

LUTHER COLLEGE
Decorah, Iowa

FINANCIAL STATEMENTS

May 31, 2010 and 2009

LUTHER COLLEGE
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INDEPENDENT AUDITORS' REPORT

To the Board of Regents
Luther College
Decorah, Iowa

We have audited the accompanying statements of financial position of Luther College as of May 31, 2010 and 2009 and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the College'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 College's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 Luther College at May 31, 2010 and 2009 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 described in Note 1 to the financial statements, in fiscal year 2009, the College adopted authoritative guidance on Fair Value Measurements and Endowment Funds Net Asset Classifications.

Baker Tilly Virchow Krause, LLP

Minneapolis, Minnesota
September 23, 2010

LUTHER COLLEGE

STATEMENTS OF FINANCIAL POSITION May 31, 2010 and 2009

ASSETS	2010	2009
Cash and cash equivalents	\$ 12,208,282	\$ 4,682,103
Student accounts receivable, net of allowance for doubtful accounts of \$226,000 in 2010 and \$205,000 in 2009	217,778	142,270
Accrued interest receivable	65,544	154,178
Government grants receivable	348,547	296,962
Contributions receivable, net	4,573,000	4,738,000
Other receivables	749,895	86,321
Inventories	493,003	530,449
Prepaid expenses and other assets	268,508	367,847
Cash surrender value of life insurance	3,702,757	3,440,962
Investments		
Short term investments	6,404,469	9,335,336
Marketable securities	10,829,599	10,712,789
Mortgages and contracts receivable	1,867,818	2,007,327
Real estate	455,035	1,383,321
Endowment investments	98,727,878	93,439,758
Deposits held by trustee	-	2,493,772
Beneficial interest in funds held in trust	1,826,626	1,704,065
Student notes receivable, net of allowance for doubtful accounts of \$360,800 in 2010 and \$340,200 in 2009	7,386,196	7,247,350
Unamortized debt issuance costs	329,027	344,461
Cash restricted for plant acquisitions	2,283,601	2,253,329
Construction in progress	615,760	8,401,788
Property, plant and equipment, net	86,539,807	77,318,312
TOTAL ASSETS	\$ 239,893,130	\$ 231,080,700
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 2,214,995	\$ 2,438,629
Accrued liabilities	5,926,962	5,464,652
Deferred revenue	314,397	648,856
Other liabilities	4,693,208	3,839,138
Asset retirement obligations	2,442,471	2,332,638
Interest rate swap liability	1,861,068	1,381,429
Notes, loans and bonds payable	31,502,569	32,938,887
Annuities payable	5,160,690	5,330,520
Deposits held in custody for others	472,420	410,010
Government grants refundable	5,721,730	5,731,474
Total Liabilities	60,310,510	60,516,233
NET ASSETS		
Unrestricted	80,524,996	78,330,122
Temporarily restricted	18,058,481	15,551,919
Permanently restricted	80,999,143	76,682,426
Total Net Assets	179,582,620	170,564,467
TOTAL LIABILITIES AND NET ASSETS	\$ 239,893,130	\$ 231,080,700

See accompanying notes to financial statements.

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
Year Ended May 31, 2010
(With Comparative Totals for 2009)

	2010				2009 Total
	Operating	Long-Term Investment	Plant	Total	
UNRESTRICTED NET ASSETS					
Revenues, Gains and Other Support					
Tuition and fees	\$ 79,184,768	\$ -	\$ -	\$ 79,184,768	\$ 73,845,811
Less: Scholarships and grants	(35,199,593)	-	-	(35,199,593)	(31,377,659)
Net tuition and fees	43,985,175	-	-	43,985,175	42,468,152
Government grants and contracts	1,901,747	-	924,858	2,826,605	1,940,972
Private gifts and grants	2,360,026	5,304	897,004	3,262,334	2,874,978
Endowment income	4,763,696	42,900	-	4,806,596	4,780,234
Investment income	145,200	-	41,846	187,046	326,279
Gain (loss) on investments	9,268	943,927	(346,156)	607,039	(5,734,778)
Other sources	1,795,905	-	185,979	1,981,884	2,736,631
Sales and services of educational activities	1,160,996	-	-	1,160,996	871,544
Sales and services of auxiliary enterprises	17,689,691	-	-	17,689,691	13,532,266
Loss on swap agreement valuation	-	-	(479,639)	(479,639)	(820,654)
Actuarial adjustment	-	53,716	-	53,716	(68,648)
	73,811,704	1,045,847	1,223,892	76,081,443	62,906,976
Net assets released from restrictions	823,591	258,796	228,462	1,310,849	17,921,857
Total Revenues, Gains and Other Support	74,635,295	1,304,643	1,452,354	77,392,292	80,828,833
Expenses					
Program Expenses					
Instruction	29,480,488	-	3,008,500	32,488,988	30,689,902
Research	281,369	-	42,005	323,374	293,578
Public service	945,814	-	9,077	954,891	933,304
Academic support	3,185,717	-	762,039	3,947,756	3,797,828
Student services	10,314,552	-	328,683	10,643,235	10,783,578
Auxiliary enterprises	14,319,162	-	2,199,854	16,519,016	13,056,020
Support Expenses					
Institutional support	9,635,292	-	684,866	10,320,158	10,226,044
Allocable Expenses					
Operation and maintenance of plant	9,040,527	-	-	9,040,527	9,251,502
Depreciation and amortization	-	-	5,824,689	5,824,689	5,218,856
Accretion	-	-	121,833	121,833	116,355
Interest	-	-	853,740	853,740	874,609
Less: Allocated expenses	(9,040,527)	-	(6,800,262)	(15,840,789)	(15,461,322)
Total Expenses	68,162,394	-	7,035,024	75,197,418	69,780,254
Change in Unrestricted Net Assets					
Prior to Reclassification	6,472,901	1,304,643	(5,582,670)	2,194,874	11,048,579
Net Asset Reclassification Based on Change in Law	-	-	-	-	(29,833,116)
Change in Unrestricted Net Assets after Reclassification	6,472,901	1,304,643	(5,582,670)	2,194,874	(18,784,537)
TEMPORARILY RESTRICTED NET ASSETS					
Gifts and grants	458,445	-	946,769	1,405,214	1,561,214
Endowment income	309,234	17,793	-	327,027	375,398
Gain (loss) on investments	-	1,930,878	-	1,930,878	(18,677,777)
Actuarial adjustment	-	154,292	-	154,292	(392,360)
Reclassification due to change in donor restriction	-	-	-	-	245,490
Net assets released from restrictions	(823,591)	(258,796)	(228,462)	(1,310,849)	(17,921,857)
Change in Temporarily Restricted Net Assets Prior to Reclassification	(55,912)	1,844,167	718,307	2,506,562	(34,809,892)
Net Asset Reclassification Based on Change in Law	-	-	-	-	29,832,529
Change in Temporarily Restricted Net Assets after Reclassification	(55,912)	1,844,167	718,307	2,506,562	(4,977,363)

