

LIPSCOMB UNIVERSITY

Financial Statements

May 31, 2007 and 2006

(With Independent Auditors' Report Thereon)



LATTIMORE BLACK MORGAN & CAIN, PC
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

LIPSCOMB UNIVERSITY

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LATTIMORE BLACK MORGAN & CAIN, PC
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

INDEPENDENT AUDITORS' REPORT

The Board of Trustees of
Lipscomb University:

We have audited the accompanying statements of financial position of Lipscomb University (the "University") as of May 31, 2007 and 2006, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lipscomb University as of May 31, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3, during 2007 the University adopted Financial Accounting Standards Board ("FASB") Statement on Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

Lattimore Black Morgan & Cain, PC

Brentwood, Tennessee
October 5, 2007

LIPSCOMB UNIVERSITY

Statements of Financial Position

May 31, 2007 and 2006

Assets

| | <u>2007</u> | <u>2006</u> |
|---------------------------------------|-----------------------|-----------------------|
| Cash and cash equivalents | \$ 2,521,584 | \$ 541,592 |
| Accounts receivable, net | 790,880 | 715,756 |
| Investments, excluding real estate | 108,998,051 | 78,533,645 |
| Real estate investments | 10,816,054 | 9,197,022 |
| Prepaid expenses and other assets | 4,369,701 | 4,820,385 |
| Cash value of life insurance policies | 3,014,227 | 3,289,690 |
| Student loans receivable | 2,305,498 | 2,360,777 |
| Property and equipment, net | <u>83,747,142</u> | <u>79,881,620</u> |
| | <u>\$ 216,563,137</u> | <u>\$ 179,340,487</u> |

Liabilities and Net Assets

Liabilities:

| | | |
|--|--------------------------|--------------------------|
| Current portion of notes and loans payable | \$ 2,050,000 | \$ 50,000 |
| Current portion of bonds payable | 1,900,000 | 1,910,000 |
| Student accounts and dormitory deposits collected in advance | 2,984,952 | 2,385,596 |
| Accounts payable | 1,574,575 | 1,484,226 |
| Accrued expenses and liabilities | 4,436,922 | 4,220,774 |
| Deferred revenue | 686,851 | 461,036 |
| Actuarial liability for annuities payable | 3,553,904 | 3,474,596 |
| Notes and loans payable, excluding current portion | 4,014,000 | 4,440,175 |
| Bonds payable, excluding current portion | 64,600,000 | 43,500,000 |
| Accrued postretirement benefit obligation | 4,741,533 | 3,178,082 |
| Federal student loans refundable | <u>2,181,775</u> | <u>2,142,467</u> |
| Total liabilities | <u>92,724,512</u> | <u>67,246,952</u> |

Net assets:

Unrestricted:

| | | |
|---------------------------------|-------------------|-------------------|
| Undesignated | 3,592,422 | 3,504,925 |
| Designated for student loans | 289,265 | 289,193 |
| Funds functioning as endowment | 41,199,550 | 31,386,734 |
| Designated for plant facilities | <u>2,824,987</u> | <u>3,421,393</u> |
| Total unrestricted | 47,906,224 | 38,602,245 |

| | | |
|-------------------------|------------------------------|------------------------------|
| Temporarily restricted | 46,081,815 | 44,871,390 |
| Permanently restricted | <u>29,850,586</u> | <u>28,619,900</u> |
| Total net assets | <u>123,838,625</u> | <u>112,093,535</u> |
| | <u>\$ 216,563,137</u> | <u>\$ 179,340,487</u> |

See accompanying notes to the financial statements.

