

LIPSCOMB UNIVERSITY

Financial Statements

May 31, 2017 and 2016

(With Independent Auditors' Report Thereon)

LIPSCOMB UNIVERSITY

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INDEPENDENT AUDITORS' REPORT

The Board of Trustees of
Lipscomb University:

We have audited the accompanying financial statements of Lipscomb University (the University) which are comprised of the statements of financial position as of May 31, 2017 and 2016, and the related statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risk of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University as of May 31, 2017 and 2016, 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.

LBMC, PC

Brentwood, Tennessee
August 30, 2017

LIPSCOMB UNIVERSITY

Statements of Financial Position

May 31, 2017 and 2016

Assets

	<u>2017</u>	<u>2016</u>
Assets:		
Cash and cash equivalents	\$ 12,012,432	\$ 6,496,306
Accounts receivable, net	2,256,784	1,822,572
Student loans receivable	2,121,066	1,970,342
Contributions receivable, net	25,247,982	22,400,869
Investments, excluding real estate	89,247,959	82,551,581
Real estate investments	17,679,786	16,730,366
Prepaid expenses and other assets	1,159,973	735,653
Cash from bond proceeds restricted for capital projects	-	24,777,072
Property and equipment, net	<u>179,336,020</u>	<u>148,387,418</u>
	<u>\$ 329,062,002</u>	<u>\$ 305,872,179</u>

Liabilities and Net Assets

Liabilities:		
Student accounts and deposits collected in advance	\$ 5,003,009	\$ 5,387,948
Accounts payable, including construction payables of \$4,073,873 and \$2,169,891 in 2017 and 2016, respectively	6,878,762	5,027,574
Accrued expenses and liabilities	11,974,148	12,593,383
Accrued unrealized loss on swap agreements	5,754,682	7,804,737
Deferred revenue	1,852,785	1,932,569
Annuities payable	2,540,686	1,447,482
Obligations under capital leases	2,631,231	2,980,923
Revolving and construction lines of credit	-	5,000,000
Notes payable	6,072,417	1,217,093
Bonds payable	98,229,002	96,051,135
Accrued pension benefit liability	200,556	700,561
Accrued postretirement benefit obligation	5,320,243	5,414,410
Federal student loans refundable	<u>1,942,871</u>	<u>2,129,648</u>
Total liabilities	<u>148,400,392</u>	<u>147,687,463</u>

Net assets:		
Unrestricted:		
Undesignated	31,398,004	26,143,774
Designated for student loans	257,210	274,795
Funds functioning as endowment	17,856,550	10,647,122
Designated for pension and postretirement benefit plans	(5,520,799)	(6,114,971)
Designated for plant facilities	<u>39,431,876</u>	<u>37,914,483</u>
Total unrestricted	83,422,841	68,865,203
Temporarily restricted	45,880,300	40,707,174
Permanently restricted	<u>51,358,469</u>	<u>48,612,339</u>
Total net assets	<u>180,661,610</u>	<u>158,184,716</u>
	<u>\$ 329,062,002</u>	<u>\$ 305,872,179</u>

See accompanying notes to the financial statements.

LIPSCOMB UNIVERSITY

Statements of Activities and Changes in Net Assets

Years ended May 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Changes in unrestricted net assets:		
Revenues and other support:		
Tuition and education fees	\$ 138,084,598	\$ 133,816,344
Less financial aid	<u>(35,528,573)</u>	<u>(33,376,345)</u>
Net tuition and fees	102,556,025	100,439,999
Private gifts	4,061,236	3,334,280
Endowment draw for operations	1,250,000	1,500,000
Auxiliary enterprises revenue	20,872,847	19,964,118
Rental income	1,683,089	1,498,606
Other income	4,979,898	4,220,126
Satisfaction of restrictions	<u>7,866,627</u>	<u>8,857,076</u>
Total revenues and other support	<u>143,269,722</u>	<u>139,814,205</u>
Expenses:		
Instruction	58,876,711	58,100,700
Institutional support	29,323,069	27,708,462
Student services	21,726,924	20,641,842
Auxiliary enterprises	13,496,859	12,824,067
Academic support	14,974,278	15,262,600
Public services	<u>2,664,111</u>	<u>2,481,112</u>
Total expenses	<u>141,061,952</u>	<u>137,018,783</u>
Change in unrestricted net assets from operating activities	<u>2,207,770</u>	<u>2,795,422</u>
Non-operating activities:		
Investment income (loss), net after the application of endowment draws	6,449,618	(5,571,187)
Gain on interest rate swap agreements	2,050,055	193,499
Change in postretirement benefit obligation	94,167	5,364
Change in defined benefit retirement plan obligation	500,005	(751,976)
Retirement incentive plan expense	(114,750)	(325,279)
Refunding expense of prepaid bond costs	-	(745,059)
Satisfaction of restrictions, capital gifts	<u>3,370,773</u>	<u>4,071,877</u>
Change in unrestricted net assets from non-operating activities	<u>12,349,868</u>	<u>(3,122,761)</u>
Increase (decrease) in unrestricted net assets	<u>14,557,638</u>	<u>(327,339)</u>
Changes in temporarily restricted net assets:		
Private gifts	12,278,009	13,847,262
Adjustments of actuarial liability for annuities payable	122,508	78,344
Investment income, net	2,464,712	1,293,747
Other income	47,282	4,630
Government and other grants	1,516,594	1,529,896
Net assets released from restrictions	<u>(11,255,979)</u>	<u>(12,902,593)</u>
Increase in temporarily restricted net assets	<u>5,173,126</u>	<u>3,851,286</u>
Changes in permanently restricted net assets:		
Private gifts	2,660,046	1,671,287
Investment income, net	57,537	(14,243)
Adjustments of actuarial liability for annuities	9,968	10,399
Transfers and changes in value of split interest	<u>18,579</u>	<u>(26,360)</u>
Increase in permanently restricted net assets	<u>2,746,130</u>	<u>1,641,083</u>
Increase in net assets	22,476,894	5,165,030
Net assets at beginning of year	<u>158,184,716</u>	<u>153,019,686</u>
Net assets at end of year	<u>\$ 180,661,610</u>	<u>\$ 158,184,716</u>

See accompanying notes to the financial statements.