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
 Year Ended May 31, 2010
 (With Comparative Totals for 2009)

	2010				2009 Total
	Operating	Long-Term Investment	Plant	Total	
PERMANENTLY RESTRICTED NET ASSETS					
Private gifts	\$ -	\$ 2,795,987	\$ -	\$ 2,795,987	\$ 2,966,736
Endowment income	-	145,446	-	145,446	71,819
Gain (loss) on investments	-	540,778	-	540,778	(5,567,395)
Actuarial adjustment	-	841,623	-	841,623	(883,956)
Other sources	(7,117)	-	-	(7,117)	198
Reclassification due to change in donor restriction	-	-	-	-	(245,490)
Change in Permanently Restricted Net Assets Prior to Reclassification	(7,117)	4,323,834	-	4,316,717	(3,658,088)
Net Asset Reclassification Based on Change in Law	-	-	-	-	587
Change in Permanently Restricted Net Assets after Reclassification	(7,117)	4,323,834	-	4,316,717	(3,657,501)
TRANSFERS					
Transfer for debt service	(2,601,214)	-	2,601,214	-	-
Nonmandatory transfers	(3,613,490)	557,437	3,056,053	-	-
Total Transfers	(6,214,704)	557,437	5,657,267	-	-
CHANGE IN NET ASSETS	195,168	8,030,081	792,904	9,018,153	(27,419,401)
NET ASSETS - Beginning of Year	9,956,692	104,188,469	56,419,306	170,564,467	197,983,868
NET ASSETS - END OF YEAR	<u>\$ 10,151,860</u>	<u>\$ 112,218,550</u>	<u>\$ 57,212,210</u>	<u>\$ 179,582,620</u>	<u>\$ 170,564,467</u>

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
Year Ended May 31, 2009

	Operating	Long-Term Investment	Plant	Total
UNRESTRICTED NET ASSETS				
Revenues, Gains and Other Support				
Tuition and fees	\$ 73,845,811	\$ -	\$ -	\$ 73,845,811
Less: Scholarships and grants	(31,377,659)	-	-	(31,377,659)
Net tuition and fees	42,468,152	-	-	42,468,152
Government grants and contracts	1,940,972	-	-	1,940,972
Private gifts and grants	2,874,978	-	-	2,874,978
Endowment income	4,758,043	22,191	-	4,780,234
Investment income	221,404	-	104,875	326,279
Loss on investments	(3,892)	(5,694,550)	(36,336)	(5,734,778)
Other sources	2,736,871	-	(240)	2,736,631
Sales and services of educational activities	871,544	-	-	871,544
Sales and services of auxiliary enterprises	13,532,266	-	-	13,532,266
Loss on swap agreement valuation	-	-	(820,654)	(820,654)
Actuarial adjustment	-	(68,648)	-	(68,648)
	69,400,338	(5,741,007)	(752,355)	62,906,976
Net assets released from restrictions	667,528	-	17,254,329	17,921,857
Total Revenues, Gains and Other Support	70,067,866	(5,741,007)	16,501,974	80,828,833
Expenses				
Program Expenses				
Instruction	28,027,169	-	2,662,733	30,689,902
Research	253,046	-	40,532	293,578
Public service	917,626	-	15,678	933,304
Academic support	3,141,691	-	656,137	3,797,828
Student services	10,455,813	-	327,765	10,783,578
Auxiliary enterprises	10,959,253	-	2,096,767	13,056,020
Support Expenses				
Institutional support	9,498,912	-	727,132	10,226,044
Allocable Expenses				
Operation and maintenance of plant	9,251,502	-	-	9,251,502
Depreciation and amortization	-	-	5,218,856	5,218,856
Accretion	-	-	116,355	116,355
Interest	-	-	874,609	874,609
Less: Allocated expenses	(9,251,502)	-	(6,209,820)	(15,461,322)
Total Expenses	63,253,510	-	6,526,744	69,780,254
Change in Unrestricted Net Assets				
Prior to Reclassification	6,814,356	(5,741,007)	9,975,230	11,048,579
Net Asset Reclassification Based on Change in Law	-	(29,833,116)	-	(29,833,116)
Change in Unrestricted Net Assets after Reclassification	6,814,356	(35,574,123)	9,975,230	(18,784,537)
TEMPORARILY RESTRICTED NET ASSETS				
Gifts and grants	218,259	-	1,342,955	1,561,214
Endowment income	324,501	50,897	-	375,398
Loss on investments	-	(18,677,777)	-	(18,677,777)
Actuarial adjustment	-	(392,360)	-	(392,360)
Reclassification due to change in donor restriction	-	245,490	-	245,490
Net assets released from restrictions	(667,528)	-	(17,254,329)	(17,921,857)
Change in Temporarily Restricted Net Assets				
Assets Prior to Reclassification	(124,768)	(18,773,750)	(15,911,374)	(34,809,892)
Net Asset Reclassification Based on Change in Law	-	29,832,529	-	29,832,529
Change in Temporarily Restricted Net Assets after Reclassification	(124,768)	11,058,779	(15,911,374)	(4,977,363)