LIPSCOMB UNIVERSITY

Statements of Activities and Changes in Net Assets

Years ended May 31, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|--|-----------------------|-----------------------|
| Changes in unrestricted net assets: | | |
| Revenues and other support: | | |
| Tuition and education fees | \$ 46,969,713 | \$ 43,929,699 |
| Less financial aid | <u>(11,198,019)</u> | <u>(10,986,739)</u> |
| Net tuition and fees | 35,771,694 | 32,942,960 |
| Private gifts | 4,233,380 | 1,657,949 |
| Investment/endowment income (loss), net | 14,591,488 | 6,937,040 |
| Auxiliary enterprises revenue | 10,311,115 | 9,520,294 |
| Increase in cash value of life insurance | 179,009 | 284,228 |
| Rental income | 757,635 | 651,011 |
| Gain (loss) on interest rate swap agreements | (882,546) | 1,597,183 |
| Matured trust income | - | 1,039,359 |
| Other income | 864,336 | 1,788,532 |
| Satisfaction of restrictions | <u>6,110,243</u> | <u>5,659,903</u> |
| Total revenues and other support | <u>71,936,354</u> | <u>62,078,459</u> |
| Expenses: | | |
| Instruction | 22,225,254 | 21,280,732 |
| Institutional support | 12,634,363 | 11,577,562 |
| Student services | 10,530,689 | 9,727,619 |
| Auxiliary enterprises | 7,391,823 | 7,458,278 |
| Academic support | 6,824,052 | 6,321,531 |
| Public services | <u>697,531</u> | <u>736,959</u> |
| Total expenses | <u>60,303,712</u> | <u>57,102,681</u> |
| Increase in unrestricted net assets before effect of adoption of FASB Statement No. 158 | 11,632,642 | 4,975,778 |
| Effect of adoption of recognition provisions of FASB Statement No. 158 (Note 3) | <u>(2,328,663)</u> | <u>-</u> |
| Increase in unrestricted net assets | <u>9,303,979</u> | <u>4,975,778</u> |
| Changes in temporarily restricted net assets: | | |
| Private gifts | 3,798,240 | 4,608,068 |
| Adjustments of actuarial liability for annuities payable | (177,747) | 381,410 |
| Investment income, net | 2,006,449 | 422,557 |
| Other income | 959,720 | 742,914 |
| Government and other grants | 371,856 | 78,195 |
| Net assets released from restrictions | <u>(5,748,093)</u> | <u>(5,250,517)</u> |
| Increase in temporarily restricted net assets | <u>1,210,425</u> | <u>982,627</u> |
| Changes in permanently restricted net assets: | | |
| Private gifts | 1,135,054 | 1,105,924 |
| Investment income, net | 351,246 | 225,987 |
| Adjustments of actuarial liability for annuities payable | 106,536 | (49,740) |
| Net assets released from restrictions, including changes in value of split interest agreements | <u>(362,150)</u> | <u>(409,386)</u> |
| Increase in permanently restricted net assets | <u>1,230,686</u> | <u>872,785</u> |
| Increase in net assets | 11,745,090 | 6,831,190 |
| Net assets at beginning of year | <u>112,093,535</u> | <u>105,262,345</u> |
| Net assets at end of year | <u>\$ 123,838,625</u> | <u>\$ 112,093,535</u> |

See accompanying notes to the financial statements.

LIPSCOMB UNIVERSITY

Statements of Cash Flows

Years ended May 31, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|--|----------------------------|--------------------------|
| Cash flows from operating activities: | | |
| Increase in net assets | \$ <u>11,745,090</u> | \$ <u>6,831,190</u> |
| Adjustments to reconcile increase in net assets to cash flows used by operating activities: | | |
| Depreciation and amortization | 4,161,603 | 4,582,970 |
| Provision for uncollectible accounts | 16,993 | 30,512 |
| (Gain) loss on interest rate swap agreement | 882,546 | (1,597,183) |
| Net (gain) loss on investments | (14,659,656) | (7,046,905) |
| Gifts restricted for investments and plant facilities | (4,933,294) | (5,713,992) |
| Non-cash gifts of securities and real estate | (1,700,977) | (414,076) |
| (Increase) decrease in operating assets: | | |
| Accounts receivable | (92,117) | 90,207 |
| Prepaid expenses and other assets | (431,862) | 200,927 |
| Increase (decrease) in operating liabilities: | | |
| Student accounts and dormitory deposits collected in advance | 599,356 | (128,800) |
| Accounts payable | 90,349 | 303,698 |
| Accrued expenses and liabilities | 216,148 | 436,204 |
| Deferred revenue | 225,815 | (13,885) |
| Actuarial liability for annuities payable | 79,308 | (451,799) |
| Accrued postretirement benefit obligation | <u>1,563,451</u> | <u>(36,689)</u> |
| Total adjustments | <u>(13,982,337)</u> | <u>(9,758,811)</u> |
| Net cash used by operating activities | <u>(2,237,247)</u> | <u>(2,927,621)</u> |
| Cash flows from investing activities: | | |
| Purchases of plant facilities | (7,765,206) | (12,232,118) |
| Proceeds from sale of investments | 127,122,108 | 101,725,303 |
| Purchases of investments | (141,225,880) | (95,761,863) |
| Proceeds from sale of real estate investments | 104,876 | 448,600 |
| Purchase of real estate investments | (1,985,828) | (520,771) |
| Net increase in federal student loans refundable | 39,308 | (12,359) |
| Collection (disbursements) of student loans, net | 55,279 | (81,635) |
| (Increase) decrease in cash value of life insurance policies | <u>275,463</u> | <u>(284,228)</u> |
| Net cash used by investing activities | <u>(23,379,880)</u> | <u>(6,719,071)</u> |
| Cash flows from financing activities: | | |
| Proceeds from notes and loans payable | 1,623,825 | 4,076,175 |
| Payments of notes and loans payable | (50,000) | (31,300) |
| Proceeds from bonds payable | 23,000,000 | - |
| Payments of bonds payable | (1,910,000) | (1,805,000) |
| Gifts restricted for investments and plant facilities | <u>4,933,294</u> | <u>5,713,992</u> |
| Net cash provided by financing activities | <u>27,597,119</u> | <u>7,953,867</u> |
| Increase in cash | 1,979,992 | (1,692,825) |
| Cash and cash equivalents at beginning of year | <u>541,592</u> | <u>2,234,417</u> |
| Cash and cash equivalents at end of year | \$ <u><u>2,521,584</u></u> | \$ <u><u>541,592</u></u> |

See accompanying notes to the financial statements.

