

Texas Lutheran University

Consolidated Financial Statements

May 31, 2020 and 2019

Texas Lutheran University

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Independent Auditors' Report

To the Board of Regents of
Texas Lutheran University

We have audited the accompanying consolidated financial statements of Texas Lutheran University and subsidiary (the University), which comprise the consolidated statements of financial position as of May 31, 2020 and 2019, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Texas Lutheran University and subsidiary as of May 31, 2020 and 2019, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly US, LLP

Baker Tilly US, LLP (formerly known as Baker Tilly Virchow Krause, LLP)
Minneapolis, Minnesota
October 2, 2020

Texas Lutheran University

Consolidated Statements of Financial Position

May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Assets		
Cash and cash equivalents	\$ 2,102,502	\$ 651,521
Receivables:		
Student accounts, net of allowance for doubtful accounts	192,807	185,412
Contributions, net	771,554	1,345,623
Other	484,089	452,633
Inventories	301,653	257,902
Other assets	1,872,149	1,705,070
Student loans receivable, net	2,284,003	2,857,873
Investments	80,007,111	81,177,230
Mineral rights and royalties	618,355	1,594,962
Funds administered by third-parties	13,160,732	13,364,935
Cash-restricted	966,223	999,756
Property held for sale	1,555,000	1,555,000
Property, plant and equipment, net	87,862,787	82,685,995
Right-of-use assets, finance leases	218,707	168,538
Right-of-use assets, operating leases	149,476	197,865
	<u> </u>	<u> </u>
Total assets	<u>\$ 192,547,148</u>	<u>\$ 189,200,315</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable	\$ 331,869	\$ 775,236
Payroll related liabilities	2,674,026	2,868,681
Deposits and other unearned revenue	5,588,311	1,596,155
Liabilities related to split-interest agreements	2,748,571	2,984,740
Other accrued liabilities	522,811	546,307
Lease liabilities, finance leases	166,575	151,874
Lease liabilities, operating leases	149,476	197,865
Asset retirement obligations	1,018,423	993,629
Advances from U.S. Government for student loans	2,525,444	3,223,916
Line of credit, operating	1,500,000	3,000,000
Line of credit, construction	615,803	1,485,588
Bonds payable, net	23,966,464	25,234,337
	<u> </u>	<u> </u>
Total liabilities	<u>41,807,773</u>	<u>43,058,328</u>
Net Assets		
Net assets without donor restrictions	72,174,422	65,738,332
Net assets with donor restrictions	78,564,953	80,403,655
	<u> </u>	<u> </u>
Total net assets	<u>150,739,375</u>	<u>146,141,987</u>
	<u> </u>	<u> </u>
Total liabilities and net assets	<u>\$ 192,547,148</u>	<u>\$ 189,200,315</u>

See notes to consolidated financial statements

Texas Lutheran University

Consolidated Statements of Activities
Year Ended May 31, 2020
With Comparative Totals for 2019

	Without Donor Restrictions	With Donor Restrictions	Total	2019 Total
Operating Revenues, Gains and Other Support				
Tuition and fees, net of scholarships				
of \$27,197,429 and \$25,786,734, respectively	\$ 15,278,554	\$ -	\$ 15,278,554	\$ 13,908,818
Long-term investment income and gains allocated for operations	1,121,816	3,603,324	4,725,140	6,959,825
Investment return	823,630	828	824,458	512,255
Contributions	2,525,681	542,295	3,067,976	3,148,612
Government and private grants	4,342,838	4,379	4,347,217	3,500,400
Auxiliary enterprises	6,693,528	-	6,693,528	7,922,400
Other revenue	1,219,626	-	1,219,626	1,187,100
	<u>32,005,673</u>	<u>4,150,826</u>	<u>36,156,499</u>	<u>37,139,410</u>
Net assets released from restrictions - operating	4,065,914	(4,065,914)	-	-
	<u>36,071,587</u>	<u>84,912</u>	<u>36,156,499</u>	<u>37,139,410</u>
Total operating revenues, gains and other support				
Operating Expenses				
Instruction	12,226,304	-	12,226,304	12,551,591
Academic support	2,221,178	-	2,221,178	2,456,848
Public service	656,338	-	656,338	566,212
Research	158,186	-	158,186	62,350
Student services	6,906,160	-	6,906,160	7,589,379
Institutional support	8,048,148	-	8,048,148	8,324,334
Development and fund-raising	907,824	-	907,824	1,183,793
Auxiliary enterprises	4,946,917	-	4,946,917	5,530,411
	<u>36,071,055</u>	<u>-</u>	<u>36,071,055</u>	<u>38,264,918</u>
Total operating expenses				
Change in net assets from operating activities	532	84,912	85,444	(1,125,508)
Nonoperating Activities				
Investment return	293,265	1,015,468	1,308,733	1,593,245
Net gains (losses) on investments	246,979	(394,807)	(147,828)	(1,643,832)
Long-term investment activities	540,244	620,661	1,160,905	(50,587)
Less: Long-term investment income and gains allocated for operations	(1,121,816)	(3,603,324)	(4,725,140)	(4,959,825)
Long-term investment activities	(581,572)	(2,982,663)	(3,564,235)	(5,010,412)
Contributions - endowment	-	1,079,233	1,079,233	1,330,276
Capital giving activities - contributions and grants	6,850,000	321,215	7,171,215	1,295,371
Board designated funds allocated to operations	-	-	-	(2,000,000)
Change in value of split-interest agreements	167,130	(341,399)	(174,269)	128,916
	<u>6,435,558</u>	<u>(1,923,614)</u>	<u>4,511,944</u>	<u>(4,255,849)</u>
Change in net assets from nonoperating activities				
Change in net assets before inherent contribution	6,436,090	(1,838,702)	4,597,388	(5,381,357)
Inherent contribution	-	-	-	22,464,386
Change in net assets	6,436,090	(1,838,702)	4,597,388	17,083,029
Net Assets, Beginning	<u>65,738,332</u>	<u>80,403,655</u>	<u>146,141,987</u>	<u>129,058,958</u>
Net Assets, Ending	<u>\$ 72,174,422</u>	<u>\$ 78,564,953</u>	<u>\$ 150,739,375</u>	<u>\$ 146,141,987</u>