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
Year Ended May 31, 2009

	Operating	Long-Term Investment	Plant	Total
PERMANENTLY RESTRICTED NET ASSETS				
Private gifts	\$ -	\$ 2,966,736	\$ -	\$ 2,966,736
Endowment income	-	71,819	-	71,819
Loss on investments	-	(5,567,395)	-	(5,567,395)
Actuarial adjustment	-	(883,956)	-	(883,956)
Other sources	198	-	-	198
Reclassification due to change in donor restriction	-	(245,490)	-	(245,490)
Change in Permanently Restricted Net				
Assets Prior to Reclassification	198	(3,658,286)	-	(3,658,088)
Net Asset Reclassification Based on Change in Law	-	587	-	587
Change in Permanently Restricted Net Assets after Reclassification	198	(3,657,699)	-	(3,657,501)
TRANSFERS				
Transfer for debt service	(2,725,636)	-	2,725,636	-
Nonmandatory transfers	(3,499,777)	295,470	3,204,307	-
Total Transfers	(6,225,413)	295,470	5,929,943	-
CHANGE IN NET ASSETS	464,373	(27,877,573)	(6,201)	(27,419,401)
NET ASSETS - Beginning of Year	9,492,319	132,066,042	56,425,507	197,983,868
NET ASSETS - END OF YEAR	\$ 9,956,692	\$ 104,188,469	\$ 56,419,306	\$ 170,564,467

LUTHER COLLEGE

STATEMENTS OF CASH FLOWS
Years Ended May 31, 2010 and 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 9,018,153	\$ (27,419,401)
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	5,824,689	5,218,856
Accretion	121,833	116,355
Loss on disposal of property	-	40,875
Loss on interest rate swap valuation	479,639	820,654
(Gains) losses on endowment investments, net	(6,660,479)	26,535,864
(Gains) losses on other investments, net	(1,034,998)	7,306,643
Gain on sale of real estate	(4,343)	
(Increase) decrease in beneficial interest in funds held in trust	(122,561)	489,510
Increase in investment real estate	-	(39,920)
Actuarial adjustment of annuities payable	144,883	(1,638,561)
Loan cancellations, reinstatements and write-offs	121,352	109,122
Change in allowance on student notes receivable	20,600	(6,400)
Change in allowance on student accounts receivable	21,000	(48,000)
Changes in assets and liabilities		
Student accounts receivable	(96,508)	68,870
Accrued interest receivable	88,634	161,846
Government grants receivable	(51,585)	(114,606)
Contributions receivable for operations	15,000	57,000
Other receivables	(663,574)	14,035
Inventories	37,446	76,748
Prepaid expenses and other assets	99,339	(193,948)
Cash surrender value of life insurance	(261,795)	102,359
Accounts payable	238,518	82,658
Accrued liabilities	462,310	206,290
Deferred revenue	(334,459)	493,148
Other liabilities	854,070	(58,955)
Deposits held in custody for others	62,410	(111,425)
Asset retirement obligation remediation	(12,000)	(269,591)
Contributions restricted for loans, long-term investment and plant	(4,639,760)	(4,309,691)
Contributions under split-interest agreements	(6,057)	(153,766)
Investment income restricted for reinvestment	(145,446)	(71,819)
Cash Flows from Operating Activities	<u>3,576,311</u>	<u>7,464,750</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales (purchases) of endowment investments, net	1,372,359	(3,285,854)
Sales (purchases) of marketable securities, net	3,849,055	(3,217,715)
Proceeds on sale of real estate	762,899	-
Decrease in mortgages and contracts receivable	139,509	515,526
Purchases of property, plant and equipment	(7,706,874)	(14,862,369)
Withdrawals from deposits held by trustee for construction, net	2,493,772	8,300,492
Disbursements of loans to students	(970,481)	(853,337)
Repayments of loans from students	689,683	698,107
Cash Flows from Investing Activities	<u>629,922</u>	<u>(12,705,150)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of principal on indebtedness	(1,436,318)	(1,398,670)
Bond issuance costs	-	(6,155)
Receipt of investment income restricted for reinvestment	145,446	71,819
Contributions received restricted for loans, long-term investment and plant	4,789,760	5,081,691
Increase in cash held for plant acquisitions	(30,272)	(275,746)
Decrease in government grants refundable	(9,744)	(24,913)
Proceeds from issuance of split-interest agreements	21,500	212,024
Payments to annuitants	(160,426)	(162,946)
Cash Flows from Financing Activities	<u>3,319,946</u>	<u>3,497,104</u>
Change in Cash and Cash Equivalents	7,526,179	(1,743,296)
CASH AND CASH EQUIVALENTS - Beginning of year	<u>4,682,103</u>	<u>6,425,399</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 12,208,282</u>	<u>\$ 4,682,103</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid, net of capitalized amounts of \$294,156 in 2010 and \$134,282 in 2009	\$ 861,244	\$ 899,495
Payments on swap settlements	830,531	438,341
NONCASH INVESTMENT AND FINANCING ACTIVITIES		
Property, plant and equipment acquired through accounts payable	283,732	745,884
Proceeds from issuance of bonds deposited with trustee	-	11,000,000
Bond issuance costs paid from bond proceeds	-	205,736

See accompanying notes to financial statements.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

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

Net Asset Classifications – For purposes of financial reporting, the College classifies resources into three net asset categories pursuant to any donor-imposed restrictions and applicable law. Accordingly, the net assets of the College are classified in the accompanying financial statements in the categories that follow:

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

Temporarily Restricted Net Assets – Net assets subject to donor-imposed stipulations that will be met by action of the College and/or the passage of time.

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

Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Investment income received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class. In all other cases, income earned on donor restricted funds is initially classified as temporarily restricted net assets and is reclassified as unrestricted net assets when expenses are incurred for their intended purpose. Expenses are reported as decreases in unrestricted net assets.

Contributions, including unconditional promises to give, are recognized as revenues in the period received and are reported as increases in the appropriate categories of net assets in accordance with donor restrictions. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassification between the applicable classes of net assets. However, contributions received with donor-imposed restrictions that are met in the same year as received are initially reported as revenues of the unrestricted net asset class. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. The College has conditional promises to give of \$1,900,000 at May 31, 2010.

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

In the absence of donor stipulations or law to the contrary, losses on the investments of a donor-restricted endowment fund reduce temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs. Any remaining loss reduces unrestricted net assets. If losses reduce the assets of a donor-restricted endowment fund below the level required by the donor stipulations or law, gains that restore the fair value of the assets of the endowment fund to the required level are classified as increases in unrestricted net assets.