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

(1) Nature of operations

Lipscomb University (the "University") is a private, not-for-profit, co-educational, church-related university of approximately 2,500 students seeking undergraduate and graduate degrees. The University also provides pre-kindergarten through high school educational services for approximately 1,400 additional students. The President and the Board of Trustees, the governing board of the University, have oversight responsibility for all of the University's financial affairs.

(2) Summary of significant accounting policies

The financial statements of the University are presented on the accrual basis. The significant accounting policies followed 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 statement 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.

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 plant facilities - Represents the residual equity of net capital assets less any related debt and unamortized gifts.

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.

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

All contributions are considered to be available for unrestricted use 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. Contributions restricted for capital improvements are released from temporarily restricted net assets over the life of the applicable asset to offset annual depreciation recognized in changes in unrestricted net assets.

(b) Cash equivalents

The University considers all highly-liquid investments with original maturities of less than three months to be 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 realized. The University reviews the adequacy of its allowance for uncollectible accounts on an ongoing basis, using historical payment trends, analyses of accounts receivable by payor source and aging of receivables, as well as review of specific accounts, and makes adjustments in the allowance as necessary. The carrying amount of accounts receivable is reduced by the allowance, which reflects management's estimate of the amounts that will not be collected. A late payment fee is assessed when a student has not made financial arrangements to pay their account balance in full. Interest charges are applied to accounts in internal collections. Accounts are sent to collection agencies or attorneys after the University has exhausted all other efforts in collecting the balance.

In addition, as the University determines that federal Perkins student loans 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) Investments

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

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

The University's spending policy allows for a 5.5% annual draw from endowment earnings. 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 donor agreements. During 2007 and 2006, the Board of Trustees authorized an additional draw of \$2,250,000 and \$875,000, respectively, for planned unrestricted initiatives.

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

(e) Property and equipment

Property and equipment are stated at cost. Donated assets are recorded at their estimated market value at the date of the gift. Depreciation is provided over the assets' estimated useful lives using the straight-line method.

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

(f) Fair value of interest rate swap agreement

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 to stabilize cash flow requirements by maintaining interest rate swap contracts to convert variable-rate debt to a fixed rate.

(g) 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 currently 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 these financial statements. As of May 31, 2007 and 2006, assets under such split-interest agreements total \$1,875,712 (net of liabilities of \$1,178,364) and \$1,998,937 (net of liabilities of \$1,030,956), respectively, and are included in investments on the statements of financial position.

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

(h) Income taxes

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

(i) Revenue 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 reflected as a reduction of tuition and educational fees. Financial aid does not include payments made to students for services rendered to the University.

(j) Advertising costs

Advertising and promotion costs are expensed as incurred. The University incurred advertising costs of \$426,634 and \$207,011 for the years ended May 31, 2007 and 2006, respectively.

(k) Long-lived assets

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 (the "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 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 Government and are therefore recorded as liabilities.

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

(n) Intentions to give

The University is of the opinion that all intentions to give do not meet the criteria of unconditional promises to give. Accordingly, the University generally records intentions to give only when the related gifts are actually received. As of May 31, 2007 and 2006, the University had received current intentions to give future gifts of approximately \$3,625,000 and \$5,535,000, respectively, which will be primarily restricted for construction projects when received.

(o) Program efforts

The University's primary program services are instruction and public service. Expenses reported as academic support, student services, and auxiliary enterprises are incurred in support of these primary program services. Institutional support includes fund-raising expenses of \$1,507,591 and \$1,582,426 in 2007 and 2006, respectively. For purposes of reporting fund-raising expenses, the University includes only those fund-raising costs incurred by its development office and expenses incurred for capital campaigns.

(p) 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 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.

(q) 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.

(r) Reclassifications

Certain reclassifications have been made to the 2006 financial statements in order for them to conform to the 2007 presentation. These reclassifications have no effect on total net assets or changes in net assets as previously reported.

(s) New accounting standard

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement on Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). The standard clarifies the definition of fair value for financial reporting, establishes a framework for measuring the fair value and requires disclosures about the use of fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. At this time, the University is evaluating the impact of FAS 157.

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

(3) Change in accounting principle

In September 2006, the FASB issued Statement on Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158). This statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multi-employer plan) as an asset or liability in the statement of financial position and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets of a not-for-profit organization. FAS 158 is effective for employers without publicly traded equity securities with fiscal years ending after June 15, 2007. The University has implemented the early adoption of the financial statement presentation and disclosure requirements of FAS 158 effective June 1, 2006. The effect of adopting the FAS is shown on the statement of activities. The implementation of FAS 158 increased the accrued postretirement benefit liability by approximately \$1,400,000 and recognized past service costs related to the University's pension liability of approximately \$900,000 resulting in a decrease of approximately \$2,300,000 in unrestricted net assets.

