

# **LUTHER COLLEGE**

Decorah, Iowa

## **CONSOLIDATED FINANCIAL STATEMENTS** Including Independent Auditors' Report

As of and for the Years Ended May 31, 2016 and 2015

# LUTHER COLLEGE

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**INDEPENDENT AUDITORS' REPORT**

To the Board of Regents  
Luther College  
Decorah, Iowa

***Report on the Financial Statements***

We have audited the accompanying consolidated financial statements of Luther College and subsidiary (the "College"), which comprise the consolidated statements of financial position as of May 31, 2016 and 2015, 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 consolidated financial position of Luther College and subsidiary as of May 31, 2016 and 2015, 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 Vichow Krause, LLP*

Minneapolis, Minnesota  
September 27, 2016

# LUTHER COLLEGE

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION As of May 31, 2016 and 2015

<b>ASSETS</b>	2016	2015
Cash and cash equivalents	\$ 19,987,641	\$ 18,348,362
Student accounts receivable, net of allowance for doubtful accounts of \$130,000 in 2016 and \$140,200 in 2015	185,256	220,930
Government grants receivable	114,725	326,085
Contributions receivable, net (Note 5)	5,774,000	6,077,000
Other receivables	943,613	757,962
Inventories	503,977	499,227
Prepaid expenses and other assets	425,250	489,020
Investments		
Short term investments	8,447,463	8,516,521
Marketable securities (Note 6)	10,200,328	10,681,381
Mortgages and contracts receivable	496,001	656,007
Real estate	455,035	1,544,035
Endowment (Note 7)	143,024,000	145,880,652
Beneficial interest in funds held in trust	1,990,487	2,147,977
Cash surrender value of life insurance	5,047,326	4,920,726
Student notes receivable, net (Note 8)	6,119,673	6,307,694
Cash restricted for plant acquisitions	3,876,018	2,741,318
Construction in progress (Note 9)	1,247,863	622,622
Property, plant and equipment, net (Note 10)	82,998,356	87,850,655
<b>TOTAL ASSETS</b>	<b>\$ 291,837,012</b>	<b>\$ 298,588,174</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>LIABILITIES</b>		
Accounts payable	\$ 1,717,175	\$ 2,148,182
Accrued liabilities (Note 11)	10,501,516	11,690,003
Deferred revenue	1,418,743	1,694,432
Asset retirement obligations	2,256,110	2,146,772
Capital lease obligation (Note 12)	692,586	747,295
Interest rate swap liability (Note 14)	2,146,548	2,322,078
Long term debt (Note 13)	29,953,370	31,524,012
Annuities payable	5,299,761	5,711,216
Deposits held in custody for others	425,528	448,358
Government grants refundable	5,205,029	5,266,542
Total Liabilities	59,616,366	63,698,890
<b>NET ASSETS</b>		
Unrestricted (Note 3)	96,524,895	95,851,618
Temporarily restricted (Note 3)	28,725,807	33,223,851
Permanently restricted (Note 3)	106,969,944	105,813,815
Total Net Assets	232,220,646	234,889,284
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 291,837,012</b>	<b>\$ 298,588,174</b>

See accompanying notes to consolidated financial statements.

**LUTHER COLLEGE**

CONSOLIDATED STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2016  
(With Comparative Totals for 2015)

	2016					2015 Total
	Operating	Long-Term Investment	Plant	Subsidiary	Total	
<b>UNRESTRICTED NET ASSETS</b>						
Revenues, Gains and Other Support						
Tuition and fees	\$ 89,751,320	\$ -	\$ -	\$ -	\$ 89,751,320	\$ 88,962,515
Less: Scholarships and grants	(49,135,317)	-	-	-	(49,135,317)	(46,566,964)
Net tuition and fees	40,616,003	-	-	-	40,616,003	42,395,551
Government grants and contracts	1,295,898	-	20,000	-	1,315,898	1,320,143
Private gifts and grants	5,327,440	4,618	159,351	-	5,491,409	5,411,428
Investment income	82,814	-	7,712	1,832	92,358	67,368
Endowment income	-	350,802	-	-	350,802	364,819
Gain (loss) on investments	-	(563,871)	7,710	-	(556,161)	309,053
Spending allowance appropriation	5,997,620	(1,305,389)	-	-	4,692,231	5,058,001
Other sources	2,099,286	-	-	257,552	2,356,838	2,304,405
Sales and services of educational activities	1,073,778	-	-	-	1,073,778	1,474,194
Sales and services of auxiliary enterprises	21,304,935	-	-	-	21,304,935	19,477,499
Gain on swap agreement valuation	-	-	175,530	-	175,530	53,226
Actuarial adjustment	-	37,403	-	-	37,403	91,891
	<u>77,797,774</u>	<u>(1,476,437)</u>	<u>370,303</u>	<u>259,384</u>	<u>76,951,024</u>	<u>78,327,578</u>
Net assets released from restrictions	1,336,487	58,657	136,074	-	1,531,218	1,916,617
Total Revenues, Gains and Other Support	<u>79,134,261</u>	<u>(1,417,780)</u>	<u>506,377</u>	<u>259,384</u>	<u>78,482,242</u>	<u>80,244,195</u>
Expenses						
Program Expenses						
Instruction	27,535,916	-	3,111,614	-	30,647,530	33,532,502
Research	565,432	-	51,947	-	617,379	522,811
Public service	417,618	-	337	-	417,955	390,297
Academic support	3,536,880	-	887,732	-	4,424,612	4,470,111
Student services	12,162,487	-	558,362	-	12,720,849	13,123,293
Auxiliary enterprises	14,545,957	-	2,705,458	-	17,251,415	17,418,346
Support Expenses						
Institutional support	10,986,869	-	394,032	-	11,380,901	11,423,042
Subsidiary	-	-	-	348,324	348,324	347,363
Allocable Expenses						
Operation and maintenance of plant	7,746,747	-	-	-	7,746,747	9,183,653
Depreciation and amortization	-	-	6,348,712	322,060	6,670,772	6,761,994
Accretion	-	-	112,537	-	112,537	107,084
Interest	-	-	1,216,938	24,209	1,241,147	1,380,807
Less: Allocated expenses	(7,746,747)	-	(7,678,187)	(346,269)	(15,771,203)	(17,433,538)
Total Expenses	<u>69,751,159</u>	<u>-</u>	<u>7,709,482</u>	<u>348,324</u>	<u>77,808,965</u>	<u>81,227,765</u>
Change in Unrestricted Net Assets	<u>9,383,102</u>	<u>(1,417,780)</u>	<u>(7,203,105)</u>	<u>(88,940)</u>	<u>673,277</u>	<u>(983,570)</u>

**LUTHER COLLEGE**

CONSOLIDATED STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2016  
(With Comparative Totals for 2015)

