

Report of Independent Auditors  
and Consolidated Financial Statements for

**California Lutheran University**

May 31, 2012 and 2011

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## REPORT OF INDEPENDENT AUDITORS

To the Board of Regents  
California Lutheran University and Affiliate

We have audited the accompanying consolidated statement of financial position of California Lutheran University and Affiliate (the "University") as of May 31, 2012, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from the consolidated financial statements of the University as of May 31, 2011, which were audited by other auditors whose report dated September 20, 2011 expressed an unqualified opinion on those consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the University as of May 31, 2012 and the changes in its consolidated net assets and its consolidated cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*Moss Adams LLP*

Los Angeles, California  
September 13, 2012

**CALIFORNIA LUTHERAN UNIVERSITY**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**YEARS ENDED MAY 31, 2012 AND 2011**

<b>ASSETS</b>	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 18,598,497	\$ 12,248,617
Deposits held by trustee - available funds	12,012,698	10,505,124
Receivables		
Student accounts, net	1,592,008	1,888,693
Grants	165,172	263,563
Contributions	4,120,419	5,809,538
Other	1,191,738	1,260,836
Student loans receivable, net	1,623,193	1,659,175
Prepaid expenses, inventories and deposits	778,347	1,240,378
Investments		
Endowment	55,648,989	56,611,628
Deferred gifts held by University	3,167,377	2,317,010
California Lutheran Educational Foundation investments	6,017,531	7,202,087
Other	381,846	709,769
Funds held in trust by others	321,519	369,524
Deposits with trustee - reserved funds	11,266,205	12,595,236
Debt acquisition costs	2,071,664	2,160,428
Construction in progress	1,019,180	3,323,523
Property, plant, and equipment, net	<u>126,211,859</u>	<u>120,129,614</u>
<b>TOTAL ASSETS</b>	<u><u>\$ 246,188,242</u></u>	<u><u>\$ 240,294,743</u></u>

**CALIFORNIA LUTHERAN UNIVERSITY**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (CONTINUED)**  
**YEARS ENDED MAY 31, 2012 AND 2011**

<b>LIABILITIES AND NET ASSETS</b>	<u>2012</u>	<u>2011</u>
<b>LIABILITIES</b>		
Accounts payable	\$ 952,561	\$ 1,570,324
Accrued liabilities	7,190,980	7,153,459
Student housing deposits	749,575	924,096
Deferred revenue	1,433,756	1,690,318
Interest rate exchange agreement liability	227,178	140,592
Annuities payable	4,879,648	5,674,116
Deposits held in trust for others	1,636,644	351,359
Government grants refundable	1,552,872	1,553,502
Long-term debt	<u>73,585,128</u>	<u>74,488,750</u>
 TOTAL LIABILITIES	 <u>92,208,342</u>	 <u>93,546,516</u>
<b>NET ASSETS</b>		
Unrestricted	103,822,348	94,814,287
Temporarily restricted	14,529,069	18,761,998
Permanently restricted	<u>35,628,483</u>	<u>33,171,942</u>
 TOTAL NET ASSETS	 <u>153,979,900</u>	 <u>146,748,227</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$ 246,188,242</u>	 <u>\$ 240,294,743</u>

**CALIFORNIA LUTHERAN UNIVERSITY**  
**CONSOLIDATED STATEMENTS OF ACTIVITIES**  
**FOR THE YEAR ENDED MAY 31, 2012, WITH SUMMARIZED INFORMATION FOR 2011**

	2012			Total	2011 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
<b>OPERATING</b>					
<b>Revenues, gains and other support</b>					
Tuition and fees	\$ 99,438,404	\$ -	\$ -	\$ 99,438,404	\$ 91,033,508
Less: Scholarships and grants	(31,304,504)	-	-	(31,304,504)	(28,776,553)
Net tuition and fees	68,133,900	-	-	68,133,900	62,256,955
Government and grants	1,696,128	-	-	1,696,128	1,887,749
Contributions	1,906,379	1,339,241	-	3,245,620	3,048,876
Long-term investment income and gains allocated for operations	662,180	1,492,410	-	2,154,590	1,971,520
Interest and dividends	250,072	-	-	250,072	474,638
Sales and services of educational activities	1,117,356	-	-	1,117,356	1,262,029
Other sources	2,135,174	-	-	2,135,174	2,009,023
Sales and services of auxiliary enterprises	15,269,388	-	-	15,269,388	15,427,031
	91,170,577	2,831,651	-	94,002,228	88,337,821
Net assets released from restrictions	2,230,931	(2,230,931)	-	-	-
Transfers	(21,431)	(311,214)	332,645	-	-
<b>TOTAL REVENUES, GAINS AND OTHER SUPPORT</b>	<b>93,380,077</b>	<b>289,506</b>	<b>332,645</b>	<b>94,002,228</b>	<b>88,337,821</b>
<b>Expenses</b>					
<b>Program Expenses</b>					
Instruction	32,344,538	-	-	32,344,538	30,045,610
Public service	3,706,460	-	-	3,706,460	3,674,248
Academic support	5,651,021	-	-	5,651,021	4,693,373
Student services	15,962,929	-	-	15,962,929	15,061,375
Auxiliary enterprises	16,402,034	-	-	16,402,034	15,603,255
<b>Support Expenses</b>					
Institutional support	13,849,127	-	-	13,849,127	12,784,273
<b>Allocable expenses</b>					
Operation and maintenance of plant	7,218,088	-	-	7,218,088	6,979,596
Depreciation	6,530,014	-	-	6,530,014	5,964,490
Interest	3,530,215	-	-	3,530,215	3,478,191
Less: Allocated expenses	(17,278,317)	-	-	(17,278,317)	(16,422,277)
<b>TOTAL OPERATING EXPENSES</b>	<b>87,916,109</b>	<b>-</b>	<b>-</b>	<b>87,916,109</b>	<b>81,862,134</b>
Change in net assets from operating activities	5,463,968	289,506	332,645	6,086,119	6,475,687
<b>NONOPERATING</b>					
Endowment (loss) income	(356,321)	(568,007)	-	(924,328)	7,327,318
Less: Long-term investment income and gains allocated for operations	(662,180)	(1,492,410)	-	(2,154,590)	(1,971,520)
Investment return distributed	(1,018,501)	(2,060,417)	-	(3,078,918)	5,355,798
Net gains (losses) on other investments	(172,712)	(3,091)	-	(175,803)	(75,956)
Net gain (loss) on CEFA bond reserve	707,065	-	-	707,065	(626,726)
Unrealized loss on interest rate exchange agreement	(86,586)	-	-	(86,586)	(140,592)
Deferred giving - gifts	2,789	86,188	788,398	877,375	680,381
Capital giving - gifts	56,574	3,159,189	-	3,215,763	3,670,143
Gains (losses) on funds held in trust by others	(10,743)	-	(17,889)	(28,632)	161,411
Adjustment to actuarial liability for annuities payable	(257,768)	(45,064)	65,877	(236,955)	1,393,801
Loss on disposal of property, plant and equipment	(47,755)	-	-	(47,755)	(80,247)
Net assets released from restrictions - nonoperating	4,093,227	(4,093,227)	-	-	-
Change in net assets from nonoperating activities	3,265,590	(2,956,422)	836,386	1,145,554	10,338,013
Change in net assets before reclassification of net assets	8,729,558	(2,666,916)	1,169,031	7,231,673	16,813,700
Reclassification of prior year net assets	278,503	(1,566,013)	1,287,510	-	-
<b>TOTAL CHANGE IN NET ASSETS</b>	<b>9,008,061</b>	<b>(4,232,929)</b>	<b>2,456,541</b>	<b>7,231,673</b>	<b>16,813,700</b>
NET ASSETS, beginning of year	94,814,287	18,761,998	33,171,942	146,748,227	129,934,527
NET ASSETS, end of year	<b>\$ 103,822,348</b>	<b>\$ 14,529,069</b>	<b>\$ 35,628,483</b>	<b>\$ 153,979,900</b>	<b>\$ 146,748,227</b>

