

TEXAS LUTHERAN UNIVERSITY

FINANCIAL STATEMENTS Including Independent Auditors' Report

As of and for the Years Ended May 31, 2018 and 2017

TEXAS LUTHERAN UNIVERSITY

TABLE OF CONTENTS

Independent Auditors' Report	1 - 2
Statements of Financial Position	3
Statements of Activities	4 - 5
Statements of Cash Flows	6
Notes to Financial Statements	7 - 28

INDEPENDENT AUDITORS' REPORT

To the Board of Regents
Texas Lutheran University
Seguin, Texas

We have audited the accompanying financial statements of Texas Lutheran University (the "University"), which comprise the statements of financial position as of May 31, 2018 and 2017, 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 Texas Lutheran University as of May 31, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Minneapolis, Minnesota
August 31, 2018

TEXAS LUTHERAN UNIVERSITY

STATEMENTS OF FINANCIAL POSITION

As of May 31, 2018 and 2017

ASSETS	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 396,200	\$ 1,635,089
Receivables		
Student accounts, net of allowance for doubtful accounts	127,976	116,864
Contributions, net	2,049,001	2,663,711
Other	404,223	344,541
Inventories	331,609	350,574
Other assets	1,776,001	1,624,193
Student loans receivable, net	3,338,272	3,660,197
Investments	86,063,116	82,745,204
Mineral rights and royalties, net	1,713,028	2,946,327
Funds administered by third parties	13,498,770	12,953,215
Cash - restricted	510,090	461,803
Property, plant and equipment, net	<u>65,361,916</u>	<u>62,069,861</u>
TOTAL ASSETS	<u>\$ 175,570,202</u>	<u>\$ 171,571,579</u>
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 1,063,312	\$ 2,599,203
Payroll related liabilities	2,708,158	2,544,233
Deposits and other unearned revenue	1,642,260	1,569,501
Liabilities related to split-interest agreements	2,185,876	2,482,396
Other accrued liabilities	557,388	555,435
Asset retirement obligations	936,512	925,935
Advances from U.S. Government for student loans	3,135,345	3,036,779
Line of credit - operating	4,000,000	2,500,000
Line of credit - construction	3,825,182	-
Bonds payable, net	<u>26,457,211</u>	<u>27,725,084</u>
Total Liabilities	<u>46,511,244</u>	<u>43,938,566</u>
NET ASSETS		
Unrestricted	47,727,232	45,162,233
Temporarily restricted	16,594,261	20,506,395
Permanently restricted	<u>64,737,465</u>	<u>61,964,385</u>
Total Net Assets	<u>129,058,958</u>	<u>127,633,013</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 175,570,202</u>	<u>\$ 171,571,579</u>

See accompanying notes to financial statements.

TEXAS LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES
For the Year Ended May 31, 2018
With Comparative Totals for 2017

	2018			Total	2017 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
REVENUES, GAINS AND OTHER SUPPORT					
Tuition and fees	\$ 39,350,404	\$ -	\$ -	\$ 39,350,404	\$ 34,940,541
Less: Scholarship allowances	(24,961,055)	-	-	(24,961,055)	(21,340,471)
Net tuition and fees	14,389,349	-	-	14,389,349	13,600,070
Investment return	1,722,091	4,435,188	(81)	6,157,198	7,589,769
Contributions	2,601,814	1,195,347	1,990,270	5,787,431	5,395,524
Government and private grants	3,459,666	-	-	3,459,666	3,371,728
Change in value of split-interest agreements	117,713	(451)	782,891	900,153	926,137
Auxiliary enterprises	8,075,999	-	-	8,075,999	7,636,258
Loss on sale of property	-	-	-	-	(1,434)
Other revenue	1,139,319	-	-	1,139,319	1,138,386
	<u>31,505,951</u>	<u>5,630,084</u>	<u>2,773,080</u>	<u>39,909,115</u>	<u>39,656,438</u>
Net assets released from restrictions	9,542,218	(9,542,218)	-	-	-
Total Revenues, Gains and Other Support	<u>41,048,169</u>	<u>(3,912,134)</u>	<u>2,773,080</u>	<u>39,909,115</u>	<u>39,656,438</u>
EXPENSES					
Instruction	12,664,954	-	-	12,664,954	11,608,973
Academic support	2,501,267	-	-	2,501,267	2,440,528
Public service	658,470	-	-	658,470	653,471
Research	47,310	-	-	47,310	57,781
Student services	7,072,667	-	-	7,072,667	6,931,974
Institutional support	8,468,526	-	-	8,468,526	8,321,176
Development and fund-raising	1,288,044	-	-	1,288,044	1,313,187
Auxiliary enterprises	5,781,932	-	-	5,781,932	5,547,837
Total Expenses	<u>38,483,170</u>	<u>-</u>	<u>-</u>	<u>38,483,170</u>	<u>36,874,927</u>
Change in Net Assets Before Loss on Debt Refunding	2,564,999	(3,912,134)	2,773,080	1,425,945	2,781,511
Loss on debt refunding	-	-	-	-	(214,487)
Change in Net Assets	2,564,999	(3,912,134)	2,773,080	1,425,945	2,567,024
Net Assets - Beginning of Year	<u>45,162,233</u>	<u>20,506,395</u>	<u>61,964,385</u>	<u>127,633,013</u>	<u>125,065,989</u>
NET ASSETS - END OF YEAR	<u>\$ 47,727,232</u>	<u>\$ 16,594,261</u>	<u>\$ 64,737,465</u>	<u>\$ 129,058,958</u>	<u>\$ 127,633,013</u>

See accompanying notes to financial statements.