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

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

Cash Equivalents – The College considers all highly liquid investments, except for those held for plant and long-term investments, with a maturity of three months or less when purchased to be cash equivalents.

Receivables – Student accounts receivable are carried at the unpaid balance of the original amount billed to students and student notes receivable are carried at the amount of unpaid principal. Both receivables are less an estimate made for doubtful accounts based on a review of all outstanding amounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Student accounts and loans receivable are written off when deemed uncollectible. Recoveries of student accounts and loans receivable previously written off are recorded when received. Receivables are generally unsecured. Receivables include campus charges of \$9,100 and \$16,500 due from employees at May 31, 2010 and 2009, respectively.

After a student is no longer enrolled in an institution of higher education and after a grace period, interest is charged on Perkins student loans receivable and is recognized as it is charged. Perkins student loans receivable are considered to be past due if a payment is not made within 30 days of the payment due date, at which time, late fees are charged and recognized. The Perkins Loan Program receivables may be assigned to the U.S. Department of Education. Students may be granted a deferment, forbearance or cancellation of their student loan receivable based on eligibility requirements defined by the U.S. Department of Education.

Inventories – Bookstore inventories are valued at a percentage of retail value, which approximates cost and is not in excess of market. All other inventories are valued at cost.

Deposits Held by Trustee – Certificates of deposit and money market funds held by trustee at May 31, 2009 included amounts restricted for construction as required by the trust indentures.

Unamortized Debt Issuance Costs – Costs of debt issuance are deferred and amortized over the term of the related indebtedness.

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

Deferred Revenue – Certain revenue related to summer courses and programs is deferred and recognized as revenue in the same period expenses are recognized. Students are generally billed for courses and programs prior to the start of the course or program. Also included in deferred revenue for 2009 were revenues from a government grant and an insurance claim that will be recognized as they are earned in accordance with the agreements.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

Asset Retirement Obligations – Asset retirement obligations are estimated costs and obligations associated with the retirement of long-lived assets. These liabilities were initially recorded at fair value and the related asset retirement costs were recorded as decreases in unrestricted net assets. Asset retirement costs are subsequently accreted over the useful lives of the related assets.

The estimate of the losses that are probable from environmental remediation liabilities for asbestos removal was calculated using the expected cash flow approach and based on an inventory of the College's long-lived assets combined with an estimate of the current market prices to remove the asbestos. The College utilized a credit-adjusted risk-free rate to discount the asset retirement obligation. It is reasonably possible that changes in this estimate could occur and that actual results could differ from this estimate and could have a significant effect on the financial statements.

Government Grants Refundable – Funds provided by the United States government under the Federal Perkins Loan Program are loaned to qualified students and may be reloaned after collections. These funds are ultimately refundable to the government and are included as liabilities in the statements of financial position. Revenues from other government grants are recognized as they are earned in accordance with the agreement. Any funding received before it is earned is recorded as a refundable advance. Expenses incurred before cash is received are recorded as receivables.

Tuition and Fees and Auxiliary Revenues – Tuition revenue is recognized in the period the classes are provided. Revenue from auxiliary enterprises is recognized when goods or services are provided. Financial assistance in the form of scholarships and grants that cover a portion of tuition, living and other costs is reflected as a reduction of tuition and fees revenues.

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

Fund-Raising and Advertising Expenses – Fund-raising expenses totaled approximately \$2,048,000 and \$2,026,000 for the years ended May 31, 2010 and 2009, respectively. Advertising expenses totaled approximately \$523,000 and \$592,000 for the years ended May 31, 2010 and 2009, respectively. Advertising costs are expensed when incurred.

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

Income Tax Status – The Internal Revenue Service has determined that the College is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code. The College is also exempt from state income tax. However, any unrelated business income may be subject to taxation.

In accordance with the accounting standard on *Accounting for Uncertainty in Income Taxes*, the College has addressed the determination of whether tax benefits claimed on a tax return should be recorded in the financial statements. Under this guidance, the College may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merit of the position. Examples of tax positions include the tax-exempt status of the College and various positions related to the potential sources of unrelated business taxable income. There were no significant unrecognized tax benefits identified or recorded as liabilities during fiscal year 2010. Open tax years subject to examination by the U.S. and state taxing authorities are for the years 2007 to 2009, which statutes expire in 2010 to 2012, respectively.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

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.

Fair Value of Financial Instruments – The carrying amounts of cash and cash equivalents, accounts receivable, grants receivable, other receivables, accounts payable and deposits held in custody for others approximate fair value because of the short term maturity of these financial instruments. The carrying amounts of contributions receivable are recorded using the applicable discount rates in effect at the date of the gifts.

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

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

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

The fair values for investments and other financial instruments recorded at fair value on a recurring basis are included in Note 2. Other investments are carried at cost.

Reclassifications - Certain amounts appearing in the 2009 financial statements have been reclassified to conform to the 2010 presentation. The reclassifications have no effect on reported amounts of total net assets or change in total net assets.

Recent Accounting Pronouncements – The College adopted the provisions of Financial Accounting Standards Board (FASB) ASC Topics 958-205-45, 958-205-50 and 958-2-5-55 (formerly FASB Staff Position FSP 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classifications of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures*) for the year ended May 31, 2009. The Topics provide guidance on classifying net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of Uniform Prudent Management of Institutional Funds Act (UPMIFA). The Topics also require enhanced disclosures for all not-for-profit organizations, not just those subject to UPMIFA. The State of Iowa adopted UPMIFA effective July 1, 2008. As a result of adopting the provisions of the Topics, the College reclassified \$29,800,000 of unrestricted net assets into temporarily restricted net assets. This represented the amount of accumulated net gains in existence at June 1, 2008 that had not yet been appropriated for spending by the College's governing board.

The College adopted the provisions of FASB ASC Topic 820 (formerly FAS No. 157, *Fair Value Measurements and Disclosures*) effective June 1, 2008. The Topic defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measures that are required under other accounting pronouncements, but did not change existing guidance as to whether or not a financial instrument is carried at fair value.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

Recent Accounting Pronouncements (cont.) – The College's adoption of ASC Topic 820 in fiscal year 2009, with respect to financial assets and liabilities measured at fair value on a recurring basis, resulted in increased disclosures in the financial statements about fair value measurements. The College's adoption in fiscal year 2010 of the provisions of this Topic with respect to nonrecurring fair value measurements of nonfinancial assets and liabilities, did not have a material impact on the College's financial statements.