**CALIFORNIA LUTHERAN UNIVERSITY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED MAY 31, 2012 AND 2011**

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	7,231,673	\$ 16,813,700
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Interest earned on deposits with Trustee	(132,213)	(578,658)
Depreciation, amortization, and accretion	6,618,779	6,053,683
(Gain) loss on investments, net	1,100,131	(7,251,362)
Unrealized (gain) loss on CEFA bond proceeds	(707,065)	626,726
Change in allowance for doubtful accounts	(41,191)	77,419
Change in interest rate exchange agreement liability	86,586	140,592
Actuarial adjustment of annuities payable	(753,907)	(52,049)
Loan cancellations and write-offs	34,850	12,116
Loss on disposal of assets	47,755	80,247
(Gain) loss on funds held in trust by others	48,005	(136,953)
Changes in current assets and liabilities:		
Student accounts receivable	337,876	(243,562)
Grants receivable	98,391	1,489,349
Contributions receivable	1,689,117	719,441
Other receivables	69,098	164,344
Prepaid expenses, inventories and deposits	462,031	(91,541)
Accounts payable	372,169	(185,946)
Accrued liabilities	37,519	(228,084)
Deferred revenue	(256,562)	733,997
Student housing deposits	(174,521)	529,090
Deposits held in trust for others	1,285,285	28,746
Contributions restricted for plant, loans, and long-term investment	<u>(4,093,138)</u>	<u>(4,350,524)</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>13,360,668</u>	<u>14,350,771</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(29,807,427)	(17,171,520)
Sales of investments	30,332,046	18,193,680
Deposits to trustee reserve accounts	660,735	91,707
Purchases of property, plant, and equipment, and CIP	(11,345,602)	(13,237,603)
Disbursements of loans to students	(154,000)	(92,000)
Repayments of loans from students	<u>155,131</u>	<u>169,119</u>
NET CASH USED IN INVESTING ACTIVITIES	<u>(10,159,117)</u>	<u>(12,046,617)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	716,679	-
Payments of principal on indebtedness	(1,620,301)	(1,183,817)
Increase (decrease) in refundable governmental grants, net	(630)	18,669
Payments to annuitants	(754,063)	(812,284)
Increase in annuities payable from new gifts	713,506	17,657
Contributions received restricted for plant, loans and long-term investment	<u>4,093,138</u>	<u>4,350,524</u>
NET CASH FROM FINANCING ACTIVITIES	<u>3,148,329</u>	<u>2,390,749</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	6,349,880	4,694,903
CASH AND CASH EQUIVALENTS, beginning of year	<u>12,248,617</u>	<u>7,553,714</u>
CASH AND CASH EQUIVALENTS, end of year	<u>18,598,497</u>	<u>\$ 12,248,617</u>

## CALIFORNIA LUTHERAN UNIVERSITY NOTES TO FINANCIAL STATEMENTS

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### **Note 1 - Organization**

California Lutheran University ("CLU") is an institution of higher education affiliated with the Evangelical Lutheran Church in America. CLU offers undergraduate and graduate degrees in the liberal arts and sciences and professional fields.

California Lutheran Educational Foundation (the "Foundation") is a private foundation whose primary function is to provide fundraising support for California Lutheran University.

**Principles of consolidation** - The consolidated financial statements include the accounts of California Lutheran University and California Lutheran Educational Foundation (collectively referred to as the "University"). All significant intercompany balances and transactions have been eliminated in consolidation.

### **Note 2 - Summary of Significant Accounting Policies**

**Basis of Presentation** - These consolidated financial statements, which are presented on the accrual basis of accounting, have been prepared to focus on the University as a whole. For the purpose of financial reporting, the University classifies resources into three net asset categories pursuant to any donor-imposed restrictions and applicable law. Accordingly, the net assets of the University are classified in the accompanying consolidated financial statements in the categories that follow:

**Permanently restricted net assets** - Net assets subject to donor-imposed stipulations that they would be maintained permanently by the University. Generally, the donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes.

**Temporarily restricted net assets** - Net assets subject to donor-imposed stipulations that will be met by action of the University and/or the passage of time.

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

The 2012 consolidated statement of activities is presented with 2011 summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with Generally Accepted Accounting Principles (GAAP). Accordingly, such information should be read in conjunction with the University's consolidated financial statements for the year ended May 31, 2011, from which the summarized information was derived.

**Revenue recognition** - Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Income earned on donor restricted funds is initially classified as temporarily restricted net assets and is reclassified as unrestricted net assets when expenses are incurred for their intended purpose.