See notes to consolidated financial statements

Texas Lutheran University
Consolidated Statements of Activities
Year Ended May 31, 2019

	Without Donor Restrictions	With Donor Restrictions	2019 Total
Operating Revenues, Gains and Other Support			
Tuition and fees, net of scholarships of \$25,786,734	\$ 13,908,818	\$ -	\$ 13,908,818
Long-term investment income and gains allocated for operations	3,284,104	3,675,721	6,959,825
Investment return	518,176	(5,921)	512,255
Contributions	1,728,679	1,419,933	3,148,612
Government and private grants	3,470,911	29,489	3,500,400
Auxiliary enterprises	7,922,400	-	7,922,400
Other revenue	1,187,100	-	1,187,100
	<u>32,020,188</u>	<u>5,119,222</u>	<u>37,139,410</u>
Net assets released from restrictions - operating	4,421,420	(4,421,420)	-
	<u>36,441,608</u>	<u>697,802</u>	<u>37,139,410</u>
Operating Expenses			
Instruction	12,551,591	-	12,551,591
Academic support	2,456,848	-	2,456,848
Public service	566,212	-	566,212
Research	62,350	-	62,350
Student services	7,589,379	-	7,589,379
Institutional support	8,324,334	-	8,324,334
Development and fund-raising	1,183,793	-	1,183,793
Auxiliary enterprises	5,530,411	-	5,530,411
	<u>38,264,918</u>	<u>-</u>	<u>38,264,918</u>
Change in net assets from operating activities	<u>(1,823,310)</u>	<u>697,802</u>	<u>(1,125,508)</u>
Nonoperating Activities			
Investment return	247,673	1,345,572	1,593,245
Net losses on investments	(449,853)	(1,193,979)	(1,643,832)
Long-term investment activities	(202,180)	151,593	(50,587)
Less: Long-term investment income and gains allocated for operations	(1,284,104)	(3,675,721)	(4,959,825)
Long-term investment activities	(1,486,284)	(3,524,128)	(5,010,412)
Contributions - endowment	-	1,330,276	1,330,276
Capital giving activities - contributions and grants	-	1,295,371	1,295,371
Board designated funds allocated to operations	(2,000,000)	-	(2,000,000)
Release from restrictions - capital	652,830	(652,830)	-
Change in value of split-interest agreements	203,478	(74,562)	128,916
	<u>(2,629,976)</u>	<u>(1,625,873)</u>	<u>(4,255,849)</u>
Change in net assets from nonoperating activities	<u>(2,629,976)</u>	<u>(1,625,873)</u>	<u>(4,255,849)</u>
Change in net assets before inherent contribution	(4,453,286)	(928,071)	(5,381,357)
Inherent contribution	22,464,386	-	22,464,386
	<u>18,011,100</u>	<u>(928,071)</u>	<u>17,083,029</u>
Change in net assets	<u>18,011,100</u>	<u>(928,071)</u>	<u>17,083,029</u>
Net Assets, Beginning	<u>47,727,232</u>	<u>81,331,726</u>	<u>129,058,958</u>
Net Assets, Ending	<u>\$ 65,738,332</u>	<u>\$ 80,403,655</u>	<u>\$ 146,141,987</u>

See notes to consolidated financial statements

Texas Lutheran University

Consolidated Statements of Cash Flows

May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 4,597,388	\$ 17,083,029
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	2,953,965	3,266,868
Accretion of asset retirement obligations	24,794	57,117
Net realized and unrealized (gains) losses on investments	(350,804)	1,306,105
Gifts and grants restricted for long-term purposes - plant	(7,134,539)	(1,112,622)
Gifts and grants restricted for long-term purposes - endowment	(1,079,233)	(1,328,570)
Change in value of split interest agreements	434,908	485,746
Inherent contribution	-	(22,464,386)
(Increases) decrease in assets		
Receivables	(38,851)	(44,096)
Inventories	(43,751)	73,707
Other assets	(167,079)	70,931
Increases (decrease) in liabilities		
Accounts payable	(373,540)	(38,599)
Payroll related liabilities	(194,655)	160,523
Deposits and other unearned revenue	3,992,156	(46,105)
Other accrued liabilities	(23,496)	(11,081)
Net Cash Flow From Operating Activities	<u>2,597,263</u>	<u>(2,541,433)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	6,326,529	14,617,978
Purchases of investments	(3,863,043)	(8,988,766)
Proceeds from repayment of student loans	573,870	480,399
Purchases of property and equipment	(1,260,903)	(2,001,794)
Net Cash Flows From Investing Activities	<u>1,776,453</u>	<u>4,107,817</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of principal on bonds payable	(1,295,000)	(1,250,000)
Proceeds on long-term line of credit	-	1,000,000
Repayments of line of credit, construction	(869,785)	(3,339,594)
Proceeds from line of credit, operating	8,000,000	4,000,000
Payments of line of credit, operating	(9,500,000)	(5,000,000)
Restricted gifts and grants proceeds for long term purposes - plant	858,607	1,740,793
Restricted gifts and grants proceeds for long term purposes - endowment	1,079,233	2,235,975
Payments to annuitants	(432,830)	(248,974)
Finance lease payments	(98,021)	(48,168)
Advances from (payments to) U.S. Government	(698,472)	88,571
Net Chash Flow From Financing Activites	<u>(2,956,268)</u>	<u>(821,397)</u>
Net Change in Cash and Cash Equivalents	1,417,448	744,987
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH - Beginning of Year	<u>1,651,277</u>	<u>906,290</u>
CASH, CASH EQUIVALENTS AND RESTRICTED CASH - END OF YEAR	<u>\$ 3,068,725</u>	<u>\$ 1,651,277</u>
Supplemental disclosures of cash flow information		
Cash paid for interest	1,069,018	1,170,518
Property, plant and equipment additions in accounts payable	29,959	99,786
Right-of-use assets obtained in exchange for new lease liability		
Finance leases	112,722	200,042
Operating leases	-	117,693

See notes to consolidated financial statements

Texas Lutheran University

Notes to Consolidated Financial Statements

May 31, 2020 and 2019

1 Summary of 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 1,400 students. The main campus and administrative offices are located in Seguin, Texas. The University is supported primarily by tuition and fees from students.