LIPSCOMB UNIVERSITY

Statements of Cash Flows

Years ended May 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Increase in net assets	\$ <u>22,476,894</u>	\$ <u>5,165,030</u>
Adjustments to reconcile change in net assets to cash flows provided by operating activities:		
Depreciation	6,757,169	5,966,695
Provision for uncollectible accounts	418,452	133,652
Net gain on interest rate swap agreements	(2,050,055)	(193,499)
Amortization of bond issuance costs and bond discount (premiums), net	(221,630)	715,076
Loss on disposal of property and equipment	-	46,724
Net (gain) loss on investments, excluding real estate	(8,709,058)	4,015,412
Net loss on sale of real estate investments	9,500	-
Gifts restricted for investments and plant facilities	(10,052,734)	(3,056,860)
Non-cash gifts of fixed assets	(3,000)	-
(Increase) decrease in operating assets:		
Accounts receivable	(852,664)	151,545
Contributions receivable, net	(2,847,113)	(4,155,220)
Prepaid expenses and other assets	(424,320)	201,635
Increase (decrease) in operating liabilities:		
Student accounts and deposits collected in advance	(384,939)	718,977
Accounts payable	(52,794)	(1,286,227)
Accrued expenses and liabilities	(619,235)	1,925,167
Deferred revenue	(79,784)	556,089
Annuities payable	1,093,204	(288,534)
Accrued postretirement benefit obligation	(94,167)	(5,364)
Accrued pension benefit liability	(500,005)	700,561
Total adjustments	<u>(18,613,173)</u>	<u>6,145,829</u>
Net cash provided by operating activities	<u>3,863,721</u>	<u>11,310,859</u>
Cash flows from investing activities:		
Purchases of plant facilities	(35,266,830)	(18,314,240)
Proceeds from sale of investments	13,903,145	54,409,484
Purchases of investments	(11,890,465)	(54,467,956)
Proceeds from sale of real estate investments	136,500	2,140,000
Purchases of real estate investments	(1,576,465)	(5,011,385)
Net decrease in federal student loans refundable	(186,777)	(87,667)
Change in student loans receivable, net	<u>(150,724)</u>	<u>191,788</u>
Net cash used by investing activities	<u>(35,031,616)</u>	<u>(21,139,976)</u>
Cash flows from financing activities:		
Proceeds from lines of credit	-	8,991,300
Payments of notes and loans payable	(144,676)	(7,534,067)
Proceeds from bonds payable	2,593,156	93,103,632
Cash from bond proceeds restricted for capital projects	24,777,072	(24,777,072)
Payments of bonds payable	(163,659)	(62,875,870)
Payment of debt issuance costs	(30,000)	(1,010,080)
Payments of capital leases	(400,606)	(249,602)
Gifts restricted for investments and plant facilities	<u>10,052,734</u>	<u>3,056,860</u>
Net cash provided by financing activities	<u>36,684,021</u>	<u>8,705,101</u>
Increase (decrease) in cash and cash equivalents	5,516,126	(1,124,016)
Cash and cash equivalents at beginning of year	<u>6,496,306</u>	<u>7,620,322</u>
Cash and cash equivalents at end of year	<u>\$ 12,012,432</u>	<u>\$ 6,496,306</u>

See accompanying notes to the financial statements.

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2017 and 2016

(1) Nature of operations

Lipscomb University (the University) is a private, 501(c)(3) not-for-profit, educational, church-related university located in Nashville, Tennessee with an enrollment of approximately 4,600 students seeking undergraduate, graduate and doctoral degrees. The University also provides pre-kindergarten through high school education for approximately 1,225 additional students through Lipscomb Academy.

The University is governed by a self-perpetuating Board of Trustees that has oversight responsibility to establish the general policies that govern the operations of the University, including its financial affairs. The Board of Trustees is comprised of 30 members that may serve up to three successive four-year terms.

(2) Summary of significant accounting policies

The financial statements of the University are presented on the accrual basis. The significant accounting policies are described below.

(a) Basis of presentation

For external accounting and reporting purposes, net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the University and changes therein are classified and reported as follows:

Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations. The University has chosen to provide further classification information about unrestricted net assets on the statements of financial position. The sub-classifications are as follows:

Undesignated - Represents the cumulative results of unrestricted activities of the University that are also undesignated by the Board of Trustees.

Designated for student loans - Represents University funds designated to serve as revolving loan funds for students.

Funds functioning as endowment - Represents amounts designated by the Board of Trustees to generate income to support operating needs. Such amounts include cumulative unrestricted gains (losses) on endowment investments.

Designated for pension and postretirement benefit plans - Represents the benefit obligations in excess of plan assets related to the pension and postretirement benefit plans (see Notes 15 and 16).

Designated for plant facilities - Represents the residual equity or deficit of net capital assets less any related debt and adjusted for the interest rate swaps.

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Notes to the Financial Statements

May 31, 2017 and 2016

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met either 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.

All contributions are reported as unrestricted net assets unless specifically restricted by the donor. Amounts received that are restricted by the donor for future periods or specific purposes are reported as temporarily or permanently restricted support. When a restricted gift's purpose is fulfilled, the University reports the support as satisfaction of restrictions.

(b) Cash equivalents

The University reports all highly-liquid investments with original maturities of less than three months as cash equivalents.

(c) Receivables and credit policies

The University reports accounts receivable, net of an allowance for doubtful accounts, at the amount which represents management's estimate of the amount that ultimately will be collected. The University reviews the adequacy of its allowance for uncollectible accounts on an ongoing basis, using historical payment trends, analysis of accounts receivable by payor source and aging of receivables, as well as a review of specific accounts, and makes adjustments in the allowance as necessary. Interest charges are applied to accounts in internal collections. Accounts are sent to external collection agencies or attorneys for collection after the University has exhausted all other efforts in collecting the balance. In addition, as the University determines that Federal Perkins student loans receivable are uncollectible and not eligible for reimbursement by the Federal government, the loans are written off and assigned to the U.S. Department of Education.

(d) Revenue and support recognition

Student tuition and educational fees are recorded as revenues during the year the related academic services are rendered. Student tuition and educational fees received in advance of services to be rendered are recorded as deferred revenue. Financial aid provided by the University for tuition and educational fees is reported as a reduction of tuition and educational fees. Financial aid does not include payments made to students for services rendered to the University.

Contributions, other than conditional promises to give, are reported in the fiscal year the cash or the unconditional promise is received. Conditional promises to give are not reported until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value.

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Notes to the Financial Statements

May 31, 2017 and 2016

Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. Amortization of the 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 fundraising activity. Contributions of property and equipment without donor stipulations concerning the use of such assets are reported as unrestricted revenue. The University does not impose 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 property and equipment with such donor stipulations are reported as temporarily restricted net assets; the restrictions are considered to be released upon the acquisition of such assets.

