

Consolidated Financial Statements and Report of Independent Auditors

**Abilene Christian University**

May 31, 2013 and 2012

## **Report of Independent Auditors**

Board of Trustees  
Abilene Christian University

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Abilene Christian University (the University), which comprise the consolidated statements of financial position as of May 31, 2013 and 2012, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

#### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditor's 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit 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 auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Abilene Christian University as of May 31, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated August 13, 2013, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control over financial reporting and compliance.

*Dennis Kinard & Co., PC*  
Certified Public Accountants

Abilene, Texas  
August 13, 2013

**Abilene Christian University**

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

May 31, 2013 and 2012

ASSETS	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 3,805,367	\$ 6,962,991
Accounts and notes receivable, net	4,901,369	5,113,956
Contributions receivable, net	19,227,638	8,697,329
Inventories	1,803,244	1,694,074
Prepaid expenses and other assets	4,367,013	3,131,706
Investments	324,855,809	303,710,570
Charitable trusts and annuities	34,083,817	27,998,680
Property and equipment, net	<u>141,628,353</u>	<u>143,751,766</u>
Total assets	<u>\$ 534,672,610</u>	<u>\$ 501,061,072</u>
LIABILITIES AND NET ASSETS		
Accounts payable	\$ 1,772,066	\$ 1,671,162
Accrued interest payable	399,692	399,482
Accrued salaries and benefits	10,743,923	14,914,914
Deposits and other liabilities	8,679,061	8,072,255
Reserve for charitable trusts and annuities	19,718,979	16,975,861
Net advances on lines of credit	20,000,000	15,800,000
Long-term obligations	<u>59,396,713</u>	<u>64,027,517</u>
Total liabilities	<u>120,710,434</u>	<u>121,861,191</u>
Net assets		
Unrestricted	193,604,924	189,577,154
Temporarily restricted	116,304,003	92,766,169
Permanently restricted	<u>104,053,249</u>	<u>96,856,558</u>
Total net assets	<u>413,962,176</u>	<u>379,199,881</u>
Total liabilities and net assets	<u>\$ 534,672,610</u>	<u>\$ 501,061,072</u>

The accompanying notes are an integral part of these consolidated statements.

# Abilene Christian University

## CONSOLIDATED STATEMENTS OF ACTIVITIES

Year ended May 31, 2013

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating:				
Revenues, gains, and other support				
Tuition and fees	\$ 97,703,226	\$ -	\$ -	\$ 97,703,226
Less scholarship allowances	<u>(39,670,349)</u>	<u>-</u>	<u>-</u>	<u>(39,670,349)</u>
Net tuition and fees	58,032,877	-	-	58,032,877
Auxiliary enterprises sales and services	22,338,619	-	-	22,338,619
Private gifts and grants	1,692,395	5,574,480	-	7,266,875
Endowment support	7,565,762	8,343,308	-	15,909,070
Government grants and contracts	5,507,968	-	-	5,507,968
Other revenue	2,731,821	-	-	2,731,821
Net assets released from restrictions	<u>11,872,438</u>	<u>(11,872,438)</u>	<u>-</u>	<u>-</u>
Total revenues, gains, and other support	109,741,880	2,045,350	-	111,787,230
Expenses				
Operating expenses:				
Instruction and research	35,725,374	-	-	35,725,374
Public services	2,621,071	-	-	2,621,071
Academic support	10,405,562	-	-	10,405,562
Student services	18,302,509	-	-	18,302,509
Expenses of auxiliary enterprises	21,562,778	-	-	21,562,778
Fundraising	3,626,433	-	-	3,626,433
Management and general	<u>21,402,466</u>	<u>-</u>	<u>-</u>	<u>21,402,466</u>
Total operating expenses	<u>113,646,193</u>	<u>-</u>	<u>-</u>	<u>113,646,193</u>
Change in net assets from operating activities	(3,904,313)	2,045,350	-	(1,858,963)
Non-operating:				
Contributions for endowment, plant, and other	539,233	14,270,489	4,397,187	19,206,909
Investment return, net of amount designated for operations	6,411,987	8,178,305	661,787	15,252,079
Other revenues	311,804	-	-	311,804
Net assets released from endowment, plant, and other	1,116,815	(1,116,815)	-	-
Expenses for endowment, plant, and other	<u>(482,434)</u>	<u>-</u>	<u>-</u>	<u>(482,434)</u>
Changes in value of split-interest agreements	<u>34,678</u>	<u>160,505</u>	<u>2,137,717</u>	<u>2,332,900</u>
Net non-operating revenues, expenses, and other changes	<u>7,932,083</u>	<u>21,492,484</u>	<u>7,196,691</u>	<u>36,621,258</u>
Total change in net assets	4,027,770	23,537,834	7,196,691	34,762,295
Net assets at beginning of year	<u>189,577,154</u>	<u>92,766,169</u>	<u>96,856,558</u>	<u>379,199,881</u>
Net assets at end of year	<u>\$ 193,604,924</u>	<u>\$ 116,304,003</u>	<u>\$ 104,053,249</u>	<u>\$ 413,962,176</u>

The accompanying notes are an integral part of these consolidated statements.

# Abilene Christian University

## CONSOLIDATED STATEMENTS OF ACTIVITIES

Year ended May 31, 2012

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating:				
Revenues, gains, and other support				
Tuition and fees	\$ 95,478,126	\$ -	\$ -	\$ 95,478,126
Less scholarship allowances	<u>(35,162,203)</u>	<u>-</u>	<u>-</u>	<u>(35,162,203)</u>
Net tuition and fees	60,315,923	-	-	60,315,923
Auxiliary enterprises sales and services	21,562,816	-	-	21,562,816
Private gifts and grants	2,493,379	2,423,370	-	4,916,749
Endowment support	6,770,390	8,151,071	-	14,921,461
Government grants and contracts	6,302,301	-	-	6,302,301
Other revenue	3,997,065	-	-	3,997,065
Net assets released from restrictions	<u>10,962,087</u>	<u>(10,962,087)</u>	<u>-</u>	<u>-</u>
Total revenues, gains, and other support	112,403,961	(387,646)	-	112,016,315
Expenses				
Operating expenses:				
Instruction and research	34,832,280	-	-	34,832,280
Public services	2,716,016	-	-	2,716,016
Academic support	9,859,661	-	-	9,859,661
Student services	19,332,806	-	-	19,332,806
Expenses of auxiliary enterprises	21,654,203	-	-	21,654,203
Fundraising	3,756,285	-	-	3,756,285
Management and general	<u>21,000,362</u>	<u>-</u>	<u>-</u>	<u>21,000,362</u>
Total operating expenses	<u>113,151,613</u>	<u>-</u>	<u>-</u>	<u>113,151,613</u>
Change in net assets from operating activities	(747,652)	(387,646)	-	(1,135,298)
Non-operating:				
Contributions for endowment, plant, and other	3,844,902	5,499,031	4,613,324	13,957,257
Investment return, net of amount designated for operations	2,780,983	(11,008,692)	(869,283)	(9,096,992)
Other revenues	104,655	-	-	104,655
Net assets released from endowment, plant, and other	1,386,352	(1,386,352)	-	-
Expenses for endowment, plant, and other	(729,260)	-	-	(729,260)
Changes in value of split-interest agreements	<u>30,470</u>	<u>(11,211)</u>	<u>(424,729)</u>	<u>(405,470)</u>
Net non-operating revenues, expenses, and other changes	<u>7,418,102</u>	<u>(6,907,224)</u>	<u>3,319,312</u>	<u>3,830,190</u>
Total change in net assets	6,670,450	(7,294,870)	3,319,312	2,694,892
Net assets at beginning of year	<u>182,906,704</u>	<u>100,061,039</u>	<u>93,537,246</u>	<u>376,504,989</u>
Net assets at end of year	<u>\$ 189,577,154</u>	<u>\$ 92,766,169</u>	<u>\$ 96,856,558</u>	<u>\$ 379,199,881</u>

The accompanying notes are an integral part of these consolidated statements.

**Abilene Christian University**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities		
Change in net assets	\$ 34,762,295	\$ 2,694,892
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation of property and equipment	7,115,644	7,264,305
Gain on sale of property and equipment	(67,948)	(8,731)
Provision for credit losses	596,624	691,313
(Increase) decrease in:		
Accounts and notes receivable	(885,785)	(567,020)
Contributions receivable	(10,530,309)	(3,087,833)
Inventories	(109,170)	403,747
Prepaid expenses and other assets	(1,235,307)	(1,001,944)
Increase (decrease) in:		
Accounts payable	100,904	(1,321,824)
Accrued interest payable	210	(72,772)
Accrued salaries and benefits	(4,170,991)	852,694
Deposits and other liabilities	606,806	(2,374,323)
Noncash contributions	(2,064,241)	(3,974,716)
Contributions restricted for long-term investment	(7,881,715)	(5,278,862)
Interest and dividends restricted for reinvestment	(366,243)	(143,033)
Equity in loss of unconsolidated entity	40,273	32,834
Changes in value of split-interest agreements	(2,332,900)	405,470
Net unrealized and realized gains on investments	<u>(20,109,217)</u>	<u>5,649,231</u>
Net cash (used in) provided by operating activities	(6,531,070)	163,428
Cash flows from investing activities		
Purchases of property and equipment	(4,880,937)	(8,958,190)
Proceeds from sale of equipment	101,654	8,731
Repayment of loans from students, faculty, and others	501,748	724,040
Proceeds from sales and maturities of investments	49,771,924	53,553,797
Purchases of investments	<u>(48,404,324)</u>	<u>(51,695,362)</u>
Net cash used in investing activities	\$ (2,909,935)	\$ (6,366,984)

The accompanying notes are an integral part of these consolidated statements.

