
As of and for the Years Ended May 31, 2014 and 2013

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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). At May 31, 2014 and 2013, the University's investment in Garfield Commons, LLC totaled \$1,519,112 and \$1,389,327, respectively, and is included as real estate in Endowment Investments (see Note 6).

**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 (Garfield Station) located in Parkland two blocks from the University's main entrance. 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 contributed an additional \$500,000 in cash as part of its capital contributions and GP contributed an additional \$4,220,000 in cash as part of its capital contributions.

Following its capital contributions to Garfield North, the University has a 29% ownership interest, and is applying the equity method of accounting for its investment. 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, five members of the University's Board of Regents are personally invested in GP. At May 31, 2014 and 2013, the University's investment in Garfield North, LLC totaled \$500,000 and \$79,318, respectively, and is included as real estate in Endowment Investments (see Note 6).

PACIFIC LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS  
As of and for the Years Ended May 31, 2014 and 2013

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

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**Garfield North, LLC** (continued) - 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 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 that was signed during the year ended May 31, 2014. Garfield Station is expected to be completed by November 2014. At May 31, 2014 and 2013, the amount due from Garfield North, LLC totaled \$1,000,000 and \$1,270,169, respectively, and is included other receivables on the statements of financial position.

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, 2014 and 2013, the University owed \$207,000 and \$2,541,000, respectively, 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, 2014 and 2013 were \$153,735 and \$185,810, respectively. Gifts from non-compensated board members totaled \$389,221 and \$1,219,492 at May 31, 2014 and 2013, 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, 2014 and 2013, student loans represented approximately 3% of total assets.

At May 31, 2014 and 2013, student loans consisted of the following:

	<u>2014</u>	<u>2013</u>
Federal government programs	\$ 7,563,738	\$ 7,813,861
Less allowance for doubtful accounts:		
Beginning of year	391,000	397,000
Decrease	<u>14,000</u>	<u>6,000</u>
End of year	<u>377,000</u>	<u>391,000</u>
Student loans receivable, net	<u>\$ 7,186,738</u>	<u>\$ 7,422,861</u>

Funds advanced by the Federal government of \$7,390,342 and \$7,430,278 at May 31, 2014 and 2013, respectively, are ultimately refundable to the government and are classified as liabilities in the statement of financial position.

**PACIFIC LUTHERAN UNIVERSITY**

**NOTES TO FINANCIAL STATEMENTS**  
As of and for the Years Ended May 31, 2014 and 2013

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

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

A student loan receivable is considered to be delinquent if any portion of the receivable balance is outstanding for more than 60 days after the billing date. At May 31, 2014 and 2013, the following amounts were past due under student loan programs:

	Amounts Past Due			
	60-89 days	90-119 days	120+ days	Total
May 31, 2014	\$ 5,099	\$ 3,562	\$ 865,427	\$ 874,088
2013	4,366	4,841	1,032,487	1,041,694

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**NOTE 16 - SUBSEQUENT EVENTS**

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In June 2014, the Washington Higher Education Facilities Authority issued Revenue Bonds (Pacific Lutheran University) Series 2014 on behalf of the University totaling \$10,000,000. The bond proceeds were used to provide a portion of the funds (1) 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 (2) to pay the costs of issuing the bonds. The Series 2014 Revenue Bonds consist of term bonds of \$5,800,000 maturing on November 1, 2041 and \$4,200,000 maturing on November 1, 2044. The term bonds have interest rates of 4.625% to 5.25%, respectively. The term bonds are subject to annual sinking fund payments on November 1 in the years 2037 through 2044 in amounts varying from \$1,055,000 to \$1,475,000. The bonds are secured by a pledge of, and lien on, all unrestricted revenues and the University's interest, if any, in the Project Fund and the Debt Service Fund. In addition, the bonds require that a rate covenant ratio be maintained.

The University has evaluated subsequent events through December 16, 2014, which is the date that the financial statements were issued.