(e) Investments and endowment

Investments in marketable equity securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statements of financial position. Real estate investments are reported at their original cost to the University or the appraised value at the date of the gift. Investment income reported in the statements of activities includes interest, dividends, and realized and unrealized gains and losses, net of investment expenses. Investment income (loss) is reported in the period earned as an increase (decrease) in unrestricted net assets unless the use of the assets received is limited by donor-imposed restrictions. Investment income (loss) that is restricted by the donor is reported as an increase (decrease) in unrestricted net assets if the restrictions are met or expire in the year in which the income (loss) is earned. All other donor-restricted investment income (loss) is reported as an increase (decrease) in temporarily or permanently restricted net assets unless otherwise specified by the donor.

The University's spending policy allows for an annual unrestricted endowment draw amount of the lesser of 4.5% or \$1,500,000 (actual draws were \$1,250,000 and \$1,500,000 for the years ending May 31, 2017 and 2016, respectively) and an annual 5.0% draw from the restricted endowment. It is the University's intent to incrementally eliminate the unrestricted draw through 2021. Earnings drawn from funds functioning as endowment are unrestricted in purpose. The use of earnings drawn from restricted endowment funds is restricted as stipulated in the corresponding donor agreements. The Board of Trustees, at its discretion, can authorize additional net draws for special projects. There were no such additional draws authorized for 2017 or 2016.

Endowment income distributed to funds may be a combination of capital appreciation and yield pursuant to the University's total return investment policy.

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Notes to the Financial Statements

May 31, 2017 and 2016

(f) Property and equipment

Property and equipment with a value in excess of \$3,000 are reported at cost. Donated assets are recorded at their estimated market value at the date of the gift. Depreciation is recorded over the assets' estimated useful life using the straight-line method.

The estimated useful lives of fixed assets are as follows:

Buildings and campus	10-60 years
Computer equipment and software	5 years
Furniture, fixtures and office equipment	10 years
General and laboratory equipment	10 years
Automobiles	5 years

Disbursements for maintenance and repairs are reported as incurred. Disbursements for renewals or betterments are capitalized. When property or equipment is retired or sold, the cost and the related accumulated depreciation are removed from the statements of financial position, and the resulting gain or loss is included in the statements of activities.

(g) Fair value of interest rate swap agreements

The University uses derivatives to manage risks related to interest rate movements. Interest rate swap contracts designated and qualifying as cash flow hedges are reported at fair value. The gain or loss on the effective portion of the hedge is included in the statements of activities and changes in net assets. The University's interest rate risk management strategy is intended to stabilize cash flow requirements by maintaining interest rate swap contracts to convert variable-rate debt to a synthetic fixed rate.

(h) Life income and gift annuities

The University's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts for which the University serves as trustee. Assets held in these trusts are included in investments. Contribution revenues are recognized at the dates the trusts are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries.

The University is the named trustee for certain estates and trusts of friends of the University and pays the trust income to the named beneficiaries. In such cases where the University is not the sole beneficiary, only the University's portion is included in the statements of financial position. As of May 31, 2017 and 2016, assets under such split-interest agreements totaled \$372,346 (or \$279,260 net of liabilities) and \$357,291 (or \$269,619 net of liabilities), respectively, and are included in investments on the statements of financial position.

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Notes to the Financial Statements

May 31, 2017 and 2016

(i) Income taxes

The University is exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and, accordingly, no provision for income taxes is included in the financial statements.

As of May 31, 2017 and 2016, the University had accrued no interest or penalties related to uncertain tax positions. It is the University's policy to recognize interest and/or penalties related to income tax matters in income tax expense.

(j) Advertising costs

Advertising and promotion costs are expensed as incurred. The University incurred advertising costs of \$1,506,832 and \$1,366,516 for the years ended May 31, 2017 and 2016, respectively.

(k) Long-lived assets

The University's management evaluates the recoverability of the investment in long-lived assets on an ongoing basis and recognizes any impairment in the year of determination. It is reasonably possible that relevant conditions could change and necessitate a change in management's estimate of the recoverability of these assets.

(l) Financial instruments

The carrying value of cash and cash equivalents, investments, receivables other than student loans, prepaid expenses and other assets, accounts payable, accrued expenses and liabilities, and debt approximate fair value. A reasonable estimate of the fair value of the notes receivable from students under government loan programs and Federal student loans refundable cannot be made because the notes receivable are not saleable and can only be assigned to the U.S. Government or its designees. The fair value of notes receivable from students under University loan programs approximates carrying value.

(m) Federal student loans refundable

Funds provided by the U.S. Government under the Federal Perkins Loan program are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the U.S. Government and are, therefore, recorded as liabilities.

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Notes to the Financial Statements

May 31, 2017 and 2016

(n) Program efforts

The University's primary program services are instruction and student services. Expenses reported as academic support, institutional support, and auxiliary enterprises are incurred in support of these primary program services. Institutional support includes fundraising expenses of approximately \$4,216,000 and \$4,130,000 in 2017 and 2016, respectively. For purposes of reporting fundraising expenses, the University includes only those fundraising costs incurred by its development office and expenses incurred for capital campaigns.

(o) Allocation of costs in the statements of activities and changes in net assets

Costs related to the operation and maintenance of physical plant, including depreciation of plant assets, are allocated to operating programs and supporting activities using square footage of plant assets based on periodic inventories of facilities. Interest expense on external debt is allocated to the activities which have most directly benefited from the proceeds of the external debt.

(p) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(q) Events occurring after reporting date

The University's management has evaluated events and transactions that occurred between May 31, 2017 and August 30, 2017, which is the date that the financial statements were available to be issued, for possible recognition or disclosure in the financial statements.

(3) Credit risks and concentrations

The University generally maintains cash on deposit with financial institutions in excess of federally insured amounts. The University has not experienced any losses in such accounts and management believes the University is not exposed to any significant credit risk related to cash.

The University has significant investment instruments. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur and that such changes could materially affect the amounts reported in the statements of financial position.

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Notes to the Financial Statements

May 31, 2017 and 2016

The University holds life insurance policies with various insurance companies. As of May 31, 2017, four insurance companies, rated A- and better by A.M. Best, held approximately 68% of the cash value of life insurance policies owned by the University. As of May 31, 2016, two insurance companies, rated A- by A.M. Best, held approximately 42%, of the cash value of life insurance policies owned by the University.