TEXAS LUTHERAN UNIVERSITY

STATEMENT OF ACTIVITIES
For the Year Ended May 31, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS AND OTHER SUPPORT				
Tuition and fees	\$ 34,940,541	\$ -	\$ -	\$ 34,940,541
Less: Scholarship allowances	(21,340,471)	-	-	(21,340,471)
Net tuition and fees	13,600,070	-	-	13,600,070
Investment return	1,121,338	6,451,639	16,792	7,589,769
Contributions	704,602	3,132,589	1,558,333	5,395,524
Government and private grants	3,371,728	-	-	3,371,728
Change in value of split-interest agreements	12,533	(6,064)	919,668	926,137
Auxiliary enterprises	7,636,258	-	-	7,636,258
Loss on sale of property	(1,434)	-	-	(1,434)
Other revenue	1,138,386	-	-	1,138,386
	<u>27,583,481</u>	<u>9,578,164</u>	<u>2,494,793</u>	<u>39,656,438</u>
Net assets released from restrictions	3,923,253	(3,923,253)	-	-
Total Revenues, Gains and Other Support	<u>31,506,734</u>	<u>5,654,911</u>	<u>2,494,793</u>	<u>39,656,438</u>
EXPENSES				
Instruction	11,608,973	-	-	11,608,973
Academic support	2,440,528	-	-	2,440,528
Public service	653,471	-	-	653,471
Research	57,781	-	-	57,781
Student services	6,931,974	-	-	6,931,974
Institutional support	8,321,176	-	-	8,321,176
Development and fund-raising	1,313,187	-	-	1,313,187
Auxiliary enterprises	5,547,837	-	-	5,547,837
Total Expenses	<u>36,874,927</u>	<u>-</u>	<u>-</u>	<u>36,874,927</u>
Change in Net Assets Before Loss on Debt Refunding	(5,368,193)	5,654,911	2,494,793	2,781,511
Loss on debt refunding	(214,487)	-	-	(214,487)
Change in Net Assets	(5,582,680)	5,654,911	2,494,793	2,567,024
Net Assets - Beginning of Year	<u>50,744,913</u>	<u>14,851,484</u>	<u>59,469,592</u>	<u>125,065,989</u>
NET ASSETS - END OF YEAR	<u>\$ 45,162,233</u>	<u>\$ 20,506,395</u>	<u>\$ 61,964,385</u>	<u>\$ 127,633,013</u>

See accompanying notes to financial statements.

TEXAS LUTHERAN UNIVERSITY

STATEMENTS OF CASH FLOWS
For the Years Ended May 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 1,425,945	\$ 2,567,024
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	3,691,821	3,381,869
Accretion of asset retirement obligations	53,782	50,589
Loss on debt refunding	-	214,487
Net realized and unrealized gains on investments	(5,066,157)	(6,697,785)
Loss on sale of property	-	1,434
Gifts and grants restricted for long-term purposes - plant	(2,035,092)	(2,128,207)
Gifts and grants restricted for long-term purposes - endowment	(2,054,578)	(1,547,316)
Change in value of split-interest agreements	(600,739)	(718,079)
(Increase) decrease in assets		
Receivables	51,012	43,504
Inventories	18,965	17,487
Other assets	(151,808)	118,431
Increase (decrease) in liabilities		
Accounts payable	190,110	(19,748)
Payroll related liabilities	163,925	(167,580)
Deposits and other unearned revenue	72,759	(24,066)
Other accrued liabilities	1,953	9,543
Net Cash Flows From Operating Activities	(4,238,102)	(4,898,413)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	7,081,012	6,990,433
Purchases of investments	(4,108,885)	(5,326,831)
Disbursement of student loans	(307,000)	(282,500)
Proceeds from repayment of student loans	628,925	490,858
Proceeds from sale of property, plant and equipment	-	1,500
Purchases of property and equipment	(8,725,955)	(10,997,071)
Change in cash - restricted	(48,287)	2,820,244
Net Cash Flows From Investing Activities	(5,480,190)	(6,303,367)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from bonds payable	-	4,500,000
Repayments of principal on bonds payable	(1,295,000)	(1,250,000)
Proceeds from long-term line of credit	5,820,101	-
Repayments of principal on long-term line of credit	(1,994,919)	-
Proceeds from short-term borrowings	4,750,000	5,000,000
Payments of short-term borrowings	(3,250,000)	(2,500,000)
Bond issue costs	-	(17,244)
Restricted gifts and grants proceeds for long-term purposes - plant	2,490,786	1,149,045
Restricted gifts and grants proceeds for long-term purposes - endowment	2,091,788	1,553,983
Payments to annuitants	(231,919)	(275,643)
Advances from U.S. Government	98,566	57,615
Net Cash Flows From Financing Activities	8,479,403	8,217,756
Net Change in Cash and Cash Equivalents	(1,238,889)	(2,984,024)
CASH AND CASH EQUIVALENTS - Beginning of Year	1,635,089	4,619,113
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 396,200	\$ 1,635,089
Supplemental disclosures of cash flow information		
Cash paid for interest, net of capitalized interest of \$214,000 in 2018 and \$318,000 in 2017	\$ 1,120,644	\$ 917,310
Property, plant and equipment additions in accounts payable	\$ 349,264	\$ 2,075,265
Bond issue costs paid from proceeds on Series 2016 bonds	\$ -	\$ 135,455
Proceeds on Series 2016 bonds deposited into escrow account for refunding of the Series 2007 bonds	\$ -	\$ 5,222,301

See accompanying notes to financial statements.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2018 and 2017

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Texas Lutheran University (the "University") is an independent institution providing graduate and undergraduate education in a variety of programs. The University has an enrollment averaging approximately 1,300 students. The main campus and administrative offices are located in Seguin, Texas. The University is supported primarily by tuition and fees from students.

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

Net Asset Classifications - 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. Unrestricted net assets may be designated for specific purposes by actions of the Board.

Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Investment income and gains and losses on investments are reported in the statement of activities as increases and decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law. Investment income and gains received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class. Investment income and gains earned on donor restricted funds that are classified as temporarily restricted net assets are reclassified as unrestricted net assets when expenses are incurred for their intended purpose.