The consolidated financial statements include the accounts of Texas Lutheran University, and the Weston Ranch Foundation (the Foundation), collectively referred to as the University. The University obtained majority-voting rights on the Board of Directors for the Foundation during fiscal year 2019. The purpose of the Foundation is to conduct supporting activities for Texas Lutheran University in connection with its environmental programs, campus ministries and community relations. All transactions and balances between the entities have been eliminated in the consolidated financial statements.

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 Assets

For the purposes of financial reporting, the University classifies resources into two 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:

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

Net Assets Without Donor Restrictions - Net assets not subject to donor-imposed stipulations. The Board of Regents has established policies that affect the presentation of board designations on net assets without donor restrictions. The Board approved policy states that bequests without restrictions over \$50,000 are reported to the Executive Committee of the Board of Regents for recommendation on undesignated or designated use. Bequests without restrictions under \$50,000 are distributed to current undesignated funds. (See Note 9).

Revenues from sources other than contributions are generally reported as increases in net assets without donor restrictions. Expenses are reported as decreases in net assets without donor restrictions. Investment income, gains and losses on investments are reported in the statement of activities as increases and decreases in net assets without donor restrictions unless their use is 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 net assets without donor restrictions. Investment income and gains earned on donor restricted funds that are classified as donor-restricted net assets are reclassified as net assets without donor restrictions when expenses are incurred for their intended purpose.

Unconditional contributions, including 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 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. Contributions whose restrictions are met in the same year received, are recorded in net assets without donor restrictions. Contributions that include a measurable barrier, or those for which the University has limited discretion over how the contribution should be spent, and a right of return or release from future obligations are recorded as conditional contributions. Conditional contributions are not recognized until they become unconditional, that is, when the conditions surrounding the indications of the barrier have been met in accordance with donor restrictions.

Texas Lutheran University

Notes to Consolidated Financial Statements

May 31, 2020 and 2019

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

A portion of the University's revenue is derived from cost-reimbursable grants and contracts, which are conditioned upon certain performance requirements and/ or the incurrence of allowable qualifying expenses. Amounts received are recognized as revenue when the University has incurred expenditures in compliance with specific grant or contract provisions and has received payment. Amounts received prior to incurring qualifying expenditures, if any, are reported as unearned revenue in the consolidated statement of financial position. Expenses incurred before cash is received are recorded as receivables. The University received cost-reimbursable grants of \$3,709,634 that have not been recognized at May 31, 2020 because qualifying expenditures have not yet been incurred.

On April 20, 2020, the University entered into a new loan facility under the recent government enacted Paycheck Protection Program (PPP) (part of the Coronavirus Aid, Relief and Economic Stability Act) administered by the Small Business Administration. The University borrowed \$3,576,400 under the loan facility. The loan carries a fixed interest rate of 1% and matures on April 20, 2022. No payments are required for the first six months. Borrowings under this facility are unsecured. Loans under the PPP have a loan forgiveness feature based on the level of payroll, rent and utilities costs over a twenty-four week period commencing on the date of the loan. Management anticipates that most of the outstanding balance on the loan will be forgiven. The PPP loan is recorded as deferred revenue in the May 31, 2020 consolidated statement of financial position.

Tuition and Fees and Auxiliary Enterprises Revenues

Financial assistance in the form of scholarships and grants that cover a portion of tuition is reflected as a reduction of tuition and fees revenues.

Tuition revenue is recognized in the fiscal year in which the academic programs are delivered, i.e. when the performance obligation is satisfied. In addition, withdrawals that occur prior to the 16th day of the academic term may receive a full or partial refund in accordance with the University's refund policy. Payments for tuition are due approximately one to two weeks prior to the start of the academic term. Generally, the University's performance obligations are satisfied equally over the academic term. Performance obligations for certain auxiliary services are satisfied when the service is performed. The University applies the practical expedient as allowed for within the accounting standards and, therefore, does not disclose information about remaining performance obligations that have original expected durations of one year or less. All remaining performance obligations will be satisfied in connection with the completion of the 2020-21 academic year. The University determines the transaction price based on standard charges for goods and services provided reduced by discounts of institutional scholarships in accordance with the University's policies.

The University also provides auxiliary services, such as room and board. Revenue from these services is recognized in the fiscal year in which the goods and services are provided. Students that withdraw from the University prior to the 16th day of the semester may receive a partial refund in accordance with the University's refund policy. Refunds issued reduce the amount of revenue recognized. Payments for services are due before the beginning of each academic term. Performance obligations for certain ancillary services are satisfied when the service is performed. The University applies the practical expedient as allowed for within the accounting standards and, therefore, does not disclose information about remaining performance obligations that have original expected durations of one year or less. All remaining performance obligations will be satisfied in connection with the completion of the 2020-21 academic year.

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Unearned revenue represents payments received for tuition or room and board prior to the start of the summer and fall academic terms. The following table notes the activity within the unearned revenue accounts relating to tuition and fees:

	<u>2020</u>	<u>2019</u>
Balance at beginning of the year	\$ 1,596,155	\$ 1,642,260
Revenue recognized during the year	(1,596,155)	(1,642,260)
Cash received in advance of performance	<u>2,011,911</u>	<u>1,596,155</u>
Balance at end of the year	<u>\$ 2,011,911</u>	<u>\$ 1,596,155</u>

Operating Measure

The University's operating revenues in excess of expenses includes support for operating activities from both donor restricted net assets and net assets without donor restrictions designated for long-term investment (the donor restricted and quasi endowment) according to the University's spending policy, which is detailed in Note 10. The measure of operations excludes endowment support for non-operating activities, investment return in excess of amounts made available for current support, capital giving activities and changes in the value of split-interest agreements.