	2016					2015 Total
	Operating	Long-Term Investment	Plant	Subsidiary	Total	
<b>TEMPORARILY RESTRICTED NET ASSETS</b>						
Gifts and grants	\$ 1,165,294	\$ -	\$ 1,256,792	\$ -	\$ 2,422,086	\$ 1,274,152
Endowment income	-	1,860,959	-	-	1,860,959	1,937,357
Gain (loss) on investments	-	(3,467,758)	-	-	(3,467,758)	2,108,238
Spending allowance appropriation	336,305	(4,109,385)	-	-	(3,773,080)	(4,122,082)
Actuarial adjustment	-	(24,267)	-	-	(24,267)	(186,130)
Other sources (uses)	(32,505)	-	-	-	(32,505)	(5,060)
Net assets released from restrictions	<u>(1,336,487)</u>	<u>(58,657)</u>	<u>(136,074)</u>	<u>-</u>	<u>(1,531,218)</u>	<u>(1,916,617)</u>
Change in Temporarily Restricted Net Assets Prior to Reclassification	<u>132,607</u>	<u>(5,799,108)</u>	<u>1,120,718</u>	<u>-</u>	<u>(4,545,783)</u>	<u>(910,142)</u>
Reclassification due to change in donor restriction	<u>-</u>	<u>-</u>	<u>47,739</u>	<u>-</u>	<u>47,739</u>	<u>-</u>
Change in Temporarily Restricted Net Assets	<u>132,607</u>	<u>(5,799,108)</u>	<u>1,168,457</u>	<u>-</u>	<u>(4,498,044)</u>	<u>(910,142)</u>
<b>PERMANENTLY RESTRICTED NET ASSETS</b>						
Private gifts	-	3,004,702	-	-	3,004,702	4,702,856
Endowment income	-	367,508	-	-	367,508	391,458
Gain (Loss) on investments	-	(684,824)	-	-	(684,824)	425,986
Spending allowance appropriation	-	(919,151)	-	-	(919,151)	(935,919)
Loss on investments (FHIT)	-	(151,067)	-	-	(151,067)	(66,297)
Actuarial adjustment	-	(413,300)	-	-	(413,300)	(39,453)
Change in Permanently Restricted Net Assets Prior to Reclassification	<u>-</u>	<u>1,203,868</u>	<u>-</u>	<u>-</u>	<u>1,203,868</u>	<u>4,478,631</u>
Reclassification due to change in donor restriction	<u>-</u>	<u>(47,739)</u>	<u>-</u>	<u>-</u>	<u>(47,739)</u>	<u>-</u>
Change in Permanently Restricted Net Assets	<u>-</u>	<u>1,156,129</u>	<u>-</u>	<u>-</u>	<u>1,156,129</u>	<u>4,478,631</u>
<b>TRANSFERS</b>						
Transfer for debt service	(2,751,964)	2,225	2,749,739	-	-	-
Nonmandatory transfers	<u>(6,287,450)</u>	<u>3,155,283</u>	<u>3,132,167</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Transfers	<u>(9,039,414)</u>	<u>3,157,508</u>	<u>5,881,906</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>CHANGE IN NET ASSETS</b>	476,295	(2,903,251)	(152,742)	(88,940)	(2,668,638)	2,584,919
NET ASSETS - Beginning of Year	<u>15,246,053</u>	<u>163,858,845</u>	<u>55,056,954</u>	<u>727,432</u>	<u>234,889,284</u>	<u>232,304,365</u>
<b>NET ASSETS - END OF YEAR</b>	<u>\$ 15,722,348</u>	<u>\$ 160,955,594</u>	<u>\$ 54,904,212</u>	<u>\$ 638,492</u>	<u>\$ 232,220,646</u>	<u>\$ 234,889,284</u>

**LUTHER COLLEGE**

CONSOLIDATED STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2015

	2015				
	Operating	Long-Term Investment	Plant	Subsidiary	Total
<b>UNRESTRICTED NET ASSETS</b>					
Revenues, Gains and Other Support					
Tuition and fees	\$ 88,962,515	\$ -	\$ -	\$ -	\$ 88,962,515
Less: Scholarships and grants	<u>(46,566,964)</u>	-	-	-	<u>(46,566,964)</u>
Net tuition and fees	42,395,551	-	-	-	42,395,551
Government grants and contracts	1,320,143	-	-	-	1,320,143
Private gifts and grants	5,111,246	-	300,182	-	5,411,428
Investment income	63,983	-	1,650	1,735	67,368
Endowment income	-	364,819	-	-	364,819
Gain (loss) on investments	-	349,343	(40,290)	-	309,053
Spending allowance appropriation	5,912,759	(854,758)	-	-	5,058,001
Other sources	2,028,833	-	-	275,572	2,304,405
Sales and services of educational activities	1,474,194	-	-	-	1,474,194
Sales and services of auxiliary enterprises	19,477,499	-	-	-	19,477,499
Gain on swap agreement valuation	-	-	53,226	-	53,226
Actuarial adjustment	-	91,891	-	-	91,891
	<u>77,784,208</u>	<u>(48,705)</u>	<u>314,768</u>	<u>277,307</u>	<u>78,327,578</u>
Net assets released from restrictions	1,198,506	272,897	445,214	-	1,916,617
Total Revenues, Gains and Other Support	<u>78,982,714</u>	<u>224,192</u>	<u>759,982</u>	<u>277,307</u>	<u>80,244,195</u>
Expenses					
Program Expenses					
Instruction	30,252,502	-	3,280,000	-	33,532,502
Research	470,864	-	51,947	-	522,811
Public service	389,996	-	301	-	390,297
Academic support	3,604,112	-	865,999	-	4,470,111
Student services	12,570,242	-	553,051	-	13,123,293
Auxiliary enterprises	14,574,980	-	2,843,366	-	17,418,346
Support Expenses					
Institutional support	11,014,097	-	408,945	-	11,423,042
Subsidiary	-	-	-	347,363	347,363
Allocable Expenses					
Operation and maintenance of plant	9,183,653	-	-	-	9,183,653
Depreciation and amortization	-	-	6,439,934	322,060	6,761,994
Accretion	-	-	107,084	-	107,084
Interest	-	-	1,347,198	33,609	1,380,807
Less: Allocated expenses	<u>(9,183,653)</u>	-	<u>(7,894,216)</u>	<u>(355,669)</u>	<u>(17,433,538)</u>
Total Expenses	<u>72,876,793</u>	<u>-</u>	<u>8,003,609</u>	<u>347,363</u>	<u>81,227,765</u>
Change in Unrestricted Net Assets	<u>6,105,921</u>	<u>224,192</u>	<u>(7,243,627)</u>	<u>(70,056)</u>	<u>(983,570)</u>

**LUTHER COLLEGE**

CONSOLIDATED STATEMENT OF ACTIVITIES  
For the Year Ended May 31, 2015

	2015				
	Operating	Long-Term Investment	Plant	Subsidiary	Total
<b>TEMPORARILY RESTRICTED NET ASSETS</b>					
Gifts and grants	\$ 803,327	\$ -	\$ 470,825	\$ -	\$ 1,274,152
Endowment income	-	1,937,357	-	-	1,937,357
Gain on investments	-	2,108,238	-	-	2,108,238
Spending allowance appropriation	339,266	(4,461,348)	-	-	(4,122,082)
Actuarial adjustment	-	(186,130)	-	-	(186,130)
Other sources	(5,060)	-	-	-	(5,060)
Net assets released from restrictions	<u>(1,198,506)</u>	<u>(272,897)</u>	<u>(445,214)</u>	<u>-</u>	<u>(1,916,617)</u>
Change in Temporarily Restricted Net Assets	<u>(60,973)</u>	<u>(874,780)</u>	<u>25,611</u>	<u>-</u>	<u>(910,142)</u>
<b>PERMANENTLY RESTRICTED NET ASSETS</b>					
Private gifts	-	4,702,856	-	-	4,702,856
Endowment income	-	391,458	-	-	391,458
Gain on investments	-	425,986	-	-	425,986
Spending allowance appropriation	-	(935,919)	-	-	(935,919)
Loss on investments (FHIT)	-	(66,297)	-	-	(66,297)
Actuarial adjustment	-	(39,453)	-	-	(39,453)
Change in Permanently Restricted Net Assets	<u>-</u>	<u>4,478,631</u>	<u>-</u>	<u>-</u>	<u>4,478,631</u>
<b>TRANSFERS</b>					
Transfer for debt service	(2,755,370)	(414,760)	3,170,130	-	-
Nonmandatory transfers	<u>(2,683,844)</u>	<u>793,716</u>	<u>1,890,128</u>	<u>-</u>	<u>-</u>
Total Transfers	<u>(5,439,214)</u>	<u>378,956</u>	<u>5,060,258</u>	<u>-</u>	<u>-</u>
<b>CHANGE IN NET ASSETS</b>	605,734	4,206,999	(2,157,758)	(70,056)	2,584,919
NET ASSETS - Beginning of Year	<u>14,640,319</u>	<u>159,651,846</u>	<u>57,214,712</u>	<u>797,488</u>	<u>232,304,365</u>
<b>NET ASSETS - END OF YEAR</b>	<u>\$ 15,246,053</u>	<u>\$ 163,858,845</u>	<u>\$ 55,056,954</u>	<u>\$ 727,432</u>	<u>\$ 234,889,284</u>