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

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. Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class. 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.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Government grants received from the Department of Education and the State of Texas in which the agency has placed limitations on the use of the resources are reported as unrestricted revenues when grants are awarded to students because the limitations are not considered donor-imposed restrictions.

Tuition and Fees and Auxiliary Enterprises Revenues - Tuition revenue is recognized in the period the classes are provided. Revenue from auxiliary enterprises is recognized when goods or services are provided. 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.

Cash and Cash Equivalents and Restricted Cash - The University considers all highly liquid investments with an initial maturity of three months or less, except for those held in the investment portfolio, to be cash and cash equivalents.

Restricted cash is cash from donors held for funding capital projects and cash held as required for certain grants until appropriate expenditures occur.

Student Accounts Receivable - The University's student accounts receivable are due from students. Credit is extended to students and collateral is not required. Student accounts receivable are due at the end of the semester and are stated at amounts due from students net of an allowance for doubtful accounts. Accounts inactive (no payments have been received) for more than six months are considered past due. The University does not charge interest on past due accounts. The University determines its allowance based on accounts that have been inactive for over 360 days. The University writes off student accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. Students whose accounts are not current are not allowed to enroll in classes.

Inventories - Bookstore inventories are valued using the retail method, which approximates cost and is not in excess of market. Other inventories consist of supplies and are carried at the lower of cost (first-in, first-out) or market.

Other Assets - The University's other assets consist of life insurance - cash surrender values, a health insurance trust, other prepaids and other assets.

Investments - Investments in publically traded securities are stated at fair value based on quoted market prices from national security exchanges. Other investments, for which quoted prices are not available, are stated at fair value as estimated by management using values provided by external investment managers or general partners. Land held for investment is recorded at the fair value on the date of the contribution. Certificates of deposit are recorded at cost. Cash held in transition for investments are included in investments and are recorded at fair value, which approximates cost.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Mineral Rights and Royalties - Mineral rights and royalties are valued at estimated fair value. The University of Texas has estimated the value of certain oil and gas assets for which Texas Lutheran University holds 5% of this interest and the University of Texas holds the remaining 95%. The University is following the valuation methodology used by the University of Texas, and valued the 5% interest in these oil and gas assets at \$1,713,028 and \$2,946,327 at May 31, 2018 and 2017, respectively.

Beneficial Interest in Trusts - The University receives assets that will be divided between the University and other beneficiaries upon the death of the donor. Investments held in these split-interest agreements are stated at fair value. The net realized and unrealized gains (losses) in market value of investments are reflected as change in value of split-interest agreements in the statement of activities.

Property, Plant and Equipment, Net - Property, plant and equipment are stated at cost or fair value at the date of gift if donated, less accumulated depreciation. The University capitalizes items in excess of \$5,000 with a useful life of at least three years. Depreciation is provided on the straight-line method over estimated useful lives as follows: buildings 10-50 years, improvements other than building 10-20 years, software 3-10 years and equipment 3-20 years.

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. As of May 31, 2018 and 2017, there have been no such losses.

Unearned Revenue - Unearned revenue, primarily tuition and fees, consists of payments received before services or products are provided to the payer. Tuition and fees are normally recognized as revenues at the beginning of each semester. The portion of payments received relating to future services or products are recorded as unearned revenue.

Assets and Liabilities Related to Split-Interest Agreements - Under charitable gift annuity and charitable remainder trust agreements, the University agrees to pay a donor an annuity in consideration for a specific gift. For these types of agreements, assets are generally recorded at fair value when received with a liability recognized equal to the present value of amounts which the University expects to pay to annuity beneficiaries. Changes in the calculated liability due to increases or decreases in the actuarially determined life expectancy of annuity beneficiaries are reflected as change in value of split-interest agreements in the statement of activities. To calculate the present value of the gift annuities, life expectancy tables with discount rates ranging from 1.2% to 7.4% were used.

Total assets held by the University under split interest agreements totaled \$373,138 and \$695,313 at May 31, 2018 and 2017, respectively. The University did not receive new gifts under split interest agreements for the years ended May 31, 2018 and 2017.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2018 and 2017 are as follows:

	2018	2017
Balance, Beginning of the year	\$ 925,935	\$ 895,941
Accretion expense	53,782	50,589
Abatements	(43,205)	(20,595)
Balance, End of the year	\$ 936,512	\$ 925,935

Advances from U. S. Government for Student Loans - Funds provided by the United States Government under the Federal Perkins Loan Program 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.

Advertising Expenses - Advertising expenses approximated \$203,000 and \$286,000 for the years ended May 31, 2018 and 2017, respectively. Advertising costs are expensed when incurred.

Income Taxes - The University is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code according to an Internal Revenue Service determination letter. Accordingly, the University is not subject to federal income taxes except to the extent it derives income from certain activities not substantially related to its tax-exempt purposes (unrelated trade or business activities). The University had no material unrelated business income during the year.

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, 2018 and 2017. The University's tax returns are subject to review and examination by federal authorities.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2018 and 2017

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

Concentrations of Credit Risk - Financial instruments that potentially subject the University to concentrations of credit risk consist principally of cash and cash equivalents, receivables and investments. Cash and cash equivalents in excess of federally insured limits are subject to the usual risks of balances in excess of those limits. At May 31, 2018, approximately 80% of the University's cash and cash equivalents are on deposit with two banks. Investments are generally placed in a variety of managed funds administered by different investment managers in order to limit credit risk. At May 31, 2018, approximately 60% of the University's investments are held by one custodian. Other receivables are due from a variety of sources concentrated primarily in the Southern 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.

New Accounting Pronouncements - In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*. This new accounting guidance outlines a single comprehensive model for entities to use in accounting for revenue from contracts with customers. For public business entities, including not-for-profit organizations that have issued, or are a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market, ASU No. 2014-09 is effective for fiscal years beginning after December 15, 2017 (fiscal year 2019). The University is assessing the impact this new standard will have on its financial statements.