(4) 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.

The University holds various life insurance policies with various insurance companies. One insurance company, A.M. Best rated A (Excellent) holds approximately 64% of the cash value of life insurance policies owned by the University as of May 31, 2007 and 2006.

(5) Accounts receivable

A summary of accounts receivable as of May 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|---|-------------------|-------------------|
| Student accounts receivable | \$ 1,373,706 | \$ 1,399,313 |
| Other accounts receivable | <u>300,938</u> | <u>304,783</u> |
| Subtotal | 1,674,644 | 1,704,096 |
| Less allowance for uncollectible accounts | <u>(883,764)</u> | <u>(988,340)</u> |
| Accounts receivable, net | \$ <u>790,880</u> | \$ <u>715,756</u> |

Other accounts receivable includes amounts due from Federal award programs of \$94,919 and \$109,483 at May 31, 2007 and 2006, respectively.

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

(6) Investments

A summary of investments as of May 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|--|-----------------------|----------------------|
| Short-term investments | \$ 22,377,967 | \$ 2,680,574 |
| Mutual funds | 45,157,555 | 42,840,687 |
| Marketable equity securities | 30,070,676 | 24,389,620 |
| Corporate bonds and government securities | 4,454,435 | 4,937,164 |
| Limited partnership interests in equity securities | 6,812,379 | 3,566,900 |
| Real estate investment trusts | - | 18,007 |
| Other | <u>125,039</u> | <u>100,693</u> |
| | <u>\$ 108,998,051</u> | <u>\$ 78,533,645</u> |

Short-term Investments and Corporate Bonds and Government Securities includes approximately \$19 million and \$3 million, respectively, at May 31, 2007, which are restricted for construction and related expenditures in connection with the Educational Facilities Revenue Refunding Bonds, (Lipscomb University Project) Series 2006 (see note 11).

Certain investments are combined in a common investment pool. Interests owned by unrestricted, temporarily restricted and permanently restricted net assets 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 and (losses) in the statements of activities for the years ended May 31, 2007 and 2006:

| | <u>2007</u> | <u>2006</u> |
|----------------------------|----------------------|---------------------|
| Interest and dividends | \$ 3,224,887 | \$ 2,726,418 |
| Gain on investments | 14,659,656 | 7,046,905 |
| Payments to beneficiaries | (736,716) | (1,935,861) |
| Investment management fees | <u>(198,644)</u> | <u>(251,878)</u> |
| | <u>\$ 16,949,183</u> | <u>\$ 7,585,584</u> |

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

| | <u>2007</u> | <u>2006</u> |
|------------------------|----------------------|---------------------|
| Unrestricted | \$ 14,591,488 | \$ 6,937,040 |
| Temporarily restricted | 2,006,449 | 422,557 |
| Permanently restricted | <u>351,246</u> | <u>225,987</u> |
| | <u>\$ 16,949,183</u> | <u>\$ 7,585,584</u> |

LIPSCOMB UNIVERSITY

Notes to the Financial Statements

May 31, 2007 and 2006

(7) Real estate investments

A summary of real estate investments as of May 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|--|----------------------|---------------------|
| Properties adjacent to the University | \$ 11,794,313 | \$ 9,808,485 |
| Properties not adjacent to the University | <u>1,506,114</u> | <u>1,610,990</u> |
| | 13,300,427 | 11,419,475 |
| Accumulated depreciation on real estate investments | <u>(2,484,373)</u> | <u>(2,222,453)</u> |
| | <u>\$ 10,816,054</u> | <u>\$ 9,197,022</u> |

Depreciation expense on these properties amounted to \$261,920 and \$209,944 for the years ended May 31, 2007 and 2006, respectively.

(8) Property and equipment

A summary of property and equipment as of May 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|--|----------------------|----------------------|
| Buildings and campus | \$ 117,445,183 | \$ 106,291,097 |
| Computer equipment and software | 5,195,770 | 4,695,649 |
| Furniture, fixtures and office equipment | 4,202,938 | 3,117,605 |
| General equipment | 6,921,734 | 6,017,823 |
| Laboratory equipment | 2,296,618 | 2,105,061 |
| Library books and equipment | 5,849,700 | 5,508,654 |
| Automobiles | 285,769 | 281,889 |
| Construction in progress | <u>4,224,006</u> | <u>11,323,612</u> |
| | 146,421,718 | 139,341,390 |
| Accumulated depreciation | <u>(62,674,576)</u> | <u>(59,459,770)</u> |
| | <u>\$ 83,747,142</u> | <u>\$ 79,881,620</u> |

Depreciation expense on these assets amounted to \$3,899,683 and \$4,373,026 for the years ended May 31, 2007 and 2006, respectively.