Additionally, from time to time, the College may be required to measure certain assets and liabilities at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These adjustments to fair value would usually result from the application of the lower-of-cost-or-market accounting or write-down of individual assets. The College did not measure any assets or liabilities at fair value on a nonrecurring basis during the years ended May 31, 2010 or 2009.

The College also adopted the provisions of FASB ASC Topic 825 (formerly FAS No. 159, *The Fair Value Option for Financial Assets and Liabilities, including an amendment of FASB Statement No. 115*) effective June 1, 2008. ASC Topic 825 provides, among other things, an option to elect fair value as an alternative measurement for selected financial assets and liabilities not previously recorded at fair value. The College did not elect fair value accounting for any assets or liabilities that were not currently required to be measured at fair value.

In September 2009, the FASB issued ASU No. 2009-12, *Investment in Certain Entities That Calculate Net Asset Value per Share* (ASU 2009-12). ASU 2009-12 (formerly FAS No. 157-g) amends former FASB Statement No. 157, *Fair Value Measurements*, adds disclosures, and provides guidance for estimating fair value of investments in investment companies that calculate net asset value per share, allowing the Net Asset Value per Share (NAV) to be used as a practical expedient for fair value where investment companies follow the American Institute of Certified Public Accountants (AICPA) Guide in arriving at their reported NAV. The College adopted ASU 2009-12 effective June 1, 2009. See Note 2 for these additional disclosures.

In March 2008, the FASB issued ASC Topic 815-10-50 (formerly FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133*). This guidance requires enhanced disclosures to provide additional information regarding the accounting treatment for derivatives and hedging activities, the reasons the College invests using derivative instruments and the effect derivatives have on the College's financial statements. It also requires qualitative disclosures about the objectives and strategies for using derivative instruments, quantitative disclosures about the fair value of, and gains and losses on, derivative instruments, as well as disclosures about credit-risk related contingent features in derivative agreements. The College adopted ASC 815-10-50 effective June 1, 2009. See Note 17 for these additional disclosures.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements*. This amends ASC 820 (formerly FAS 157-4) to require additional disclosures. The guidance requires entities to disclose transfers of assets in and out of Levels 1 and 2 of the fair value hierarchy, and the reasons for those transfers. ASU 2010-06 is effective for fiscal year 2011. In addition, the guidance requires separate presentation of purchases and sales in the Level 3 asset reconciliation; which is effective for fiscal year 2012. The adoption of this guidance is not expected to have a material impact on the College's financial statements.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 2 – FAIR VALUE MEASUREMENTS

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

Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data.

Level 3 – Inputs are unobservable for the asset or liability. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following table summarizes financial instruments measured at fair value on a recurring basis by classification within the fair value hierarchy as of May 31, 2010:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
ASSETS				
Privately held securities	\$ 675,208	\$ -	\$ -	\$ 675,208
Equity securities	2,390,738	-	2,390,738	-
Fixed Income securities	4,786,361	-	4,786,361	-
Mutual funds	72,569,614	72,569,614	-	-
Alternative investments				
Limited partnership, other	1,819,264	-	1,819,264	-
Hedge funds	1,558,665	-	1,558,665	-
Private equity funds	3,548,603	-	-	3,548,603
Real estate partnerships	1,313,573	-	-	1,313,573
Real estate funds (REIT)	675,622	-	-	675,622
Funds of funds	8,919,495	-	-	8,919,495
Partnerships, real assets	2,431,958	-	-	2,431,958
Beneficial interest in funds held in trust	1,826,626	-	-	1,826,626
	<u>1,826,626</u>	<u>-</u>	<u>-</u>	<u>1,826,626</u>
Total	<u>\$ 102,515,727</u>	<u>\$ 72,569,614</u>	<u>\$ 10,555,028</u>	<u>\$ 19,391,085</u>
LIABILITIES				
Interest rate exchange agreements	<u>\$ 1,861,068</u>	<u>\$ -</u>	<u>\$ 1,861,068</u>	<u>\$ -</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 2 – FAIR VALUE MEASUREMENTS (cont.)

The following table summarizes financial instruments measured at fair value on a recurring basis by classification within the fair value hierarchy as of May 31, 2009:

	Total	Level 1	Level 2	Level 3
ASSETS				
Short - term investments	\$ 2,031,203	\$ -	\$ 2,031,203	\$ -
Privately held securities	1,062,204			1,062,204
Equity securities	10,692,485	659,496	-	10,032,989
Fixed Income securities	5,558,085	-	-	5,558,085
Mutual funds	58,195,450	58,195,450	-	-
Alternative investments				
Hedge funds	1,363,213	-	-	1,363,213
Private equity funds	3,168,892	-	-	3,168,892
Real estate partnerships	1,338,651	-	-	1,338,651
Real estate funds (REIT)	1,604,378	-	-	1,604,378
Funds of funds	8,818,052	-	-	8,818,052
Partnerships, real assets	2,026,067	-	-	2,026,067
Beneficial interest in funds held in trust	1,704,065	-	-	1,704,065
	<u>\$ 97,562,745</u>	<u>\$ 58,854,946</u>	<u>\$ 2,031,203</u>	<u>\$ 36,676,596</u>
LIABILITIES				
Interest rate exchange agreements	<u>\$ 1,381,429</u>	<u>\$ -</u>	<u>\$ 1,381,429</u>	<u>\$ -</u>

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

Short-term investments – The fair value of short-term investments, consisting primarily of money market funds, is classified as Level 2 as these funds are not traded on a regular basis.

Privately held securities – Investments in privately held securities that are not traded in an active market are classified as Level 3 as the valuation is based on significant unobservable inputs.

Equity securities – Investments in equity securities that are traded in an active market for which closing stock prices are readily available are classified as Level 1. Other investments in equity securities are comprised of commingled trust funds which are not actively traded, however the underlying assets are marketable. In fiscal year 2009, investments in equity securities for which net asset values were available were all classified as Level 3. In fiscal year 2010, those investments are classified as Level 2 if the College has the ability to redeem its investment at the net asset value in the near term.