In February 2016, FASB issued ASU 2016-02, *Leases*. ASU No. 2016-02 was issued to increase transparency and comparability among entities. Lessees will need to recognize nearly all lease transactions (other than leases that meet the definition of a short-term lease) on the statement of financial position as a lease liability and a right-of-use asset (as defined). Lessor accounting under the new guidance will be similar to the current model. For public business entities, including not-for-profit organizations that have issued, or are a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market, ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018 (fiscal year 2020). Early application is permitted. Upon adoption, lessees and lessors will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach, which includes a number of optional practical expedients that entities may elect to apply. The University is assessing the impact this standard will have on its financial statements.

In August 2016, FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new guidance improves and simplifies the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017 (fiscal year 2019). The standard is to be applied retroactively with transition provisions. The University is assessing the impact this standard will have on its financial statements.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2018 and 2017

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New Accounting Pronouncements (continued) - In November 2016, FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): *Restricted Cash*. The new guidance requires restricted cash and restricted cash equivalents be included in cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts shown on the statement of cash flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2018 (fiscal year 2020), with early adoption permitted. ASU 2016-18 is to be applied retroactively with transition provisions. The University is assessing the impact this standard will have on its financial statements.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The new guidance is intended to clarify and improve accounting guidance for contributions received and contributions made. The amendments in this ASU should assist entities in (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) or as exchange (reciprocal) transactions subject to other guidance and (2) determining whether a contribution is conditional. ASU 2018-08 should be applied on a modified retrospective basis and is effective concurrently with ASU 2014-09, which for the University is the fiscal year beginning after June 15, 2018 (fiscal year 2020). The University is currently assessing the impact this standard will have on its financial statements.

NOTE 2 - FAIR VALUE MEASUREMENTS

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 are 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 that are observable for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or market-corroborated data.
- 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 short-term investments (consisting primarily of money market funds) and bond and equity mutual funds for which quoted prices are readily available.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 2 - FAIR VALUE MEASUREMENTS (CONTINUED)

Valuation Techniques and Inputs (continued)

Level 2 - Level 2 assets include:

- > Investments in bond and equity mutual 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:

- > Mineral rights and royalties, net, for which quoted prices are not readily available. The University of Texas has valued certain oil and gas assets, of which Texas Lutheran University holds 5% interest, based on current production through June 2017 and 2016, respectively, future production with a decline curve to July 2046, effective fair market oil and gas prices, and an annual discount factor to arrive at the net present value of the geological estimates over the decline period.
- > Funds administered by third parties 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).

Transfers between levels of the fair value hierarchy are considered to be made as of the beginning of the fiscal year. There were no such transfers during the years ended May 31, 2018 and 2017.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

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.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 2 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following table presents financial instruments that are measured at fair value on a recurring basis as of May 31, 2018:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total May 31, 2018</u>
ASSETS				
Investments				
Short-term investments	\$ 3,242,987	\$ -	\$ -	\$ 3,242,987
Mutual funds - bond funds				
U.S. fixed income	5,597,172	-	-	5,597,172
Global fixed income	2,521,622	-	-	2,521,622
Other fixed income	3,690	22,587	-	26,277
Mutual funds - equity funds				
U.S. equities	26,573,322	335,685	-	26,909,007
Non-U.S. equities	16,554,891	-	-	16,554,891
Total investments	<u>54,493,684</u>	<u>358,272</u>	<u>-</u>	<u>54,851,956</u>
Mineral rights and royalties, net	-	-	1,713,028	1,713,028
Funds administered by third parties	<u>-</u>	<u>-</u>	<u>13,498,770</u>	<u>13,498,770</u>
Subtotal assets included in valuation hierarchy	<u>\$ 54,493,684</u>	<u>\$ 358,272</u>	<u>\$ 15,211,798</u>	<u>70,063,754</u>
Investments measured using NAV				
Alternative Investments				
Private equity funds				3,276,392
Real asset funds				3,198,982
Hedge funds				15,190,543
Limited partnership				4,085,976
Offshore fund				<u>5,454,767</u>
Subtotal assets using NAV				<u>31,206,660</u>
Total assets at fair value				<u>\$ 101,270,414</u>
Total investments at May 31, 2018 include:				
Investments included in the valuation hierarchy				\$ 54,851,956
Investments measured using NAV				31,206,660
Investments at cost				<u>4,500</u>
				<u>\$ 86,063,116</u>

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 2 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following table presents financial instruments that are measured at fair value on a recurring basis as of May 31, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total May 31, 2017</u>
ASSETS				
Investments				
Short-term investments	\$ 2,497,659	\$ -	\$ -	\$ 2,497,659
Mutual funds - bond funds				
U.S. fixed income	5,455,934	-	-	5,455,934
Global fixed income	2,526,806	-	-	2,526,806
Other fixed income	5,629	188,257	-	193,886
Mutual funds - equity funds				
U.S. equities	26,575,360	411,751	-	26,987,111
Non-U.S. equities	14,212,191	-	-	14,212,191
Total investments	<u>51,273,579</u>	<u>600,008</u>	<u>-</u>	<u>51,873,587</u>
Mineral rights and royalties, net	-	-	2,946,327	2,946,327
Funds administered by third parties	<u>-</u>	<u>-</u>	<u>12,953,215</u>	<u>12,953,215</u>
Subtotal assets included in valuation hierarchy	<u>\$ 51,273,579</u>	<u>\$ 600,008</u>	<u>\$ 15,899,542</u>	<u>67,773,129</u>
Investments measured using NAV				
Alternative Investments				
Private equity funds				3,526,348
Real asset funds				3,058,586
Hedge funds				13,256,639
Limited partnership				5,317,476
Offshore fund				<u>5,708,068</u>
Subtotal assets using NAV				<u>30,867,117</u>
Total assets at fair value				<u>\$ 98,640,246</u>
Total investments at May 31, 2017 include:				
Investments included in the valuation hierarchy				\$ 51,873,587
Investments measured using NAV				30,867,117
Investments at cost				<u>4,500</u>
				<u>\$ 82,745,204</u>