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 grants until appropriate expenditures occur.

Student Accounts Receivable

The University's student accounts receivable are due from students. Credit is extended to students for tuition, room and board 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, prepaids and other assets.

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Investments

Investments in publicly 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.

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 percent of this interest and the University of Texas holds the remaining 95 percent. The University follows the valuation methodology used by the University of Texas, and valued the 5 percent interest in these oil and gas assets at \$618,355 and \$1,594,962 at May 31, 2020 and 2019, respectively.

Funds Administered by Third Parties

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 10-80 years, improvements other than building 10-20 years, software 3-10 years and equipment 3-20 years.

Assets Held for Sale

The University classified to assets held for sale the net book value of land held by the Weston Ranch Foundation.

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, 2020 and 2019, there have been no such losses.

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 changes 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 percent to 7.4 percent were used.

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Notes to Consolidated Financial Statements

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Total assets held by the University under split-interest agreements totaled \$2,056,171 and \$2,281,242 at May 31, 2020 and 2019, respectively. The University received no new gifts under a split-interest agreement at May 31, 2020 and received new gifts totaling \$1,106,052 at May 31, 2019.

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, 2020 and 2019 are as follows:

	<u>2020</u>	<u>2019</u>
Balance, Beginning of the year	\$ 993,629	\$ 936,512
Accretion expense	24,794	57,117
Balance, End of the Year	<u>\$ 1,018,423</u>	<u>\$ 993,629</u>

Advances From U.S. Government for Student Loans

Funds provided by the United States Government under the Federal Perkins Loan Program were loaned to qualified students. These funds are ultimately refundable to the government and are included as liabilities in the consolidated statements of financial position.

Advertising Expenses

Advertising expenses approximated \$163,000 and \$227,000 for the years ended May 31, 2020 and 2019, respectively. Advertising costs are expensed when incurred.

Income Taxes

The University and Foundation are exempt from state and federal income tax under Section 501(c)(3) and 501(a), respectively, of the Internal Revenue Code according to their Internal Revenue Service determination letters. Accordingly, the University and Foundation are not subject to federal income taxes except to the extent they derive income from certain activities not substantially related to their tax-exempt purposes (unrelated trade or business activities). Neither the University nor the Foundation had material unrelated business income during the year.

The University and Foundation follow 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 or Foundation for uncertain tax positions as of May 31, 2020 and 2019. The University and Foundation's tax returns are subject to review and examination by federal authorities.

Use of Estimates

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

Concentrations

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, 2020, approximately 85 percent 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, 2020, approximately 65 percent 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.

Reclassifications

Certain amounts appearing in the 2019 financial statements have been reclassified to conform with the 2020 presentation. The reclassifications have no effect on the reported amounts of total net assets or changes in total net assets.

New Accounting Pronouncements Implemented in the Current Year

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 standard provided clarity and improved 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. The University adopted ASU 2018-08 prospectively as of June 1, 2019 and the adoption did not have a material impact on the University's financial statements for the year ending May 31, 2020.

In November 2016, FASB issued ASU 2016-18, *Statement of Cash Flows, (Topic 230): Restricted Cash*. The guidance required 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 consolidated statement of cash flows. This standard has been retroactively applied to the prior period presented. The effects of the required retroactive application of this change in presentation for the year ended May 31, 2019 are to increase net cash flows from investing activities by \$489,666, increasing beginning cash, cash equivalents and restricted cash by \$510,090 and increase ending cash, cash equivalents, and restricted cash by \$999,756.

2. Fair Value Measurements and Investments

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 short-term investments, consisting primarily of money market funds, bond and equity mutual funds and marketable hedge funds for which quoted prices are readily available.

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, 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 percent interest, based on current production through June 2019 and 2018, respectively, future production with a decline curve to July 2045, 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).

There were no change in fair value methods or assumptions during the year ended May 31, 2020 or 2019.

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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.

The following table presents financial instruments that are measured at fair value on a recurring basis as of May 31, 2020:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total May 31, 2020</u>
Assets				
Investments:				
Short-term investments	\$ 3,554,375	\$ -	\$ -	\$ 3,554,375
Mutual funds, bond funds:				
U.S. fixed income	6,032,541	-	-	6,032,541
Global fixed income	1,922,630	-	-	1,922,630
Other fixed income	305,667	72,344	-	378,011
Mutual funds, equity funds:				
U.S. equities	26,676,514	189,190	-	26,865,704
Non-U.S. equities	15,278,443	-	-	15,278,443
Marketable hedge funds	229,849	-	-	229,849
Total investments	54,000,019	261,534	-	54,261,553
Mineral rights and royalties	-	-	618,355	618,355
Funds administered by third parties	-	-	13,160,732	13,160,732
Subtotal assets included in valuation hierarchy	\$ 54,000,019	\$ 261,534	\$ 13,779,087	68,040,640
Investments measured using NAV:				
Private equity funds				2,760,451
Real asset funds				2,452,540
Hedge funds				11,576,729
Limited partnership				3,705,428
Offshore fund				5,245,910
Subtotal assets using NAV				25,741,058
Total assets at fair value				\$ 93,781,698
Total investments at May 31, 2020 include:				
Investments included in the valuation hierarchy				\$ 54,261,553
Investments measured using NAV				25,741,058
Investments at cost				4,500
				\$ 80,007,111