**Abilene Christian University**

**CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED**

Years ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from financing activities		
Proceeds from contributions restricted for:		
Investment in endowment and other	\$ 6,155,261	\$ 3,780,278
Investment in plant	<u>1,726,454</u>	<u>1,498,584</u>
	7,881,715	5,278,862
Other financing activities:		
Interest and dividends restricted for reinvestment	366,243	143,033
Payments of split-interest obligations	(1,533,773)	(1,519,650)
Proceeds from lines of credit	14,152,385	32,666,847
Payments of lines of credit	(9,952,385)	(30,166,847)
Proceeds from long-term obligations	-	6,820,404
Payments of long-term obligations	<u>(4,630,804)</u>	<u>(4,774,773)</u>
	<u>(1,598,334)</u>	<u>3,169,014</u>
Net cash provided by financing activities	<u>6,283,381</u>	<u>8,447,876</u>
Net (decrease) increase in cash and cash equivalents	(3,157,624)	2,244,320
Cash and cash equivalents at beginning of year	<u>6,962,991</u>	<u>4,718,671</u>
Cash and cash equivalents at end of year	<u>\$ 3,805,367</u>	<u>\$ 6,962,991</u>
Non-cash investing and financing activities:		
Improvements capitalized by increases to accounts payable	\$ 66,339	\$ 30,000
Equipment capitalized by an increase to long-term obligations	-	85,769
Equipment capitalized by a non-cash contribution	145,000	-
Investments acquired by non-cash contributions	1,919,241	3,974,716
Other required disclosures:		
Cash paid for interest	\$ 2,857,518	\$ 3,026,399

The accompanying notes are an integral part of these consolidated statements.



## **Abilene Christian University**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

May 31, 2013 and 2012

#### **NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### Consolidation

The accompanying consolidated financial statements include the financial position, activities, and cash flows of Abilene Christian University (the “University” or “ACU”), a not for profit institution of higher education in Abilene, Texas; its subsidiaries, ACIMCO, ACU Management LLC, and ACU in Oxford (UK); and additionally the Grace L. Woodward Memorial Endowment Trust. All significant interrelated accounts and transactions have been eliminated in the accompanying consolidated financial statements.

Stone-Campbell Restoration Movement Publishers (“SCRMP”) was dissolved as a separate entity on May 31, 2013, and its assets, liabilities, and net assets were absorbed by the University at that time. The financial position, activities, and cash flows of SCRMP are included in the accompanying consolidated financial statements as of and for the years ended May 31, 2013 and 2012. No gains or losses were recognized in the dissolution of SCRMP.

The ACU Foundation (the “Foundation”) was dissolved as a separate entity on May 31, 2012, and its assets, liabilities, and net assets were absorbed by the University at that time. The financial position, activities, and cash flows of the Foundation are included in the accompanying consolidated financial statements as of and for the years ended May 31, 2013 and 2012. No gains or losses were recognized in the dissolution of the Foundation.

##### Basis of Accounting

The consolidated financial statements of the University have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The focus of these financial statements is to present the University as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of transactions into three classes of net assets - unrestricted, temporarily restricted, or permanently restricted.

- Unrestricted net assets—Net assets not subject to donor-imposed stipulations.
- Temporarily restricted net assets—Net assets subject to donor-imposed stipulations that may or will be met by actions of the University and/or the passage of time.
- Permanently restricted net assets—Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### Statement of Activities

The University defines operating activities, as included in the accompanying statement of activities, as the revenue and expenses resulting from its educational programs and other core mission activities. Donor-restricted contributions to endowments and capital contributions, as well as investment returns in excess of the University's defined spending limit, are excluded from operating activities and separately reported as non-operating activities in the accompanying statement of activities.

##### Contributions

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class.

Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. Amortization of discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any. An allowance for uncollectible contributions receivable is provided based upon management's judgment, including such factors as prior collection history, type of contribution, and nature of fund-raising activity. Contributions of land, building, and equipment without donor stipulations concerning the use of such assets are reported as revenues of the unrestricted net asset class. The University does not imply a time restriction on the use of contributed long-lived assets unless specified by donors. Contributions of cash or other assets to be used to acquire land, building, and equipment with such donor stipulations are reported as revenues of the temporarily restricted net asset class; the restrictions are considered to be released upon the acquisition of such assets.

##### Endowment

The University's endowment is subject to the version of the *Uniform Prudent Management of Institutional Funds Act* ("UPMIFA") enacted by the state of Texas, which is described in Note I. Under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 958 *Not-for-Profit Entities*, a not-for-profit organization that is subject to an enacted version of UPMIFA shall classify a portion of a donor-restricted endowment fund of perpetual duration as permanently restricted net assets. The amount classified as permanently restricted shall be the amount of the fund (a) that must be retained permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, the organization's governing board determines must be retained (preserved) permanently consistent with the relevant law.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### Fair Value Measurements

ASC Topic 820 *Fair Value Measurements and Disclosures* ("ASC 820") provides a framework for measuring the fair value of assets and liabilities and illustrates key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The standard establishes a hierarchy that prioritizes the inputs to fair value measurements based on the extent to which inputs to valuation techniques are observable in the marketplace. The University has implemented this standard with respect to the valuation of its financial assets and liabilities and their corresponding designations within the fair value hierarchy described in Note O.

##### Fair Value Option

For certain assets and liabilities, the University has elected the fair value option provided by ASC Topic 825 *Financial Instruments* ("ASC 825"), which allows entities to measure eligible financial instruments at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported within the change in net assets. The decision to elect the fair value option is determined on an instrument-by-instrument basis, must be applied to an entire instrument, and is irrevocable once elected. The University has elected to apply the fair value option to its investments in real estate and mineral interests in order to present the most relevant values on these investments.

##### Investments

Readily marketable equity and fixed income securities (investments readily marketable on national exchanges) are carried at fair value, as determined by the last reported sales price on the date of valuation, or if there has been no sale on that date, the average of the bid and asked prices. Real estate and mineral interests are carried at fair value based on appraised values or reserve analyses. In addition, the University maintains non-marketable alternative investments (primarily limited partnerships) carried at fair value based on information provided by external investment managers at the most recent valuation date prior to fiscal year-end. Other investments include cash and cash equivalents carried at cost, which approximates fair value, and notes receivable carried at net realizable value, which approximates fair value. The net realized and unrealized gains (losses) in fair value of investments are reflected in the consolidated statements of activities within investment return, net of amount designated for operations. The value of endowment support is determined by the amounts provided from the endowment to support the operations of the University. Total investment income reported in Note D is determined by combining endowment support and investment return, net of amount designated for operations.

Income and realized and unrealized gains and losses on investments of endowments and similar funds are reported as changes in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanent endowment fund; as changes in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income or if the funds have not been appropriated for use in operations; and as changes in unrestricted net assets in all other cases.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Non-endowment investments in for-profit entities in which the University does not own a controlling interest in the investee but possesses the ability to significantly influence the operating and financial policies of the investee are recorded on the equity method of accounting. The equity method of accounting requires investments to be initially recorded at cost and subsequently increased (decreased) for the University's share of the investee's net income (loss) and reduced when distributions are received. At May 31, 2013, the University owned 47% of the outstanding common stock of Connected Consulting, Inc. ("Connected Consulting"). The value of the University's investment in Connected Consulting under the equity method was \$116,097 at May 31, 2013. At May 31, 2013 and 2012, the University owned 25% of the outstanding common stock of Genesis Network Solutions, Inc. ("Genesis"). The value of the University's investment in Genesis under the equity method was \$75,927 and \$85,297 at May 31, 2013 and 2012, respectively. Two ACU board of trustees members have indirect ownership in Genesis.

##### Use of Estimates

The preparation of consolidated financial statements in conformity with US GAAP 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 revenue and expenses during the reporting period. Significant estimates include the valuation of investments and other financial instruments, provisions for credit losses and uncollectible pledges, asset retirement obligations, and the accumulated post-retirement benefit obligation. Actual results could differ from those estimates.

##### U.S. Income Tax Status and Accounting for Uncertainty in Income Taxes

The University is a tax-exempt institution as an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended ("IRC") and is not a "private foundation" under Section 501(a) of the IRC; accordingly, no provision for income taxes has been made in the consolidated financial statements. The Foundation, SCRMP, and ACIMCO have also been accorded recognition as exempt from income tax under Section 501(a) of the IRC, as organizations described in Section 501(c)(3) and 509(a)(3) of the IRC. For the years ended May 31, 2013 and 2012, the University incurred unrelated business activity related to certain retail sales, advertising, rental income, oil and gas working interest, and certain alternative investments, resulting in an immaterial amount of unrelated business income.

Tax positions taken related to the University's tax-exempt status, unrelated business income activities, deductibility of expenses for unrelated business activities, and other miscellaneous tax positions have been reviewed, and management believes that material positions taken by the University will more likely than not be sustained by examination. Accordingly, the University has not recorded a liability for uncertain tax positions. As of May 31, 2013, the University's tax years 2007 to 2013 remain subject to examination.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, the University considers all cash and other highly liquid investments with original maturities of three months or less to be cash equivalents. The University places its cash and cash equivalents with high quality financial institutions, which at times may exceed federally insured limits. The University has not experienced any losses on such accounts. Deposits subject to credit risk were \$3,431,632 and \$6,618,536 at May 31, 2013 and 2012, respectively. Cash balances of \$338,791 and \$322,932 at May 31, 2013 and 2012, respectively, were restricted for the Federal Perkins loan program and are required to be reported in a separate account.

##### Accounts and Notes Receivable

Accounts and notes receivable are recorded at the contractual amounts owed by students and others. The values are adjusted, when necessary, through an allowance for credit losses. Interest income is recorded on the accrual basis in accordance with the terms of receivables.

ASC Topic 310 *Receivables* ("ASC 310") addresses disclosures of student loans and other financing receivables and requires enhanced disclosures for certain financing receivables, such as student loans. Other trade receivables, such as student accounts, are exempted from the enhanced disclosures. ASC 310 defines a loan portfolio segment as the level at which an entity develops and documents a systematic methodology to determine the allowance for credit losses and a class of financing receivables as the level of disaggregation of portfolio segments based on the initial measurement attribute, risk characteristics, and methods for assessing risk. The University's student loan portfolio consists of a single segment (Student Loans). The classes of financing receivables within the Student Loan segment are Institutional Notes and Federal Perkins Notes. The allowance for credit losses is presented by portfolio segment in Note B.