## **CALIFORNIA LUTHERAN UNIVERSITY**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **Note 2 - Summary of Significant Accounting Policies (continued)**

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 net assets released from restriction between the applicable classes of net assets. Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the temporarily restricted net asset class, and a release to unrestricted net assets is made to reflect the expiration of such restrictions. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met.

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

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. Losses on investments of endowment funds created by a board designation of unrestricted funds are classified as reductions in unrestricted net assets.

**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.

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.

**Cash equivalents** - The University considers all highly liquid investments, except those held for long-term investment, with original maturities of three months or less when purchased to be cash equivalents.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 2 – Summary of Significant Accounting Policies (continued)**

**Student accounts receivable** - Student accounts receivable are carried at the unpaid balance of the original amount billed to students less an estimate made for doubtful accounts based on historical experience and management's evaluation of receivables at the end of each year. Student accounts are written off when deemed uncollectible. Recoveries of student accounts previously written off are recorded when received. A student account receivable is considered to be delinquent if any portion of the balance is outstanding for more than 90 days after the billing date. Interest is charged on past due accounts receivable. Receivables are generally unsecured.

**Deposits with trustee** - Deposits with trustee include amounts restricted for debt service as required by the trust indenture as well as bond construction funds for property additions. In prior years, the University sold its future interest to earnings on certain trustee bond reserves. Revenue from such sale had been deferred and recognized as income as earned.

**Debt acquisition costs** - Costs of bond issuance are deferred and amortized on a straight-line basis over the term of the related indebtedness. Amortization of approximately \$89,000 was recorded for the years ended May 31, 2012 and 2011.

**Property, plant and equipment** - Physical plant assets are stated at cost (or at fair value if donated), less accumulated depreciation, computed on a straight-line basis over the estimated useful lives of buildings and improvements (10 - 40 years) and equipment (3 - 10 years). Normal repair and maintenance expenses are charged to operations as incurred, The University capitalizes physical plant additions in excess of \$10,000.

**Asset retirement obligations** - Asset retirement obligations are estimated costs and obligations associated with the retirement of long-lived assets. These liabilities were initially recorded at fair value and the related asset retirement costs were recorded as decreases in unrestricted net assets. Asset retirement costs are subsequently accreted over the useful lives of the related assets. The asset retirement obligation of \$721,247 and \$754,256 at May 31, 2012 and 2011, respectively, is included in accrued liabilities on the consolidated statements of financial position. The asset retirement obligation was reduced in 2012 due to remediation of two buildings on campus. Therefore, there was no accretion expense for the years ended May 31, 2012 and 2011.

**Grants to specified students** - Amounts received from state and federal agencies designated for the benefit of specified students are considered agency transactions and, therefore, are not reflected as revenues and expenses of the University. The amount of such grants from state and federal agencies approximated \$4,292,000 and \$2,929,000, respectively, during the year ended May 31, 2012. Corresponding grants from state and federal agencies for the year ended May 31, 2011 were approximately \$4,063,000 and \$2,905,000, respectively.

## **CALIFORNIA LUTHERAN UNIVERSITY**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **Note 2 - Summary of Significant Accounting Policies (continued)**

**Government grants refundable** - Funds provided by the United States Government under the Federal Perkins Loan Program are loaned to qualified students and may be re-loaned after collections. These funds are ultimately refundable to the government and are included as liabilities in the consolidated 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.

**Deferred revenue** - The University has deferred revenue/advances from prepayments on student accounts and from vendors related to its bookstore and food service operations.

**Unemployment compensation** - The University has elected to pay unemployment compensation claims as they arise.

**Retirement plans** - The University has certain contributory retirement plans for academic and nonacademic personnel. Contributions for employees are determined on a percentage of annual compensation. The cost of the retirement plans is paid currently and approximated \$2,993,000 and \$2,689,000 for the years ended May 31, 2012 and 2011, respectively.

**Fundraising and advertising expenses** - Fundraising expenses approximated \$2,280,000 and \$1,984,000 for the years ended May 31, 2012 and 2011, respectively. Advertising costs approximated \$859,000 and \$919,000 for the years ended May 31, 2012 and 2011, respectively, and are expensed as incurred.

**Functional allocation of expenses** - The costs of providing the various programs and other activities have been summarized on a functional basis in the consolidated statements of activities. Accordingly, certain expenses have been allocated among the programs and supporting services benefited.

**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 amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

**Income tax status** - The Internal Revenue Service has determined that the University and Foundation are exempt from federal income tax under Section 501 (c)(3) of the Internal Revenue Code as non-profit organizations. It is also exempt from state income taxes. However, any unrelated business income may be subject to taxation.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 2 – Summary of Significant Accounting Policies (continued)**

The University follows the accounting standards for contingencies in evaluating uncertain tax positions. This guidance prescribes recognition threshold principles for the consolidated financial statements recognition of tax positions taken or expected to be taken on a tax return that are not certain to be realized. No liability has been recognized by the University for uncertain tax positions as of May 31, 2012. The University's tax returns are subject to review and examination by federal and state authorities. The tax returns for the current year as well as fiscal years 2009 to 2011 are open to examination by federal and state authorities.

**Impairment of long-lived assets** - The University reviews long-lived assets, including property and equipment and intangibles, 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.

**Reclassifications** - Certain amounts appearing in the 2011 consolidated financial statements have been reclassified to conform with the 2012 presentation. The reclassifications have no effect on reported amounts of total net assets or change in total net assets. Reclassifications of net assets from unrestricted to temporarily and permanently restricted net assets occurred to show donor designations.

**Investments and investment income** - Investments are measured at fair value in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures in the consolidated statements of financial position (see Footnote 3). Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in non-operating unrestricted revenues, gains and other support unless the income or loss is restricted by donor or law.

**Fair value of financial instruments** - The carrying amounts of cash and cash equivalents, accounts receivable and other receivables, accounts payable and accrued liabilities, deposits and deferred revenue approximate fair value because of the short-term maturity of these financial instruments.

A reasonable estimate of the fair value of the receivables from students under government loan programs and grants refundable to the government for student loans could not be made because the notes receivable are not saleable and can only be assigned to the U.S. government or its designee. The fair value of receivables under institutional loan programs approximates carrying value.