LUTHER COLLEGE

CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Years Ended May 31, 2016 and 2015

	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ (2,668,638)	\$ 2,584,919
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation, amortization, and accretion	6,783,309	6,869,078
Loss on disposal of property	31,295	3,320
Gain on interest rate swap valuation	(175,530)	(53,226)
(Gain) Loss on investments, net	5,612,634	(2,649,319)
Decrease (Increase) in beneficial interest in funds held in trust	157,490	39,482
Noncash contributions of investment assets	-	(1,089,000)
Actuarial adjustment of annuities payable	(230,921)	(316,430)
Loan cancellations, reinstatements and write-offs	98,574	94,522
Change in allowance on student notes receivable	(5,200)	17,900
Changes in assets and liabilities		
Receivables	35,674	(27,953)
Contributions receivable for operations	90,000	419,000
Accrued interest, grants and other receivables	25,709	(255,524)
Prepaid expenses, inventories, and other assets	(67,580)	(565,660)
Accounts payable and accrued liabilities	(1,298,682)	898,202
Deferred revenue and deposits held for others	(298,519)	(181,446)
Asset retirement obligation	(3,199)	(36,420)
Contributions restricted for loans, long-term investment and plant	(4,445,464)	(5,473,864)
Investment income restricted for reinvestment	(367,508)	(391,458)
Cash Flows from Operating Activities	<u>3,273,444</u>	<u>(113,877)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of investments	(27,954,812)	(47,275,410)
Sales of investments	26,837,941	44,301,085
Decrease in mortgages and contracts receivable, net of repayments	160,006	40,026
Purchases of property, plant and equipment	(2,783,445)	(1,926,455)
Disbursements of loans to students	(965,132)	(825,088)
Repayments of loans from students	1,059,779	1,087,880
Cash Flows from Investing Activities	<u>(3,645,663)</u>	<u>(4,597,962)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments of principal on indebtedness	(1,583,018)	(2,035,683)
Payments on capital lease obligations	(54,709)	(52,775)
Receipt of investment income restricted for reinvestment	367,508	391,458
Contributions and grants received restricted for loans, long-term investment and plant	4,658,464	4,909,864
Increase in cash held for plant acquisitions	(1,134,700)	(1,423,777)
Decrease in government grants refundable	(61,513)	(78,570)
Proceeds from issuance of split-interest agreements	12,000	1,123,000
Payments to annuitants	(192,534)	(207,100)
Cash Flows from Financing Activities	<u>2,011,498</u>	<u>2,626,417</u>
<b>Change in Cash and Cash Equivalents</b>	1,639,279	(2,085,422)
CASH AND CASH EQUIVALENTS - Beginning of year	<u>18,348,362</u>	<u>20,433,784</u>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<u>\$ 19,987,641</u>	<u>\$ 18,348,362</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Interest paid, net of capitalized amounts of \$28,900 in 2016 and \$25,400 in 2015	\$ 1,249,799	\$ 1,402,315
Payments on swap settlements	701,699	748,368
<b>NONCASH INVESTMENT AND FINANCING ACTIVITIES</b>		
Property, plant and equipment acquired through accounts payable	133,267	454,079
Noncash contribution of land	-	69,000
Proceeds received from bond issuances	-	8,704,181
Bond proceeds used to refinance Series 1998B Bonds	-	(1,836,650)
Bond proceeds used to refinance Series 2010 Bonds	-	(6,847,826)
Bond proceeds used to pay bond issuance costs	-	(19,705)

See accompanying notes to consolidated financial statements.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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Luther College is an institution of higher education affiliated with the Evangelical Lutheran Church in America. The accounting policies of the College reflect practices common to universities and colleges and conform to accounting principles generally accepted in the United States of America. The more significant accounting policies are summarized below:

**Consolidation** – The consolidated financial statements include the accounts of Luther College and Luther College Ventures, Inc. (collectively referred to as the “College”). Luther College owns 100% interest in Luther College Ventures, Inc. Luther College Ventures, Inc. was formed on November 3, 2010 and is the sole member of Luther College Wind Energy Project, LLC. Luther College Wind Energy Project, LLC was formed on July 13, 2005 to construct a wind turbine. The wind turbine was placed in service on October 31, 2011. All material transactions and balances between the entities have been eliminated in the consolidated financial statements.

**Net Asset Classifications** – For purposes of financial reporting, the College classifies resources into three net asset categories pursuant to any donor-imposed restrictions and applicable law. Accordingly, the net assets of the College 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 College. Generally, the donors of these assets permit the College 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 College and/or the passage of time.

**Unrestricted Net Assets** – Net assets not subject to donor-imposed stipulations.

Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Investment income received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class. In all other cases, income earned on donor restricted funds is initially classified as temporarily restricted net assets and is reclassified as unrestricted net assets when expenses are incurred for their intended purpose. Expenses are reported as decreases 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. 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 reclassification between the applicable classes of net assets. However, contributions received with donor-imposed restrictions that are met in the same year as received are initially reported as revenues of the unrestricted net asset class. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. The College had conditional promises to give of \$1,200,000 and \$2,175,000 at May 31, 2016 and 2015, respectively.

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.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

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**Net Asset Classifications** (cont.) – 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.

Gains and losses on investments of endowment funds created by a board designation of unrestricted funds are included in changes in unrestricted net assets.

**Cash Equivalents** – The College considers all highly liquid investments, except for those held for plant and long-term investments, with a maturity of three months or less when purchased to be cash equivalents. Certain cash held by the College is restricted for the Perkins Loan Fund.

**Student Accounts Receivable and Other Receivables** – Student accounts receivable are carried at the unpaid balance of the original amount billed to students less an estimate made for doubtful accounts which is based on a review of all outstanding amounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Student accounts are written off when deemed uncollectible. Recoveries of student accounts previously written off are recorded when received. Receivables are generally unsecured. Other receivables include campus charges due from employees of \$6,882 and \$5,128 at May 31, 2016 and 2015, respectively.

**Inventories** – All inventories are valued at cost.

**Deferred Debt Acquisition Costs** – Costs of debt issuance are deferred and amortized over the term of the related indebtedness. The unamortized balance is included as a reduction to long-term debt on the statement of financial position.

**Physical Plant and Equipment** – Physical plant assets are stated at cost at the date of acquisition less accumulated depreciation. The College depreciates its assets on the straight-line basis over estimated useful lives as follows: buildings – 30 years; improvements – 15 years; equipment and library books – 10 years; computer and vehicles – 4 years. Normal repair and maintenance expenses are charged to operations as incurred. The College capitalizes physical plant additions in excess of \$5,000.

**Deferred Revenue** – Certain revenue related to summer courses and programs is deferred and recognized as revenue in the same period expenses are recognized. Students are generally billed for courses and programs prior to the start of the course or program.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

**Asset Retirement Obligations** – The College 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 College reviews its estimates annually and adjusts the recorded liability as needed.