Estimated allowances for credit losses are maintained at levels that, in the judgment of management, are adequate to meet the present and potential future risks of uncollectible receivable balances. Management's judgment is based on a variety of factors, which include experience related to charge-offs and recoveries and scrutiny of individual accounts and notes receivable. Receivables are unsecured and considered past due based on contractual terms. Amounts deemed by management to be uncollectible are charged to expense. Recoveries on receivables previously charged-off are credited to expense. Provisions for credit losses are charged to expense and credited to the allowance for credit losses. Past due receivables are not placed on nonaccrual status, and payments received on past due receivables are applied to principal and interest according to contractual terms.

Student loans are evaluated for possible impairment based on four credit quality status indicators: deferred, current, performing, and nonperforming. Deferred loans do not require repayment during the time in which a student is enrolled in college-level courses based on the terms of the loan. Current loans are those in repayment status and in which the borrower remains current with all contractual terms of the loan. Performing loans are those in which the borrower is not current with all contractual terms of the loan but has established a recent payment history. Nonperforming loans are those in which the borrower has defaulted on the terms of the loan and no recent payment history exists; nonperforming loans are considered impaired.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

##### Accounts and Notes Receivable - continued

The assets and liabilities of student loans financed primarily by the federal government and administered by the University for the Federal Perkins Loan Program are included with those of the University. The total of the federal government portion of these net assets is included in deposits and other liabilities in the accompanying statements of financial position.

##### Inventories

Inventories are valued at amounts, which, in the aggregate, approximate the lower of cost or market on the first-in, first-out basis. Losses of \$5,707 and \$78,423 were recorded for obsolete inventory for the years ended May 31, 2013 and 2012, respectively.

##### Taxes Collected from Customers and Remitted to Governmental Authorities

Sales and use taxes are reported on a gross basis within revenues and costs. These taxes amounted to \$543,000 and \$501,630 for the years ended May 31, 2013 and 2012, respectively.

##### Property and Equipment

Investments in the physical plant are recorded at cost. Significant renovations to existing buildings are capitalized, while maintenance and repairs are expensed when incurred. Purchases and improvements under \$5,000 are not capitalized. Provision for depreciation is made on a straight-line basis over the estimated useful life of the asset. Currently, these estimated useful lives are as follows:

Buildings and building improvements	10-55 years
Improvements other than buildings	5-15 years
Equipment	5-20 years

When disposition is made of plant assets, the cost and accumulated depreciation are removed from the accounting records, and the resulting gain or loss is recognized in the consolidated statements of activities.

##### Advertising Costs

Advertising costs are expensed as incurred and totaled \$333,116 and \$348,740 for the years ended May 31, 2013 and 2012, respectively.

##### Functional Allocation of Expenses

The expenses of providing various programs and support services have been categorized on a functional basis in the statements of activities. Accordingly, expenses such as depreciation, interest expense, and operation and maintenance of plant have been allocated directly or based on square footage among the functional categories.

# Abilene Christian University

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

### NOTE B - FINANCING RECEIVABLES

In accordance with ASC Topic 310 *Receivables*, the University's accounts and notes receivable are considered financing receivables, which represent a contractual right to receive money either on demand or on a fixed or determinable date.

Financing receivables consisted of the following at May 31, 2013:

	Student & Commercial <u>Accounts</u>	Student <u>Loans</u>	Grants, Minerals, <u>Other</u>	<u>Total</u>
Gross receivables	\$ 1,420,460	\$ 2,582,544	\$ 1,522,764	\$ 5,525,768
Less allowance for credit losses	<u>(328,616)</u>	<u>(295,783)</u>	<u>-</u>	<u>(624,399)</u>
Receivables, net of allowance for credit losses	<u>\$ 1,091,844</u>	<u>\$ 2,286,761</u>	<u>\$ 1,522,764</u>	<u>\$ 4,901,369</u>

Financing receivables consisted of the following at May 31, 2012:

	Student & Commercial <u>Accounts</u>	Student <u>Loans</u>	Grants, Minerals, <u>Other</u>	<u>Total</u>
Gross receivables	\$ 1,364,815	\$ 2,665,780	\$ 1,690,492	\$ 5,721,087
Less allowance for credit losses	<u>(306,950)</u>	<u>(300,181)</u>	<u>-</u>	<u>(607,131)</u>
Receivables, net of allowance for credit losses	<u>\$ 1,057,865</u>	<u>\$ 2,365,599</u>	<u>\$ 1,690,492</u>	<u>\$ 5,113,956</u>

Activity in the allowance for credit losses and the recorded investment in the Student Loan segment of financing receivables were as follows as of and for the years ended May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Allowance for credit losses:		
Beginning balance	\$ 300,181	\$ 296,964
Charge-offs	(80,173)	(134,558)
Recoveries	(15,814)	(16,868)
Provision	<u>91,589</u>	<u>154,643</u>
Ending balance	<u>\$ 295,783</u>	<u>\$ 300,181</u>
Allowance for credit losses:		
Allocated to student loans individually evaluated for impairment	\$ 153,749	\$ 194,631
Allocated to student loans collectively evaluated for impairment	<u>142,034</u>	<u>105,550</u>
Ending balance	<u>\$ 295,783</u>	<u>\$ 300,181</u>

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE B - FINANCING RECEIVABLES - Continued**

	<u>2013</u>	<u>2012</u>
Financing receivables:		
Balance individually evaluated for impairment	\$ 382,686	\$ 450,901
Balance collectively evaluated for impairment	<u>2,199,858</u>	<u>2,214,879</u>
Ending balance	<u>\$ 2,582,544</u>	<u>\$ 2,665,780</u>

Student loans consisted of the following aging categories at May 31, 2013:

	<u>Past Due</u>			<u>Current and Deferred</u>	<u>Total</u>	<u>&gt; 90 Days and Accruing</u>
	<u>30-59 Days</u>	<u>60-89 Days</u>	<u>&gt; 90 Days</u>			
Institutional Notes	\$ 66,814	\$ 30,134	\$ 493,777	\$ 160,462	\$ 751,187	\$ 493,777
Federal Perkins	<u>69,625</u>	<u>56,833</u>	<u>201,579</u>	<u>1,503,320</u>	<u>1,831,357</u>	<u>201,579</u>
	<u>\$ 136,439</u>	<u>\$ 86,967</u>	<u>\$ 695,356</u>	<u>\$ 1,663,782</u>	<u>\$ 2,582,544</u>	<u>\$ 695,356</u>

Student loans consisted of the following aging categories at May 31, 2012:

	<u>Past Due</u>			<u>Current and Deferred</u>	<u>Total</u>	<u>&gt; 90 Days and Accruing</u>
	<u>30-59 Days</u>	<u>60-89 Days</u>	<u>&gt; 90 Days</u>			
Institutional Notes	\$ 29,854	\$ 42,540	\$ 566,133	\$ 114,176	\$ 752,703	\$ 566,133
Federal Perkins	<u>77,841</u>	<u>70,838</u>	<u>262,056</u>	<u>1,502,342</u>	<u>1,913,077</u>	<u>262,056</u>
	<u>\$ 107,695</u>	<u>\$ 113,378</u>	<u>\$ 828,189</u>	<u>\$ 1,616,518</u>	<u>\$ 2,665,780</u>	<u>\$ 828,189</u>

Student loan credit quality indicators are summarized below as of May 31, 2013:

	<u>Institutional Notes</u>	<u>Federal Perkins</u>	<u>Total</u>
Deferred	\$ -	\$ 979,141	\$ 979,141
Current	160,462	524,179	684,641
Performing	436,976	99,100	536,076
Nonperforming	<u>153,749</u>	<u>228,937</u>	<u>382,686</u>
	<u>\$ 751,187</u>	<u>\$ 1,831,357</u>	<u>\$ 2,582,544</u>



**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE B - FINANCING RECEIVABLES - Continued**

Student loan credit quality indicators are summarized below as of May 31, 2012:

	<u>Institutional Notes</u>	<u>Federal Perkins</u>	<u>Total</u>
Deferred	\$ 1,000	\$ 1,030,970	\$ 1,031,970
Current	113,176	471,372	584,548
Performing	443,896	154,465	598,361
Nonperforming	<u>194,631</u>	<u>256,270</u>	<u>450,901</u>
	<u>\$ 752,703</u>	<u>\$ 1,913,077</u>	<u>\$ 2,665,780</u>

The following table summarizes the University's investment in impaired student loans as of and for the year ended May 31, 2013:

	<u>Recorded Investment</u>	<u>Unpaid Principal</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income</u>
With no related allowance					
Institutional Notes	\$ -	\$ -	\$ -	\$ -	\$ -
Federal Perkins	228,937	228,937	-	242,604	56,896
With a related allowance					
Institutional Notes	153,749	153,749	153,749	174,190	15,177
Federal Perkins	-	-	-	-	-
Total					
Institutional Notes	153,749	153,749	153,749	174,190	15,177
Federal Perkins	<u>228,937</u>	<u>228,937</u>	<u>-</u>	<u>242,604</u>	<u>56,896</u>
	<u>\$ 382,686</u>	<u>\$ 382,686</u>	<u>\$ 153,749</u>	<u>\$ 416,794</u>	<u>\$ 72,073</u>

No allowance is recorded on Federal Perkins loans because the University does not bear the risk of loss on these loans.