The carrying amounts of the actuarial liability for trusts and annuities payable are based on life expectancies, quoted market prices, and the applicable discount rates in effect at the time the agreements were received by the University. The carrying amounts of long-term debt approximates fair value because these financial instruments bear interest at rates which approximate current market rates for notes with similar maturities and credit quality.

## **CALIFORNIA LUTHERAN UNIVERSITY**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **Note 2 - Summary of Significant Accounting Policies (continued)**

Contributions of assets other than cash are recorded at their estimated fair value at the date of the gift. Estimates of fair value involve assumptions and estimation methods that are uncertain and, therefore, the estimates could differ from actual results.

Cash surrender value of life insurance policies is considered to approximate fair value and is included in investments.

The fair values for investments and other financial instruments recorded at fair value on a recurring basis are included in Note 3.

#### **Note 3 - Fair Value Measurements**

The University follows the FASB guidance on fair value measurements. Fair value is defined in the 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. The three levels are defined as follows:

- Level 1** - Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- 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 inputs that are derived principally from or corroborated by observable market data.
- Level 3** - Inputs are unobservable for the asset or liability. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

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.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 3 - Fair Value Measurements (continued)**

The following table summarizes financial instruments measured at fair value on a recurring basis by classification within the fair value hierarchy as of May 31, 2012:

	2012			
	Total	Level 1	Level 2	Level 3
<b>ASSETS</b>				
Deposits with trustee				
Cash and short term investments	\$ 17,451,022	\$ 17,451,022	\$ -	\$ -
Government bonds	5,827,881	5,827,881	-	-
Funds held in trust by others	321,519	-	-	321,519
Total funds held by others	23,600,422	23,278,903	-	321,519
Investments				
Cash equivalents and short term investments	6,403,231	3,677,309	2,725,922	-
Equity securities funds - U.S.	13,978,937	2,320,865	11,658,072	-
Equity securities funds - Non-U.S.	9,609,431	5,818,284	3,791,147	-
Total equity securities	23,588,368	8,139,149	15,449,219	-
Comingled funds - U.S.	16,474,181	2,799,310	13,674,871	-
Comingled funds - Non-U.S.	9,796,935	9,796,935	-	-
Corporate bonds	1,137,950	1,137,950	-	-
Government bonds	1,962,048	1,962,048	-	-
Total fixed income	29,371,114	15,696,243	13,674,871	-
Commodities and other investments	1,053,305	182,562	849,938	20,805
Hedge funds	52,776	-	-	52,776
Partnerships				
Private equity	3,256,187	-	-	3,256,187
Venture capital	867,022	-	-	867,022
Real estate	623,740	-	-	623,740
Total partnerships	4,746,949	-	-	4,746,949
Total investments	65,215,743	27,695,263	32,699,950	4,820,530
Total Assets	<u>\$ 88,816,165</u>	<u>\$ 50,974,166</u>	<u>\$ 32,699,950</u>	<u>\$ 5,142,049</u>
<b>LIABILITIES</b>				
Interest rate exchange agreement	<u>\$ 227,178</u>	<u>\$ -</u>	<u>\$ 227,178</u>	<u>\$ -</u>

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 3 - Fair Value Measurements (continued)**

The following table summarizes financial instruments measured at fair value on a recurring basis by classification within the fair value hierarchy as of May 31, 2011:

	2011			
	Total	Level 1	Level 2	Level 3
<b>ASSETS</b>				
Deposits with trustee				
Cash and short term investments	\$ 3,336,865	\$ 3,336,865	\$ -	\$ -
Government bonds	19,763,495	19,763,495	-	-
Funds held in trust by others	369,524	-	-	369,524
Total funds held by others	23,469,884	23,100,360	-	369,524
Investments				
Cash equivalents and short term investments	6,758,176	4,134,900	2,623,276	-
Equity securities funds - U.S.	14,986,073	2,844,813	12,141,260	-
Equity securities funds - Non-U.S.	11,125,403	11,125,403	-	-
Total equity securities	26,111,476	13,970,216	12,141,260	-
Comingled funds - U.S.	13,657,481	4,442,840	9,214,641	-
Comingled funds - Non-U.S.	9,253,961	9,253,961	-	-
Corporate bonds	1,797,116	1,797,116	-	-
Government bonds	2,656,491	2,656,491	-	-
Total fixed income	27,365,049	18,150,408	9,214,641	-
Commodities and other investments	1,221,420	98,818	1,102,902	19,700
Hedge funds	1,132,362	-	-	1,132,362
Partnerships				
Private equity	2,810,853	-	-	2,810,853
Venture capital	702,245	-	-	702,245
Real estate	738,913	-	-	738,913
Total partnerships	4,252,011	-	-	4,252,011
Total investments	66,840,494	36,354,342	25,082,079	5,404,073
Total Assets	<u>\$ 90,310,378</u>	<u>\$ 59,454,702</u>	<u>\$ 25,082,079</u>	<u>\$ 5,773,597</u>
<b>LIABILITIES</b>				
Interest rate exchange agreement	<u>\$ 140,592</u>	<u>\$ -</u>	<u>\$ 140,592</u>	<u>\$ -</u>

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying consolidated statements of financial position, as well as general classification of such instruments pursuant to the valuation hierarchy.

**Cash and short-term investments** - The fair value of cash equivalents and short-term investments, primarily consisting of intercompany amounts due to the endowment and cash surrender value of life insurance policies, with readily determinable market values is classified at Level 1. The fair value of short-term investments consisting primarily of money market funds, is classified as Level 2 as these funds are not traded on a regular basis.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 3 - Fair Value Measurements (continued)**

**Equity securities, fixed income and commodities** - Investments in fixed income securities are comprised of comingled mutual funds, U.S. Treasury notes, mortgage-backed securities, municipal bonds, and corporate bonds and notes. Along with equity securities and investments in commodity indexes, these investments are actively traded on an exchange and are valued based on quoted prices from the applicable exchange. To the extent valuation adjustments are not applied to these securities, they are categorized as Level 1. Comingled funds that are not actively traded are categorized as Level 2.