Substantially all of the College'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 College's long-lived assets combined with an estimate of the current market prices to remove the asbestos. The College 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, 2016 and 2015 are as follows:

	2016	2015
Balance, Beginning of the year	\$ 2,146,772	\$ 2,076,108
Abatements	(3,199)	(36,420)
Accretion expense	112,537	107,084
Balance, End of the year	\$ 2,256,110	\$ 2,146,772

**Grants to Specified Students** – Amounts received from state and federal agencies designated for the benefit of specified students are considered agency transactions and, therefore, are not reflected as revenues and expenses of the College.

**Government Grants Refundable** – 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.

**Tuition and Fees and Auxiliary 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.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

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**Fund-Raising and Advertising Expenses** – Fund-raising expenses totaled approximately \$2,439,000 and \$2,503,000 for the years ended May 31, 2016 and 2015, respectively. Advertising expenses totaled approximately \$612,000 and \$622,000 for the years ended May 31, 2016 and 2015, respectively. Advertising costs are expensed when incurred.

**Functional Allocation of Expenses** – The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain expenses have been allocated among the programs and supporting services benefited.

**Income Tax Status** – The Internal Revenue Service has determined that the College is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The College is also exempt from state income tax. However, any unrelated business income may be subject to taxation. Luther College Ventures, Inc. is organized as a C corporation pursuant to the provisions of the Internal Revenue code. As of May 31, 2016, Luther College Ventures, Inc. had recorded tax deductions, principally depreciation, in excess of financial statement expenses. Income tax benefits of \$80,000 in 2016 and \$70,000 in 2015 are included in the subsidiaries institutional support expenses. No tax expense was required for other College operations.

The College 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 College for uncertain tax positions as of May 31, 2016 and 2015. The College's tax returns are subject to review and examination by federal and state authorities.

**Impairment of Long-Lived Assets** – The College reviews long-lived assets, including property and equipment and intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be fully recoverable. An impairment loss would be recognized when the estimated future cash flows from the use of the asset are less than the carrying amount of that asset. To date, there have been no such losses.

**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.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

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**New 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. For all other entities, the ASU is effective date for fiscal years beginning after December 15, 2018. Early application is permitted for all entities for fiscal years beginning after December 15, 2016. The College is assessing the impact this new standard will have on its financial statements.

In May 2015, FASB issued ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. Under the new guidance, investments measured at net asset value, as a practical expedient for fair value, are excluded from the fair value hierarchy disclosure requirements. For non-public business entities, ASU 2015-07 is effective for fiscal years beginning after December 15, 2016 with early application permitted. The College elected to adopt the guidance in fiscal 2016. ASU 2015-07 is to be applied retrospectively, and as a result, the guidance was retrospectively applied to fiscal 2015. The adoption of the standard did not have a significant impact on the College’s statement of financial position or results of operations.

In January 2016, FASB issued ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This new guidance is intended to improve the recognition and measurement of financial instruments and eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for Institutions that are not public business entities. For non-public business entities, ASU 2016-01 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted for fiscal years beginning after December 15, 2017. However, the new guidance permits entities that are not public business entities to adopt upon issuance the provision that eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost. The College elected to adopt this provision in fiscal 2016. ASU 2016-01 is to be applied by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption of ASU 2016-01. The College is assessing the impact the remainder of 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, with early adoption permitted. ASU 2016-14 is to be applied retroactively with transition provisions. The College is assessing the impact this standard will have on its financial statements.

**Reclassifications** – Certain amounts appearing in the 2015 financial statements have been reclassified to conform with the 2016 presentation. The reclassifications have no effect on the reported amounts of total net assets or change in total net assets.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 2 - FAIR VALUE OF FINANCIAL INSTRUMENTS

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**Fair Value Hierarchy** – Fair value is defined in the accounting guidance as the exchange price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the assets or liability in an orderly transaction between market participants at the measurement date. Under this guidance, a three-level hierarchy is used for fair value measurements which is based on the transparency of information, such as the pricing source, used in the valuation of an asset or liability as of the measurement date.

Financial instruments measured and reported at fair value are classified and disclosed in one of the following three categories. There have been no changes in the techniques and inputs used at May 31, 2016 and 2015.

- 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 inputs.
- 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.

#### **(a) Assets**

- Level 1 - Level 1 assets include investments in publicly traded domestic and international mutual funds.
- Level 3 - Level 3 assets include beneficial interest in funds held in trust by others as 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). Since the College has an irrevocable right to receive the income earned from the trust's assets, the fair value of the College's beneficial interest is estimated to approximate the fair value of the trusts' assets.

#### **(b) Liabilities**

- Level 2 - Level 2 liabilities include interest rate exchange agreements as the fair value is based on observable inputs to a valuation model (interest rates, credit spreads, etc.) which take into account the present value of the estimated future cash flows and credit valuation adjustments.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 2 - FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Certain fixed income securities and alternative investments are measured at fair value using the net asset value (NAV) per share (or its equivalent) of such investment funds as a practical expedient for fair value. The College has estimated the fair value of these funds by using the net asset value provided by the investee. The College adopted ASU 2015-07, *Disclosures for Investment in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, during the year ended May 31, 2016. Under the new guidance, investments measured using the net asset value per share (or its equivalent) practical expedient are not classified in the fair value hierarchy.

Except for the implementation of ASU 2015-7, there have been no changes in the techniques and inputs used as of May 31, 2016 and 2015.

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 College believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table summarizes financial instruments measured at fair value on a recurring basis by the fair value hierarchy as of May 31, 2016:

	Total	Level 1	Level 2	Level 3
<b>ASSETS</b>				
Mutual funds				
U.S. equity funds	\$ 42,959,871	\$ 42,959,871	\$ -	\$ -
Non-U.S. equity funds	35,392,757	35,392,757	-	-
U.S. fixed income funds	17,534,380	17,534,380	-	-
Non-U.S. fixed income funds	2,722,820	2,722,820	-	-
Beneficial interest in funds held in trust	1,990,487	-	-	1,990,487
Subtotal assets by valuation hierarchy	100,600,315	\$ 98,609,828	\$ -	\$ 1,990,487
Investments measured using NAV				
Fixed income securities	15,867,636			
Alternative investments				
Hedge funds	3,695,791			
Private equity funds	6,093,284			
Real estate partnerships	631,988			
Real estate funds (REIT)	136,725			
Funds of funds	12,655,275			
Partnerships, real assets	3,376,662			
Subtotal assets by NAV	42,457,361			
Total assets at fair value	\$ 143,057,676			
<b>LIABILITIES</b>				
Interest rate exchange agreements	\$ 2,146,548	\$ -	\$ 2,146,548	\$ -

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### **NOTE 2 - FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)**

The following table summarizes financial instruments measured at fair value on a recurring basis by the fair value hierarchy as of May 31, 2015:

	Total	Level 1	Level 2	Level 3
<b>ASSETS</b>				
Mutual funds				
U.S. equity funds	\$ 42,864,445	\$ 42,864,445	\$ -	\$ -
Non-U.S. equity funds	39,865,616	39,865,616	-	-
U.S. fixed income funds	17,809,450	17,809,450	-	-
Non-U.S. fixed income funds	2,245,689	2,245,689	-	-
Beneficial interest in funds held in trust	2,147,977	-	-	2,147,977
Subtotal assets by valuation hierarchy	104,933,177	\$ 102,785,200	\$ -	\$ 2,147,977
Investments measured using NAV				
Fixed income securities	15,514,145			
Alternative investments				
Hedge funds	2,854,801			
Private equity funds	5,949,524			
Real estate partnerships	576,541			
Real estate funds (REIT)	745,867			
Funds of funds	13,339,517			
Partnerships, real assets	3,517,277			
Subtotal assets by NAV	42,497,672			
Total assets at fair value	\$ 147,430,849			
<b>LIABILITIES</b>				
Interest rate exchange agreements	\$ 2,322,078	\$ -	\$ 2,322,078	\$ -

## LUTHER COLLEGE

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

#### **NOTE 2 - FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)**

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, 2016.