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE B - FINANCING RECEIVABLES - Continued**

The following table summarizes the University's investment in impaired student loans as of and for the year ended May 31, 2012:

	<u>Recorded Investment</u>	<u>Unpaid Principal</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income</u>
With no related allowance					
Institutional Notes	\$ -	\$ -	\$ -	\$ -	\$ -
Federal Perkins	256,270	256,270	-	271,614	62,845
With a related allowance					
Institutional Notes	194,631	194,631	194,631	156,192	8,710
Federal Perkins	-	-	-	-	-
Total					
Institutional Notes	194,631	194,631	194,631	156,192	8,710
Federal Perkins	<u>256,270</u>	<u>256,270</u>	<u>-</u>	<u>271,614</u>	<u>62,845</u>
	<u>\$ 450,901</u>	<u>\$ 450,901</u>	<u>\$ 194,631</u>	<u>\$ 427,806</u>	<u>\$ 71,555</u>

**NOTE C - CONTRIBUTIONS RECEIVABLE**

Contributions receivable consisted of the following at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Unconditional promises expected to be collected in:		
Less than one year	\$ 7,830,658	\$ 3,323,055
One year to five years	9,216,910	5,373,551
Over five years	<u>3,200,000</u>	<u>493,750</u>
	20,247,568	9,190,356
Less discount for net present value	(562,579)	(133,732)
Less allowance for uncollectible contributions receivable	<u>(457,351)</u>	<u>(359,295)</u>
	<u>\$ 19,227,638</u>	<u>\$ 8,697,329</u>

**Abilene Christian University**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

**NOTE C - CONTRIBUTIONS RECEIVABLE - Continued**

The contributions are to be utilized for the following purposes:

	<u>2013</u>	<u>2012</u>
Operations and scholarships	\$ 2,693,978	\$ 1,569,622
Endowment	7,540,560	6,069,876
Acquisition of land, building, and equipment	<u>8,993,100</u>	<u>1,057,831</u>
	<u>\$ 19,227,638</u>	<u>\$ 8,697,329</u>

Contributions receivable have been discounted using rates ranging from 0.15% to 4.49% as of May 31, 2013 and 2012.

**NOTE D - INVESTMENTS**

Investments consisted of the following at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Mutual funds and investment partnerships managed by third parties	\$ 245,150,796	\$ 221,633,266
Notes receivable	216,878	244,217
Stocks and bonds	19,831,881	18,927,695
Real estate and mineral interests	56,288,232	59,609,946
Outside managed	2,252,869	2,103,398
Other investments	<u>1,115,153</u>	<u>1,192,048</u>
	<u>\$ 324,855,809</u>	<u>\$ 303,710,570</u>

The University invests in non-marketable alternative investments (primarily limited partnerships) that are carried at estimated fair value provided by the management of the investment partnerships. The University believes that the carrying value of its alternative investments is a reasonable estimate of fair value. The University has pledged equity securities valued at \$38,342,906 and \$25,567,847 at May 31, 2013 and 2012, respectively, under a pledge agreement in connection with a line of credit (see Note G).

Outside managed investments primarily include several outside managed trusts comprised of stocks, bonds, real estate, mineral interests, and other assets.

**Abilene Christian University**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

**NOTE D - INVESTMENTS - Continued**

Investment income consisted of the following for the years ended May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Interest income	\$ 366,806	\$ 226,637
Dividend income	1,574,166	1,370,303
Mineral income	8,929,170	9,629,104
Ranch income	222,063	280,489
Equity in loss of unconsolidated entity	(40,273)	(32,834)
Net realized and unrealized gains (losses)	<u>20,109,217</u>	<u>(5,649,230)</u>
Total investment income	<u>\$ 31,161,149</u>	<u>\$ 5,824,469</u>

Total investment income includes gains (losses) from fair value changes of real estate and mineral interests, which are reported at fair value under the fair value option provided by ASC 825. These gains (losses) for the years ended May 31, 2013 and 2012, were (\$3,169,769) and \$344,640, respectively.

The University maintains an investment pool for use by its endowment (excluding assets held in trust). The University's policy allows the pool to invest in domestic equities, international equities, fixed income securities, marketable alternative investments, real estate, mineral interests, and other investments determined appropriate by management. Investments in mutual funds and investment partnerships are administered by professional third-party managers with different investment styles to diversify risk and maximize returns.

External investment expenses of \$369,404 and \$420,831 were recorded as reductions to investment return for the years ended May 31, 2013 and 2012, respectively.

The investment pool consisted of the following at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Mutual funds and investment partnerships managed by third parties	\$ 253,990,722	\$ 228,891,578
Cash and cash equivalents	<u>4,914,076</u>	<u>5,866,871</u>
	<u>\$ 258,904,798</u>	<u>\$ 234,758,449</u>

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE E - PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Land	\$ 3,438,702	\$ 3,438,702
Buildings	150,885,216	150,885,216
Improvements to land and buildings	52,131,569	50,156,857
Equipment	<u>20,369,925</u>	<u>19,330,428</u>
	226,825,412	223,811,203
Less accumulated depreciation and amortization	<u>(88,705,620)</u>	<u>(81,624,163)</u>
	138,119,792	142,187,040
Assets held for sale	1,361,621	1,385,549
Construction in progress	<u>2,146,940</u>	<u>179,177</u>
	<u>\$ 141,628,353</u>	<u>\$ 143,751,766</u>

Depreciation expense on property and equipment for the years ending May 31, 2013 and 2012, was \$7,115,644 and \$7,264,305, respectively. No interest costs were capitalized during the years ended May 31, 2013 and 2012.

Construction in progress as of May 31, 2013, consisted of renovation projects for ACU at City Square, ACU School of Nursing, The Department of Agriculture and Environmental Science, and other small projects. Construction in progress as of May 31, 2012, consisted of three small renovation projects.

In 2011, the University entered into a plan to dispose of an educational facility in Irving, Texas. The costs of this facility, net of accumulated depreciation of \$125,903 and \$101,975 at May 31, 2013 and 2012, respectively, are classified as assets held for sale in the table above.

**Abilene Christian University**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

**NOTE F - LONG-TERM OBLIGATIONS**

Long-term obligations consisted of the following as of May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Series 2011 Higher Education Revenue Bonds due in quarterly payments of \$800,000 plus interest at 65% of the 90-day LIBOR rate plus 2.06% (2.24% and 2.36% at May 31, 2013 and 2012, respectively) but not less than 3.25%, maturing on June 8, 2025.	\$ 13,563,079	\$ 14,078,165
Series 2010 Higher Education Revenue Bonds due in semiannual payments of \$330,196 including interest at a fixed rate of 5.596%, maturing on October 1, 2024.	5,545,423	5,881,329
Series 2009 Higher Education Revenue Bonds due in semiannual payments of \$250,000 plus interest accruing at 62.075% of the 30-day LIBOR rate plus 0.90% (1.02% and 1.05% as of May 31, 2013 and 2012, respectively), maturing on October 1, 2028.	7,750,000	8,250,000
Series 2006B Higher Education Revenue Bonds due in semiannual payments of \$65,485 plus interest at 65% of the 30-day LIBOR rate plus 0.90% (1.03% and 1.06% at May 31, 2013 and 2012, respectively), maturing on October 1, 2026.	1,767,077	1,898,047
Series 2006 Taxable Higher Education Revenue Bonds due in semiannual payments of \$150,000 plus interest at the 30-day LIBOR rate plus 0.65% (0.85% and 0.89% at May 31, 2013 and 2012, respectively), maturing on April 1, 2026.	3,900,000	4,200,000
Series 2006 Higher Education Revenue Bonds due in semiannual payments of \$25,390 plus interest at 65% of the 30-day LIBOR rate plus 0.55% (0.68% and 0.71% at May 31, 2013 and 2012, respectively) but not less than 3.25%, maturing on June 8, 2025.	660,133	710,913
Series 2005B Higher Education Revenue Bonds due in semiannual payments of \$50,750 plus interest at 65% of the 30-day LIBOR rate plus 1.00% (1.13% and 1.16% at May 31, 2013 and 2012, respectively), maturing on October 1, 2026.	1,268,750	1,370,250
Series 2005 Higher Education Revenue Bonds due in semiannual payments of \$167,500 plus interest at 65% of the 30-day LIBOR rate plus 1.00% (1.13% and 1.16% at May 31, 2013 and 2012, respectively), maturing on April 1, 2026.	4,355,000	4,690,000

# Abilene Christian University

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

### NOTE F - LONG-TERM OBLIGATIONS - Continued

	<u>2013</u>	<u>2012</u>
Series 2003 Higher Education Revenue Bonds due in semiannual payments ranging from \$217,982 to \$346,200 plus interest at 65% of the 30-day LIBOR rate plus 1.00% (1.13% and 1.16% at May 31, 2013 and 2012, respectively), maturing on October 1, 2023.	5,939,347	6,379,943
Series 2001 Higher Education Revenue Improvement Bonds due in semiannual payments ranging from \$247,688 to \$376,888 plus interest at 5.00%, maturing on April 1, 2021.	5,043,272	5,544,841
Series 1998 Higher Education Revenue Refunding Bonds due in annual payments ranging from \$915,000 to \$1,220,000 plus interest at 4.75%, maturing on October 1, 2018.	6,525,000	7,440,000
Cafeteria loan due in semiannual payments of \$115,643, including interest at a fixed rate of 6.5%, maturing on August 10, 2015. The loan is secured by the University's gross revenues on a parity basis with the lender of the Series 2009 tax-exempt revenue bonds and is subject to certain financial covenants.	1,758,717	1,868,032
Miscellaneous notes payable	1,320,915	1,726,705
Less discount on miscellaneous note payable	<u>-</u>	<u>(10,708)</u>
	<u>\$ 59,396,713</u>	<u>\$ 64,027,517</u>

At May 31, 2012, miscellaneous notes payable included a note that required imputation of interest at an effective rate of 4.06%. The principal value of this note was \$274,269 at May 31, 2012. The note was paid off during the year ended May 31, 2013.

The Omnibus Agreement to the Bond Agreements, amended in February 2010, requires the University to comply with three financial covenants including a debt service coverage ratio, liquidity ratio, and a primary reserve ratio. As of May 31, 2013 and 2012, the University was in compliance with all bond covenants.

At May 31, 2013 and 2012, the University had outstanding interest rate swap agreements on the 2003, 2005, 2006B, 2006 taxable, and 2009 bond issues. A swap agreement on the Series 2006 bond issue expired during the year ended May 31, 2012. Refer to Note P for further discussion of derivative instruments.

The Series 1998 bonds were refinanced on July 3, 2013, as described further in Note V.

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE F - LONG-TERM OBLIGATIONS - Continued**

A schedule of future fiscal year principal payments of long-term obligations is as follows:

2014	\$ 4,523,627
2015	4,666,490
2016	6,195,635
2017	4,800,199
2018	4,951,888
Thereafter	<u>34,258,874</u>
	<u>\$ 59,396,713</u>

Total interest expense for the years ended May 31, 2013 and 2012, was \$2,857,728 and \$2,953,627 respectively.