**Partnerships and Hedge Funds** - The fair value of certain funds has been estimated using the Net Asset Value ("NAV") as reported by the management of the fund. FASB guidance allows for the use of the NAV as a "practical expedient" for estimating the fair value of alternative investments. NAV reported by each partnership and hedge fund is used as a practical expedient to estimate the fair value of the University's interest in each fund. Investments are categorized as Level 2 instruments when the University has the ability to redeem its investment in the entity at the NAV per share in the near term. If the University does not know when it will have the ability to redeem its investment or it does not have the ability to redeem its investment at NAV per share in the near term, the investments are categorized as Level 3 instruments. The University generally considers a redemption period of 90 days or less to be considered near term.

**Funds held in trust by others** - The University's beneficial interest in irrevocable split interest agreements held or controlled by a third party are classified as Level 3 as the fair values are based on significant unobservable inputs. Since the University has an irrevocable right to receive the income earned from the trust's assets, the fair value of the University's beneficial interest is estimated to approximate the fair value of the trust's assets. The fair values are based on the market values of the trust assets.

**Interest rate exchange agreement** - Interest rate exchange agreement is classified as Level 2 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.

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.



# CALIFORNIA LUTHERAN UNIVERSITY

## NOTES TO FINANCIAL STATEMENTS

### Note 3 - Fair Value Measurements (continued)

The following table presents a reconciliation of the consolidated statements of financial position amounts for financial instruments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended May 31, 2012 and 2011:

	Partnerships			Hedge Funds	Commodities and Other	Funds Held	Total
	Private Equity	Venture Capital	Real Estate			in Trust by Others	
Balance at June 1, 2011	\$ 2,810,853	\$ 702,245	\$ 738,913	\$ 1,132,362	\$ 19,700	\$ 369,524	\$ 5,773,597
Total realized gain (loss)	124,246	11,244	-	(40,702)	-	(28,005)	66,783
Total unrealized gain (loss)	205,225	45,079	43,977	(30,826)	1,105	-	264,560
Purchases	1,657,253	145,245	-	400,000	-	-	2,202,498
Sales	(1,541,390)	(36,791)	(159,150)	(1,408,058)	-	(20,000)	(3,165,389)
Transfers in to Level 3	-	-	-	-	-	-	-
Transfers out of Level 3	-	-	-	-	-	-	-
Balance at May 31, 2012	<u>\$ 3,256,187</u>	<u>\$ 867,022</u>	<u>\$ 623,740</u>	<u>\$ 52,776</u>	<u>\$ 20,805</u>	<u>\$ 321,519</u>	<u>\$ 5,142,049</u>

The amount of total gains or losses for the period included in change in net assets attributable to the change in unrealized gains or losses relating to financial instruments still held at May 31, 2012

\$ 291,824

	Partnerships			Hedge Funds	Commodities and Other	Funds Held	Total
	Private Equity	Venture Capital	Real Estate			in Trust by Others	
Balance at June 1, 2010	\$ 2,111,286	\$ 1,041,625	\$ 494,966	\$ 2,018,796	\$ 18,753	\$ 213,818	\$ 5,899,244
Total realized gain (loss)	754	2,988	-	9,021	-	23,102	35,865
Total unrealized gain (loss)	425,794	103,129	148,947	69,958	947	161,006	909,781
Purchases and sales, net	(213,546)	41,069	95,000	(603,213)	-	(47,156)	(727,846)
Adjustment	486,565	(486,566)	-	-	-	18,754	18,753
Transfers out of Level 3	-	-	-	(362,200)	-	-	(362,200)
Balance at May 31, 2011	<u>\$ 2,810,853</u>	<u>\$ 702,245</u>	<u>\$ 738,913</u>	<u>\$ 1,132,362</u>	<u>\$ 19,700</u>	<u>\$ 369,524</u>	<u>\$ 5,773,597</u>

The amount of total gains or losses for the period included in change in net assets attributable to the change in unrealized gains or losses relating to financial instruments still held at May 31, 2011

\$ 898,456

The University's policy is to recognize transfers in and transfers out as of the last day of the reporting period.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 3 - Fair Value Measurements (continued)**

Transfers out of Level 3 are due to liquidation of the underlying hedge fund.

The following table lists investments valued at NAV by major class:

	Fair Value at May 31, 2012	Unfunded Commitments	Redemption Frequency	Redemption Notice Period	Investee Strategies and Other Restrictions
Hedge Funds	\$ 52,776	\$ -	Quarterly	45-60 days	[1]
Equity Securities Funds - U.S.	11,658,072	-	Daily/Monthly	2-5 days	[1]
Equity Securities Funds - Non U.S.	3,791,147	-	Daily/Monthly	2-5 days	[1]
U.S. Comingled Funds	13,674,871	-	Daily/Monthly	2-5 days	[1]
Commodities and Other	849,938	-	Daily/Monthly	2-5 days	[1]
Partnerships					
Private Equity	3,256,187	2,300,000	Not permitted	n/a	[2]
Venture Capital	867,022	200,000	Not permitted	n/a	[2]
Real Estate	623,740	100,000	Not permitted	n/a	[2]
Balance at May 31, 2012	<u>\$ 34,773,753</u>	<u>\$ 2,600,000</u>			

[1] Absolute total return in long/short equity and multi-strategy hedge funds.

[2] Venture and buyout, in the U.S. and international.

The University's investment strategy incorporates a diversified asset allocation approach and maintains, within defined limits, exposure to the world equity, fixed-income, commodities, real estate and private equity markets. This strategy provides the University with a long-term asset mix that is most likely to meet the University's long-term return goals with the appropriate level of risk.

The alternative investments were entered into to diversify the University's portfolio, to provide predictability in overall earnings and to provide market-neutral holdings. The University's management, the finance and investment committee of the Board of Regents and the University's external investment consultants regularly review performance reports provided by the general partners of these investments. The University's external investment consultants attend meetings of the various general partners in order to evaluate the risk associated with these investments. In addition, the University monitors its portfolio mix to ensure that it is in accordance with Board policy.

Investments, in general, are subject to various risks, including credit, interest and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated financial statements.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 4 - Credit Quality of Student Loans Receivable**

The University issues uncollateralized loans to students based on financial need. Student loans are funded through Federal government loan programs or institutional resources. Student loans receivable are carried at the amount of unpaid principal less an estimate for doubtful accounts. Allowances for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. At May 31, 2012 and 2011 student loans represented 0.66% and 0.69% of total assets, respectively.