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 2 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following table presents a reconciliation of the statement of financial position amounts for financial instruments measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the year ended May 31, 2018:

	Balance May 31, 2017	Transfers in (out)	Purchases	Sales/ Distributions	Realized gains	Unrealized gains (losses)	Balance May 31, 2018
Assets							
Mineral rights and royalties, net	\$ 2,946,327	\$ -	\$ -	\$ -	\$ -	\$ (1,233,299)	\$ 1,713,028
Funds administered by third parties	<u>12,953,215</u>	<u>-</u>	<u>347,760</u>	<u>(338,343)</u>	<u>75,057</u>	<u>461,081</u>	<u>13,498,770</u>
	<u>\$ 15,899,542</u>	<u>\$ -</u>	<u>\$ 347,760</u>	<u>\$ (338,343)</u>	<u>\$ 75,057</u>	<u>\$ (772,218)</u>	<u>\$ 15,211,798</u>

The amount of total losses for the period included in change in net assets attributable to the change in unrealized gains or losses relating to assets measured at fair value still held at May 31, 2018 \$ (772,218)

The following table presents a reconciliation of the statement of financial position amounts for financial instruments measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the year ended May 31, 2017:

	Balance May 31, 2016	Transfers in (out)	Purchases	Sales/ Distributions	Realized gains	Unrealized gains (losses)	Balance May 31, 2017
Assets							
Mineral rights and royalties, net	\$ 4,391,622	\$ -	\$ -	\$ -	\$ -	\$ (1,445,295)	\$ 2,946,327
Funds administered by third parties	<u>12,016,122</u>	<u>-</u>	<u>269,804</u>	<u>(215,086)</u>	<u>855,300</u>	<u>27,075</u>	<u>12,953,215</u>
	<u>\$ 16,407,744</u>	<u>\$ -</u>	<u>\$ 269,804</u>	<u>\$ (215,086)</u>	<u>\$ 855,300</u>	<u>\$ (1,418,220)</u>	<u>\$ 15,899,542</u>

The amount of total losses for the period included in change in net assets attributable to the change in unrealized gains or losses relating to assets measured at fair value still held at May 31, 2017 \$ (1,418,220)

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

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, 2018:

Investment Type	Unfunded Commitments	May 31, 2018 Fair Value	May 31, 2017 Fair Value	Redemption Frequency	Redemption Notice Period	Remaining Life (Years)
Alternative investments						
Private equity funds (a)	\$ 1,199,574	\$ 3,276,392	\$ 3,526,348	Not redeemable	N/A	1 to 4
Real asset funds (b)	560,000	3,198,982	3,058,586	Not redeemable or quarterly	N/A	1 to 10
Hedge funds (c)	-	15,190,543	13,256,639	Last day of fiscal year or anniversary date subject to lock up period	100 days	N/A
Limited partnership (d)	-	4,085,976	5,317,476	Last day of calendar month	30 days	N/A
Offshore fund (e)	-	5,454,767	5,708,068	Last day of calendar month	30 days	N/A
Total	\$ 1,759,574	\$ 31,206,660	\$ 30,867,117			

- (a) Comprised of various private equity funds, the primary objectives of these funds are to achieve long-term returns and capital appreciation through investments in a diversified portfolio of private equity limited partnerships and closed-end private funds focused on investment partnerships. The investment is not redeemable. Instead, distributions are received through the liquidation of the underlying assets of the fund.
- (b) Comprised of various real asset funds which invest in real estate, infrastructure, natural resources or income producing timberlands. Real asset strategies generally seek to capitalize on transitional real estate assets and build/maintain exposures to hard assets expected to protect against long-term inflation. The total fair value of \$3,198,982 consists of \$1,598,326 that is non-redeemable and \$ 1,600,656 that is redeemable on a quarterly basis.
- (c) Comprised of various hedge funds which seek to protect capital in down markets and produce high return in the context of reasonable volatility. Hedge fund investments primarily consist of long/short equity and absolute return strategies. Funds can be redeemed on the last day of the fiscal year or anniversary date, subject to a lock up period, with 100 days written notice.
- (d) Comprised of a limited partnership, the objective of this fund is to seek long-term capital appreciation by investing primarily in equity securities of issuers located outside the United States. Funds can be redeemed on the last day of each calendar month with thirty days written notice.
- (e) Comprised of an offshore fund, which invests in equity securities. The primary objective of this fund is to achieve maximum total return. Funds can be redeemed on the last day of each calendar month with thirty days written notice.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 3 - STUDENT ACCOUNTS RECEIVABLE, NET

The University's student accounts receivable relate to tuition and fees for student attendance as well as room and board charges. At May 31, student accounts receivable consisted of the following:

	2018	2017
Student accounts receivable - gross	\$ 1,363,089	\$ 1,347,235
Less allowance for doubtful accounts		
Beginning of year	(1,230,371)	(1,175,831)
Increases	(4,742)	(54,540)
End of year	(1,235,113)	(1,230,371)
Student accounts receivable, net	\$ 127,976	\$ 116,864

NOTE 4 - CONTRIBUTIONS RECEIVABLE, NET

Contributions receivable consist of the following unconditional promises to give as of May 31:

	2018	2017
Contributions receivable - gross	\$ 2,288,261	\$ 2,834,539
Less unamortized discount	(24,847)	(29,102)
	2,263,414	2,805,437
Less allowance for doubtful accounts	(214,413)	(141,726)
Contributions receivable, net	\$ 2,049,001	\$ 2,663,711

The maturity of contributions receivable at May 31, 2018 is as follows:

Less than one year	\$ 1,097,345
One to five years	1,190,916
Total contributions receivable - gross	\$ 2,288,261

At May 31, 2018 and 2017, promises due in one to five years were discounted using interest rates ranging between 1.8% and 3%. Promises due in less than one year were not discounted. At May 31, 2018, 37% of the outstanding balance was due from one donor and 35% of the outstanding balance was due from two additional donors.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 5 - CREDIT QUALITY OF STUDENT LOANS RECEIVABLE

The University issues uncollateralized loans to students based on financial need. Student loans are funded through a Federal government loan program. Student notes receivable are carried at the amount of unpaid principal less an estimate for doubtful accounts. Allowances for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. At May 31, 2018 and 2017, student loans represented 1.9% and 2.1% of total assets, respectively.