Capitalized interest on construction projects amounted to \$90,167 and \$37,549 for the years ended May 31, 2007 and 2006, respectively.

Construction in progress at May 31, 2007 consisted primarily of the A.M. Burton Building (College of Pharmacy) and the Bennett Campus Center. Construction in progress at May 31, 2006 consisted primarily of the Ezell Center project.

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The University has construction contracts to build various buildings, including the renovation of the A.M. Burton Building (College of Pharmacy) and the Bennett Campus Center. These contracts have a value of approximately \$9,169,000 to be paid at various stages of completion through fiscal year 2008.

(9) Line of credit

The University has a \$3,000,000 line of credit available with a bank at May 31, 2007, which matures in December 2007 and bears interest at LIBOR plus 0.375%. The University had no borrowings under this line as of May 31, 2007 or 2006.

(10) Notes and loans payable

A summary of notes and loans payable as of May 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|---|---------------------|---------------------|
| Note payable to bank, due in October 2012; with interest payable monthly at 4.94%; principal due in various installments through October 2012. | \$ 364,000 | \$ 414,000 |
| Line of credit with a bank with \$8,000,000, reduced to \$5,700,000 at May 31, 2007 per note schedule, at LIBOR plus .40% (5.72% at May 31, 2007); principal due in various installments through May 2011; interest paid monthly. | <u>5,700,000</u> | <u>4,076,175</u> |
| Total notes and loans payable | 6,064,000 | 4,490,175 |
| Less current portion | <u>(2,050,000)</u> | <u>(50,000)</u> |
| Notes and loans payable, excluding current portion | \$ <u>4,014,000</u> | \$ <u>4,440,175</u> |

A summary of future maturities of notes and loans payable as of May 31, 2007 is as follows:

| <u>Year</u> | <u>Amount</u> |
|----------------------|---------------------|
| 2008 | \$ 2,050,000 |
| 2009 | 1,755,000 |
| 2010 | 1,060,000 |
| 2011 | 1,065,000 |
| 2012 | 65,000 |
| 2013 and later years | <u>69,000</u> |
| | \$ <u>6,064,000</u> |

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(11) Bonds payable

A summary of bonds payable as of May 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|--|----------------------|----------------------|
| Taxable Revenue Bonds Series 2003; due in annual payments of varying amounts through February 2023; bearing interest at a variable rate (3.76% as of May 31, 2007) | \$ 36,200,000 | \$ 37,900,000 |
| Taxable Revenue Bonds Series 2003B; due in annual payments of varying amounts through November 2023; bearing interest at a variable rate (3.76% as of May 31, 2007) | 7,300,000 | 7,400,000 |
| Dormitory and Student Services Building Bonds of 1966; due in semi-annual payments of varying amounts through December 2006; bearing interest at a fixed rate of 3.00% | - | 110,000 |
| Taxable Revenue Bonds Series 2006; due in annual payments of varying amounts through July 2028; bearing interest at a variable rate (3.76% as of May 31, 2007) | <u>23,000,000</u> | <u>-</u> |
| Total bonds payable | 66,500,000 | 45,410,000 |
| Less current portion | <u>(1,900,000)</u> | <u>(1,910,000)</u> |
| Bonds payable, excluding current portion | <u>\$ 64,600,000</u> | <u>\$ 43,500,000</u> |

A summary of future maturities of bonds payable as of May 31, 2007 is as follows:

| <u>Year</u> | <u>Amount</u> |
|----------------------|----------------------|
| 2008 | \$ 1,900,000 |
| 2009 | 2,100,000 |
| 2010 | 2,300,000 |
| 2011 | 2,400,000 |
| 2012 | 2,500,000 |
| 2013 and later years | <u>55,300,000</u> |
| | <u>\$ 66,500,000</u> |

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The Educational Facilities Revenue Refunding Bonds, (David Lipscomb University Project) Series 2003 are secured by an irrevocable letter of credit expiring on February 15, 2008. The provisions of the Series 2003 bond agreement place certain restrictions and limitations upon the University. These include maintenance of certain financial ratios and restrictions on additional borrowings. Under the terms of the letter of credit agreement, the University may not borrow more than \$1,000,000 in the aggregate without prior approval of the issuing bank or its affiliates. The University was in compliance with related financial ratios and restrictions as of May 31, 2007 and 2006.

The Educational Facilities Revenue Refunding Bonds (David Lipscomb University Project) Series 2003B were issued for the purpose of financing the construction and furnishings of a 148 bed addition to the Johnson Residence Hall and are cross-collateralized with the Series 2003 bond agreement. The University was in compliance with related financial ratios and restrictions as of May 31, 2007 and 2006.