	2012	2011
Federal government programs	\$ 1,699,395	\$ 1,733,909
Institutional programs	8,798	10,266
	1,708,193	1,744,175
Less allowance for doubtful accounts	(85,000)	(85,000)
Student loans receivable, net	<u>\$ 1,623,193</u>	<u>\$ 1,659,175</u>

Funds advanced by the Federal government of approximately \$1,600,000 at May 31, 2012 and 2011, are ultimately refundable to the government and are classified as liabilities in the consolidated statements 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, the following amounts were past due under student loan programs:

<u>May 31.</u>	<u>1-60 days</u>	<u>60-90 days</u>	<u>90+ days</u>	<u>Total</u>
2012	\$ 114,160	\$ 39,893	\$ 64,794	\$ 218,847
2011	144,492	25,233	86,653	256,378

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 5 - Contributions Receivable**

Contributions receivable include the following unconditional promises to give at May 31:

	<u>2012</u>	<u>2011</u>
Temporarily restricted - plant projects	\$ 4,576,133	\$ 6,351,807
Less: Present value discount	<u>(455,714)</u>	<u>(542,269)</u>
Contributions Receivable, net	<u>\$ 4,120,419</u>	<u>\$ 5,809,538</u>
Amounts due in:		
Less than one year	\$ 1,538,194	
One to five years	<u>2,582,225</u>	
	<u>\$ 4,120,419</u>	

Gross unconditional promises to give have been reduced by an allowance for unfulfilled pledges of \$120,848 and \$189,333 at May 31, 2012 and 2011, respectively. An interest rate of 5% was used at May 31, 2012 and 2011 to discount net unconditional promises to give.

Approximately \$2,100,000 and \$2,700,000 of the contributions receivable at May 31, 2012 and 2011, respectively, are due from members of the governing board of the University.

**Note 6 - Construction in Progress**

At May 31, 2012, the following major projects were in progress:

	<u>Estimated Total Cost</u>	<u>Cost to Date</u>	<u>Funding Plan</u>
New dining commons	\$ 15,000,000	\$ 771,000	Donations/operations
Other projects		<u>248,000</u>	Operations
		<u>\$ 1,019,000</u>	

The Board approved the construction of a new dining common in the amount of \$15,000,000. The University does not anticipate drawing on new debt to finance the dining common. Of the \$15,000,000, \$5,000,000 will be allocated from the CEFA bond. Before the year ended May 31, 2012, the University received a pledge of \$2,000,000 from a related party to assist in the construction. The remaining \$8,000,000 will be internally generated from the Capital Project Reserve. The University completion of the dining common is scheduled for early 2014.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 7 - Property, Plant and Equipment**

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

	<u>2012</u>	<u>2011</u>
Land	\$ 946,660	\$ 946,660
Improvements other than buildings	36,601,088	35,628,863
Buildings	130,641,816	120,754,154
Equipment	12,792,292	11,354,846
Library books or materials	<u>3,621,584</u>	<u>3,423,204</u>
	184,603,440	172,107,727
Less: Accumulated depreciation	<u>(58,391,581)</u>	<u>(51,978,113)</u>
Property, plant and equipment, net	<u>\$ 126,211,859</u>	<u>\$ 120,129,614</u>

Depreciation expense totaled \$6,530,014 and \$5,964,490 for the years ended May 31, 2012 and 2011, respectively.

**Note 8 - Restrictions and Limitations on Net Asset Balances**

Permanently restricted net assets consist of the following at May 31:

	<u>2012</u>	<u>2011</u>
Endowment funds	\$ 33,302,302	\$ 30,531,839
Student loan funds	304,278	304,278
Annuity, life income and similar funds	2,021,903	2,140,660
Perpetual trusts held by others	<u>-</u>	<u>195,165</u>
	<u>\$ 35,628,483</u>	<u>\$ 33,171,942</u>

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

	<u>2012</u>	<u>2011</u>
Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other departmental support	\$ 3,302,336	\$ 3,015,103
Acquisition of buildings and equipment	2,994,194	4,270,158
Endowment funds	7,082,263	10,127,071
Term endowment fund	<u>48,573</u>	<u>263,229</u>
	13,427,366	17,675,561
Annuity, life income and similar funds	<u>1,101,703</u>	<u>1,086,437</u>
	<u>\$ 14,529,069</u>	<u>\$ 18,761,998</u>

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 8 - Restrictions and Limitations on Net Asset Balances**

The University's unrestricted net assets were allocated as follows at May 31:

	<u>2012</u>	<u>2011</u>
Operations	\$ 28,987,421	\$ 21,144,451
Long-term investment	15,009,979	15,618,211
Plant	<u>59,824,948</u>	<u>58,051,625</u>
	<u>\$ 103,822,348</u>	<u>\$ 94,814,287</u>

**Note 9 - Net Assets Released from Restrictions**

Net assets were released from temporary donor restrictions during the years ended May 31, 2012 and 2011 by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors as follows:

	<u>2012</u>	<u>2011</u>
Scholarships, instruction and other departmental support	\$ 2,230,931	\$ 1,877,292
Maturity of term endowment	-	305,141
Acquisition of buildings and equipment	<u>4,093,227</u>	<u>10,766,894</u>
	<u>\$ 6,324,158</u>	<u>\$ 12,949,327</u>

**Note 10 - Long-Term Debt**

The University had the following long-term debt outstanding at May 31:

	<u>2012</u>	<u>2011</u>
Notes payable	\$ 4,220,128	\$ 4,068,750
California Educational Facilities Authority (CEFA)		
Revenue Bonds		
1999 Series	1,775,000	1,880,000
2004 Series A	5,465,000	5,465,000
2004 Series C	24,795,000	25,375,000
2008 Series	<u>37,330,000</u>	<u>37,700,000</u>
	<u>\$ 73,585,128</u>	<u>\$ 74,488,750</u>

## **CALIFORNIA LUTHERAN UNIVERSITY**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **Note 10 - Long-Term Debt (continued)**

The University has a bank note outstanding secured by 14 individual homes totaling \$3,543,750 and \$4,068,750 at May 31, 2012 and 2011, respectively, which matures through February 1, 2019. The required monthly payment ranges between \$48,000 and \$50,000. The University entered into an interest rate exchange agreement related to this note to fix the interest rate at 4.18%. (See Note 17)

In September 2011, the University acquired a note in the amount of \$717,000 for leasehold improvements at the Woodland Hills campus at a 7.50% rate for 10 years, through August 10, 2021. The required monthly payment averages \$8,500. The outstanding balance at May 31, 2012 totals \$676,378.