At May 31, student loans receivable consisted of the following:

	2018	2017
Federal government programs	\$ 3,549,272	\$ 3,871,197
Less allowance for doubtful accounts		
Beginning of year	(211,000)	(211,000)
Change	-	-
End of year	(211,000)	(211,000)
Student loans receivable, net	\$ 3,338,272	\$ 3,660,197

Perkins Loan funds advanced by the Federal government totaled \$3,135,345 and \$3,036,779 at May 31, 2018 and 2017, 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 Loan Program receivables may be assigned to the U.S. Department of Education. 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.

At May 31, 2018 and 2017, the following amounts were past due under student loan programs:

	Amounts Past Due			
	1-60 days	60-90 days	90+ days	Total
May 31,				
2018	\$ 8,431	\$ 1,079	\$ 778,738	\$ 788,248
2017	8,321	3,515	778,414	790,250

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 6 - INVESTMENTS

Investments consist of the following as of May 31:

	2018	2017
Investment - at fair value		
Short-term investments	\$ 3,242,987	\$ 2,497,659
Mutual funds - bond funds	8,145,071	8,176,626
Mutual funds - equity funds	43,463,898	41,199,302
Alternative investments	31,206,660	30,867,117
	<u>86,058,616</u>	<u>82,740,704</u>
Investments - at cost or original gift value		
Land held for investment	4,500	4,500
	<u>4,500</u>	<u>4,500</u>
 Total investments	 <u>\$ 86,063,116</u>	 <u>\$ 82,745,204</u>

The following summarizes total investment return for the year ended May 31:

Dividend, interest and royalty income, net of fees of \$225,000 for 2018 and 2017	\$ 1,091,041	\$ 891,984
Net realized gains on sales of investments	2,062,791	106,456
Net unrealized gains on investments	3,003,366	6,591,329
	<u>6,157,198</u>	<u>7,589,769</u>
 Total investment return	 <u>\$ 6,157,198</u>	 <u>\$ 7,589,769</u>

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 such changes could materially affect the amounts reported in the financial statements.

The net investment return on alternative investments was \$2,649,716 and \$3,108,682 for the years ended May 31, 2018 and 2017, respectively.

NOTE 7 - PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consist of the following at May 31:

	2018	2017
Buildings	\$ 76,406,372	\$ 62,227,375
Improvements other than buildings	24,574,780	22,359,045
Software	1,556,981	1,556,981
Equipment	16,433,024	15,593,909
	<u>118,971,157</u>	<u>101,737,310</u>
Less accumulated depreciation	(58,307,023)	(55,256,013)
	<u>60,664,134</u>	<u>46,481,297</u>
Construction in progress	943,636	11,834,418
Land	3,754,146	3,754,146
	<u>65,361,916</u>	<u>62,069,861</u>
 Total property, plant and equipment, net	 <u>\$ 65,361,916</u>	 <u>\$ 62,069,861</u>

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 8 - BONDS PAYABLE, NET AND LINES OF CREDIT

Bonds and notes payable consist of the following as of May 31:

	2018	2017
The City of Terrell Hills, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2007	\$ -	\$ 395,000
City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2011	8,035,000	8,395,000
City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2013	8,845,000	9,385,000
City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue and Refunding Bonds (Texas Lutheran University Project), Series 2016	9,875,000	9,875,000
Total bonds payable	26,755,000	28,050,000
Debt issuance costs, net of accumulated amortization	(297,789)	(324,916)
Total bonds payable, net	\$ 26,457,211	\$ 27,725,084

The University has the following bonds outstanding:

City of Terrell Hills, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2007 - Tax-exempt bonds used for renovation of the University HVAC system with semi-annual interest payments ranging from 4.33% to 4.81% due each March 1st and September 1st. The final principal payment of \$395,000 was paid in September 2017.

City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2011 - Tax-exempt bonds used for construction of new residence hall, with semi-annual interest payments of 4.34% due each March 1st and September 1st. Annual principal payments ranging from \$380,000 to \$845,000 are due September 2018 through September 2031.

City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue Refunding Bonds (Texas Lutheran University Project), Series 2013 - Tax-exempt bonds with semi-annual interest payments of 2.70% due each March 1st and September 1st. Annual principal payments ranging from \$555,000 to \$610,000 are due September 2018 through September 2022, with a \$5,940,000 balloon payment due September 2023.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 8 - BONDS PAYABLE, NET AND LINES OF CREDIT (CONTINUED)

City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue and Refunding Bonds (Texas Lutheran University Project), Series 2016 - Tax-exempt bonds with semi-annual interest payments of 2.75% due each March 1st and September 1st. Annual principal payments ranging from \$305,000 to \$1,140,000 are due September 2019 through September 2038.

The Series 2016 bonds were issued to refund \$5,090,000 of the outstanding obligations of the City of Terrell Hills, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2007. The proceeds of the Series 2016 bond issue, along with \$80,181 from the University, were placed in an escrow account until September 2017, at which time, the refunded bonds were called and the outstanding balance was paid. Of the remaining proceeds from the Series 2016 bond issue, \$2,000,000 was used to finance the 2017 HVAC expansion project and \$2,500,000 was used for constructing, acquiring, equipping, and otherwise improving educational and housing facilities. The University recognized a loss of \$214,487 on the transaction during the year ended May 31, 2017.