The Educational Facilities Revenue Refunding Bonds, (Lipscomb University Project) Series 2006 are secured by an irrevocable letter of credit expiring on November 15, 2011. The provisions of the Series 2006 bond agreement place certain restrictions and limitations upon the University. These include maintenance of certain financial ratios and restrictions on additional borrowings. Under the terms of the letter of credit agreement, the University may not borrow more than \$1,000,000 in the aggregate without prior approval of the issuing bank or its affiliates. The Lipscomb University Project will consist of the acquisition, renovation, construction and furnishings of a 176 bed residence village, a 300 space parking garage, a tennis center, renovation of the A.M. Burton Building (College of Pharmacy, Collins Auditorium, and a new music wing), renovation of the Bennett Campus Center, landscaping and infrastructure and all other related costs for education facilities. The University was in compliance with related financial ratios and restrictions as of May 31, 2007.

(12) Interest rate swap agreements

In June 2003, the University entered into an interest rate swap agreement with a commercial bank to reduce the impact of changes in interest rates on its taxable revenue bond Series 2003. Under the interest rate swap agreement, which is classified as a cash flow hedge, the University pays interest at a fixed rate of 3.17% as of May 31, 2007 and 2006 and will receive interest at LIBOR. The existing agreement terminates in November 2023 and has an original notional amount of \$47,000,000. The current notional amount is \$43,500,000. Notional amounts do not quantify risk or represent assets or liabilities of the University, but are used in the determination of cash settlements under the agreement. The fair value of the agreement of \$1,170,713 and \$1,720,206 as of May 31, 2007 and 2006, respectively, is reported within prepaid expenses and other assets on the statements of financial position.

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Notes to the Financial Statements

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In May 2006, the University entered into an interest rate swap agreement with a commercial bank to reduce the impact of changes in interest rates on its taxable revenue bond Series 2006. Under the interest rate swap agreement, which is classified as a cash flow hedge, the University pays interest at a fixed rate of 4.07% as of May 31, 2007 and 2006 and will receive interest at LIBOR. The existing agreement terminates in November 2028 and has a notional amount of \$23,000,000. Notional amounts do not quantify risk or represent assets or liabilities of the University, but are used in the determination of cash settlements under the agreement. The fair value of the agreement of \$(1,051,436) and \$(718,381) as of May 31, 2007 and 2006, is reported within accrued expenses on the statements of financial position as of May 31, 2007.

The decrease in the estimated fair value of the interest rate swap agreements of \$(882,546) during the year ended May 31, 2007 is reported as a loss in the statement of activities and changes in net assets. The increase in the estimated fair value of the interest rate swap agreements of \$1,597,183 during the year ended May 31, 2006 is reported as income in the statement of activities and changes in net assets.

(13) Employee benefit plans

(a) Defined contribution plan

The University sponsors a defined contribution pension plan covering substantially all employees. The University matches employee contributions up to 7% of the employee's compensation, subject to IRS limitations. The University made contributions to the plan of \$1,038,526 and \$1,024,568 in 2007 and 2006, respectively.

(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 makes annual contributions to the plan according to the actuarial funding agreement. The assets of the plan are primarily invested in United States Government and corporate bonds, equity securities, and mutual funds. The following table sets forth the plan's funded status and amounts recognized in the statement of financial position.

The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at May 31, 2007 and 2006:

| | <u>2007</u> | <u>2006</u> |
|--|---------------------|---------------------|
| Fair value of plan assets | \$ 8,186,654 | \$ 7,176,943 |
| Benefit obligation | <u>6,240,353</u> | <u>6,116,425</u> |
| Funded status | \$ <u>1,946,301</u> | \$ <u>1,060,518</u> |
| Prepaid benefit cost recognized in the financial statements, included in prepaid expenses and other assets | \$ <u>1,946,301</u> | \$ <u>1,967,589</u> |

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Implementation of FAS 158 resulted in an approximately \$900,000 decrease in unrestricted net assets primarily due to the immediate recognition of past service costs that were deferred under previously allowed accounting principles.

Weighted-average assumptions used to determine benefit obligations at May 31, 2007 and 2006 were as follows:

| | <u>2007</u> | <u>2006</u> |
|-------------------------------|--------------|--------------|
| Discount rate | <u>6.0 %</u> | <u>6.0 %</u> |
| Rate of compensation increase | <u>5.0 %</u> | <u>5.0 %</u> |

Weighted-average assumptions used to determine net cost for the years ended May 31, 2007 and 2006 were as follows:

| | <u>2007</u> | <u>2006</u> |
|--|--------------|--------------|
| Discount rate | <u>6.0 %</u> | <u>6.0 %</u> |
| Expected long-term rate of return on plan assets | <u>8.0 %</u> | <u>8.0 %</u> |
| Rate of compensation increase | <u>5.0 %</u> | <u>5.0 %</u> |

A summary of other information related to this plan for 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|--------------------------|-------------------|---------------------|
| Pension income (expense) | \$ <u>874,183</u> | \$ <u>(163,458)</u> |
| Employer contribution | \$ <u>678</u> | \$ <u>2,686</u> |
| Benefits paid | \$ <u>173,330</u> | \$ <u>249,136</u> |
| Settlements | \$ <u>91,827</u> | \$ <u>2,466,394</u> |