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The following table presents financial instruments that are measured at fair value on a recurring basis as of May 31, 2019:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total May 31, 2019</u>
Assets				
Investments:				
Short-term investments	\$ 1,734,450	\$ -	\$ -	\$ 1,734,450
Mutual funds, bond funds:				
U.S. fixed income	6,410,118	-	-	6,410,118
Global fixed income	3,080,775	-	-	3,080,775
Other fixed income	455,480	21,562	-	477,042
Mutual funds, equity funds:				
U.S. equities	25,221,277	279,017	-	25,500,294
Non-U.S. equities	15,095,567	-	-	15,095,567
Marketable hedge funds	193,048	-	-	193,048
	<u>52,190,715</u>	<u>300,579</u>	<u>-</u>	<u>52,491,294</u>
Mineral rights and royalties	-	-	1,594,962	1,594,962
Funds administered by third parties	-	-	13,364,935	13,364,935
	<u>-</u>	<u>-</u>	<u>13,364,935</u>	<u>13,364,935</u>
Subtotal assets included in valuation hierarchy	<u>\$ 52,190,715</u>	<u>\$ 300,579</u>	<u>\$ 14,959,897</u>	<u>67,451,191</u>
Investments measured using NAV:				
Private equity funds				3,021,036
Real asset funds				2,928,861
Hedge funds				14,192,927
Limited partnership				2,830,324
Offshore fund				5,708,288
				<u>28,681,436</u>
Subtotal assets using NAV				<u>28,681,436</u>
Total assets at fair value				<u>\$ 96,132,627</u>
Total investments at May 31, 2019 include:				
Investments included in the valuation hierarchy				\$ 52,491,294
Investments measured using NAV				28,681,436
Investments at cost				4,500
				<u>\$ 81,177,230</u>

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May 31, 2020 and 2019

The following table presents a reconciliation of the consolidated 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, 2020:

	Balance May 31, 2019	Transfers In (Out)	Purchases	Sales/ Distributions	Realized Gains	Unrealized Losses	Balance May 31, 2020
Assets:							
Mineral rights and royalties	\$ 1,594,962	\$ -	\$ -	\$ -	\$ -	\$ (976,607)	\$ 618,355
Funds administered by third parties	13,364,935	-	324,685	(290,642)	57,683	(295,929)	13,160,732
	<u>\$ 14,959,897</u>	<u>\$ -</u>	<u>\$ 324,685</u>	<u>\$ (290,642)</u>	<u>\$ 57,683</u>	<u>\$ (1,272,536)</u>	<u>\$ 13,779,087</u>

The amount of total losses for the period included in change in net assets attributable to the change in unrealized losses relating to assets measured at fair value still held at May 31, 2020

\$ (1,272,536)

The following table presents a reconciliation of the consolidated 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, 2019:

	Balance May 31, 2018	Transfers In (Out)	Purchases	Sales/ Distributions	Realized Gains	Unrealized Losses	Balance May 31, 2019
Assets:							
Mineral rights and royalties	\$ 1,713,028	\$ -	\$ -	\$ -	\$ -	\$ (118,066)	\$ 1,594,962
Funds administered by third parties	13,498,770	-	687,064	(491,975)	2,929	(331,853)	13,364,935
	<u>\$ 15,211,798</u>	<u>\$ -</u>	<u>\$ 687,064</u>	<u>\$ (491,975)</u>	<u>\$ 2,929</u>	<u>\$ (449,919)</u>	<u>\$ 14,959,897</u>

The amount of total losses for the period included in change in net assets attributable to the change in unrealized losses relating to assets measured at fair value still held at May 31, 2019

\$ (449,919)

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.

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.

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 consolidated financial statements.

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Notes to Consolidated Financial Statements

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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, 2020:

Investment Type	Unfunded Commitments	May 31 2020 Fair Value	May 31 2019 Fair Value	Redemption Frequency	Redemption Notice Period	Remaining Life (Years)
Private equity funds (a)	\$ 801,074	\$ 2,760,451	\$ 3,021,036	Not redeemable	N/A	1 to 3
Real asset funds (b)	412,000	2,452,540	2,928,861	Not redeemable or quarterly Last day of fiscal year or anniversary date subject to lock up period	N/A	1 to 8
Hedge funds (c)	-	11,576,729	14,192,927	Last day of calendar month	100 days	N/A
Limited partnership (d)	-	3,705,428	2,830,324	Last day of calendar month	30 days	N/A
Offshore fund (e)	-	5,245,910	5,708,288	Last day of calendar month	30 days	N/A
Total	<u>\$ 1,213,074</u>	<u>\$ 25,741,058</u>	<u>\$ 28,681,436</u>			

(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 investments are 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 \$2,452,540 consists of \$1,187,589 that is nonredeemable and \$1,264,951 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.

The net investment return on nonmarketable investments was \$(264,166) and \$537,090 for the years ended May 31, 2020 and 2019, respectively.

Texas Lutheran University

Notes to Consolidated Financial Statements

May 31, 2020 and 2019

3. Liquidity and Availability

The following table reflects the University's financial assets as May 31, 2020 and 2019, reduced by amounts not available for general expenditure within one year. Financial assets are considered unavailable when illiquid or not convertible to cash within one year. Other financial assets that are excluded from this measure of liquidity include endowments and accumulated earnings restricted by donors or the University's Board of Regents net of appropriations within one year, assets held for or by others and annuity reserves.

	<u>2020</u>	<u>2019</u>
Financial assets:		
Cash and cash equivalents	\$ 2,102,502	\$ 651,521
Accounts receivable from students and other	676,896	638,045
Contributions, net	771,554	1,345,623
Student loans receivable	2,284,003	2,857,873
Investments	80,007,111	81,177,230
Mineral rights and royalties, net	618,355	1,594,962
Funds administered by third parties	13,160,732	13,364,935
Cash - restricted	<u>966,223</u>	<u>999,756</u>
Financial assets at May 31	100,587,376	102,629,945
Less those unavailable for general expenditure within one year:		
Contributions receivable for construction projects and endowment	771,554	1,345,623
Student loans receivable, Federal Perkins Loan Program	2,284,003	2,857,873
Endowment net assets restricted by donors, net of appropriation for next year	55,243,920	57,702,166
Endowment net assets designated by the Board of Regents, net of appropriation for next year	16,847,203	17,575,033
Short-term investments held for plant	1,379,816	1,058,601
Investments held for others for split-interest agreements	2,056,171	2,281,242
Mineral rights and royalties	618,355	1,594,962
Assets held in trust by others	<u>13,160,732</u>	<u>13,364,935</u>
Financial assets not available for expenditure within one year	<u>92,361,754</u>	<u>97,780,435</u>
Financial assets available to meet cash needs for general purposes within one year	<u>\$ 8,225,622</u>	<u>\$ 4,849,510</u>

The University's practice is to structure its financial assets to be available as its general expenses, liabilities and obligations come due and targets a minimum of 60 days of operating expense coverage at any point in time.