The bond agreements include certain nonfinancial covenants. At May 31, 2018 and 2017, the University was in compliance with those covenants.

Aggregate maturities of bonds and notes payable at May 31:

2019	\$ 1,250,000
2020	1,295,000
2021	1,340,000
2022	1,390,000
2023	1,440,000
Thereafter	<u>20,040,000</u>
	<u>\$ 26,755,000</u>

Debt issuance costs consist of costs incurred in connection with bond financing and are amortized using the straight-line method which approximates the effective interest rate over the term of the bonds. Amortization expense was approximately \$27,100 and \$26,500 for the years ended May 31, 2018 and 2017, respectively.

The University has the following lines of credit available:

A \$4,000,000 unsecured operating line of credit agreement with a bank. The interest rate is at the floating prime rate plus 0.25% and was 5.00% at May 31, 2018. Interest only payments are due monthly. The line of credit matures on March 11, 2019. The outstanding balance was \$4,000,000 and \$2,500,000 for the years ended May 31, 2018 and 2017, respectively.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 8 - BONDS PAYABLE, NET AND LINES OF CREDIT (CONTINUED)

A \$5,725,000 secured line of credit agreement with a bank to finance the costs of construction projects. The line of credit is secured by board-designated endowment funds totaling approximately \$12,360,000. The interest rate is at the three month London Interbank Offered Rate plus 2.50% and was 4.82% at May 31, 2018. Interest only payments are due monthly. The line of credit matures on October 25, 2018. The outstanding balance at May 31, 2018 was \$3,825,182. There was no outstanding balance at May 31, 2017.

Interest expense was approximately \$899,000 and \$599,000 for the years ended May 31, 2018 and 2017, respectively. Interest of approximately \$214,000 and \$318,000 was capitalized for the years ended May 31, 2018 and 2017, respectively.

NOTE 9 - NET ASSETS

Permanently restricted net assets consist of the following categories as of May 31:

	2018	2017
Pooled endowment	\$ 50,685,909	\$ 48,417,993
Split-interest agreements	13,300,520	12,754,515
Annuity contracts, contributions receivable and other assets held for endowment	751,036	791,877
	\$ 64,737,465	\$ 61,964,385

The income generated from permanently restricted net assets is used for scholarships and University operations.

Temporarily restricted net assets consist of the following as of May 31:

	2018	2017
Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other support - operating	\$ 3,104,767	\$ 3,249,367
Scholarships, instruction and other support - endowment	12,813,433	11,808,167
Acquisition of buildings and equipment	416,061	5,066,605
Contributions receivable - operating and restricted	61,750	183,555
Split-interest agreements	198,250	198,701
	\$ 16,594,261	\$ 20,506,395

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 9 - NET ASSETS (CONTINUED)

Net assets were released from temporary donor restrictions during the years ended May 31, 2018 and 2017 by incurring expenses satisfying the restricted purpose or by occurrence of events specified by the donor as follows:

	<u>2018</u>	<u>2017</u>
Scholarships, instruction and other support	\$ 4,666,040	\$ 3,917,287
Property, plant and equipment acquired and placed into service	<u>4,876,178</u>	<u>5,966</u>
	<u>\$ 9,542,218</u>	<u>\$ 3,923,253</u>

NOTE 10 - Endowment

The University's endowment consists of approximately 650 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 generally accepted accounting principles ("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 Texas enacted version of 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 donor-restricted endowment funds:

1. The duration and preservation of the 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.

The University's endowment net assets include funds invested in the University's investment pool and excludes net assets related to contributions receivable, annuity contracts and other assets held for endowments.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 10 - ENDOWMENT (CONTINUED)

Endowment net asset composition by type of fund consists of the following as of May 31, 2018:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 12,813,433	\$ 50,685,909	\$ 63,499,342
Board-designated endowment funds	<u>22,183,133</u>	<u>-</u>	<u>-</u>	<u>22,183,133</u>
Total endowment net assets	<u>\$ 22,183,133</u>	<u>\$ 12,813,433</u>	<u>\$ 50,685,909</u>	<u>\$ 85,682,475</u>

Endowment net asset composition by type of fund consists of the following as of May 31, 2017:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 11,808,167	\$ 48,417,993	\$ 60,226,160
Board-designated endowment funds	<u>21,816,166</u>	<u>-</u>	<u>-</u>	<u>21,816,166</u>
Total endowment net assets	<u>\$ 21,816,166</u>	<u>\$ 11,808,167</u>	<u>\$ 48,417,993</u>	<u>\$ 82,042,326</u>

Changes in endowment net assets for the year ended May 31, 2018 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2017	\$ 21,816,166	\$ 11,808,167	\$ 48,417,993	\$ 82,042,326
Investment return:				
Investment income	285,417	794,355	-	1,079,772
Net appreciation - realized and unrealized	<u>1,308,176</u>	<u>3,640,833</u>	<u>-</u>	<u>4,949,009</u>
Total investment return	1,593,593	4,435,188	-	6,028,781
Additions to endowment	15,800	-	2,267,916	2,283,716
Appropriation of endowment assets for expenditure	<u>(1,242,426)</u>	<u>(3,429,922)</u>	<u>-</u>	<u>(4,672,348)</u>
Endowment net assets, May 31, 2018	<u>\$ 22,183,133</u>	<u>\$ 12,813,433</u>	<u>\$ 50,685,909</u>	<u>\$ 85,682,475</u>

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 10 - ENDOWMENT (CONTINUED)

Changes in endowment net assets for the year ended May 31, 2017 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2016	\$ 19,752,530	\$ 8,839,101	\$ 46,882,059	\$ 75,473,690
Investment return:				
Investment income	244,492	682,834	-	927,326
Net appreciation - realized and unrealized	<u>2,065,549</u>	<u>5,768,805</u>	<u>-</u>	<u>7,834,354</u>
Total investment return	2,310,041	6,451,639	-	8,761,680
Additions to endowment	988,128	-	1,535,934	2,524,062
Appropriation of endowment assets for expenditure	<u>(1,234,533)</u>	<u>(3,482,573)</u>	<u>-</u>	<u>(4,717,106)</u>
Endowment net assets, May 31, 2017	<u>\$ 21,816,166</u>	<u>\$ 11,808,167</u>	<u>\$ 48,417,993</u>	<u>\$ 82,042,326</u>

Funds with Deficiencies - From time to time, the fair value of assets associated with individual donor-restricted pooled endowment funds may fall below the level that the donor or UPMIFA requires the University to retain as a fund of perpetual duration. There were no deficiencies of this nature that are reported in unrestricted net assets as of May 31, 2018 and 2017.