**NOTE G - NET ADVANCES ON LINES OF CREDIT**

The University has entered into line of credit agreements to provide operating cash flows, maximize endowment earnings, and facilitate cash management. The University executed a line of credit agreement with Bank of America, N.A. (the "Vision Debt"), which matures on December 22, 2013, and provides for maximum borrowings of up to \$20,000,000. For each draw request, the University has the option to pay interest at prime minus 1.75% (1.50% at May 31, 2013 and 2012) or LIBOR plus 0.50% (0.70% and 0.74% at May 31, 2013 and 2012, respectively). \$20,000,000 and \$15,800,000 were outstanding on the Vision Debt at May 31, 2013 and 2012, respectively. The Vision Debt is subject to a pledge agreement that grants the lender a security interest in certain types of investment securities that are pledged as collateral for advances on the Vision Debt. The pledge agreement sets a maximum borrowing base (\$30,019,697 and \$20,384,074 at May 31, 2013 and 2012, respectively) on the Vision Debt relative to the value of the securities pledged. The Vision Debt was refinanced on July 3, 2013, as described further in Note V.

An agreement with Bank of America, N.A. (the "BOA Operating Line") matures on April 5, 2014, and provides for maximum borrowings of \$8,000,000. For each new request, the University has the option to pay interest at prime (3.25% at May 31, 2013 and 2012) or the 30-day LIBOR rate plus 1.25% (1.45% and 1.49% at May 31, 2013 and 2012, respectively). No amount was outstanding on the BOA Operating Line at May 31, 2013 and 2012. Another agreement with Bank of America, N.A. (the "BOA Endowment Line") matures on April 5, 2014, and provides for maximum borrowings of \$5,000,000 with interest rate terms that are identical to the BOA Operating Line. No amount was outstanding on the BOA Endowment Line at May 31, 2013 and 2012.

An agreement with First Financial Bank, Abilene (the "FFIN Line"), matures on September 30, 2013, and provides for maximum borrowings of up to \$9,500,000 with interest payable at prime (3.25% at May 31, 2013 and 2012). No amount was outstanding on the FFIN Line at May 31, 2013 and 2012.



**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE H - RESTRICTIONS ON NET ASSET BALANCES**

Permanently restricted net assets are listed below according to the purpose for which the income for these items is to be used at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Student loans	\$ 611,804	\$ 563,193
Scholarships	65,806,169	60,944,562
Instruction, research, and divisional support	17,753,361	17,366,495
General operations	<u>5,001,216</u>	<u>5,890,648</u>
	89,172,550	84,764,898
Life income, student loan funds, and other accounts	<u>14,880,699</u>	<u>12,091,660</u>
	<u>\$ 104,053,249</u>	<u>\$ 96,856,558</u>

Temporarily restricted net assets are listed below according to the purpose for which the income for these items is to be used at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Gifts and other unexpended revenues and gains available for:		
Student loans	\$ 760,339	\$ 753,366
Scholarships	58,023,898	47,961,935
Instruction, research, and divisional support	30,766,644	28,061,086
General operations and unappropriated earnings	14,733,955	13,110,341
Acquisition of property and equipment	10,034,484	1,233,319
Life income, student loan funds, and other accounts	<u>1,984,683</u>	<u>1,646,122</u>
	<u>\$ 116,304,003</u>	<u>\$ 92,766,169</u>

**NOTE I - ENDOWMENT**

The University's endowment consists of individual endowment funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. Unrestricted endowment represents board-designated funds.

# Abilene Christian University

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

### NOTE I - ENDOWMENT - Continued

#### Interpretation of Relevant Law

The University interprets the State of Texas UPMIFA as allowing the University, absent donor stipulations to the contrary as stated in the gift instrument, to appropriate so much of a donor-restricted endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment is established. In the absence of explicit donor stipulations, the University designates 50% of endowment gifts to permanently restricted net assets and 50% to temporarily restricted net assets. The assets in the endowment fund remain restricted until appropriated for expenditure by the University.

The following factors are considered in making a determination to appropriate or accumulate donor restricted endowment funds: 1) The duration and preservation of the fund; 2) The purposes of the University and the donor restricted endowment fund; 3) General economic conditions; 4) The possible effect of inflation and deflation; 5) The expected total return from income and the appreciation of investments; 6) Other resources of the University; and 7) The investment policies of the University.

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

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 134,704,083	\$ 87,655,844	\$ 84,764,898	\$ 307,124,825
Contributions	539,233	4,232,552	4,232,552	9,004,337
Real estate, mineral, and other income	8,498,920	316,259	175,100	8,990,279
Dividends and interest	13,644	1,877,011	-	1,890,655
Net realized and unrealized losses	4,930,970	14,329,597	-	19,260,567
Endowment support	(7,565,762)	(8,343,308)	-	(15,909,070)
Transfers and other	<u>400,334</u>	<u>(59,354)</u>	<u>-</u>	<u>340,980</u>
Endowment net assets, end of year	<u>\$ 141,521,422</u>	<u>\$ 100,008,601</u>	<u>\$ 89,172,550</u>	<u>\$ 330,702,573</u>

# Abilene Christian University

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

### NOTE I – 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, beginning of year	\$ 128,572,166	\$ 94,069,926	\$ 79,590,565	\$ 302,232,657
Contributions	3,436,997	4,577,455	4,577,455	12,591,907
Real estate, mineral, and other income	9,222,177	211,043	-	9,433,220
Dividends and interest	386,710	1,157,220	-	1,543,930
Net realized and unrealized losses	(1,011,728)	(4,152,898)	(232,591)	(5,397,217)
Endowment support	(6,770,390)	(8,151,071)	-	(14,921,461)
Transfers and other	<u>868,151</u>	<u>(55,831)</u>	<u>829,469</u>	<u>1,641,789</u>
Endowment net assets, end of year	<u>\$ 134,704,083</u>	<u>\$ 87,655,844</u>	<u>\$ 84,764,898</u>	<u>\$307,124,825</u>

#### Return Objective and Risk Parameters

The University has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowments include those assets of donor-restricted funds that the University must hold in perpetuity or for a donor specified period as well as board designated funds. The University expects its endowment funds, over time, to provide an average rate of return in excess of 5.5% annually plus inflation. Actual returns in any given year may vary from this amount.

#### Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through capital appreciation (realized and unrealized) and current yield (interest, dividends, rents, and royalties). 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 an amount equal to 70% of an endowment's prior year distribution for spending, adjusted for inflation plus 1%, plus 30% of its beginning of year market value, times the target rate of 4.5%. Distributions are then limited to no less than 2% nor greater than 6% of beginning endowment market value and annual increases for an individual endowment to 7%. Accordingly, over time, the University expects the current spending policy to allow its endowment to grow at an average of at least 1% plus inflation 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.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE J - CHARITABLE TRUSTS AND ANNUITIES

The University is party to a number of charitable trusts and annuities, the majority of which the University is the trustee. Assets under charitable trusts and annuities consist of the following at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
University as trustee:		
Charitable trusts	\$ 27,884,046	\$ 22,775,896
Charitable gift annuities	<u>4,990,971</u>	<u>4,149,770</u>
	32,875,017	26,925,666
Third-party trustee	<u>1,208,800</u>	<u>1,073,014</u>
	<u>\$ 34,083,817</u>	<u>\$ 27,998,680</u>

For charitable trusts and annuities for which the University is trustee, contributions are recorded at fair value in the year of the agreement and are reflected as charitable trusts and annuities in the accompanying consolidated financial statements. For the years ended May 31, 2013 and 2012, \$1,783,622 and \$760,000, respectively, were recorded as contribution revenue related to these types of agreements. In addition to the recording of the asset, a liability is recorded representing the discounted future cash flows expected to be paid to the specified beneficiary designated by the donor. The estimated liability of future cash flows is based upon the life expectancy of the donor, the current market value of the trust, and the applicable federal rate ("AFR") related to each trust based on the AFR in effect at the date the trust was created. Investment income, payments to beneficiaries, and adjustments to the liability are reflected as changes in value of split-interest agreements in the consolidated statements of activities. The estimated liability for the future cash flows, as of May 31, 2013 and 2012, was \$19,718,979 and \$16,975,861, respectively.

For charitable trusts of which the University is not the trustee, contributions are recognized in the year the University becomes aware of the existence of the agreement and are valued at the discounted present value of expected future cash flows. The expected future cash flows have been discounted at a rate of 6% over the life expectancy of the parties involved and calculated based upon the current market value of the trust's assets and other factors stipulated in the agreements. The present value of the expected future cash flows has been reflected as a component of charitable trusts and annuities in the consolidated statements of financial position. The change in estimated present value is reflected as a change in value of split-interest agreements in the consolidated statements of activities.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE K - RETIREMENT PLAN

The University has a 403(b) defined contribution retirement plan covering substantially all full and part-time personnel. Employees are required to contribute 2% of salary to participate in the 403(b) plan, for which the University contributes up to 4% of the employee's salary. Employees have the option of contributing an additional 1% or 2% of base pay into the 403(b) plan, for which the University contributes a corresponding 2% or 4% of the employee's salary. University contributions under the plan, net of forfeitures, totaled \$2,838,193 and \$3,017,777 for the years ended May 31, 2013 and 2012, respectively.

Effective January 1, 2009, the University's 401(a) and 401(k) defined contribution plans were frozen to new participants and new contributions. Assets remaining in those plans will be distributed to participants in accordance with the provisions of the plan agreements.

The University has a 457(b) deferred compensation plan covering a select group of key employees. Qualified employees may defer a portion of their compensation as contributions to the plan. The University does not contribute to the plan. The values of the plan assets at May 31, 2013 and 2012 were \$387,252 and \$275,922, respectively, which are recorded as assets and liabilities on the consolidated statements of financial position.

#### NOTE L - POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

In addition to the University's defined contribution pension plans, the University sponsors a defined benefit health care plan that provides postretirement medical benefits to certain retired employees who had worked 10 years and attained age 55 while in service with the University as of May 31, 1995. The University is required to recognize the funded status of this benefit plan, measured as the difference between plan assets at fair value and the benefit obligation, as an asset or liability in its statement of financial position and to recognize previously unrecognized gains or losses and prior service costs or credits as a component of its consolidated statement of activities.