The University has an unsecured \$4,000,000 line of credit for operating purposes with available funds of \$2,500,000 and a secured \$1,360,655 line of credit for construction projects with available funds of \$744,852 as of May 31, 2020, which it could draw upon in the event of an anticipated liquidity need.

As of May 31, 2020, the University has \$16,847,203 of board designated endowment funds, net of appropriations for next year, that could be used to fund operating expenses with approval from the Board.

Texas Lutheran University

Notes to Consolidated Financial Statements

May 31, 2020 and 2019

4. Student Accounts Receivable, Net

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

	<u>2020</u>	<u>2019</u>
Student accounts receivable, gross	\$ 1,507,698	\$ 1,450,405
Less allowance for doubtful accounts		
Beginning of year	(1,264,993)	(1,235,113)
Increases	<u>(49,898)</u>	<u>(29,880)</u>
End of year	<u>(1,314,891)</u>	<u>(1,264,993)</u>
Student accounts receivable, net	<u>\$ 192,807</u>	<u>\$ 185,412</u>

5. Contributions Receivable, Net

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

	<u>2020</u>	<u>2019</u>
Contributions receivable, gross	\$ 813,956	\$ 1,429,321
Less unamortized discount	<u>(1,704)</u>	<u>(12,232)</u>
	812,252	1,417,089
Less allowance for doubtful accounts	<u>(40,698)</u>	<u>(71,466)</u>
Contributions receivable, net	<u>\$ 771,554</u>	<u>\$ 1,345,623</u>

The maturity of contributions receivable at May 31, 2020 is as follows:

Less than one year	\$ 745,639
One to five years	<u>68,317</u>
Total contributions receivable, gross	<u>\$ 813,956</u>

At May 31, 2020 and 2019, promises due in one to five years were discounted using interest rates ranging between 2.2 percent and 3 percent. Promises due in less than one year were not discounted. At May 31, 2020, 81 percent of the outstanding balance was due from two donors.

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6. Credit Quality of Student Loans Receivable

The University issues uncollateralized loans to students based on financial need. Student loans were 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, 2020 and 2019, student loans represented 1.2 percent and 1.5 percent of total assets, respectively.

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

	<u>2020</u>	<u>2019</u>
Federal government programs	\$ 2,495,003	\$ 3,068,873
Less allowance for doubtful accounts		
Beginning of year	(211,000)	(211,000)
Change	<u>-</u>	<u>-</u>
End of year	<u>(211,000)</u>	<u>(211,000)</u>
Student loans receivable, net	<u>\$ 2,284,003</u>	<u>\$ 2,857,873</u>

Perkins Loan funds advanced by the Federal government totaled \$2,525,444 and \$3,223,916 at May 31, 2020 and 2019, respectively, are ultimately refundable to the government and are classified as liabilities in the statement of financial position.

The Extension Act amended section 461 of the Higher Education Act to end the University's authority to make new Perkins Loans after June 30, 2018. The University is not required to assign the outstanding Perkins Loans to the Department of Education or liquidate their Perkins Loan Funds due to the wind-down of the Perkins Loan Program. However, the University may choose to liquidate at any time in the future. As of May 31, 2020, the University continues to service the Perkins Loan Program. During the year ended May 31, 2020, the University returned to the government \$649,492 in excess cash and recognized \$110,710 in reimbursement for cancellations, which equally reduced the receivable for Perkins cancellations and the government grants refundable.

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. 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, 2020 and 2019, the following amounts were past due under student loan programs:

	<u>Amounts Past Due</u>			
	<u>1-60 days</u>	<u>60-90 days</u>	<u>90+ days</u>	<u>Total</u>
May 31:				
2020	\$ 2,796	\$ 1,091	\$ 930,317	\$ 934,204
2019	2,884	512	1,001,446	1,004,842

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Notes to Consolidated Financial Statements

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7. Property, Plant and Equipment, Net

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

	<u>2020</u>	<u>2019</u>
Buildings	\$ 77,463,772	\$ 77,066,857
Improvements other than buildings	26,075,976	25,606,137
Software	1,556,981	1,556,981
Equipment	17,037,141	16,824,763
	122,133,870	121,054,738
Less accumulated depreciation	<u>(64,359,588)</u>	<u>(61,503,166)</u>
	57,774,282	59,551,572
Construction in progress	223,578	379,393
Land	29,864,927	22,755,030
Total property, plant and equipment, net	<u>\$ 87,862,787</u>	<u>\$ 82,685,995</u>

8. Bonds Payable, Net and Lines of Credit

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

	<u>2020</u>	<u>2019</u>
City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2011	\$ 7,255,000	\$ 7,655,000
City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas Lutheran University Project), Series 2013	7,725,000	8,290,000
City of Olmos Park, Texas Higher Education Facilities Corporation Higher Education Revenue and Refunding Bonds (Texas Lutheran University Project), Series 2016	9,230,000	9,560,000
Total bonds payable	24,210,000	25,505,000
Debt issuance costs, net of accumulated amortization	<u>(243,536)</u>	<u>(270,663)</u>
Total bonds payable, net	<u>\$ 23,966,464</u>	<u>\$ 25,234,337</u>

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The University has the following bonds outstanding:

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 percent due each March 1 and September 1. Annual principal payments ranging from \$420,000 to \$845,000 are due September 2020 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 percent due each March 1 and September 1. Annual principal payments ranging from \$580,000 to \$610,000 are due September 2020 through September 2022, with a \$5,940,000 balloon payment due September 2023.

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 percent due each March 1 and September 1. Annual principal payments ranging from \$305,000 to \$1,140,000 are due September 2020 through September 2037.

The bond agreements include certain nonfinancial covenants. At May 31, 2020 and 2019, the University was in compliance with those covenants.