(4) Accounts receivable

A summary of accounts receivable as of May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Student accounts receivable	\$ 3,143,703	\$ 2,785,216
Other accounts receivable	<u>725,725</u>	<u>273,998</u>
Subtotal	3,869,428	3,059,214
Less allowance for uncollectible accounts	<u>(1,612,644)</u>	<u>(1,236,642)</u>
	<u>\$ 2,256,784</u>	<u>\$ 1,822,572</u>

(5) Contributions receivable

A summary of contributions receivable as of May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Unconditional promises expected to be collected in:		
Less than one year	\$ 1,937,451	\$ 2,933,010
One year to five years	16,498,542	9,677,951
Over five years	<u>15,740,040</u>	<u>11,579,177</u>
	34,176,033	24,190,138
Less discount for net present value	(8,609,390)	(1,652,198)
Less allowance for uncollectible contributions receivable	<u>(318,661)</u>	<u>(137,071)</u>
	<u>\$ 25,247,982</u>	<u>\$ 22,400,869</u>

Such contributions receivable as of May 31, 2017 and 2016 are to be utilized for the following purposes:

	<u>2017</u>	<u>2016</u>
Unrestricted	\$ 3,307,289	\$ 1,510,719
Operations and scholarships	4,900,304	4,057,891
Acquisition of property and equipment	16,636,420	16,294,471
Endowment	<u>403,969</u>	<u>537,788</u>
	<u>\$ 25,247,982</u>	<u>\$ 22,400,869</u>

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Notes to the Financial Statements

May 31, 2017 and 2016

Contributions receivable have been discounted using rates ranging from 0.12% to 5.00% as of May 31, 2017 and 2016. The weighted average discount rate of pledges outstanding as of May 31, 2017 and 2016 was 4.75% and 1.85%, respectively.

(6) Investments, excluding real estate

A summary of investments as of May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Short-term investments	\$ 3,915,375	\$ 7,821,433
Mutual funds	47,672,781	38,654,343
Marketable equity securities	4,365,739	4,344,811
Corporate bonds and government securities	3,615,390	3,616,863
Limited partnerships, private equity and other funds	27,557,237	26,087,935
Life insurance policies	<u>2,121,437</u>	<u>2,026,196</u>
	<u>\$ 89,247,959</u>	<u>\$ 82,551,581</u>

Certain investments are combined in a common investment pool. Interests in the pooled investment fund are adjusted at the end of each quarter, utilizing the unit method of allocating interests. Investment income is allocated monthly.

The following schedule summarizes the investment gains (losses) in the statements of activities for the years ended May 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Interest and dividends	\$ 1,683,648	\$ 1,408,958
Unrealized gain (loss) on investments, net	8,543,839	(10,481,526)
Realized gain on investments, net	165,219	6,466,114
Investment management fees	<u>(170,839)</u>	<u>(185,229)</u>
	<u>\$ 10,221,867</u>	<u>\$ (2,791,683)</u>

The above investment returns are classified in the statement of activities and changes in net assets as follows:

	<u>2017</u>	<u>2016</u>
Endowment draw for operations	\$ 1,250,000	\$ 1,500,000
Unrestricted investment gain (loss) after the application of endowment draws	6,449,618	(5,571,187)
Temporarily restricted	2,464,712	1,293,747
Permanently restricted	<u>57,537</u>	<u>(14,243)</u>
	<u>\$ 10,221,867</u>	<u>\$ (2,791,683)</u>

Notes to the Financial Statements

May 31, 2017 and 2016

(7) Fair value measurements

Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 820, *Fair Value Measurement* ("ASC 820"), provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below.

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the University has the ability to access.

Level 2 - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability; and
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for asset measurement at fair value. There have been no changes in the methodologies used at May 31, 2017 and 2016.

- (i) ***Short-term investments:*** Short-term investments consist primarily of money market funds that are valued at the closing price reported on the active market on which the individual securities are traded.
- (ii) ***Mutual funds:*** Valued at the net asset value of shares held by the University at year end based on a quoted price in an active market.
- (iii) ***Marketable equity securities, corporate bonds and government securities:*** Valued at the closing price reported on the active market on which the individual securities are traded.

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- (iv) *Limited partnerships, private equity and other investment funds:* Valued at fair value based on the beginning of year value of the University's interest plus actual contributions and allocated investment income less actual distributions and allocated administrative expenses.
- (v) *Life insurance policies:* Valued at the cash value of the underlying insurance policies. The policies are not available for immediate liquidity.
- (vi) *Interest rate swaps:* The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the University's management believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables set forth by level, within the fair value hierarchy, the University's financial instruments at fair value as of May 31, 2017 and 2016:

Fair Value Measurements as of May 31, 2017 using the following inputs				
	Total	Level 1	Level 2	Level 3
Short-term investments	\$ 3,915,375	\$ 3,915,375	\$ -	\$ -
Mutual funds:				
Large cap	23,495,820	23,495,820	-	-
International	18,648,685	18,648,685	-	-
Exchange traded	<u>5,528,276</u>	<u>5,528,276</u>	-	-
Total mutual funds	47,672,781	47,672,781	-	-
Marketable equity securities	4,365,739	4,365,739	-	-
Corporate bonds and government securities	3,615,390	3,615,390	-	-
Limited partnerships, private equity and other investment funds	27,557,237	-	13,594,512	13,962,725
Life insurance policies	<u>2,121,437</u>	<u>-</u>	<u>-</u>	<u>2,121,437</u>
Total investments	<u>\$ 89,247,959</u>	<u>\$ 59,569,285</u>	<u>\$ 13,594,512</u>	<u>\$ 16,084,162</u>
Interest rate swaps	<u>\$ (5,754,682)</u>	<u>\$ -</u>	<u>\$ (5,754,682)</u>	<u>\$ -</u>

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Fair Value Measurements as of
May 31, 2016 using the following inputs

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Short-term investments	\$ 7,821,433	\$ 7,821,433	\$ -	\$ -
Mutual funds:				
Large cap	19,968,606	19,968,606	-	-
International	15,673,094	15,673,094	-	-
Hedge	14,207	14,207	-	-
Exchange traded	<u>2,998,436</u>	<u>2,998,436</u>	-	-
Total mutual funds	38,654,343	38,654,343	-	-
Marketable equity securities	4,344,811	4,344,811	-	-
Corporate bonds and government securities	3,616,863	3,616,863	-	-
Limited partnerships, private equity and other investment funds	26,087,935	-	11,644,614	14,443,321
Life insurance policies	<u>2,026,196</u>	-	-	<u>2,026,196</u>
Total investments	<u>\$ 82,551,581</u>	<u>\$ 54,437,450</u>	<u>\$ 11,644,614</u>	<u>\$ 16,469,517</u>
Interest rate swaps	<u>\$ (7,804,737)</u>	<u>\$ -</u>	<u>\$ (7,804,737)</u>	<u>\$ -</u>