	<u>Balances May 31, 2015</u>	<u>Net realized and unrealized losses included in change in net assets</u>	<u>Purchases</u>	<u>Sales</u>	<u>Net transfers in (out) of Level 3</u>	<u>Balances May 31, 2016</u>
Beneficial interest in funds held in trust	\$ 2,147,977	\$ (157,490)	\$ -	\$ -	\$ -	\$ 1,990,487

The amount of total loss for the periods included in change in net assets attributable to the change in unrealized gains relating to financial instruments still held at May 31, 2016. \$ (157,490)

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, 2015.

	<u>Balances May 31, 2014</u>	<u>Net realized and unrealized losses included in change in net assets</u>	<u>Purchases</u>	<u>Sales</u>	<u>Net transfers in (out) of Level 3</u>	<u>Balances May 31, 2015</u>
Beneficial interest in funds held in trust	\$ 2,187,460	\$ (64,190)	\$ 27,007	\$ (2,300)	-	\$ 2,147,977

The amount of total loss for the periods included in change in net assets attributable to the change in unrealized gains relating to financial instruments still held at May 31, 2015. \$ (64,190)

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 2 - FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

The College's interests in many of its partnership investments represent commitments that are not subject to redemption; instead the College is a limited partner in funds that invest in private companies or properties, or pursue specific investment strategies. The nature of these investments is that distributions are received through the liquidation of the underlying assets of the partnership. The "NAV" reported by each fund is used as a "practical expedient" to estimate the fair value of the College's interest therein, unless management has deemed the "NAV" to be an inappropriate representation of the fair value under the College's valuation policy.

A summary of the significant categories of such investments and their attributes is as follows:

	Private Equity Funds	Real Assets	Hedge Funds and Funds of Funds	Fixed Income Securities
Fair value, May 31, 2016	\$6,093,284	\$4,145,375	\$16,351,066	\$15,867,636
Significant Investment Strategy	Venture and buyout, secondaries and in special situations the U.S. and internationally	Real estate and natural resources, primarily in the U.S.	Absolute return including multi-strategy, long/short equity, long/short credit, global macro, special situations and short credit	Global sovereign bonds, US floating rate bonds, and U.S. Broad core bonds
Remaining Life	0 to 13 years	0 to 13 years	N.A.	N.A.
Dollar Amount of Unfunded Commitments	\$3,521,895	\$2,500,811	None	None
Timing to Draw Down Commitments	0 to 13 years	0 to 13 years	N.A.	N.A.
Redemption Terms	N.A.	Quarterly for two funds, N.A. for others	Monthly, quarterly, and yearly	Monthly and daily
Redemption Restrictions	N.A.	None	Ranges between quarterly with 35 days notice, calendar year end with 100 days notice and monthly with 45 days notice	Ranges between none and monthly with 10 days notice and monthly with 60 days notice
Redemption Restrictions in Place at Year End	N.A.	Two funds currently being redeemed	None	None

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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

At May 31, 2016 and 2015, the College's unrestricted net assets were allocated as follows:

	2016	2015
Operations	\$ 7,411,454	\$ 7,068,337
Long-term investment (board designated endowment funds less underwater donor restricted endowment funds)	29,233,464	27,468,974
Annuity, life income and similar funds	1,669,859	1,646,882
Loans to students	2,313,712	2,313,141
Replacement of plant facilities	4,656,670	3,410,836
Net investment in plant	51,239,736	53,943,448
 Totals	 \$ 96,524,895	 \$ 95,851,618

Temporarily restricted net assets consist of the following at May 31, 2016 and 2015:

Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other support – Operating	\$ 1,752,350	\$ 1,586,238
Scholarships, instruction and other support – Endowment	22,124,433	27,840,617
Acquisition of buildings and equipment	1,898,557	730,100
	25,775,340	30,156,955
Annuity, life income and similar funds	969,641	1,046,141
Beneficial interest in funds held in trust	35,994	42,417
Loans to students	408,832	441,338
Contributions receivable	1,536,000	1,537,000
 Totals	 \$ 28,725,807	 \$ 33,223,851

Permanently restricted net assets consist of the following at May 31, 2016 and 2015:

Endowment funds	\$ 95,127,633	\$ 92,178,921
Beneficial interest in funds held in trust - Endowment	1,446,591	1,543,537
Contributions receivable	2,417,000	3,109,000
	98,991,224	96,831,458
Beneficial interest in funds held in trust - Deferred Gifts	507,902	562,023
Annuity, life income and similar funds	7,470,818	8,420,334
 Totals	 \$ 106,969,944	 \$ 105,813,815

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 4 - NET ASSETS RELEASED FROM RESTRICTIONS

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Net assets were released from temporary donor restrictions during the years ended May 31, 2016 and 2015 by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors as follows:

	<u>2016</u>	<u>2015</u>
Scholarships, instruction and other departmental support	\$ 1,336,487	\$ 1,198,506
Matured deferred gifts	58,657	272,897
Acquisition of land, building, and equipment	<u>136,074</u>	<u>445,214</u>
Totals	<u>\$ 1,531,218</u>	<u>\$ 1,916,617</u>

These assets were reclassified to unrestricted net assets.

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### NOTE 5 - CONTRIBUTIONS RECEIVABLE

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Contributions receivable include the following unconditional promises to give at May 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Unrestricted – completed plant projects	\$ 1,763,000	\$ 1,858,000
Temporarily restricted – operations	1,701,000	1,669,000
Temporarily restricted – plant projects	741,000	217,000
Permanently restricted – endowment	<u>2,657,000</u>	<u>3,388,000</u>
Gross unconditional promises to give	6,862,000	7,132,000
Less: Unamortized discount	(345,000)	(296,000)
Less: Allowance for uncollectible accounts	<u>(743,000)</u>	<u>(759,000)</u>
Net unconditional promises to give	<u>\$ 5,774,000</u>	<u>\$ 6,077,000</u>
Amounts due in:		
Less than one year	\$ 2,147,000	
One to five years	<u>3,627,000</u>	
Totals	<u>\$ 5,774,000</u>	

At May 31, 2016 and 2015, respectively, promises due in one to five years were discounted using historical interest rates ranging between 1.67% and 6.0%. Promises due in less than one year were not discounted.

Net unconditional promises to give at May 31, 2016 and 2015 include \$761,000 and \$959,000, respectively, due from Cabinet members and Board members. The College received total contributions from board members and officers of \$537,000 and \$809,000, respectively, for the years ended May 31, 2016 and 2015.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 6 - MARKETABLE SECURITIES

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The following summarizes the College's marketable securities in funds other than endowment at May 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Equity securities	\$ 500	\$ -
Mutual funds	<u>10,199,828</u>	<u>10,681,381</u>
Totals	<u>\$ 10,200,328</u>	<u>\$ 10,681,381</u>

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### NOTE 7 - ENDOWMENT INVESTMENTS

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The following summarizes the College's endowment investments at May 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Cash and short-term investments	\$ 12,142,865	\$ 11,204,368
Equity securities	14,268	-
Fixed income securities	15,867,637	15,509,068
Mutual / Commingled funds	88,409,500	92,108,897
Real estate, at cost	6	74,792
Alternative investments	<u>26,589,724</u>	<u>26,983,527</u>
Totals	<u>\$ 143,024,000</u>	<u>\$ 145,880,652</u>

Through the College's alternative investments, the College is indirectly involved in investment activities such as securities lending, trading in futures, forward contracts and other derivative products. Derivatives are used to adjust portfolio risk exposure. While these instruments may contain varying degrees of risk, the College's risk with respect to such transactions is limited to its respective share in each investment pool.