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| <u>Year</u> | <u>Amount</u> |
|-------------------|---------------|
| 2008 | \$ 332,740 |
| 2009 | 338,837 |
| 2010 | 471,674 |
| 2011 | 430,328 |
| 2012 | 429,482 |
| 2013 through 2017 | 860,113 |

The plan weighted-average asset allocations at May 31, 2007 and 2006 by asset category are as follows:

| <u>Asset Category</u> | <u>2007</u> | <u>2006</u> |
|-----------------------|----------------|----------------|
| Equity securities | 67.1 % | 57.4 % |
| Fixed income | 11.1 % | 14.1 % |
| Other | <u>21.8 %</u> | <u>28.5 %</u> |
| Total | <u>100.0 %</u> | <u>100.0 %</u> |

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The University's investment policies and strategies for the pension 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.

(14) Health plans

Group health insurance

The University provides group health insurance coverage for active employees through a fully insured contract with CIGNA Healthcare. For active employees, 38% of the plan is funded by the employees and 62% by the employer.

Postretirement benefit plan

Certain of the University's employees are covered under a postretirement benefit plan. At May 31, 2007, the University's portion of the members covered by the plan included approximately 120 retirees. Lifetime claims of an individual in excess of \$2,000,000 are the obligation of the retiree. Total costs of the plan were \$351,884 and \$246,004 in 2007 and 2006, respectively. The employer funds 100% of the plan for retirees before August 1, 1994 and funds a percentage of such costs for retirees after August 1, 1994 based on years of service to the University. Employees hired after August 1, 1993 may participate in the retiree plan, but will have to fund all of the premium.

The following presents the plan's funded status reconciled with amounts recognized in the University's statement of financial position as of May 31, 2007 and 2006:

| | <u>2007</u> | <u>2006</u> (Revalued as of June 1, 2006) |
|---|---------------------|--|
| Accrued postretirement benefit obligation: | | |
| For retirees | \$ 2,971,827 | \$ 2,095,205 |
| For active employees | 1,769,706 | 1,772,832 |
| Change due to revaluing | - | 165,386 |
| Change due to early retirement program | - | 629,773 |
| Fund status/benefit obligation | <u>\$ 4,741,533</u> | <u>\$ 4,663,196</u> |
| Accrued postretirement benefit liability recognized | <u>\$ 4,741,533</u> | <u>\$ 3,178,082</u> |

Implementation of FAS 158 resulted in an approximately \$1,400,000 decrease in unrestricted net assets primarily due to the immediate recognition of past service costs that were deferred under previously allowed accounting principles.

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Net periodic postretirement benefit costs for 2007 and 2006 include the following components:

| | <u>2007</u> | <u>2006</u> |
|--|-------------------|-------------------|
| Service cost | \$ 29,705 | \$ 32,304 |
| Interest cost | 269,582 | 226,488 |
| Recognized prior service (income) cost | (35,139) | (68,285) |
| Recognized net (gains) losses | <u>87,736</u> | <u>55,497</u> |
| Net periodic postretirement benefit cost | <u>\$ 351,884</u> | <u>\$ 246,004</u> |

The following approximate benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| <u>Year</u> | <u>Amount</u> |
|-------------------|---------------|
| 2008 | \$ 272,600 |
| 2009 | 291,700 |
| 2010 | 312,100 |
| 2011 | 333,900 |
| 2012 | 357,300 |
| 2013 through 2017 | 2,198,500 |

The disclosures above were determined through actuarial valuation. For measurement purposes at May 31, 2007, a 7.0% annual rate of increase in the per capita cost of covered benefits (health care cost trend) was assumed. This rate was assumed to decrease 1/2% per year until reaching an ultimate level of 6.0%. The discount rate used in determining the accumulated postretirement benefit obligation was 6.0% at May 31, 2007.

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 \$490,934 and \$318,673 at May 31, 2007 and 2006, respectively, and would increase the net periodic postretirement benefit cost by \$33,279 in 2007 and \$16,852 in 2006.

In December 2003, the United States of America enacted into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"). The Act establishes a prescription drug benefit under Medicare, known as "Medicare Part D," and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The University adopted Financial Accounting Standards Board Staff Position No. 106-1 and 106-2, *"Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003"* in 2006 and has included the estimated expected federal subsidy to be received within the accumulated postretirement benefit liability at May 31, 2007 and the net periodic postretirement benefit cost in 2007.