The following presents the plan's funded status as of May 31:

	<u>2013</u>	<u>2012</u>
Accumulated postretirement benefit obligation	\$(4,323,261)	\$(4,729,779)
Plan assets at fair value	<u>-</u>	<u>-</u>
Unfunded status	<u>\$(4,323,261)</u>	<u>\$(4,729,779)</u>
Accrued postretirement benefit cost	<u>\$(4,323,261)</u>	<u>\$(4,729,779)</u>

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE L - POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued**

Approximate annual benefit costs for the year ended May 31:

	<u>2013</u>	<u>2012</u>
Net periodic postretirement benefit cost	\$ <u>218,195</u>	\$ <u>218,195</u>
Employer contributions	\$ 394,409	\$ 322,262
Plan participant contributions	<u>21,108</u>	<u>22,584</u>
Benefits paid	\$ <u>415,517</u>	\$ <u>344,846</u>

The accrued postretirement benefit cost is recorded in accrued salaries and benefit expenses on the accompanying consolidated statements of financial position.

The weighted average assumptions related to the postretirement benefit plan are as follows at May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Discount rate	3.3%	4.5%
Health care cost trend rate	8.5%	8.5%
Ultimate health care cost trend rate	5.0%	5.0%
Years to reach ultimate cost trend	7	7

The University expects to contribute \$382,000 to the postretirement benefit plan in fiscal year 2013. Benefits expected to be paid over the next five years and the five fiscal years thereafter are as follows:

2014	\$ 382,000
2015	377,000
2016	379,000
2017	378,000
2018	372,000
2019-2023	1,648,000

**NOTE M - HEALTH INSURANCE**

The University maintains a partially self-funded health insurance plan with insured specific and aggregate stop-loss coverage, administered by a third party administrator. The administrator acts as the University's agent in making benefit payments on the University's behalf. The total liability for outstanding health claims was \$554,993 and \$491,365 at May 31, 2013 and 2012, respectively, and is recorded in accrued salaries and benefit expenses in the accompanying consolidated statements of financial position. Management believes the liability is adequate to fund any health claims incurred but not paid or reported as of the end of the fiscal year.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE N - COMMITMENTS AND CONTINGENCIES

The University leases facilities and equipment to support its study abroad programs, City Square, and other operating activities under non-cancelable operating agreements that extend through 2020. Rent expense related to these agreements for the years ended May 31, 2013 and 2012, was \$905,522 and \$678,655, respectively. Future minimum rentals under the non-cancelable leases as of May 31, 2013 are as follows:

Year ending <u>May 31,</u>	
2014	\$ 662,950
2015	525,129
2016	242,348
2017	189,077
2018	63,549
Thereafter	76,666

The University makes certain payments in currencies other than the United States dollar for its study abroad programs, which are subject to foreign currency exchange risk due to fluctuations in currency exchange rates. Gains and losses resulting from the settlement and revaluation of foreign currency transactions are recognized in the consolidated statements of activities.

At May 31, 2013, the University had open construction contracts for improvements to the campus water heating and cooling loop line with remaining commitments of approximately \$2,900,000. At May 31, 2012, no significant commitments related to construction contracts were outstanding.

On August 31, 2011, the University executed a letter of credit (the "Letter") with First Financial Bank, Abilene ("FFIN") in which the University authorizes the Development Corporation of Abilene, Inc. (the "DCOA") as the beneficiary of the Letter to draw up to \$300,000 from FFIN in the event Genesis defaults on its note payable to the DCOA and fails to cure any default within the required cure period. In the event the Letter is drawn upon, the University would become the borrower on a note payable to FFIN for all amounts outstanding on the Letter. The note payable associated with the Letter has a maturity date of August 31, 2012, with interest at the prime rate (3.25% at May 31, 2013 and 2012). No amounts were outstanding on the Letter at May 31, 2013 and 2012. The Letter expires on September 19, 2013.

In the normal course of operations, the University is named as a defendant in lawsuits and is subject to periodic examinations by regulatory agencies. An estimate of the possible loss or range of loss on these events cannot be made. However, after consultation with legal counsel, management believes that liabilities, if any, arising from such litigation and examinations would not have a material effect on the University's financial position, results of operations, or cash flows.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE O - FAIR VALUE MEASUREMENTS

ASC 820 requires certain disclosures about assets and liabilities measured and reported at fair value and emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a three-tier hierarchy described below to distinguish between various types of inputs used in determining the value of the University's investments and liabilities.

ASC 820 also governs fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent) and requires disclosures by major category of investment about the attributes of these investments. For classification purposes, the standard provides that if a reporting entity has the ability to redeem an investment with a private investment fund at the net asset value per share (or its equivalent) at the measurement date or within the near term and there are no other liquidity restrictions, the private investment shall be categorized as Level 2 within the hierarchy of inputs described below:

Level 1 Inputs - Quoted prices (unadjusted) in active markets for identical assets and liabilities. Level 1 assets include publicly traded securities and mutual funds. Valuations of these instruments do not require a high degree of judgment, as valuations are based on quoted prices in readily available, active markets.

Level 2 Inputs - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and inputs other than quoted prices that are observable, such as models or other valuation methodologies as described below. Assets in this category generally include real estate, certain hedge funds-of-funds, managed long/short funds, and other equity instruments. If the University has the ability to redeem its investment at the net asset value per share (or its equivalent) at the measurement date or within 120 days thereof and upon no greater than 90 days prior written notice and there are no other potential liquidity restrictions, the investment is categorized within Level 2. Liabilities in this category include interest rate swaps and bonds payable subject to interest rate swaps.

Level 3 Inputs - Unobservable inputs for the valuation of the asset or liability. Level 3 assets include instruments for which there is little, if any, market activity. These inputs require significant management judgment or estimation. Assets in this category generally include certain hedge funds-of-funds, private equity funds, privately held stock, other similar assets, debenture bonds, and mineral interests. These financial instruments have inputs that cannot be validated by readily determinable market data and generally involve considerable judgment by management.



**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE O - FAIR VALUE MEASUREMENTS - Continued**

The following schedules classify the University's assets and liabilities carried at fair value based upon the three-tier hierarchy required by ASC 820:

		Fair Value Measurements at May 31, 2013 Using		
		Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description	May 31, 2013			
Assets:				
Investments:				
Mutual funds and investment partnerships managed by third parties	\$ 245,150,796	\$ 60,847,914	\$ 91,150,494	\$ 93,152,388
Notes receivable	216,878	-	216,878	-
Stocks and bonds	19,831,881	19,503,166	328,715	-
Real estate and mineral interests	56,288,232	-	15,268,363	41,019,869
Outside managed	2,252,869	-	2,252,869	-
Other investments	<u>1,115,153</u>	<u>-</u>	<u>1,115,153</u>	<u>-</u>
Total investments	<u>324,855,809</u>	<u>80,351,080</u>	<u>110,332,472</u>	<u>134,172,257</u>
Charitable trusts and annuities:				
Mutual funds and investment partnerships managed by third parties	31,765,017	31,765,017	-	-
Debenture bonds	60,000	-	-	60,000
Real estate	1,050,000	-	1,050,000	-
Outside managed	<u>1,208,800</u>	<u>-</u>	<u>1,208,800</u>	<u>-</u>
Total charitable trusts and annuities	<u>34,083,817</u>	<u>31,765,017</u>	<u>2,258,800</u>	<u>60,000</u>
Total assets	<u>\$ 358,939,626</u>	<u>\$ 112,116,097</u>	<u>\$ 112,591,272</u>	<u>\$ 134,232,257</u>
Liabilities:				
Interest rate swaps (Note P)	\$ 2,823,779	\$ -	\$ 2,823,779	\$ -
Bonds payable subject to interest rate swaps	<u>20,887,645</u>	<u>-</u>	<u>20,887,645</u>	<u>-</u>
Total liabilities	<u>\$ 23,711,424</u>	<u>\$ -</u>	<u>\$ 23,711,424</u>	<u>\$ -</u>

**Abilene Christian University**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

**NOTE O - FAIR VALUE MEASUREMENTS - Continued**

		Fair Value Measurements at May 31, 2012 Using		
		Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant other Observable Inputs ( Level 2)	Significant Unobservable Inputs (Level 3)
Description	May 31, 2012			
Assets:				
Investments:				
Mutual funds and investment partnerships managed by third parties	\$ 221,633,266	\$ 37,349,119	\$ 74,961,324	\$ 109,322,823
Notes receivable	244,217	-	244,217	-
Stocks and bonds	18,927,695	18,803,393	124,302	-
Real estate and mineral interests	59,609,946	-	16,290,294	43,319,652
Outside managed	2,103,398	-	2,103,398	-
Other investments	<u>1,192,048</u>	<u>-</u>	<u>1,192,048</u>	<u>-</u>
Total investments	<u>303,710,570</u>	<u>56,152,512</u>	<u>94,915,583</u>	<u>152,642,475</u>
Charitable trusts and annuities:				
Mutual funds and investment partnerships managed by third parties	25,357,649	25,357,649	-	-
Privately held stock and bonds	1,438,017	-	-	1,438,017
Real estate	130,000	-	130,000	-
Outside managed	<u>1,073,014</u>	<u>-</u>	<u>1,073,014</u>	<u>-</u>
Total charitable trusts and annuities	<u>27,998,680</u>	<u>25,357,649</u>	<u>1,203,014</u>	<u>1,438,017</u>
Total assets	<u>\$ 331,709,250</u>	<u>\$ 81,510,161</u>	<u>\$ 96,118,597</u>	<u>\$ 154,080,492</u>
Liabilities:				
Interest rate swaps (Note P)	\$ 3,808,651	\$ -	\$ 3,808,651	\$ -
Bonds payable subject to interest rate swaps	<u>21,609,339</u>	<u>-</u>	<u>21,609,339</u>	<u>-</u>
Total liabilities	<u>\$ 25,417,990</u>	<u>\$ -</u>	<u>\$ 25,417,990</u>	<u>\$ -</u>