Fixed income securities – Investments in fixed income securities are comprised of commingled trust funds which are not actively traded, however, the underlying assets are marketable. In fiscal year 2009, investments in fixed income securities for which net asset values were available were all classified as Level 3. In fiscal year 2010, those investments are classified as Level 2 if the College has the ability to redeem its investment at the net asset value in the near term.

Mutual funds – Mutual funds are classified as Level 1 as they are traded in an active market for which closing prices are readily available.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 2 – FAIR VALUE MEASUREMENTS (cont.)

Alternative investments – The valuation for alternative investments (limited partnerships, hedge funds, private equity funds, real estate partnerships, real estate funds, funds of funds, and real assets partnerships) is based on significant unobservable inputs. In cases where the investee has provided its investors with a net asset value per share that has been calculated in accordance with the AICPA Audit and Accounting Guide, *Investment Companies*, the College has estimated its fair value by using the net asset value provided by the investee as of December 31 or March 31, adjusted for cash receipts, cash disbursements, significant known valuation changes in market values of publicly held securities contained in the portfolio and security distributions through May 31. In fiscal 2009, all alternative investments were classified as Level 3. In fiscal, 2010, investments in alternative investments are classified as Level 2 if the College has the ability to redeem its investment for the net asset value in the near term; otherwise, the investment is classified as Level 3.

Beneficial interest in funds held in trust – The College’s beneficial interest in irrevocable split interest agreements held or controlled by a third party are classified as Level 3 as the fair values are based on a combination of Level 2 inputs (interest rates and yield curves) and significant unobservable inputs (entity specific estimates of cash flows). The fair values are measured at the present value of the future distributions the College expects to receive over the term of the agreements.

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

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

The following table presents a reconciliation of the statement of financial position amounts for financial instruments measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the year ended May 31, 2010.

	Balances May 31, 2009	Net realized and unrealized gains (losses) included in change in net assets	Purchases, sales, issuances and settlement, net	Net transfers in (out) of Level 3	Balances May 31, 2010
Assets					
Privately held and equity securities	\$ 11,095,193	\$ 693,516	\$ (8,724,746)	\$ (2,388,755)	\$ 675,208
Fixed income securities	5,558,085	145,439	902,101	(6,605,625)	-
Hedge funds	1,363,213	195,452	-	(1,558,665)	-
Private equity funds	3,168,892	(63,285)	442,996	-	3,548,603
Real estate partnerships	1,338,651	(293,101)	268,023	-	1,313,573
Real estate funds (REIT)	1,604,378	(928,756)	-	-	675,622
Funds of funds	8,818,052	312,079	(210,636)	-	8,919,495
Partnerships, real assets	2,026,067	34,889	371,002	-	2,431,958
Beneficial interest in funds held in trust	1,704,065	122,561	-	-	1,826,626
Total	\$ 36,676,596	\$ 218,794	\$ (6,951,260)	\$ (10,553,045)	\$ 19,391,085

The amount of total gains or losses for the periods included in change in net assets attributable to the change in unrealized gains or losses relating to financial instruments still held at May 31, 2010.

\$ (233,680)

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 2 – FAIR VALUE MEASUREMENTS (cont.)

The following table presents a reconciliation of the statement of financial position amounts for financial instruments measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the year ended May 31, 2009.

	Balances May 31, 2008	Net realized and unrealized gains (losses) included in change in net assets	Purchases, sales, issuances and settlement, net	Net transfers in (out) of Level 3	Balances May 31, 2009
Assets					
Privately held and equity securities	\$ 17,184,226	\$ (5,867,142)	\$ (221,891)	\$ -	\$ 11,095,193
Fixed income securities	5,151,863	406,222	-	-	5,558,085
Hedge funds	1,889,792	(526,579)	-	-	1,363,213
Private equity funds	3,126,364	(772,272)	814,800	-	3,168,892
Real estate partnerships	1,381,770	(174,145)	131,026	-	1,338,651
Real estate funds (REIT)	3,281,975	(1,677,597)	-	-	1,604,378
Funds of funds	10,207,727	(854,666)	(535,009)	-	8,818,052
Partnerships, real assets	2,065,172	(262,180)	223,075	-	2,026,067
Beneficial interest in funds held in trust	2,193,575	(484,430)	-	(5,080)	1,704,065
Total	\$ 46,482,464	\$ (10,212,789)	\$ 412,001	\$ (5,080)	\$ 36,676,596

The amount of total gains or losses for the periods included in change in net assets attributable to the change in unrealized gains or losses relating to financial instruments still held at May 31, 2009.

\$ (9,855,842)

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 2 – FAIR VALUE MEASUREMENTS (cont.)

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

The following table lists the alternative investments in which NAV was utilized as the practical expedient for estimating fair value by major category:

	Private Equity Funds	Real Assets	Limited Partnership, Other	Hedge Funds and Funds of Funds
Fair value, May 31, 2010	\$3,548,603	\$4,421,153	\$1,819,264	\$10,478,160
Significant Investment Strategy	Venture and buyout, in the U.S. and international	Real estate and natural resources, primarily in the U.S.	Equity and fixed income securities, both long and short	Long/short equity funds with absolute returns
Remaining Life	3 to 10 years	2 to 10 years	N.A.	N.A.
Dollar Amount of Unfunded Commitments	\$3,988,427	\$1,774,250	None	None
Timing to Draw Down Commitments	1 to 8 years	1 to 7 years	N.A.	N.A.
Redemption Terms	Over 1 year	Quarterly and over 1 year	Monthly with 3 days’ notice or quarterly	Quarterly and yearly Ranges between quarterly with 60 days notice and calendar year end with 100 days notice
Redemption Restrictions	N.A.	N.A.	3 days’ notice	
Redemption Restrictions in Place at Year End	N.A.	Redemptions currently suspended in 2 of 8 funds	None	None

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 3 – RESTRICTIONS AND LIMITATIONS ON NET ASSET BALANCES

At May 31, 2010 and 2009, the College's unrestricted net assets were allocated as follows:

	<u>2010</u>	<u>2009</u>
Operations	\$ 7,305,071	\$ 7,076,405
Long-term investment (board designated endowment funds less underwater donor restricted endowment funds)	14,649,508	12,692,324
Annuity, life income and similar funds	1,241,519	1,336,624
Loans to students	1,293,728	1,279,609
Replacement of plant facilities	1,942,441	6,743,687
Net investment in plant	<u>54,092,729</u>	<u>49,201,473</u>
 Totals	 <u>\$ 80,524,996</u>	 <u>\$ 78,330,122</u>

Temporarily restricted net assets consist of the following at May 31, 2010 and 2009:

Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other support – Operating	\$ 956,095	\$ 981,595
Scholarships, instruction and other support – Endowment	14,393,279	12,444,608
Acquisition of buildings and equipment	<u>792,040</u>	<u>368,144</u>
	16,141,414	13,794,347
Annuity, life income and similar funds	1,223,385	1,340,422
Beneficial interest in funds held in trust	143,682	131,150
Contributions receivable	<u>550,000</u>	<u>286,000</u>
 Totals	 <u>\$ 18,058,481</u>	 <u>\$ 15,551,919</u>

Permanently restricted net assets consist of the following at May 31, 2010 and 2009:

Endowment funds	\$ 70,679,162	\$ 67,096,858
Beneficial interest in funds held in trust	1,682,945	1,572,915
Student loan funds	431,966	439,084
Annuity, life income and similar funds	6,301,070	6,112,569
Contributions receivable	<u>1,904,000</u>	<u>1,461,000</u>
 Totals	 <u>\$ 80,999,143</u>	 <u>\$ 76,682,426</u>

NOTE 4 – NET ASSETS RELEASED FROM RESTRICTIONS

Net assets were released from temporary donor restrictions during the years ended May 31, 2010 and 2009 by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors as follows:

	<u>2010</u>	<u>2009</u>
Scholarships, instruction and other departmental support	\$ 823,591	\$ 667,528
Matured deferred gifts	258,796	-
Acquisition of land, building, and equipment	<u>228,462</u>	<u>17,254,329</u>
 Totals	 <u>\$ 1,310,849</u>	 <u>\$ 17,921,857</u>

These assets were reclassified to unrestricted net assets.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable include the following unconditional promises to give at May 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Unrestricted – completed plant projects	\$ 2,357,000	\$ 3,503,000
Temporarily restricted – operations	188,000	210,000
Temporarily restricted – plant projects	431,000	124,000
Permanently restricted – endowment	<u>2,150,000</u>	<u>1,699,000</u>
Gross unconditional promises to give	5,126,000	5,536,000
Less: Unamortized discount	(313,000)	(549,000)
Less: Allowance for uncollectible accounts	<u>(240,000)</u>	<u>(249,000)</u>
Net unconditional promises to give	<u>\$ 4,573,000</u>	<u>\$ 4,738,000</u>
Amounts due in:		
Less than one year	\$ 2,093,000	
One to five years	<u>2,480,000</u>	
Totals	<u>\$ 4,573,000</u>	

At May 31, 2010, promises due in one to five years were discounted using interest rates ranging between 3.10% and 6.0%. At May 31, 2009, promises due in one to five years were discounted using interest rates ranging between 3.34% and 6.0%. Promises due in less than one year were not discounted.

Net unconditional promises to give at May 31, 2010 and 2009 from related parties were \$1,317,000 and \$1,217,000, respectively.

NOTE 6 – MARKETABLE SECURITIES

The following summarizes the College's marketable securities in funds other than endowment at May 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Equity securities	\$ 624,327	\$ 965,085
Mutual funds	<u>10,205,272</u>	<u>9,747,704</u>
Totals	<u>\$ 10,829,599</u>	<u>\$ 10,712,789</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 7 – ENDOWMENT INVESTMENTS

The following summarizes the College's endowment investments at May 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Cash and short-term investments	\$ 8,823,876	\$ 10,051,714
Equity securities	2,454,632	10,789,604
Fixed income securities	4,786,361	5,558,085
Mutual / Commingled funds	63,986,024	48,447,746
Real estate	221,942	221,942
Notes receivable	7,127	51,414
Alternative investments	<u>18,447,916</u>	<u>18,319,253</u>
Totals	<u>\$ 98,727,878</u>	<u>\$ 93,439,758</u>

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

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

NOTE 8 – DEPOSITS HELD BY TRUSTEE

The following summarizes the College's deposits held by trustee at May 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Money market funds	\$ -	\$ 462,569
Short-term investments	-	<u>2,031,203</u>
Totals	<u>\$ -</u>	<u>\$ 2,493,772</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 9 – BENEFICIAL INTEREST IN FUNDS HELD IN TRUST

Funds were held by the following organizations for the benefit of the College at May 31, 2010 and 2009:

	2010	2009
Evangelical Lutheran Church in America	\$ 541,556	\$ 471,929
U.S. Bank	423,635	402,231
Bank of America	87,172	77,860
Northern Trust	312,455	297,712
Windsor Investment	415,232	410,866
Other trusts	46,576	43,467
Totals	\$ 1,826,626	\$ 1,704,065

NOTE 10 – CONSTRUCTION IN PROGRESS

At May 31, 2010 the following construction projects were in progress:

	Estimated Total Cost	Cost To Date	Funding Source
Campus landscaping	\$ 660,000	\$ 72,980	Operations and gifts
Brandt tile roof	100,000	46,310	Operations
Dieseth/Miller design plans	54,000	53,560	Operations
Pervious parking lot	220,000	11,310	Operations and grant
Sustainability house	80,000	4,900	Operations
Preus library chiller	366,000	3,973	Operations
Dieseth window replacement	470,500	135,750	Operations
Organ refurbishment	82,000	1,000	Operations and gifts
Renewable wind energy	3,500,000	48,522	Operations, grant, and external debt
Aquatic center design plans	20,000	19,290	Operations and gifts
Ylvisaker	218,200	218,165	Operations
Totals	\$ 5,770,700	\$ 615,760	

Outstanding commitments on construction contracts totaled \$1,364,200 at May 31, 2010.