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.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### **NOTE 8 - CREDIT QUALITY OF STUDENT LOAN RECEIVABLES**

The College issues uncollateralized loans to students based on financial need. Student loans are funded through federal government loan programs or institutional resources. Student loans receivable are carried at the amount of unpaid principal less an estimate for doubtful accounts. Allowances for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. At May 31, 2016 and 2015, student loans represented 2.10% and 2.11% of total assets, respectively.

At May 31, 2016 and 2015, student loans consisted of the following:

	2016	2015
Federal government programs	\$ 5,993,024	\$ 6,011,792
Institutional programs	592,449	766,902
	6,585,473	6,778,694
Less allowance for doubtful accounts		
Beginning of year	(471,000)	(453,100)
Increases	(37,849)	(19,919)
Write-offs	43,049	2,019
End of year	(465,800)	(471,000)
Student loans receivable, net	\$ 6,119,673	\$ 6,307,694

Funds advanced by the federal government of \$5,205,029 and \$5,266,542 at May 31, 2016 and 2015, 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, 2016 and 2015, the following amounts were past due under student loan programs:

<u>May 31</u>	Amounts Past Due			
	1-59 days	60-89 days	90+ days	Total
2016	\$ 87,739	\$ 93,162	\$ 663,770	\$ 844,671
2015	96,673	119,508	677,108	893,289

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 9 - CONSTRUCTION IN PROGRESS

At May 31, 2016, the following construction projects were in progress:

	Estimated Total Cost	Cost To Date	Funding Source
Dike Road upgrade	\$ 1,195,000	\$ 18,411	Operations
Facility planning	undetermined	88,499	Operations and gifts
IT server upgrade	200,000	164,483	Operations
Farwell hall HVAC	1,325,000	845,400	Operations
Main renovation	12,000,000	41,267	Operations
Softball stadium	325,000	12,631	Operations and gifts
Baseball stadium	380,000	53,656	Operations and gifts
Larsen parking lot	347,000	23,516	Operations
Totals	\$ 15,772,000	\$ 1,247,863	

Outstanding commitments on construction contracts totaled \$1,324,000 at May 31, 2016.

### NOTE 10 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following as of May 31, 2016 and 2015:

	2016	2015
Land	\$ 663,581	\$ 663,581
Buildings	139,213,889	138,635,053
Improvements other than buildings	11,756,748	11,756,748
Wind turbine	3,237,495	3,237,495
Equipment and library books	34,704,746	33,812,920
Equipment under capital lease	888,866	888,866
	190,465,325	188,994,663
Less: Accumulated depreciation	(107,466,969)	(101,144,008)
Totals	\$ 82,998,356	\$ 87,850,655

### NOTE 11 - ACCRUED LIABILITIES

Accrued liabilities consisted of the following as of May 31, 2016 and 2015:

	2016	2015
Payroll	\$ 5,892,370	\$ 6,223,131
Post-retirement benefit obligation	3,093,274	3,876,834
Subsidiary tax liability	80,000	160,000
Interest	114,602	123,254
Other	1,321,270	1,306,784
Totals	\$ 10,501,516	\$ 11,690,003

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 12 - CAPITAL LEASE OBLIGATIONS

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The College entered into one capital lease for a solar panel array during the year ended May 31, 2013.

Capitalized cost and accumulated amortization for the equipment is as follows at May 31, 2016:

Leased equipment	\$ 888,866
Less: Accumulated amortization	<u>(355,546)</u>
Net	<u>\$ 533,320</u>

The following is a schedule of future minimum lease payments under the capital lease together with the present value of the minimum lease payments as of May 31, 2016:

Year Ending May 31:	
2017	\$ 80,715
2018	80,715
2019	80,715
2020	46,722
2021	36,500
2022 – 2039	<u>628,938</u>
Total minimum lease payments	954,305
Less: Amount representing interest	<u>(261,719)</u>
Present value of minimum lease payments	<u>\$ 692,586</u>

Amortization expense is included with depreciation expense in the financial statements.

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### NOTE 13 - LONG TERM DEBT

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Long term debt outstanding at May 31, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 2011	\$ 21,530,000	\$ 22,205,000
Decorah Bank & Trust Company loan payable	162,028	200,918
Decorah Bank & Trust Company loan payable	559,421	654,355
First Citizens National Bank loan payable	1,204,696	1,651,842
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 2015	<u>6,540,483</u>	<u>6,867,531</u>
Principal outstanding on bonds	29,996,628	31,579,646
Deferred debt acquisition costs, net	<u>(43,258)</u>	<u>(55,634)</u>
Total Long Term Debt	<u>\$ 29,953,370</u>	<u>\$ 31,524,012</u>

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 13 - LONG TERM DEBT (cont.)

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In December 2011, the Iowa Higher Education Loan Authority Revenue Bonds, Series 2011, in the amount of \$24,065,000 were issued on behalf of the College. The proceeds were used to pay off Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2002 in the amount of \$13,065,000 and Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2008 in the amount of \$11,000,000. The bonds are unsecured. The interest rate is variable and at May 31, 2016 was 1.323712%. The Series 2011 Bonds mature annually in amounts from \$700,000 to \$1,205,000 from 2017 through 2039. The loan agreement requires that certain covenants be maintained. As of May 31, 2016, the College is in compliance with these covenants.

In July 2011, Luther College Wind Energy Project, LLC entered into an agreement with Decorah Bank & Trust Company through the Iowa Alternate Energy Revolving Loan Program. The proceeds in the amount of \$350,000 were used to finance the construction of a wind turbine. The loan is interest free and monthly payments of \$3,241 are due until final maturity on July 27, 2020. The loan is unsecured.

In November 2011, Luther College Wind Energy Project, LLC entered into an agreement with Decorah Bank & Trust Company in the amount of \$928,200. The proceeds were used to finance the construction of a wind turbine. In February 2015 the interest rate was reduced from 5.125% to 3.875% and is fixed until maturity. Monthly payments of \$9,936, including principal and interest, are due until August 2021. The loan agreement requires that certain covenants be maintained. As of May 31, 2016, the College is in compliance with these covenants. The loan is secured by the equipment purchased with the loan proceeds.

In January 2015, the City of Decorah, Iowa sold its Private College Facility Revenue Refunding Bonds, Series 2015, in the amount of \$6,868,000. The proceeds from the sale of the bonds were loaned to the College and were used to pay off the City of Decorah, Iowa Private College Facility Revenue Bonds, Series 2010 in the amount of \$6,847,826 and pay the costs of issuance of the bonds. The bonds are unsecured. The interest rate on the proceeds is 3.29% and is fixed until June 30, 2030. Annual principal payments will be \$327,025. The bonds have a maturity date of June 30, 2035 with an optional put date of June 30, 2030. The loan agreement requires that certain covenants be maintained. As of May 31, 2016, the College is in compliance with these covenants.

In January 2015, Luther College entered into an agreement with First Citizens National Bank in the amount of \$1,836,650. The proceeds were used to pay off the City of Decorah, Iowa Private Facility Revenue Bonds, Series 1998B. The interest rate is 2.3% and is fixed until final maturity on December 31, 2018. Monthly payments of \$40,082, including principal and interest, are due until final maturity. The loan is unsecured. The loan agreement requires that certain covenants be maintained. As of May 31, 2016, the College is in compliance with these covenants.

In order to minimize the effect of changes in the interest rate, the College has entered into interest rate swap contracts. The interest rate swap contracts are disclosed in Note 14.

Total interest expense amounted to \$1,241,147 and \$1,380,807 for the years ended May 31, 2016 and 2015, respectively. Interest totaling \$28,900 and \$25,400 was capitalized for the years ended May 31, 2016 and 2015, respectively.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 13 - LONG TERM DEBT (cont.)