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(s) as well as board-designated funds. Under this policy, as approved by the governing board, the endowment assets follow the asset allocation policy that diversifies investments among several asset provide an average annual rate between 7% and 8% annually. 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 equity-based 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 of appropriating for distribution of 6.00% and 6.25% for each of the years ending in 2018 and 2017, respectively, of its endowment fund's average fair value over the prior 12-quarters moving average of the market value of the pooled endowment through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, the University considered the long-term expected return on its endowment. Accordingly, over the long term, the University expects the current spending policy to allow its endowment to grow at an average of 1% to 2% annually. 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.

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 11 - EMPLOYEE BENEFIT PLANS

The University has a contributory defined contribution retirement plan covering academic and nonacademic personnel who have one year of service and are employed at least half-time. Contributions for employees are based on a percentage of compensation. Contributions to the retirement plan amounted to approximately \$703,000 and \$720,000 for the years ended May 31, 2018 and 2017, respectively.

The University also provides medical benefits through a self-funded health plan. Specific and aggregate stop loss coverage on the health plan is provided to limit the ultimate exposure of the University. A liability is provided for claims incurred but not reported. Management reviews this accrual on an on-going basis and believes it is adequate to cover such claims. The balance of the accrual at May 31, 2018 and 2017 was \$275,000 and \$272,000, respectively. The University has a aggregate stop loss limit of \$2,150,000.

NOTE 12 - OPERATING LEASES

The University leases certain equipment under non-cancelable operating leases expiring through July 2024. Total rental expenses approximated \$195,000 and \$200,000 for the years ended May 31, 2018 and 2017, respectively. Future minimum rentals under non-cancelable operating leases with terms of more than one year are as follows:

2019	\$	95,904
2020		94,224
2021		91,844
2022		25,404
2023		25,404
Thereafter		<u>29,638</u>
	\$	<u>362,418</u>

NOTE 13 - SCHEDULE OF FUNCTIONAL EXPENSES

The following table presents the allocation of operations and maintenance, depreciation and interest to the functional expenses as of May 31, 2018:

	Functional Expenses	Allocations	Total
EXPENSES			
Instruction	\$ 9,705,307	\$ 2,959,647	\$ 12,664,954
Academic support	1,861,880	639,387	2,501,267
Public service	624,450	34,020	658,470
Research	28,410	18,900	47,310
Student services	6,671,713	400,954	7,072,667
Institutional support	7,031,511	1,437,015	8,468,526
Development and fund-raising	1,251,312	36,732	1,288,044
Auxiliary enterprises	<u>3,215,943</u>	<u>2,565,989</u>	<u>5,781,932</u>
Total Expenses	<u>\$ 30,390,526</u>	<u>\$ 8,092,644</u>	<u>\$ 38,483,170</u>

TEXAS LUTHERAN UNIVERSITY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended May 31, 2018 and 2017

NOTE 13 - SCHEDULE OF FUNCTIONAL EXPENSES (CONTINUED)

The following table presents the allocation of operations and maintenance, depreciation and interest to the functional expenses as of May 31, 2017:

	<u>Functional Expenses</u>	<u>Allocations</u>	<u>Total</u>
EXPENSES			
Instruction	\$ 9,036,743	\$ 2,572,230	\$ 11,608,973
Academic support	1,815,681	624,847	2,440,528
Public service	620,228	33,243	653,471
Research	39,308	18,473	57,781
Student services	6,540,137	391,837	6,931,974
Institutional support	6,856,150	1,465,026	8,321,176
Development and fund-raising	1,277,289	35,898	1,313,187
Auxiliary enterprises	<u>3,040,203</u>	<u>2,507,634</u>	<u>5,547,837</u>
Total Expenses	<u>\$ 29,225,739</u>	<u>\$ 7,649,188</u>	<u>\$ 36,874,927</u>

NOTE 14 - COMMITMENTS AND CONTINGENCIES

The University participates in various federal loan programs. The amount of loans disbursed under the Federal Direct Loan Program for each of the years ending May 31, 2018 and 2017 approximated \$9,100,000 and \$8,300,000, respectively. The amount of loans disbursed under the Federal Perkins Loan Program for the years ended May 31, 2018 and 2017 was approximately \$307,000 and \$283,000, respectively. Amounts questioned as a result of audits, if any, may result in the University purchasing the loan(s) from the lender as the loan(s) may have lost its (their) guaranteed status. Management believes that such amounts, if any, would be immaterial to the financial statements.

Activity of the Federal Pell Grant program is not reflected in the statement of activities as the transactions are considered to be agency transactions. Students received approximately \$2,069,000 and \$1,830,000 from the Federal Pell Grant program for the years ended May 31, 2018 and 2017, respectively.

In order to participate in the various Federal Title IV financial aid programs, the U.S. Department of Education requires private nonprofit institutions to demonstrate financial responsibility by meeting certain ratio requirements. The University was in compliance with these requirements at May 31, 2018 and 2017.

The University is contingently liable in connection with claims and contracts, including those currently in litigation arising in the normal course of its activities. In the opinion of management, the results of these matters will not have a significant impact on the financial statements.

NOTE 15 - SUBSEQUENT EVENTS

The University has evaluated its financial statements for subsequent events through August 31, 2018 which is the date the financial statements were issued.