The 1999 Series bonds were issued to finance a portion of the costs for a new residence hall. The 1999 series bonds have interest rates varying from 5.125% to 5.25% and mature annually on April 1, 2013 through April 1, 2024 in amounts from \$110,000 to \$195,000. The CEFA 99 indenture is secured by real property.

The 2004 Series A bonds were issued to finance the cost of the construction and equipping of certain educational facilities, and paying certain costs of issuance of the 2004 Series A bonds. The bonds were issued November 16, 2004 and will mature October 1, 2029. Interest on the bonds is payable monthly and no principal payments are required until the maturity date. The bonds bear interest at a variable (weekly reset) rate, which at May 31, 2012 was 0.19%, with an average rate of 0.16% for the 2012 fiscal year. In addition to the variable rate interest, the bonds incur an annual effective letter of credit fee of 125 basis points on the letter credit amount outstanding and an annual remarketing fee equal to 0.125%. The bonds are secured by an irrevocable direct-pay-letter of credit to the trustee. The letter of credit expires September 1, 2013. The letter of credit is secured by certain real property and a pledge on future revenue.

The 2004 Series C bonds were issued to finance construction activities, refunding the Institution's outstanding Revenue Bonds 1993 Series B, advance refunding a portion of the Institution's outstanding Revenue Bonds 1998 Series A, refinancing the April 1, 2004 principal payment with respect to CEFA Revenue Bonds 1999 Series B, paying certain costs of issuance of the 2004 Series C bonds, and funding a reserve fund for the 2004 Series C bonds. The 2004 Series C bonds include one serial series of bonds and three term bonds. The 2004 Series C bonds have interest rates varying from 3.625% to 4.75% and mature annually on October 1, 2012 to October 1, 2016 in amounts from \$600,000 to \$710,000. The term bonds have interest rates varying from 4.50% to 5.00% and mature from October 1, 2017 to October 1, 2029 in amounts from \$745,000 to \$2,545,000. The bonds are secured by certain real property and a pledge on future revenue.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 10 - Long-Term Debt (continued)**

The 2008 Series bonds were issued to finance construction activities and the refunding of the Institution's outstanding Revenue Bonds 2004 Series B. The 2008 Series bonds include one serial series bond and three term bonds. The 2008 serial series bonds have interest rates varying from 3.50% to 4.50% and mature annually on October 1, 2012 to October 1, 2016 in amounts from \$395,000 to \$460,000. The term bonds have interest rates varying from 5.25% to 5.75% and mature from October 1, 2017 to October 1, 2038 in amounts from \$480,000 to \$3,650,000. The bonds are secured by certain real property and a pledge on future revenue.

The University is required to maintain debt service reserve funds of approximately \$6,746,000 which were partially funded from bond proceeds. The bond agreements require that certain financial and other covenants be maintained. As of May 31, 2012, the University is in compliance with these covenants.

Annual maturities of long-term debt for each of the five years subsequent to May 31, 2012 approximate \$1,683,000, \$1,722,000, \$1,771,000, \$1,836,000, and \$1,901,000, respectively, and approximately \$64,673,000 thereafter.

**Note 11 - Operating Leases**

The University has operating leases for offsite student facilities and one vehicle. Rental expense associated with these leases totaled approximately \$873,000 and \$980,000 for the years ended May 31, 2012 and 2011, respectively.

Future minimum lease payments on leases in effect on May 31, 2012, are as follows:

Years Ended May 31,	<u>Operating Leases</u>
2013	\$ 830,046
2014	850,380
2015	800,772
2016	703,598
2017	547,808
Thereafter	<u>661,080</u>
	<u>\$ 4,393,684</u>



## **CALIFORNIA LUTHERAN UNIVERSITY**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **Note 12 - Short-Term Credit Arrangements**

The University has a secured revolving line of credit in the amount of \$4,000,000, with interest at either the LIBOR interest rate plus 1.50% per year or the prime rate minus 0.375% determined by the University at the time of borrowing. There was no balance outstanding as of May 31, 2012 and 2011. The revolving credit line is secured by residential real estate.

#### **Note 13 - Deferred Gift Agreements**

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

When a gift is received under one of these arrangements, it is split into the amount representing the actuarial present value of the future distributions to the donor and the remaining gift value to be retained for the benefit of the University or third-party beneficiaries. The actuarial liability is adjusted annually using actuarial tables appropriate for the type of arrangement, number of lives covered and age and sex characteristics of the donor. The University used historical interest rates varying from 5% to 10% in making the calculations.

The University and Foundation received \$297,554 and \$15,226 of gift value relating to deferred gift agreements for the years ended May 31, 2012 and 2011, respectively.

#### **Note 14 - Other Concentrations of Credit Risk**

Financial instruments that potentially subject the University to concentrations of credit risk consist principally of cash, short-term investments, marketable securities and other investments, accounts, notes and mortgages receivable. Cash, cash equivalents and investments are concentrated in a limited number of financial institutions and amounts in excess of FDIC and similar coverages are subject to the usual risks of balances in excess of those limits. Marketable securities, consisting of both debt and equity instruments, are generally placed in a variety of managed funds administered by different investment managers in order to reduce credit risk.

Concentrations of credit risk with respect to the notes and mortgages are limited due to the University holding a secured position in these agreements. Student notes and receivables and other receivables are due from a variety of sources concentrated primarily in the western United States.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 14 - Other Concentrations of Credit Risk (continued)**

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. Contributions receivable for 2012 are principally due from two major contributors.

**Note 15 - Supplemental Disclosure of Cash Flow Information**

	<u>2012</u>	<u>2011</u>
Interest paid, net of interest capitalized of \$105,369 and \$19,529 for 2012 and 2011, respectively	\$ 3,530,215	\$ 3,478,191
Noncash investing and financing activities		
Retirement of fully depreciated assets	116,546	2,188,374
Refinancing home mortgages	-	4,200,000
Construction in progress included in accounts payable	111,785	878,147

**Note 16 - Endowment**

The University's endowment consists of approximately 300 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the governing board to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the governing board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

**Interpretation of Relevant Law** - The University's governing board has interpreted the California 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.