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The following table provides a summary of changes in fair value of the University's Level 3 assets for the years ended May 31, 2017 and 2016:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Total	Limited Partnership Interest, private Equity and Other	Life Insurance Policies
Balance at May 31, 2015	\$ 19,185,949	\$ 17,247,570	\$ 1,938,379
Realized gains	866,583	843,368	23,215
Unrealized (losses) gains relating to instruments still held at the reporting date	(1,785,941)	(1,928,641)	142,700
Purchases, sales and settlements, net	<u>(1,797,074)</u>	<u>(1,718,976)</u>	<u>(78,098)</u>
Balance at May 31, 2016	16,469,517	14,443,321	2,026,196
Realized gains	548,402	529,919	18,483
Unrealized (losses) gains relating to instruments still held at the reporting date	(104,073)	(224,012)	119,939
Purchases, sales and settlements, net	<u>(829,684)</u>	<u>(786,503)</u>	<u>(43,181)</u>
Balance at May 31, 2017	<u>\$ 16,084,162</u>	<u>\$ 13,962,725</u>	<u>\$ 2,121,437</u>

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 and/or general partners of the partnerships using valuation techniques as prescribed by ASC 820, such as the market approach or income approach. The use of the market approach generally consists of using comparable market transactions or values reported by the underlying portfolio managers, while the use of the income approach generally consists of the net present value of future cash flows, adjusted as appropriate for liquidity, credit, market or other risk factors. The inputs used in estimating the value of these investments may include the original transaction price, net asset value of portfolio funds or recent transactions in the same or similar instruments. 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.

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Investments that calculate net asset value 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 following table summarizes the fair value and other pertinent liquidity information of investments in major categories as of May 31, 2017 and 2016:

<u>Category of Investment</u>	<u>2017</u>				<u>2016</u>
	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if Currently Eligible)</u>	<u>Redemption Notice Period</u>	<u>Fair Value</u>
Private Equity	\$ 5,136,660	\$ 1,191,000	Not permitted during life of the funds	N/A	\$ 5,645,580
Real Estate	1,170,240	1,730,000	No immediate redemption	N/A	1,202,525
Equity Long/Short and Absolute Return Hedge Funds	8,103,818	-	Quarterly to Annually	45 - 100 days	7,523,208
International Equity	8,560,973	-	Monthly	5 days notice	7,389,709
Domestic Equity	4,085,995	-	Monthly	30 days notice	3,411,334
Other	<u>499,551</u>	<u>-</u>	No immediate redemption	N/A	<u>915,579</u>
Total	<u>\$27,557,237</u>	<u>\$ 2,921,000</u>			<u>\$ 26,087,935</u>

Private Equity - This category includes investments in private equity funds and funds-of-funds that invest in emerging growth, expansion stage or financially distressed companies in the United States and internationally. The investments cannot be redeemed upon the request of the investors but are made through distributions of scheduled liquidations of the underlying holdings. Substantially all such investments held at May 31, 2017 are scheduled to be liquidated within the next three years.

Real Estate - This category includes investments in real estate funds-of-funds that invest primarily in other real estate funds. The investments cannot be redeemed upon the request of the investors but are made through distributions of scheduled liquidations of the underlying holdings. Approximately 60% of such investments in this category were in liquidation at May 31, 2017 with final liquidation to occur within the next two years.

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Equity Long/Short and Absolute Return Hedge Funds - This category includes investments in hedge funds and hedge funds-of-funds that invest primarily in U.S. and international securities (both long and short) and other investments seeking to realize appreciation in value primarily through the allocation of capital directly and indirectly among investment funds. Certain of these investments maintain the ability to limit investor redemptions in the event that liquidity in these funds is not available to meet withdrawals. This could also occur if liquidity is available, but non-redeeming fund investors could be adversely affected by large withdrawals by other clients.

International Equity - Investments in this category include funds that seek to achieve long-term capital appreciation by investing primarily in the equity securities of non-U.S. issuers whose equity market capitalizations exceed \$5 billion.

Domestic Equity - The underlying investments in this category consist primarily of domestic equity securities focused on a long-term growth strategy.

Other - Other investments consist of limited partnership interests that are measured at fair value based on amounts reported by the partnerships and include partnership interests for companies primarily in the real estate industry.

(8) Real estate investments

A summary of real estate investments as of May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Properties adjacent to the University	\$ 22,766,248	\$ 21,189,783
Properties not adjacent to the University	<u>910,495</u>	<u>1,056,495</u>
	23,676,743	22,246,278
Accumulated depreciation on real estate investments	<u>(5,996,957)</u>	<u>(5,515,912)</u>
	\$ <u>17,679,786</u>	\$ <u>16,730,366</u>

Real estate investments include properties that are rented to third parties. Such properties are recorded at cost and depreciated over each properties' estimated useful life. Depreciation expense on these properties totaled \$481,045 and \$418,468 for the years ended May 31, 2017 and 2016, respectively. Additionally, certain of the real estate investment properties are subject to sales/leaseback transactions (see Note 19).

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(9) Property and equipment

A summary of property and equipment as of May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Buildings and campus	\$ 234,418,837	\$ 212,154,990
Computer equipment and software	3,265,515	3,210,606
Furniture, fixtures and office equipment	18,823,460	18,509,294
General equipment	7,896,345	7,895,078
Laboratory equipment	5,976,171	5,840,969
Automobiles	697,425	629,822
Construction in progress	<u>20,586,491</u>	<u>7,617,640</u>
	291,664,244	255,858,399
Accumulated depreciation	<u>(112,328,224)</u>	<u>(107,470,981)</u>
	<u>\$ 179,336,020</u>	<u>\$ 148,387,418</u>

Depreciation expense on property and equipment amounted to \$6,276,124 and \$5,548,227 for the years ended May 31, 2017 and 2016, respectively.

As of May 31, 2017 and 2016, the University had commitments remaining under construction contracts totaling approximately \$6,172,000 and \$3,435,000 that were at various stages of completion through fiscal years 2017 and 2016, respectively. The retainage payable related to construction projects at May 31, 2017 and 2016 was approximately \$467,000 and \$131,000, respectively, which is included in accrued expenses and liabilities in the accompany statements of financial position.

(10) Lines of credit

The University had a \$5,000,000 construction line of credit available with a bank with an outstanding balance of \$5,000,000 at May 31, 2016. During 2017, the University converted the construction line of credit to a term loan (see Note 11).

During 2016, the University obtained a \$2,500,000 revolving line of credit available with a bank. The outstanding balance of the line bears interest at a rate equal to 1-month LIBOR plus 1.50% per year. The line matures in May 2018 and is unsecured. The University had no outstanding borrowings under the line at May 31, 2017 and 2016. The terms of the line of credit include certain negative pledge agreements, a debt service coverage ratio and minimum unrestricted liquidity requirements. The University was in compliance with these terms as of May 31, 2017 and 2016.