Anticipated principal payments on long-term debt are as follows:

Year Ending May 31:		
2017	\$	1,622,701
2018		1,662,452
2019		1,521,422
2020		1,272,292
2021		1,269,340
Thereafter		<u>22,648,421</u>
Total	\$	<u>29,996,628</u>

### NOTE 14 - DERIVATIVES

The College uses interest rate exchange agreements as part of its risk management strategy to manage exposure to fluctuations in interest rates and to manage the overall cost of its debt. Interest rate exchange agreements are used to manage identified and approved exposures and are not used for speculative purposes. The interest rate exchange agreements are recognized as either assets or liabilities on the statements of financial position and are measured at fair value. Interest rate exchange agreements are often held for the life of the strategy, but may reflect significant interim unrealized gains or losses depending on the change in value since the inception of the contract. All unrealized and realized gains and losses from the interest rate exchange agreements are reflected in the statements of activities.

Interest rate exchange agreements between the College and a third party (counterparty) provide for periodic exchange of payments between the parties based on changes in a defined index and a fixed rate and include counterparty credit risk. Counterparty credit risk is the risk that contractual obligations of the counterparties will not be fulfilled. Concentrations of credit risk relate to groups of counterparties that have similar economic or industry characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. Counterparty credit risk is managed by requiring high credit standards for the College's counterparties. The counterparties to these contracts are financial institutions that carry investment-grade credit ratings. The interest rate exchange agreements contain collateral provisions applicable to both parties to mitigate credit risk. The College does not anticipate non-performance by its counterparties.

In fiscal years 2016 and 2015, the College paid \$701,699 and \$748,368, respectively, more than it received in interest under the swap agreements. The difference between interest received and interest paid under the swap agreements is recorded as interest expense in the statements of activities.

The following is a summary of the outstanding positions under these interest rate exchange agreements as of May 31, 2016 and 2015:

Instrument Type	Effective Date	Notional Amount	Maturity Date	Rate Paid	Rate Received
Variable to fixed rate swap	November 1, 2011	\$ 11,000,000	November 1, 2026	3.22%	74.0% of USD-LIBOR-BBA
Variable to fixed rate swap	June 15, 2009	\$ 10,530,000	September 1, 2027	3.624%	67.0% of USD-LIBOR-BBA

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 14 - DERIVATIVES (cont.)

Derivative instruments are reported in the statements of financial position at fair value as of May 31, 2016 and 2015 as follows:

Derivatives Not Designated as Hedging Instruments	Statement of Financial Position Location	Liabilities Derivative	
		Fair Value	
		2016	2015
Interest rate swap	Interest rate swap liability	\$ 2,146,548	\$ 2,322,078

The effect of derivative instruments is reported in the statements of activities as follows:

Derivatives Not Designated as Hedging Instruments	Location of Gain on Derivatives Recognized in the Statement of Changes in Net Assets	Amount of Gain on Derivatives Recognized in the Statement of Changes in Net Assets	
		2016	
		2016	2015
Interest rate swap	Gain on swap agreement valuation	\$ 175,530	\$ 53,226

### NOTE 15 - ENDOWMENT

The College's endowment consists of approximately 870 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the governing board to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the governing board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

**Interpretation of Relevant Law** – The Board of Regents of the College has interpreted the Iowa enacted version of Uniform Prudent Management of Institutional Funds Act (UPMIFA) as allowing the College to appropriate for expenditure or accumulate so much of an endowment fund as the College 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 classification.

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 College in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the College 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 College 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 College
7. The investment policies of the College

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 15 - ENDOWMENT (cont.)

Endowment net asset composition by type of fund consists of the following as of May 31, 2016:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (582,822)	\$ 22,124,433	\$ 95,127,633	\$ 116,669,244
Donor-restricted funds held in trust	-	-	1,446,591	1,446,591
Board-designated endowment funds	29,816,286	-	-	29,816,286
Contributions receivable	-	-	2,417,000	2,417,000
	<u>\$ 29,233,464</u>	<u>\$ 22,124,433</u>	<u>\$ 98,991,224</u>	<u>\$ 150,349,121</u>

Endowment net asset composition by type of fund consists of the following as of May 31, 2015:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (127,661)	\$ 27,840,617	\$ 92,178,921	\$ 119,891,877
Donor-restricted funds held in trust	-	-	1,543,537	1,543,537
Board-designated endowment funds	27,596,635	-	-	27,596,635
Contributions receivable	-	-	3,109,000	3,109,000
	<u>\$ 27,468,974</u>	<u>\$ 27,840,617</u>	<u>\$ 96,831,458</u>	<u>\$ 152,141,049</u>

Changes in endowment net assets for the year ended May 31, 2016 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2015	<u>\$ 27,468,974</u>	<u>\$ 27,840,617</u>	<u>\$ 96,831,458</u>	<u>\$ 152,141,049</u>
Investment return:				
Investment income, net of investment fees of \$101,812	350,802	1,860,959	367,508	2,579,269
Net appreciation/depreciation – realized and unrealized	(563,871)	(3,467,758)	(684,824)	(4,716,453)
Net depreciation – realized and unrealized funds held in trust	-	-	(96,946)	(96,946)
Total investment return	<u>(213,069)</u>	<u>(1,606,799)</u>	<u>(414,262)</u>	<u>(2,234,130)</u>
Contributions	-	-	3,692,730	3,692,730
Matured deferred gifts	-	-	492,449	492,449
Change in contributions receivable	-	-	(692,000)	(692,000)
Appropriation of endowment assets for expenditure	(1,305,389)	(4,109,385)	(919,151)	(6,333,925)
Other changes:				
Transfers to board / college designated endowment funds	<u>3,282,948</u>	<u>-</u>	<u>-</u>	<u>3,282,948</u>
Endowment net assets, May 31, 2016	<u>\$ 29,233,464</u>	<u>\$ 22,124,433</u>	<u>\$ 98,991,224</u>	<u>\$ 150,349,121</u>

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 15 - ENDOWMENT (cont.)

Changes in endowment net assets for the year ended May 31, 2015 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2014	\$ 26,957,718	\$ 28,256,370	\$ 92,791,576	\$ 148,005,664
Investment return:				
Investment income, net of investment fees of \$102,158	364,819	1,937,357	391,458	2,693,634
Net appreciation/depreciation – realized and unrealized	349,343	2,108,238	425,986	2,883,567
Net depreciation – realized and unrealized funds held in trust	-	-	(10,210)	(10,210)
Total investment return	714,162	4,045,595	807,234	5,566,991
Contributions	-	-	3,489,267	3,489,267
Matured deferred gifts	-	-	122,300	122,300
Change in contributions receivable	-	-	557,000	557,000
Appropriation of endowment assets for expenditure	(854,758)	(4,461,348)	(935,919)	(6,252,025)
Other changes:				
Transfers to board / college designated endowment funds	651,852	-	-	651,852
Endowment net assets, May 31, 2015	\$ 27,468,974	\$ 27,840,617	\$ 96,831,458	\$ 152,141,049

**Funds with Deficiencies** – From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the College to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$582,822 and \$127,661 as of May 31, 2016 and 2015, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the governing board. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

**Return Objectives and Risk Parameters** – The College 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 College 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 are invested in a manner that is intended to produce returns to meet needs of the spending rate, inflation, and portfolio fees while assuming a moderate level of investment risk. The College expects its endowment funds, over time, to provide an average annual rate of approximately 8.75%. Actual returns in any year may vary from this amount.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### NOTE 15 - ENDOWMENT (cont.)

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**Strategies Employed for Achieving Objectives** – To satisfy its long-term rate-of-return objectives, the College 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 College targets a diversified asset allocation that is weighted in equity based investments and balanced with fixed income and alternative investments to achieve its long-term return objectives within prudent risk constraints. The alternative investments were entered into to diversify the College's portfolio, to provide predictability in overall earnings and to provide market neutral holdings. The College monitors its portfolio mix to ensure that it is in accordance with Board policy. For the majority of alternative investments, the College utilizes fund of funds to diversify the risk inherent in alternative investments.