**Abilene Christian University**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

**NOTE O - FAIR VALUE MEASUREMENTS - Continued**

The schedule below summarizes the activity for items classified as Level 3 assets for the year ended May 31, 2013:

	<u>Investments</u>			<u>Charitable trusts and annuities</u>
	<u>Hedge funds- of-funds</u>	<u>Private equity</u>	<u>Mineral interests</u>	<u>Privately held stock and bonds</u>
Beginning balance	\$ 22,828,158	\$ 86,494,665	\$ 43,319,652	\$ 1,438,017
Total gains (losses):				
Included in net realized and unrealized gains (losses)	(2,337,537)	(4,727,264)	(3,088,768)	1,179,553
Purchases	-	7,908,399	788,985	1,723,412
Redemptions	<u>(8,157,104)</u>	<u>(8,856,929)</u>	<u>-</u>	<u>(4,280,982)</u>
Ending balance	<u>\$ 12,333,517</u>	<u>\$ 80,818,871</u>	<u>\$ 41,019,869</u>	<u>\$ 60,000</u>

The schedule below summarizes the activity for items classified as Level 3 assets for the year ended May 31, 2012:

	<u>Investments</u>			<u>Charitable trusts and annuities</u>
	<u>Hedge funds- of-funds</u>	<u>Private equity</u>	<u>Mineral interests</u>	<u>Privately held stock and bonds</u>
Beginning balance	\$ 32,448,393	\$ 77,547,266	\$ 43,316,512	\$ 1,556,787
Total gains (losses):				
Included in net realized and unrealized gains (losses)	(1,726,093)	(563,709)	(396,860)	(118,770)
Purchases	-	18,920,667	400,000	-
Redemptions	<u>(7,894,142)</u>	<u>(9,409,559)</u>	<u>-</u>	<u>-</u>
Ending balance	<u>\$ 22,828,158</u>	<u>\$ 86,494,665</u>	<u>\$ 43,319,652</u>	<u>\$ 1,438,017</u>

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE O - FAIR VALUE MEASUREMENTS - Continued**

Quantitative Information About Significant Unobservable Inputs Used in Level 3 Fair Value Measurements

ASC 820 requires disclosures about significant quantitative information used in valuations for instruments classified as Level 3 measurements. The estimated fair values of Level 3 assets managed and held in limited partnership and other private investment fund structures are based on the most recent valuations provided by the external investment fund managers, adjusted for receipts and disbursements through May 31. The University reviewed and evaluated the values provided by the managers and agreed with the valuation methods and assumptions used to determine those values. Accordingly, no significant quantitative information was developed by management to complete valuations for these investments.

The fair values of Level 3 mineral interests are estimated based on the expected net revenues generated by those assets. Geological reserve analysis provides additional information for estimating fair value and was used for the largest mineral interests to obtain a more informed estimate of fair value. These methods produce a range of values, and the fair value reported by the University falls within this range. The table below indicates the range of inputs associated with highest and lowest values considered by management in developing the University's reported fair value for mineral interests.

The fair values of Level 3 debenture bonds are assumed to approximate face value. Accordingly, no quantitative information was developed by management to complete valuations for these investments.

The following table describes valuation techniques, significant unobservable inputs, and ranges of significant input values for the University's Level 3 measurements at May 31, 2013:

Instrument	Fair Value	Principal Valuation Technique	Significant Unobservable Inputs	Range of Significant Input Values
Mineral interests	\$41,019,869	Market approach	Multiple of recent months revenue	48 times the average monthly production for the last year (low) to 10 times the most recent annual production revenue (high)
		Expected net revenues (producing wells)	Geological reserve analysis	10% discount 5% discount

**Abilene Christian University**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

**NOTE O - FAIR VALUE MEASUREMENTS - Continued**

Investments That Calculate Net Asset Per Share

ASC 820 requires additional disclosure for certain types of investments that calculate net asset value per share but are not publicly traded to assist in understanding the nature and risk of these investments by major category. The table below summarizes the fair value and other pertinent liquidity information of investments in major categories at May 31, 2013:

	<u>Fair Value</u>	<u>Unfunded Commit- ments</u>	<u>Redemption Frequency*</u>	<u>Redemption Notice Period</u>
Fixed income/absolute return funds (a)	\$ 9,210,526	\$ -	Daily	None
Emerging market long only funds (b)	23,183,798	-	Monthly	7 days to 30 days
Equity long/short and other equity hedge funds (c)	41,842,532	-	Monthly to 3 years	30 days to 90 days
Global opportunities hedge funds (d)	22,748,012	-	Monthly to 3 years	2 days to 95 days
Multi-strategy hedge funds (e)	9,403,379	-	Monthly to semi-annually	33 days to 95 days
Private equity funds (f)	58,641,061	29,069,596	(f)	(f)
Venture capital funds (g)	<u>15,586,411</u>	<u>5,473,281</u>	(g)	(g)
	<u>\$ 180,615,719</u>	<u>\$ 34,542,877</u>		

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE O - FAIR VALUE MEASUREMENTS - Continued**

Investments That Calculate Net Asset Per Share - continued

The table below summarizes the fair value and other pertinent liquidity information of investments in major categories at May 31, 2012:

	<u>Fair Value</u>	<u>Unfunded Commit- ments</u>	<u>Redemption Frequency*</u>	<u>Redemption Notice Period</u>
Fixed income/absolute return funds (a)	\$ 8,486,895	\$ -	Daily	None
Emerging market long only funds (b)	17,683,939	-	Monthly	7 days to 30 days
Equity long/short and other equity hedge funds (c)	38,799,652	-	Monthly to 31 months	30 days to 90 days
Global opportunities hedge funds (d)	23,349,506	-	Monthly to 8 months	2 days to 95 days
Multi-strategy hedge funds (e)	14,340,877	-	Monthly to semi-annually	33 days to 95 days
Private equity funds (f)	60,050,894	24,851,999	(f)	(f)
Venture capital funds (g)	<u>17,711,400</u>	<u>3,318,056</u>	(g)	(g)
	<u>\$ 180,423,163</u>	<u>\$ 28,170,055</u>		

\* Redemption frequency and redemption notice periods reflect general redemption terms and exclude liquidity restrictions noted below:

(a) This category includes investment funds that invest in a diversified portfolio of primarily U.S. based fixed income securities including: corporate bonds, treasury, agency, MBS, futures, options, and swaps. The management of the fund has discretion to allocate among the various asset groups within a risk management structure that imposes percentage allocation maximums to individual classes of securities based on rating, risk, and other criteria. Allocation to various asset types and selection of securities are influenced by economic growth, monetary policy, fiscal policy, dollar policy, commodity prices, and relative valuations. The fair value of the investments in this category has been established using the net asset value per share of the investments as provided by the fund managers.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE O - FAIR VALUE MEASUREMENTS - Continued

##### Investments That Calculate Net Asset Per Share - continued

(b) This category includes investment funds that invests long only in emerging market publicly traded common stock focusing primarily on larger, more established companies. Investment strategies may include the shifting of concentrations among various regions depending on perceived opportunities as well as index strategies using proprietary metrics. The fair value of the investments in this category has been established using the net asset value per share of the investments as provided by the fund managers.

(c) This category includes investments in hedge funds and hedge funds-of-funds that invest primarily in U.S. and international common stocks (both long and short). Managers of the funds typically have the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position. The fair values of investments in this category have been estimated using the net asset value per share of the investments as provided by the fund managers.

(d) This category includes investments in hedge funds that invest in a variety of opportunistic strategies. Investments are global in scope and include: equities (long and long/short), bonds, commodities, crops, livestock and agricultural land, precious and base metals, credit, interest rate and FX trading, insurance, energy, and private investments in public companies, as well as investments in financial services startups and other co-investments. The fair values of the investments in this category have been estimated using the net asset value per share of the investments as provided by the fund managers. Investments representing approximately \$2,875,931 (or 12.6%) and \$3,525,775 (or 15.1%) of this category at May 31, 2013 and 2012, respectively, are “sidepocket” investments, meaning that redemptions will not take place until the underlying investments in the sidepocket are sold. The timing of the sale of the sidepocket investments cannot be estimated.

(e) This category includes investments in hedge funds-of-funds that pursue multiple strategies to diversify risks and reduce volatility. Investments are global in scope and include strategies such as: equity long-short, arbitrage, credit, event driven, market neutral, relative value, systematic, and trade finance. The fair values of the investments in this category have been estimated using the net asset value per share of the investments as provided by the fund managers.

(f) This category includes investments in private equity funds and funds-of-funds that invest primarily in: distressed debt, BRIC (Brazil, Russia, India, China) country investments, energy holdings, and buyouts. The fair values of the investments in this category have been estimated using the net asset value of the University's ownership interest in the partners' capital of each underlying fund. These investments cannot be redeemed at the request of the investor. Instead, the nature of the investments in this category is that distributions are made through the liquidation of the underlying holdings. It is estimated that the underlying holdings of the funds will be liquidated over 1 to 10 years depending on the vintage year of the fund and the exit opportunities over time.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### **NOTE O - FAIR VALUE MEASUREMENTS - Continued**

##### Investments That Calculate Net Asset Per Share - continued

(g) This category includes investments in venture capital funds of funds that invest primarily in venture capital funds that provide start-up funding primarily for U.S. companies and primarily in the technology and bio-sciences areas. The fair values of the investments in this category have been estimated using the net asset value of the University's ownership interest in the partners' capital of each underlying fund. These investments cannot be redeemed at the request of the investor. Instead, distributions are made through the liquidation of the underlying holdings. It is estimated that the underlying holdings of the funds will be liquidated over 1 to 10 years depending on the vintage year of the fund and the exit opportunities over time.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

##### Cash and Cash Equivalents, Accounts Receivable, and Net Advances on Lines of Credit

The carrying amounts approximate fair value due to the short maturity of these instruments.

##### Contributions Receivable

The carrying amount approximates fair value as determined by discounting pledges at an appropriate discount rate commensurate with the risks involved.