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(11) Notes payable

A summary of notes payable as of May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Note payable to a bank, due August 2023, with monthly payments of \$15,996, including interest at a fixed rate of 4.05%. Secured by real property.	\$ 1,072,417	\$ 1,217,093
Note payable to a bank, due March 2026 with 84 monthly principal payments beginning April 1, 2019. Interest is due monthly at a rate equal to the 1-month LIBOR plus 1.95% per year (2.94% at May 31, 2017). Secured by real property.	<u>5,000,000</u>	<u>-</u>
Total notes payable	<u>\$ 6,072,417</u>	<u>\$ 1,217,093</u>

A summary of future minimum annual payments of notes payable as of May 31, 2017 is as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 151,312
2019	185,888
2020	335,723
2021	351,658
2022	363,706
2023 and later years	<u>4,684,130</u>
	<u>\$ 6,072,417</u>

The outstanding term loan converted from a construction line of credit during 2017, which includes certain negative pledge agreements, a debt service coverage ratio and minimum unrestricted liquidity requirements. The University was in compliance with these terms as of May 31, 2017 and 2016.

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(12) Bonds payable

A summary of bonds payable as of May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Public Revenue Bonds (Lipscomb University Project) Series 2016A; due in annual payments ranging from \$610,000 to \$6,970,000 per year through October 2045; bearing interest at a fixed rate of 5%; plus unamortized premium based upon effective interest rate of 4.15% of \$7,534,492 and \$7,796,713 and less debt issuance costs of \$797,407 and \$810,843 at May 31, 2017 and 2016, respectively.	\$ 69,387,086	\$ 69,635,869
Revenue Bonds (Lipscomb University Project) Series 2016B; due in monthly payments ranging from \$9,963 to \$329,630 beginning May 2019 through May 2039; bearing interest at a rate equal to 67% of the sum of 30-day LIBOR plus 1.75% (1.84% as of May 31, 2017); less debt issuance costs of \$198,321 and \$190,198 at May 31, 2017 and 2016, respectively.	24,981,829	22,396,796
Revenue Bonds (Lipscomb University Project) Series 2013; due in monthly payments ranging from \$13,638 to \$25,828 through December 2033, bearing interest at a fixed rate of 3.79%; net of unamortized debt issuance costs of \$31,667 and \$36,944 at May 31, 2017 and 2016, respectively.	<u>3,860,087</u>	<u>4,018,470</u>
Total bonds payable	\$ <u>98,229,002</u>	\$ <u>96,051,135</u>

A summary of future annual minimum payments of bonds payable as of May 31, 2017 is as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 1,312,868
2019	1,119,481
2020	1,160,101
2021	1,331,764
2022	1,423,144
2023 and later years	<u>91,881,644</u>
	\$ <u>98,229,002</u>

The terms of the bonds payable include certain negative pledge agreements, a debt service coverage ratio and minimum unrestricted liquidity requirements. The University was in compliance with these terms as of May 31, 2017 and 2016.

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(13) Interest rate swap agreements

The University has entered into four interest rate swap agreements with a commercial bank for the purpose of hedging its interest rate risk on its outstanding bonds. These agreements terminate between December 2017 and November 2028 and have a combined original notional amount of \$97,525,970 and current notional amount of \$51,695,970 as of May 31, 2017. The fair value of the University's obligations under swap agreements was \$5,754,682 and \$7,804,737 at May 31, 2017 and 2016, respectively.

The University's bonds have three components that determined the University's effective interest rate: (1) the University pays a variable rate of interest as defined in the Master Trust Indenture; (2) the University receives 67% of one month LIBOR from the bank; and (3) the University pays 3.22% to the bank per the weighted average of the University's four swap agreements.

The effective all-in rate of interest (when all three interest variables are combined) of Lipscomb University was 5.26% and 4.73% for fiscal years 2017 and 2016, respectively.

Interest expense on the University's lines of credit and notes payable was approximately \$192,000 and \$215,000 for 2017 and 2016, respectively. Interest expense on the bonds payable was approximately \$3,281,000 and \$1,971,000 for the years ended May 31, 2017 and 2016, respectively. Total interest expense was approximately \$4,435,000 and \$3,823,000 for 2017 and 2016, respectively.

(14) Capital lease obligations

The University has entered into capital lease agreements to finance the acquisition of certain equipment and real estate. The cost of equipment and real estate utilized under the capital leases totaled \$3,379,897 with accumulated depreciation of \$365,767 at May 31, 2017.

The University's obligation under these capital leases is as follows:

	<u>2017</u>	<u>2016</u>
Minimum lease payments payable	\$ 2,944,670	\$ 3,381,214
Less: portion representing interest	<u>313,439</u>	<u>400,291</u>
Capital lease obligations	<u>\$ 2,631,231</u>	<u>\$ 2,980,923</u>

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Future minimum annual lease payments payable under the capital leases as of May 31, 2017 are as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 493,398
2019	493,398
2020	493,398
2021	1,163,158
2022	104,399
2023 and later years	<u>196,919</u>
	<u>\$ 2,944,670</u>

Property and equipment utilized under capital leases is comprised of the following at May 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Land	\$ 685,849	\$ 685,849
Buildings	1,600,313	1,600,313
General equipment	<u>1,093,735</u>	<u>1,042,821</u>
	3,379,897	3,328,983
Less: accumulated amortization	<u>365,767</u>	<u>217,933</u>
	<u>\$ 3,014,130</u>	<u>\$ 3,111,050</u>

Amortization expense associated with assets under capital leases totaled \$147,833 and \$119,475 during 2017 and 2016, respectively.

Capital leased assets referenced above include land and a building related to an Italian villa located in Florence, Italy. The villa provides unique educational opportunities for University students to study abroad. The University has the right to purchase the villa at the end of the initial five-year lease term.

(15) Employee benefit plans

(a) Defined contribution plans

The University sponsors a defined contribution retirement plan covering substantially all full-time employees who have been employed at least one year. The University matches employee contributions up to 7% of an employee's compensation, subject to IRS limitations. The University made contributions to the plan of \$2,574,801 and \$2,474,846 for fiscal years 2017 and 2016, respectively. Additionally, the University sponsors a tax-deferred annuity plan which allows employee contributions for full-time employees upon hire; however, the University does not match any employee contributions under the plan.

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(b) Defined benefit plan

The University has a contributory, defined benefit retirement plan covering certain salaried employees hired prior to August 1, 1990. The University had approximately 115 participants in the plan at May 31, 2017. The University makes annual contributions to the plan according to the actuarial funding agreement. The assets of the plan are primarily invested in U.S. Government and corporate bonds, equity securities, and mutual funds, which are considered to be Level 1 investments in accordance with the fair value hierarchy.