**Spending Policy and How the Investment Objectives Relate to Spending Policy** – The Board has authorized that the amount to be allocated to operations from the endowment fund be determined by applying a spending rate of 5% to the average of the fair value of the endowment investments at the end of a predetermined number of trailing calendar quarters. The board has also authorized that the number of trailing quarters to be used in the spending allowance calculation be increased from twelve quarters (which was used for years ended May 31, 2001 through May 31, 2015) to twenty quarters (for years ending after June 1, 2016), with the fiscal year ended May 31, 2016 being a single-year transition period for which sixteen quarters would be used. In establishing this policy, the College considered the long-term expected return on its endowment. Accordingly, over the long term, the College expects the current spending policy to allow its endowment to grow at an average of 3% annually. This is consistent with the College'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.

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### NOTE 16 - DEFERRED GIFT AGREEMENTS

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The College has arrangements with donors classified as charitable lead trusts, charitable remainder trusts, and charitable gift annuities. In general, under these arrangements the College receives a gift from a donor in which it has a remainder interest and agrees to pay the donor stipulated amounts over the life of the donor. The arrangement may cover one or more lives. The College and its administrator invest and manage the related assets and makes distributions to the beneficiaries as required. When the agreement reaches the end of its term, remaining assets are retained by the College as unrestricted, temporarily restricted or permanently restricted net assets, or in some instances, distributed to third-party beneficiaries.

When a gift is received under one of these arrangements, it is split into the amount representing the actuarial present value of future distributions back to the donor and the remaining gift value to be retained for the benefit of the College or third-party beneficiaries. The actuarial liability is adjusted annually using actuarial tables appropriate for the type of arrangement, number of lives covered and age of the donor. The College used historic interest rates for each agreement ranging from 2.2% to 10.2% in making the calculation at May 31, 2016 and 2015.

During the years ended May 31, 2016 and 2015, the College received gift income relating to deferred gift agreements of approximately \$8,590 and \$620,391, respectively. Total assets (marketable securities, real estate, and cash value of life insurance) held by the College under deferred gift agreements approximated \$15,705,549 and \$17,248,900 at May 31, 2016 and 2015, respectively.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 17 - EMPLOYEE BENEFIT PLANS

The College has a 403(b) defined contribution retirement plan. Contributions for employees are determined on a percentage of annual compensation. The cost of the retirement plan is paid currently and amounted to approximately \$2,740,000 and \$2,782,000 for the years ended May 31, 2016 and 2015, respectively.

An early retirement plan is available to faculty members. In addition, in fiscal year 2015, a one-time early retirement package was offered to faculty. Fourteen faculty members accepted the package. The estimated accrued liability for the early retirement benefits is calculated using historical participation rates, current faculty membership and projected salary increases, discounted at a rate of 3.4% and 3.7% for May 31, 2016 and 2015, respectively. The plan is unfunded. The total accrued liability for the early retirement benefits is \$772,274 and \$1,010,334 for May 31, 2016 and 2015, respectively.

The College provides medical benefits through a self-insurance plan which is available to all eligible employees of the College for certain medical expenses. Estimates for claims incurred but not reported have been accrued by the College.

Faculty members who retired by May 31, 2005 with emeriti status, and their spouses, and faculty members who completed 25 years of service by May 31, 2005 and who may be granted emeriti status upon retirement, and their spouses, are eligible to receive health insurance coverage that supplements Medicare coverage. The plan is unfunded. The following tables set forth the postretirement healthcare benefit plan's status with amounts reported in the College's financial statements at May 31, 2016 and 2015:

	2016	2015
<b>Total expected benefit obligation earned to date, based on service</b>		
Current retirees and dependents		
Pre-65 payments	\$ 271,000	\$ 308,700
Post-65 payments	1,051,000	867,300
Active employees		
Pre-65 payments	909,000	1,502,550
Post-65 payments	90,000	187,950
Benefit obligation at end of year	\$ 2,321,000	\$ 2,866,500
<b>Change in projected benefit obligation</b>		
Benefit obligation at beginning of year	\$ 2,866,500	\$ 3,076,500
Net benefits earned	198,000	218,400
Total (gain) loss	(602,500)	(277,200)
Expected benefit payments	(141,000)	(151,200)
Benefit obligation at end of year	\$ 2,321,000	\$ 2,866,500
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contribution	141,000	151,200
Participant contribution	-	-
Benefits paid	(141,000)	(151,200)
Fair value of plan assets at end of year	\$ -	\$ -
<b>Funded status</b>		
Underfunded status at year end	\$ (2,321,000)	\$ (2,866,500)

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

### NOTE 17 - EMPLOYEE BENEFIT PLANS (cont.)

	2016	2015
<b>Amounts recognized in the statements of financial position consist of:</b>		
Noncurrent assets	\$ -	\$ -
Current liabilities	(141,000)	(130,000)
Noncurrent liabilities	(2,180,000)	(2,736,500)
Net amount recognized in accrued liabilities	\$ (2,321,000)	\$ (2,866,500)

#### Weighted average assumptions used to calculate the benefit obligation at May 31

Discount rate	3.4%	3.7%
Expected return on plan assets	-	-
Rate of compensation increase	-	-

#### Assumed health care cost trend rates at May 31

Health care cost trend rate assumed for next year	4.3%	5.7%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.1%	4.3%
Year that the rate reaches the ultimate trend rate	2070	2083

Assumed medical cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage point change in assumed medical trend rates would have the following effects:

	One-Percentage Point	
	Increase	Decrease
Effect on postretirement benefit obligation at May 31, 2016	\$ 236,000	\$ (277,000)

Annual premium payments were approximately \$115,000 and \$45,000 for the years ended May 31, 2016 and 2015, respectively. During the fiscal year ending May 31, 2017, the College expects to contribute \$99,000 in benefit payments for the postretirement medical plan.

Estimated future postretirement medical payments (which reflect expected future service, as appropriate) as of May 31, 2016 are as follows:

Years Ending May 31	
2017	\$ 99,000
2018	98,000
2019	108,000
2020	115,000
2021	120,000
2022-2036	2,687,000

The estimate of the accumulated postretirement benefit obligation is based on actuarial assumptions and methods provided by a third party actuary and the selection of discount rates that appropriately reflect the time value of money as of the measurement date. The discount rate used was based on the rates of return for high quality fixed income investments whose cash flows match the timing and amount of expected benefit payments. It is reasonably possible that changes in these estimates could occur in the near term and that actual results could differ from these estimates and could have a material effect on the financial statements.

# LUTHER COLLEGE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended May 31, 2016 and 2015

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### **NOTE 18 - CONCENTRATIONS OF CREDIT RISK**

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Financial instruments that potentially subject the College to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments, marketable securities and other investments, accounts receivable and notes, mortgages and contracts for deed. Cash and cash equivalents in excess of FDIC and similar coverages is subject to the usual risks of balances in excess of those limits. The College currently has 73% of its cash and cash equivalents and 100% of cash restricted for plant acquisitions in a well-capitalized bank with a tier 1 risk-based capital ratio of 13.19 and a total risk-based capital ratio of 14.22. Investments are generally placed in a variety of managed funds administered by different investment managers in order to limit credit risk. Concentrations of credit risk with respect to the mortgages and contracts for deed are limited due to the College holding a secured position in agreements. Student notes and receivables and other receivables are due from a variety of sources concentrated primarily in the Midwestern United States. In addition, the College'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 College's programs and activities.

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### **NOTE 19 - SUBSEQUENT EVENTS**

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Luther College has evaluated subsequent events through September 27, 2016 which is the date that the financial statements were issued.