##### Investments and Charitable Trusts and Annuities

The carrying amounts of money market funds, mutual funds, and marketable securities approximate fair value based on quoted market prices. The fair values of private equity instruments discussed above are determined in good faith by third party fund managers based on estimates of the underlying investments and appropriate market indices. The University uses these estimates as reported by the fund managers as the primary input to its estimation of fair valuation; however, other inputs are reviewed and considered in the determination of fair value including audit reports of the underlying funds. The fair values of real estate assets are based on independent appraisals. The fair values of mineral interests are based on independent reserve analyses as well as internal analysis using management's knowledge of the properties.



## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE O - FAIR VALUE MEASUREMENTS - Continued

##### Long-term Obligations

Long-term obligations on the consolidated statements of position total \$59,396,713 and \$64,027,517 at May 31, 2013 and 2012, respectively. Included within these amounts are bonds payable subject to interest rate swaps designated as fair value hedges with fair values disclosed in the tables above, which are determined by adjusting the principal value of the debt by the fair value of the interest rate swaps designated as fair value hedges. Also included within long-term obligations are liabilities related to interest rate swaps with fair values disclosed in the tables above, which are determined by the counterparty's present value calculations and market pricing models. Long-term obligations also include bonds and notes payable that are not reported at fair value, which have carrying values of \$35,685,289 and \$38,609,527 at May 31, 2013 and 2012, respectively. The fair values of the bonds and notes payable not reported at fair value were \$39,686,925 and \$42,440,904 at May 31, 2013 and 2012, respectively, as determined by discounting future cash flows at an appropriate rate commensurate with the risks involved. These fair values represent an estimate of what a market participant would be willing to pay to acquire the future cash flows on these instruments.

#### NOTE P - DERIVATIVE INSTRUMENTS

The University entered into three interest rate swap agreements during fiscal year 2005, two interest rate swap agreements during fiscal year 2007, and one interest rate swap agreement in fiscal year 2009. Each agreement is subject to a master netting arrangement with the lender for the debt instruments, which mitigates credit risks on the swap agreements. The University accounts for these contracts in accordance with ASC Topic 815 *Derivatives and Hedging* and has designated these swaps as fair value hedges. The primary reason for swapping from a variable to fixed rate is to stabilize the University's operating budget vis-à-vis interest expense.

Management has completed variable to fixed rate swaps on six debt issues: 1) Series 2003 has been swapped to a fixed rate of 4.59%; 2) Series 2005 has been swapped to a fixed rate of 4.59%; 3) Series 2006 had been swapped to a fixed rate of 3.29% until September 1, 2011, at which time the agreement expired; 4) Series 2006 Taxable has been swapped to a fixed rate of 6.06%; 5) Series 2006B has been swapped to a fixed rate of 4.43%; and 6) Series 2009 has been swapped to a fixed rate of 3.88%.

Management has identified the following benefits of using swap agreements to accomplish the above objectives: 1) a lower fixed rate is available using a swap than by refunding at a fixed rate; 2) less paperwork and due diligence is involved in executing a swap than in a refunding. A swap is an agreement separate from the debt but mirroring the debt repayment structure; and 3) a swap does not affect the University's bank qualified debt limit.

# Abilene Christian University

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

### NOTE P - DERIVATIVE INSTRUMENTS - Continued

The risks of using the proposed interest rate swaps include: 1) credit risk—risk that the counterparty will not fulfill its obligation on the swap contract; 2) basis risk—mismatch between the interest rate received from the swap contract and the interest actually owed on the debt; and 3) opportunity cost—if the floating rate that the University can pay on the debt averages below the fixed rate the University pays on the swap, then the University realizes the opportunity cost associated with locking in the higher interest rate.

The effectiveness of the swaps is judged by comparing the interest rates and key terms of the swaps with the interest rates and key terms on the underlying debt. The key terms of the swaps match the key terms of the floating rate debt and are, therefore, expected to offset the hedged cash flows of the debt.

Management believes the swaps are fully effective as of May 31, 2013 and 2012.

The schedule below summarizes the fair value of the swap contracts at May 31, 2013 and 2012:

Derivatives designated as hedging instruments under FASB ASC 815-20	Statement of Financial Position Location	Liabilities	
		2013	2012
Interest rate swaps	Long-term Obligations	\$ 2,823,779	\$ 3,808,651

Because the swaps are fully effective, the University recognized gains on the hedged items (the debt issues noted above) that exactly offset the interest rate swap liabilities noted above within long-term obligations on the consolidated statements of financial position. Accordingly, the interest rate swaps have no net effect within liabilities on the consolidated statements of financial position at May 31, 2013 and 2012.

The University includes the gain or loss on the hedged items within the same location on the consolidated statement of activities—interest expense—as the offsetting loss or gain on the related interest rate swaps as follows for the years ended May 31, 2013 and 2012:

	Statement of Activities Location	2013	2012
Unrestricted gain (loss) on swaps	Interest expense	\$ 984,872	\$ (884,475)
Unrestricted gain (loss) on debt issues	Interest expense	(984,872)	884,475

As of May 31, 2013 and 2012, the aggregate notional amounts of the outstanding swaps were \$23,711,424 and \$25,417,990, respectively.

## Abilene Christian University

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

#### NOTE Q - SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

The University grants credit in the form of accounts and notes receivable to students and others, a substantial portion of which are enrolled at the University. The University does not require collateral for the extension of credit with the exception of notes made to facilitate real estate sales, in which case, the collateral is typically the real estate being sold. Counterparty risks related to interest rate swap agreements are described in Note P. Management periodically monitors credit risk through the evaluation of the account's status and ability to repay.

#### NOTE R - ASSET RETIREMENT OBLIGATION

The University records a liability included within deposits and other liabilities in the accompanying consolidated statements of financial position for the estimated costs associated to remediate its asset retirement obligation.

The following presents a summary of the asset retirement obligation activity as of and for the years ended May 31, 2013 and 2012:

Asset retirement obligation at June 1, 2011	\$ 2,090,712
Payment of asset retirement obligation	<u>(46,966)</u>
Asset retirement obligation at May 31, 2012	2,043,746
Payments of asset retirement obligation	<u>(31,038)</u>
Asset retirement obligation at May 31, 2013	\$ <u>2,012,708</u>

#### NOTE S - RELATED PARTY TRANSACTIONS

The University had unsecured receivables from related parties of \$72,158 and \$67,699 at May 31, 2013 and 2012, respectively.

# Abilene Christian University

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

May 31, 2013 and 2012

### NOTE T - RECLASSIFICATIONS OF PRIOR YEAR INFORMATION

The University changed its method of reporting two types of information on the consolidated statements of cash flows during the year ended May 31, 2013.

In most years, the University has not experienced significant changes in the amounts of contributions receivable for investments in endowment or plant and has reported all gift revenues restricted for long-term investments as reductions from cash flows from operating activities and as increases to cash flows from financing activities in the consolidated statements of cash flows. For the years ended May 31, 2013 and 2012, the University experienced significant changes in the amounts of contributions receivable for restricted investments in endowment and plant at year end. In 2013, management determined that the changes in the amounts of contributions receivable for investments in endowment and plant should be excluded from contributions restricted for long-term investment to accurately reflect cash contributions received for long-term investments in the consolidated statements of cash flows.

The University has a practice of issuing notes receivable for certain students and others who negotiate alternative payment terms on their accounts receivable. When this occurs, applicable accounts receivable balances are transferred to notes receivable. Historically, increases to notes receivable have been reported as disbursements of loans to students, faculty, and others on the consolidated statements of cash flows. As no cash is disbursed when these notes are issued, management determined in 2013 that increases to notes receivable should not be reported within cash flows from investing activities.

To conform prior year cash flows to the current year presentation, the University has restated items within the consolidated statement of cash flows for the year ended May 31, 2012, as follows:

	As Previously <u>Reported</u>	As <u>Restated</u>	Net <u>Change</u>
Contributions restricted for long-term investment	\$ (9,982,541)	\$ (5,278,862)	\$ 4,703,679
Proceeds from contributions restricted for:			
Investment in endowment and other	9,060,965	3,780,278	(5,280,687)
Investment in plant	921,576	1,498,584	577,008
Increase in accounts receivable	(77,408)	(567,020)	(489,612)
Disbursement of loans to student, faculty, and others	\$ (489,612)	\$ -	<u>489,612</u>
			<u>\$ -</u>

**Abilene Christian University**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

May 31, 2013 and 2012

**NOTE U – EXPENSES BY NATURAL CLASSIFICATION**

While the consolidated statements of activities present expenses by function, the University's expenses by natural classification are as follows for the years ended May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Salaries and wages	\$ 45,203,274	\$ 45,032,074
Personnel benefits	15,437,919	15,194,771
Student wages	3,381,941	3,614,260
Operating expenses	32,111,924	31,860,390
Plant operations and maintenance	7,537,763	7,232,186
Depreciation	7,115,644	7,264,305
Interest	<u>2,857,728</u>	<u>2,953,627</u>
	<u>\$ 113,646,193</u>	<u>\$ 113,151,613</u>

**NOTE V - SUBSEQUENT EVENTS**

The University has evaluated subsequent events through August 13, 2013, the date the consolidated financial statements were available to be issued.

On July 3, 2013, the University issued \$21,480,000 in Series 2014 taxable debt to refinance the \$20,000,000 Vision Debt and to finance improvements to the Onstead-Packer Biblical Studies Building and Moody Coliseum. The agreement matures on October 1, 2032 and requires annual principal payments ranging from \$805,000 to \$1,480,000 with interest at a fixed rate of 3.65%.

On July 3, 2013, the University issued \$5,635,000 in Series 2014A tax-exempt debt to finance Phase II of improvements to the campus water heating and cooling loop line and to finance improvements to Cullen Auditorium, the Don H. Morris Center, Gardner Hall, and other improvement projects. The agreement matures on October 1, 2032 and requires annual principal payments ranging from \$225,000 to \$355,000 with interest at a fixed rate of 2.53%.

On July 3, 2013, the University issued \$6,775,000 in Series 2014B tax-exempt debt to refinance the Series 1998 bonds. The agreement matures on October 1, 2018 and requires annual principal payments ranging from \$1,115,000 to \$1,160,000 with interest at a fixed rate of 1.22%.