The following table sets forth the plan's fair value of plan assets, benefit obligations and funded status at May 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Fair value of plan assets	\$ 6,135,240	\$ 6,008,284
Benefit obligation	<u>6,335,796</u>	<u>6,708,845</u>
Funded status	\$ <u>(200,556)</u>	\$ <u>(700,561)</u>

Weighted-average assumptions used to determine benefit obligations at May 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Discount rate	<u>4.25 %</u>	<u>4.25 %</u>
Rate of compensation increase	<u>5.00 %</u>	<u>5.00 %</u>

Weighted-average assumptions used to determine net cost for the years ended May 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Discount rate	<u>4.25 %</u>	<u>4.25 %</u>
Expected long-term rate of return on plan assets	<u>7.50 %</u>	<u>7.50 %</u>
Rate of compensation increase	<u>5.00 %</u>	<u>5.00 %</u>

A summary of other information related to this plan for 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Pension expense	\$ <u>371,396</u>	\$ <u>422,604</u>
Benefits paid	\$ <u>529,400</u>	\$ <u>334,891</u>
Actuarial gain	\$ <u>(222,394)</u>	\$ <u>(38,682)</u>

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Expected benefit payments, including future service and pay, as appropriate, are estimated at May 31, 2017 to be paid for the next ten years as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 822,000
2019	819,000
2020	808,000
2021	784,000
2022	759,000
2023 through 2027	3,324,000

The plan's weighted-average asset allocations at May 31, 2017 and 2016 by asset category are as follows:

<u>Asset Category</u>	<u>2017</u>	<u>2016</u>
Equity securities	55 %	55 %
Fixed income	14 %	14 %
Limited partnerships, private equity and other investment funds	24 %	25 %
Other	7 %	6 %
Total	<u>100 %</u>	<u>100 %</u>

The University's investment policies and strategies for the defined benefit plan use target allocations for the individual asset categories. The University's investment goals are to maximize returns subject to specific risk management policies.

The disclosures above were determined through actuarial valuation.

(c) Retirement incentive plan

During 2015, the University offered a one-time retirement incentive plan to full-time employees who met certain age and years of service requirements. The plan pays out a specified percentage of the eligible employee's compensation based on years of service that will be paid in equal annual installments over a period of five years. The plan also allows eligible employees to continue their current fringe benefits, including health insurance, for five years. The University recognized a liability totaling approximately \$787,000 and \$1,097,000 at May 31, 2017 and 2016, respectively, for the outstanding obligation under the plan which is included with accrued expenses and liabilities in the accompanying statements of financial position.

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(16) Health plans

Health insurance plan

The University adopted a self-insured health insurance plan during 2012. Under the plan, the University is self-insured up to \$115,000 per individual claim for covered employees. Amounts in excess of \$115,000 per claim are covered by a stop-loss policy purchased by the University, which provides for up to \$1 million lifetime maximum reimbursement per covered individual. The self-insured health insurance plan is administered by a third party who acts as the University's agent in making benefit payments on the University's behalf. The total liability for outstanding health claims, including claims incurred but not reported, was approximately \$435,000 and \$432,000 at May 31, 2017 and 2016, respectively.

Postretirement benefit plan

Certain of the University's employees or former employees are covered under a postretirement healthcare benefit plan. The University had approximately 130 retirees covered by the plan at May 31, 2017. Lifetime claims of an individual in excess of \$2,000,000 are the obligation of the retiree. Total costs of the plan were \$354,743 and \$375,081 in 2017 and 2016, respectively. The University funds 100% of the plan for retirees who retired before August 1, 1994 and funds a percentage of such costs for retirees who retired after August 1, 1994 based on years of service to the University. Employees hired after August 1, 1993 may participate in the postretirement benefit plan, but have to fund the full premium.

The following table presents the plan's funded status reconciled with amounts recognized in the University's statements of financial position as of May 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Accrued postretirement benefit obligation:		
For retirees	\$ 2,593,577	\$ 2,644,274
For active employees	<u>2,726,666</u>	<u>2,770,136</u>
Accrued postretirement benefit obligation	\$ <u>5,320,243</u>	\$ <u>5,414,410</u>

The accumulated postretirement benefit obligation was reduced (increased) by approximately \$66,000 and (\$125,000) during 2017 and 2016, respectively, as the result of actuarial revaluations.

Net periodic postretirement benefit costs for 2017 and 2016 include the following components:

	<u>2017</u>	<u>2016</u>
Service cost	\$ 22,437	\$ 22,961
Interest cost	222,908	234,211
Recognized prior service income	(35,139)	(35,139)
Recognized net losses	<u>144,537</u>	<u>153,048</u>
Net periodic postretirement benefit cost	\$ <u>354,743</u>	\$ <u>375,081</u>

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Expected benefit payments, including future service, as appropriate, are expected as of May 31, 2017 to be paid for the next ten years as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 304,000
2019	328,000
2020	334,000
2021	345,000
2022	357,000
2023 through 2027	1,906,000

The benefit payments listed in the above table were determined through actuarial valuation. For measurement purposes at May 31, 2017, a 5.25% annual rate of increase in the per capita cost of covered benefits (health care cost trend) was assumed. This rate was assumed to decrease 0.25% per year until reaching an ultimate level of 3.0%. The discount rate used in determining the accumulated postretirement benefit obligation was 4.25% at May 31, 2017 and 2016.

The health care cost trend rate assumption has a significant effect on the amounts reported. Increasing the assumed health care cost trend by one percentage point in each year would increase the accrued postretirement benefit obligation by approximately \$219,000 and \$218,000 at May 31, 2017 and 2016, respectively, and would increase the net periodic postretirement benefit cost by approximately \$17,000 in 2017 and \$18,000 in 2016.

(17) Net assets

Temporarily restricted net assets as of May 31, 2017 and 2016 are committed for the following purposes:

	<u>2017</u>	<u>2016</u>
Annuity and life income funds which convert to unrestricted net assets upon maturity	\$ 3,063,446	\$ 1,665,605
Scholarships and instruction	16,997,174	14,055,469
Capital improvements	23,432,223	23,309,714
Other programs	<u>2,387,457</u>	<u>1,676,386</u>
	<u>\$ 45,880,300</u>	<u>\$ 40,707,174</u>

As of May 31, 2017 and 2016, permanently restricted net assets consisted primarily of investments and contributions receivable totaling \$51,358,469 and \$48,612,339, respectively, that are to be held in perpetuity, the income of which is expendable for both specific and general purposes.

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(18) Endowment

At May 31, 2017, the University's endowment consisted of approximately 580 individual funds established for a variety of purposes. The endowment includes 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.