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 16 - Endowment (continued)**

The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the University and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the University
7. The investment policies of the University

Endowment net asset composition by type of fund consists of the following as of May 31, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (134,142)	\$ 7,036,541	\$ 33,302,302	\$ 40,204,701
Board-designated endowment funds	<u>14,986,817</u>	<u>94,295</u>	<u>-</u>	<u>15,081,112</u>
Total endowment net assets	<u>\$ 14,852,675</u>	<u>\$ 7,130,836</u>	<u>\$ 33,302,302</u>	<u>\$ 55,285,813</u>

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**Note 16 - Endowment (continued)**

Changes in endowment net assets for the year ended May 31, 2012 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2011	\$ 16,390,579	\$ 10,390,300	\$ 30,531,839	\$ 57,312,718
Investment return				
Investment income, net of fees of \$304,084	296,591	631,928	-	928,519
Net depreciation - realized and unrealized	<u>(652,912)</u>	<u>(1,901,025)</u>	-	<u>(2,553,937)</u>
Total investment return	(356,321)	(1,269,097)	-	(1,625,418)
Contributions	-	40	579,783	579,823
Changes in cash surrender values	(190,152)	6,858	158,466	(24,828)
Appropriation of endowment assets for expenditure	(662,180)	(1,492,410)	-	(2,154,590)
Other changes:				
Reclassification	(363,101)	(833,495)	1,196,596	-
Transfers	<u>33,850</u>	<u>328,640</u>	<u>835,618</u>	<u>1,198,108</u>
Endowment net assets, May 31, 2012	<u>\$ 14,852,675</u>	<u>\$ 7,130,836</u>	<u>\$ 33,302,302</u>	<u>\$ 55,285,813</u>

Endowment net asset composition by type of fund consists of the following as of May 31, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (73,653)	\$ 10,390,300	\$ 30,531,839	\$ 40,848,486
Board-designated endowment funds	<u>16,464,232</u>	<u>-</u>	<u>-</u>	<u>16,464,232</u>
Total endowment net assets	<u>\$ 16,390,579</u>	<u>\$ 10,390,300</u>	<u>\$ 30,531,839</u>	<u>\$ 57,312,718</u>

**CALIFORNIA LUTHERAN UNIVERSITY**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 16 - Endowment (continued)**

Changes in endowment net assets for the year ended May 31, 2011 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2010	\$ 14,403,168	\$ 6,763,043	\$ 29,207,847	\$ 50,374,058
Investment return				
Investment income, net of fees of \$274,251	34,984	746,946	-	781,930
Net appreciation - realized and unrealized	<u>2,199,212</u>	<u>4,346,176</u>	-	<u>6,545,388</u>
Total investment return	2,234,196	5,093,122	-	7,327,318
Contributions	500	-	664,655	665,155
Changes in cash surrender values	194,457	-	56,277	250,734
Appropriation of endowment assets for expenditure	(194,350)	(1,777,170)	-	(1,971,520)
Other changes:				
Reclassification	(310,655)	304,155	6,500	-
Transfers	<u>63,263</u>	<u>7,150</u>	<u>596,560</u>	<u>666,973</u>
Endowment net assets, May 31, 2011	<u>\$ 16,390,579</u>	<u>\$ 10,390,300</u>	<u>\$ 30,531,839</u>	<u>\$ 57,312,718</u>

**Funds with deficiencies** - From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the University to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were approximately \$134,000 and \$74,000 as of May 31, 2012 and 2011, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that were deemed prudent by the governing board. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

**Return objectives and risk parameters** - The University has adopted investment and spending policies that attempt to be prudent and 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, the long-term minimum need of the endowment is to exceed a total return averaging at least the annual spending rate plus inflation, fees and costs. Actual returns in any year may vary from this amount. The long-term objective is to build endowment value over time by achieving incremental returns in excess of need while appropriately managing portfolio risk.

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**NOTES TO FINANCIAL STATEMENTS**

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**Note 16 - Endowment (continued)**

**Strategies employed for achieving objectives** - To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The University targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

**Spending policy and how the investment objectives relate to spending policy** - The University has a policy of appropriating for distribution each year 5.00% of its endowment fund's average fair value for the twelve quarters prior to and including December 31 preceding the fiscal year-end. 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 4.00% 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.

**Note 17 - Derivative Instruments**

The University uses an interest rate exchange agreement 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 agreement is recognized as either an asset or liability on the consolidated statements of financial position and is 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 gain or loss from the interest rate exchange agreement is reflected in the consolidated statements of activities.

The University entered into an interest rate exchange agreement during 2011. The interest rate exchange agreement has an original notional amount of \$4,200,000. The agreement fixes the University's one month LIBOR interest rate at 4.18% through the February 1, 2019 expiration date.

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**Note 17 - Derivative Instruments (continued)**

The interest rate exchange agreement between the University and a third party (counterparty) provides 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 could 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 University's counterparties. The counterparties to these contracts are financial institutions that carry investment-grade credit ratings. The interest rate exchange agreement contains collateral provisions applicable to both parties to mitigate credit risk. The University does not anticipate non-performance by its counterparty.

Derivative instruments are reported in the consolidated statements of financial position at fair value as of May 31, 2012 and 2011 as follows:

Derivates Not Designated as Hedging Instruments	Liabilities Derivative	
	Statement of Financial Position Location	Fair Value
		2012      2011
Interest exchange agreement	Interest rate exchange agreement liability	\$ 227,178    \$ 140,592
Derivates Not Designated as Hedging Instruments	Location of Loss on Derivates Recognized in the Statement of Changes in Net Assets	Amount of Loss on Derivatives Recognized in the Statement of Changes in Net Assets
		2012      2011
Interest exchange agreement	Unrealized loss on interest rate exchange agreement	\$ (86,586)    \$ (140,592)

**Note 18 - Subsequent Events**

The University has evaluated subsequent events through September 13, 2012, which is the date that the consolidated financial statements were available for issuance, and concluded that there were no events or transactions that need to be disclosed.