Aggregate maturities of bonds and notes payable at May 31:

2021	\$	1,340,000
2022		1,390,000
2023		1,440,000
2024		6,810,000
2025		1,580,000
Thereafter		<u>11,650,000</u>
	\$	<u>24,210,000</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 for the years ended May 31, 2020 and 2019.

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 percent and was 3.50 percent at May 31, 2020. Interest only payments are due monthly. The line of credit matures on March 10, 2021. The outstanding balance was \$1,500,000 and \$3,000,000 for the years ended May 31, 2020 and 2019, respectively.

A \$1,360,655 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 \$12,950,000. The interest rate is at the three month London Interbank Offered Rate plus 2.50 percent and was 4.45 percent at May 31, 2020. Interest only payments are due monthly. The line of credit matures on October 25, 2020. The outstanding balance at May 31, 2020 and 2019 was \$615,803 and \$1,485,588, respectively.

Interest expense was approximately \$1,054,000 and \$1,160,000 for the years ended May 31, 2020 and 2019, respectively. There was no interest expense capitalized for the years ended May 31, 2020 and 2019.

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Notes to Consolidated Financial Statements

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9. Net Assets

Net assets without donor restrictions consist of the following as of May 31:

	<u>2020</u>	<u>2019</u>
Operating	\$ (9,757,951)	\$ (9,485,958)
Invested in property, plant and equipment	63,817,096	56,527,441
Board-designated endowment	18,115,277	18,696,849
	<u>\$ 72,174,422</u>	<u>\$ 65,738,332</u>

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

	<u>2020</u>	<u>2019</u>
Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other support, operating	\$ 2,844,211	\$ 2,762,128
Scholarships, instruction and other support, endowment	6,306,642	9,289,305
Acquisition of buildings and equipment	1,379,816	1,058,601
Split-interest agreements	199,914	198,693
	<u>10,730,583</u>	<u>13,308,727</u>
Donor restricted net assets subject to time or purpose restrictions		
	<u>10,730,583</u>	<u>13,308,727</u>
Pooled endowment	53,095,418	52,016,185
Split-interest agreements	12,960,818	13,166,242
Annuity contracts, contributions receivable and other assets held for endowment	1,778,134	1,912,501
	<u>67,834,370</u>	<u>67,094,928</u>
Donor restricted net assets held in perpetuity		
	<u>67,834,370</u>	<u>67,094,928</u>
Total donor restricted net assets	<u>\$ 78,564,953</u>	<u>\$ 80,403,655</u>

The income generated from donor restricted net assets held in perpetuity is used for scholarships and University operations.

Net assets were released from donor restrictions during the years ended May 31, 2020 and 2019 by incurring expenses satisfying the restricted purpose or by occurrence of events specified by the donor as follows:

	<u>2020</u>	<u>2019</u>
Scholarships, instruction and other support	\$ 4,065,914	\$ 4,421,420
Property, plant and equipment acquired and placed into service	-	652,830
	<u>\$ 4,065,914</u>	<u>\$ 5,074,250</u>

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10. Endowment

The University's endowment consists of approximately 680 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 donor restricted endowment funds are recorded as net assets with donor restrictions 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.

Endowment net asset composition by type of fund consists of the following as of May 31, 2020:

	Without Donor Restrictions	With Donor Restriction			Total Funds May 31, 2020
		Original Gift	Accumulated Gains (Losses)	Total	
Board-designated endowment funds	\$ 18,115,277	\$ -	\$ -	\$ -	\$ 18,115,277
Donor-restricted endowment funds:					
Underwater funds	-	3,682,526	(237,570)	3,444,956	3,444,956
Other funds	-	49,412,892	6,544,212	55,957,104	55,957,104
Total endowment net assets	<u>\$ 18,115,277</u>	<u>\$ 53,095,418</u>	<u>\$ 6,306,642</u>	<u>\$ 59,402,060</u>	<u>\$ 77,517,337</u>

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Endowment net asset composition by type of fund consists of the following as of May 31, 2019:

	Without Donor Restrictions	With Donor Restriction			Total Funds May 31, 2019
		Original Gift	Accumulated Gains (Losses)	Total	
Board-designated endowment funds	\$ 18,696,849	\$ -	\$ -	\$ -	\$ 18,696,849
Donor-restricted endowment funds:					
Underwater funds	-	2,988,209	(148,970)	2,839,239	2,839,239
Other funds	-	49,027,976	9,438,275	58,466,251	58,466,251
Total endowment net assets	\$ 18,696,849	\$ 52,016,185	\$ 9,289,305	\$ 61,305,490	\$ 80,002,339

Changes in endowment net assets for the year ended May 31, 2020 are as follows:

	Without Donor Restrictions	With Donor Restriction			Total Funds May 31, 2020
		Original Gift	Accumulated Gains (Losses)	Total	
Endowment net assets, May 31, 2019	\$ 18,696,849	\$ 52,016,185	\$ 9,289,305	\$ 61,305,490	\$ 80,002,339
Investment return:					
Investment income	293,265	-	1,015,468	1,015,468	1,308,733
Net appreciation (depreciation) - realized and unrealized	246,979	-	(394,807)	(394,807)	(147,828)
Total investment return	540,244	-	620,661	620,661	1,160,905
Additions to endowment	-	1,079,233	-	1,079,233	1,079,233
Appropriation of endowment assets for expenditure	(1,121,816)	-	(3,603,324)	(3,603,324)	(4,725,140)
Endowment net assets, May 31, 2020	\$ 18,115,277	\$ 53,095,418	\$ 6,306,642	\$ 59,402,060	\$ 77,517,337

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Changes in endowment net assets for the year ended May 31, 2019 are as follows:

	Without Donor Restrictions	With Donor Restriction			Total Funds May 31, 2019
		Original Gift	Accumulated Gains (Losses)	Total	
Endowment net assets, May 31, 2018	\$ 22,183,133	\$ 50,685,909	\$ 12,813,433	\$ 63,499,342	\$ 85,682,475
Investment return:					
Investment income	247,673	-	1,345,572	1,345,572	1,593,245
Net depreciation, realized and unrealized	(449,853)	-	(1,193,979)	(1,193,979)	(1,643,832)
Total investment return	(202,180)	-	151,593	151,593	(50,587)
Additions to endowment	-	1,330,276	-	1,330,276	1,330,276
Appropriation of endowment assets for expenditure	(1,284,104)	-	(3,675,721)	(3,675,721)	(4,959,825)
Additional appropriation of endowment assets for expenditure	(2,000,000)	-	-	-	(2,000,000)
Endowment net assets, May 31, 2019	<u>\$ 18,696,849</u>	<u>\$ 52,016,185</u>	<u>\$ 9,289,305</u>	<u>\$ 61,305,490</u>	<u>\$ 80,002,339</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. In accordance with GAAP, deficiencies of this nature that are reported in net assets with donor restrictions. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of new donor restricted contributions and continued appropriation programs that were deemed prudent by the governing board.

Return Objectives and Risk Parameters

The University has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the University must hold in perpetuity or for a donor-specified period(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 percent and 8 percent 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.

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Spending Policy and How the Investment Objectives Relate to Spending Policy

The University has a policy of appropriating for distribution of 6.00 percent and 6.25 percent for each of the years ending in 2020 and 2019, 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 percent to 2 percent 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. During 2019, the Board appropriated an additional \$2,000,000 of board designated endowment funds to pay down the balance of the line of credit.

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 \$683,000 and \$719,000 for the years ended May 31, 2020 and 2019, 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 recorded in the consolidated statement of financial position 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, 2020 and 2019 was \$253,000 and \$279,000, respectively. The University has an aggregate stop-loss limit of \$1,973,000.

12. Leases

The University leases certain equipment under noncancelable operating leases expiring through July 2024 and noncancelable finance leases expiring through March 2022. The weighted-average discount rate used for the year ending May 31, 2020 was 4.86 percent. Total rental expenses approximated \$171,000 and \$241,000 for the years ended May 31, 2020 and 2019, respectively.

Future payments for the years ended May 31, as follows:

	<u>Operating Lease</u>	<u>Finance Lease</u>
2021	\$ 95,080	\$ 133,869
2022	35,324	69,097
2023	26,100	-
2024	26,100	-
2025	13,050	-
	<u>195,654</u>	<u>202,966</u>
Total	195,654	202,966
Less present value discount	<u>(46,178)</u>	<u>(36,391)</u>
Lease liability	<u>\$ 149,476</u>	<u>\$ 166,575</u>

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13. Expenses by Nature and Function

The consolidated financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the University. These expenses include depreciation and amortization, interest, central or administration, communications, media production, information technology and facilities operations and maintenance. Depreciation is allocated base on square footage and interest is allocated based on usage of space. Costs of other categories were allocated on estimates of time and effort.

The following table presents expenses as of May 31, 2020:

	Program Services		Supporting Activities			Total Expenses
	Instruction, Academic Support & Research	Student Services & Auxiliary Enterprises	Institutional Support	Public Service	Fundraising	
Expenses:						
Salaries and wages	\$ 8,663,216	\$ 3,759,493	\$ 3,146,860	\$ 318,307	\$ 541,996	\$ 16,429,872
Employee benefits	2,158,124	924,552	1,167,195	33,311	120,527	4,403,709
Services, supplies and other	1,876,603	5,087,391	1,509,372	278,680	222,501	8,974,547
Occupancy, utilities and maintenance	752,727	796,237	682,876	13,520	9,282	2,254,642
Depreciation and amortization	1,139,863	1,268,560	519,845	12,356	13,341	2,953,965
Interest	15,135	16,844	1,022,000	164	177	1,054,320
Total expenses	<u>\$ 14,605,668</u>	<u>\$ 11,853,077</u>	<u>\$ 8,048,148</u>	<u>\$ 656,338</u>	<u>\$ 907,824</u>	<u>\$ 36,071,055</u>

The following table presents expenses as of May 31, 2019:

	Program Services		Supporting Activities			Total Expenses
	Instruction, Academic Support & Research	Student Services & Auxiliary Enterprises	Institutional Support	Public Service	Fundraising	
Expenses:						
Salaries and wages	\$ 8,889,353	\$ 3,928,657	\$ 3,538,562	\$ 281,708	\$ 590,210	\$ 17,228,490
Employee benefits	2,224,250	1,027,631	1,032,010	33,055	166,358	4,483,304
Services, supplies and other	1,884,230	5,900,331	1,357,109	224,067	402,013	9,767,750
Occupancy, utilities and maintenance	817,408	847,449	669,248	13,593	10,324	2,358,022
Depreciation and amortization	1,250,484	1,410,012	577,811	13,733	14,828	3,266,868
Interest	5,064	5,710	1,149,594	56	60	1,160,484
Total expenses	<u>\$ 15,070,789</u>	<u>\$ 13,119,790</u>	<u>\$ 8,324,334</u>	<u>\$ 566,212</u>	<u>\$ 1,183,793</u>	<u>\$ 38,264,918</u>

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14. Commitments and Contingencies

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, 2020 and 2019.

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 consolidated financial statements.

15. Acquisition

On December 7, 2018, the University obtained majority voting rights on the Board of Directors for the Weston Ranch Foundation. As required by generally accepted accounting principles, the Weston Ranch Foundation was considered to be acquired by the University.

The University did not transfer any consideration as part of the acquisition and recognized an inherent contribution received of \$22,464,386 in the consolidated statement of activities for the year ended May 31, 2019. The following table summarizes the fair value of the assets acquired, at the date of acquisition.

Assets	
Cash and cash equivalents	\$ 28,926
Other receivables	79,077
Investments	2,021,383
Land	<u>20,335,000</u>
Total assets	<u>\$ 22,464,386</u>
Inherent contribution	<u>\$ 22,464,386</u>

16. Subsequent Events

The University has evaluated its consolidated financial statements for subsequent events through October 2, 2020 which is the date the consolidated financial statements were issued.