The University has interpreted the State of Tennessee's Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditures by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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

The endowment pool market value to net asset analysis as of May 31, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment pool:				
Donor-restricted	\$ -	\$ 9,877,230	\$ 51,291,351	\$ 61,168,581
Board-designated	<u>17,856,550</u>	<u>-</u>	<u>-</u>	<u>17,856,550</u>
Total endowment	<u>\$ 17,856,550</u>	<u>\$ 9,877,230</u>	<u>\$ 51,291,351</u>	<u>\$ 79,025,131</u>

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The endowment pool market value to net asset analysis as of May 31, 2016 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment pool:				
Donor-restricted	\$ -	\$ 9,540,537	\$ 48,572,103	\$ 58,112,640
Board-designated	<u>10,647,122</u>	<u>-</u>	<u>-</u>	<u>10,647,122</u>
Total endowment	<u>\$ 10,647,122</u>	<u>\$ 9,540,537</u>	<u>\$ 48,572,103</u>	<u>\$ 68,759,762</u>

Changes in endowment net assets for the fiscal years ended May 31, 2017 and 2016 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2015	\$ <u>14,439,810</u>	\$ <u>10,594,774</u>	\$ <u>46,408,392</u>	\$ <u>71,442,976</u>
Investment return:				
Investment income	1,176,598	-	-	1,176,598
Net appreciation (depreciation) - realized and unrealized	<u>(5,534,286)</u>	<u>1,149,941</u>	<u>517,561</u>	<u>(3,866,784)</u>
Total investment return	<u>(4,357,688)</u>	<u>1,149,941</u>	<u>517,561</u>	<u>(2,690,186)</u>
Contributions	2,065,000	-	1,646,150	3,711,150
Appropriation of endowment assets for expenditure	<u>(1,500,000)</u>	<u>(2,204,178)</u>	<u>-</u>	<u>(3,704,178)</u>
Endowment net assets, May 31, 2016	<u>10,647,122</u>	<u>9,540,537</u>	<u>48,572,103</u>	<u>68,759,762</u>

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	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, May 31, 2016 (Cont.)	<u>10,647,122</u>	<u>9,540,537</u>	<u>48,572,103</u>	<u>68,759,762</u>
Investment return:				
Investment income	1,461,430	-	-	1,461,430
Net appreciation (depreciation) - realized and unrealized	<u>5,951,614</u>	<u>2,669,485</u>	<u>-</u>	<u>8,621,099</u>
Total investment return	<u>7,413,044</u>	<u>2,669,485</u>	<u>-</u>	<u>10,082,529</u>
Contributions	1,046,384	-	2,719,248	3,765,632
Appropriation of endowment assets for expenditure	<u>(1,250,000)</u>	<u>(2,332,792)</u>	<u>-</u>	<u>(3,582,792)</u>
Endowment net assets, May 31, 2017	\$ <u>17,856,550</u>	\$ <u>9,877,230</u>	\$ <u>51,291,351</u>	\$ <u>79,025,131</u>

(19) Lease commitments

The University leases classroom space, vehicles and various equipment under operating leases. Rent expense under these leases was approximately \$1,878,000 and \$1,718,000 in 2017 and 2016, respectively.

A summary of approximate future minimum payments under these operating leases as of May 31, 2017 are as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 2,334,000
2019	1,320,000
2020	773,000
2021	584,000
2022	475,000
Thereafter	<u>2,799,000</u>
	<u>\$ 8,285,000</u>

It is expected that in the normal course of business, leases that expire will likely be renewed or replaced by other leases; thus, it is anticipated that future lease payments will not be less than the commitments for 2018.

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The University leases certain real estate that is subject to sale/leaseback accounting treatment (discussed below). Additionally, certain of this real estate is subleased. During 2017 and 2016, lease expense related to these properties amounted to approximately \$1,223,000 and \$893,000, respectively, and rental income under the subleases amounted to approximately \$897,000 and \$643,000, respectively.

Approximate future minimum rental payments due under the leases, including sale/leaseback agreements, as of May 31, 2017 are as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 1,068,000
2019	865,000
2020	776,000
2021	507,000
2022	180,000
Thereafter	<u>136,000</u>
	<u>\$ 3,532,000</u>

Approximate future minimum rental income under the leases at May 31 2017 are expected to be as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 980,000
2019	684,000
2020	588,000
2021	311,000
2022	89,000
Thereafter	<u>89,000</u>
	<u>\$ 2,741,000</u>

The University has entered into certain sale/leaseback transactions whereby the University has sold certain investment properties which were subsequently leased back from the purchasers. The lease agreements provide the University with an option to repurchase the properties during periods ranging from four to eight years from the purchase date. As a result of the continuing involvement in the properties due to the repurchase option, the University deferred the resulting gains and has recognized a liability equal to the sales proceeds received totaling approximately \$4,883,000 and \$4,807,000 at May 31, 2017 and 2016, respectively. The University will recognize any gains on the sale of the properties when the corresponding repurchase options expire and the continuing involvement is complete. The agreements also provide that the University will pay the purchaser an amount equal to between 3.0% and 5.0% of the appreciated market value if the University does not repurchase the property.

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Additionally, the University has entered into certain agreements that provide the University an option to purchase certain properties being rented from third parties for periods of up to eight years. The agreements also provide that the University will pay the owner an amount equal to between 3.0% and 5.0% of the appreciated market value if the University does not purchase the property.

(20) Contingent liabilities

The University is sometimes involved in legal actions arising in the normal course of operations. Although it is not possible to predict the ultimate resolution or financial liability with respect to any pending or threatened litigation, in the opinion of management, there are currently no matters pending or threatened which will have a material adverse effect on the University's financial position.

(21) Related party transactions

The University sometimes purchases goods or services or rents certain property from companies or organizations that are affiliated with or owned, directly or indirectly, by members of the Board of Trustees. Transactions with related parties are consummated at arm's length in accordance with the terms of the University's conflict of interest policy.

(22) Supplemental disclosures of cash flow statement information

	<u>2017</u>	<u>2016</u>
Approximate interest paid	\$ <u>5,284,000</u>	\$ <u>3,075,000</u>

During 2017 and 2016, the University incurred capital lease obligations of \$50,914 and \$2,344,395, respectively, for the acquisition of equipment and real estate.

(23) Subsequent event

In July 2017, the University received all of the assets and certain liabilities related to the Sound Emporium recording studio from a donor in partial satisfaction of an outstanding pledge receivable. The net assets are being appraised with an estimated fair value in excess of \$2,000,000. The newly formed for-profit single member limited liability company, Sound Emporium Studios, LLC, is wholly-owned by the University and will serve music recording artists and producers as well as provide an educational learning opportunity for the University's contemporary music students.