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Notes to the Financial Statements

May 31, 2007 and 2006

(15) Net assets

Temporarily restricted net assets as of May 31, 2007 and 2006 are committed for the following purposes:

| | <u>2007</u> | <u>2006</u> |
|--|----------------------|----------------------|
| Annuity and life income funds which convert to unrestricted net assets upon maturity | \$ 5,659,907 | \$ 4,764,616 |
| Scholarships and instruction | 8,084,135 | 7,790,763 |
| Capital improvements | 31,531,938 | 31,518,927 |
| Other programs | <u>805,835</u> | <u>797,084</u> |
| | <u>\$ 46,081,815</u> | <u>\$ 44,871,390</u> |

Permanently restricted net assets are held in perpetuity with the income from assets expendable to support certain programs. A summary of the permanently restricted net assets by the program for which the related income is expendable as of May 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|---|----------------------|----------------------|
| Investments to be held in perpetuity, the income from, which is expendable for both specific and general purposes | \$ 29,179,152 | \$ 27,972,004 |
| Annuity and life income funds, which will be held in perpetuity upon maturity | <u>671,434</u> | <u>647,896</u> |
| | <u>\$ 29,850,586</u> | <u>\$ 28,619,900</u> |

The endowment pool market value to net asset analysis as of May 31, 2007 is as follows:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|------------------|----------------------|-------------------------------|-------------------------------|-----------------------|
| Endowment pool | \$ 41,199,550 | \$ 10,552,042 | \$ 29,781,392 | \$ 81,532,984 |
| Other net assets | <u>6,706,674</u> | <u>35,529,773</u> | <u>69,194</u> | <u>42,305,641</u> |
| Total | <u>\$ 47,906,224</u> | <u>\$ 46,081,815</u> | <u>\$ 29,850,586</u> | <u>\$ 123,838,625</u> |

The endowment pool market value to net asset analysis as of May 31, 2006 is as follows:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|------------------|----------------------|-------------------------------|-------------------------------|-----------------------|
| Endowment pool | \$ 31,386,734 | \$ 10,350,159 | \$ 28,451,296 | \$ 70,188,189 |
| Other net assets | <u>7,215,511</u> | <u>34,521,231</u> | <u>168,604</u> | <u>41,905,346</u> |
| Total | <u>\$ 38,602,245</u> | <u>\$ 44,871,390</u> | <u>\$ 28,619,900</u> | <u>\$ 112,093,535</u> |

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(16) Contingent liabilities

The University is involved in various legal actions arising in the normal course of operations. In the opinion of management, such matters will not have a material adverse effect on the University's financial position. As these matters develop, it is reasonably possible management's estimate of their effect could change and an accrual for additional liabilities could be required.

The University has two standby letters of credit with a bank approximating the principal bond debt outstanding for two tax-exempt bond issues. As of May 31, 2007, these letters of credit are unused.

(17) Related party transactions

The University sometimes purchases goods or services from companies or organizations that are affiliated with or owned, directly or indirectly, by members of the Board of Trustees.

(18) Supplemental disclosures of cash flow statement information

| | <u>2007</u> | <u>2006</u> |
|--|---------------------|---------------------|
| Interest paid, net of capitalized interest of \$90,167 and \$37,549 in 2007 and 2006, respectively | \$ <u>2,853,000</u> | \$ <u>1,802,905</u> |

(19) Interest expense

Interest expense on notes and loans payable amounted to approximately \$37,000 and \$32,000 for 2007 and 2006, respectively. Interest expense on the bonds payable amounted to approximately \$2,914,000 and \$1,807,000 for the years ended May 31, 2007 and 2006, respectively. Total interest expense was approximately \$2,951,000 and \$1,839,000 for 2007 and 2006, respectively.

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May 31, 2007 and 2006

(20) Reconciliation of operating results to fund accounting basis (unaudited)

While the accompanying financial statements are prepared in accordance with Statements of Financial Accounting Standards (SFAS) No. 117, Financial Statements for Not-for-Profit Organizations, the underlying accounts are kept on a fund accounting basis, in order to monitor the University's fiduciary responsibilities on a more detailed basis. A reconciliation of the results between these two bases is as follows:

| | <u>2007</u> | <u>2006</u> |
|--|------------------|------------------|
| Increase (decrease) in unrestricted net assets | \$ 9,303,979 | \$ 4,975,778 |
| Depreciation expense | 3,899,683 | 4,373,026 |
| Investment income | (9,554,017) | (4,055,977) |
| Capitalized expenditures from current funds | (1,237,197) | (1,228,073) |
| Principal debt repayments from current funds | (1,960,000) | (1,805,000) |
| Plant gift amortization | (983,641) | (850,861) |
| Accumulated vacation accrual | - | 228,808 |
| Net gifts to LU2010 plan | (1,850,566) | - |
| Non-cash retirement plan adjustments | (743,924) | 124,083 |
| FAS 158 retirement plan adjustments | 2,328,663 | - |
| Interest rate swap agreement | 882,546 | (1,597,183) |
| Other | <u>(8)</u> | <u>(98,186)</u> |
| Current unrestricted operating fund surplus (fund accounting basis) | \$ <u>85,518</u> | \$ <u>66,415</u> |