NOTE 11 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following as of May 31, 2010 and 2009:

	2010	2009
Land	\$ 594,581	\$ 594,581
Buildings	122,399,147	111,351,790
Improvements other than buildings	12,878,442	11,541,308
Equipment and library books	27,970,793	25,814,069
	163,842,963	149,301,748
Less: Accumulated depreciation	(77,303,156)	(71,983,436)
Totals	\$ 86,539,807	\$ 77,318,312

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 12 – NOTES, LOANS AND BONDS PAYABLE

Notes, loans and bonds payable outstanding at May 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 1998B	\$ 3,507,092	\$ 3,821,748
Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2002	14,060,000	14,465,000
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 2004	2,571,429	3,085,714
Alliant Energy loan payable	364,048	566,425
Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2008	<u>11,000,000</u>	<u>11,000,000</u>
Totals	<u>\$ 31,502,569</u>	<u>\$ 32,938,887</u>

In December 1998, the City of Decorah, Iowa sold its Private College Facility Revenue Bonds (Luther College Project), Series 1998B, totaling \$4,000,000. The proceeds from the sale of the bonds were loaned to the College and used to finance the Baker Village student residence project. Monthly payments of \$42,477, including principal and interest, are due until final maturity on December 28, 2018. The interest rate is 5.30%.

In September 2002, Iowa Higher Education Loan Authority Revenue Bonds, Series 2002, in the amount of \$15,000,000 were issued on behalf of the College. The Series 2002 Bonds mature annually in amounts from \$425,000 to \$1,110,000 from 2010 through 2027. The interest rate is variable and at May 31, 2010 was 0.26%. The bonds are secured by a letter of credit which expires November 1, 2011. The letter of credit will be automatically extended for one-year terms unless the trustee provides written notice by December 31 of each year. The loan agreement includes certain financial and other covenants which include meeting a cash flow coverage ratio, a maximum leverage percentage and a liquidity ratio. As of May 31, 2010, the College is in compliance with these covenants.

In December 2004 the City of Decorah, Iowa sold its Private College Facility Revenue Bonds, Series 2004, totaling \$3,600,000. The proceeds from the sale of the bonds were loaned to the College and used to finance the acquisition, construction, improving and equipping of a renovation and expansion of the Dahl Centennial Union. The Series 2004 Bonds mature semi-annually with payments of \$257,143 from 2010 through 2014. The interest rate is variable and at May 31, 2010 was 1.193%. The bonds are secured by a letter of credit, which expires December 31, 2014. The loan agreement includes certain financial and other covenants which include meeting a cash flow coverage ratio, a maximum leverage percentage and a liquidity ratio. As of May 31, 2010, the College is in compliance with these covenants.

In December 2008, Iowa Higher Education Loan Authority Revenue Bonds, Series 2008, in the amount of \$11,000,000 were issued on behalf of the College. The proceeds were used to finance the renovation of the science building and a street. The Series 2008 Bonds mature annually in amounts from \$820,000 to \$1,205,000 from 2028 through 2038. The interest rate is variable and at May 31, 2010 was 0.26%. The bonds are secured by a letter of credit which expires December 9, 2011. The letter of credit may be extended when the time remaining on the current stated expiration date is no more than 18 months and no less than 12 months by a request of the College to the bank or at the sole discretion of the bank for a period of one-year. The loan agreement includes certain financial and other covenants which include meeting a debt service coverage ratio and an asset maintenance ratio. As of May 31, 2010, the College is in compliance with these covenants.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 12 – NOTES, LOANS AND BONDS PAYABLE (cont.)

The College has entered into several agreements with Alliant Energy to upgrade certain equipment. Management expects that future energy savings on the new equipment will offset the principal and interest payments on the loans. Principal payments on the loans are payable through 2013 in amounts ranging from \$9,820 to \$196,955. The loans are at an interest rate of 4.65%.

In order to minimize the effect of changes in the interest rate, the College has entered into interest rate swap contracts. The interest rate swap contracts are disclosed in Note 17.

Total interest expense amounted to \$853,740 and \$874,609 for the years ended May 31, 2010 and 2009, respectively. Interest totaling \$294,155 and \$134,282 was capitalized for the years ended May 31, 2010 and 2009, respectively.

Total scheduled maturities of notes, loans and bonds payable for each of the five years subsequent to May 31, 2010 are: 2011 – \$1,468,000; 2012 – \$1,591,000; 2013 – \$1,483,000; 2014 – \$1,518,000 and 2015 – \$1,579,000.

NOTE 13 – ENDOWMENT

The College's endowment consists of approximately 730 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the governing board to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the governing board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law - The Board of Regents of the College has interpreted the Iowa enacted version of Uniform Prudent Management of Institutional Funds Act (UPMIFA) as allowing the College to appropriate for expenditure or accumulate so much of an endowment fund as the College determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. Unless stated otherwise in the gift instrument, the assets in an endowment fund shall be donor-restricted assets until appropriated for expenditure by the Board of Regents. As a result of this interpretation, the College has not changed the way permanently restricted net assets are classified. See Note 1 for further information on net asset classification.

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

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

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 13 – ENDOWMENT (cont.)

Endowment net asset composition by type of fund consists of the following as of May 31, 2010:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (2,184,511)	\$ 14,393,279	\$ 70,679,162	\$ 82,887,930
Donor-restricted funds held in trust	-	-	1,238,421	1,238,421
Board-designated endowment funds	16,834,019	-	-	16,834,019
Contributions receivable	-	-	1,904,000	1,904,000
	<u>\$ 14,649,508</u>	<u>\$ 14,393,279</u>	<u>\$ 73,821,583</u>	<u>\$ 102,864,370</u>

Endowment net asset composition by type of fund consists of the following as of May 31, 2009:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (2,973,449)	\$ 12,444,608	\$ 67,096,858	\$ 76,568,017
Donor-restricted funds held in trust	-	-	1,136,424	1,136,424
Board-designated endowment funds	15,665,773	-	-	15,665,773
Contributions receivable	-	-	1,461,000	1,461,000
	<u>\$ 12,692,324</u>	<u>\$ 12,444,608</u>	<u>\$ 69,694,282</u>	<u>\$ 94,831,214</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 13 – ENDOWMENT (cont.)

Changes in endowment net assets for the year ended May 31, 2010 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2009	\$ 12,692,324	\$ 12,444,608	\$ 69,694,282	\$ 94,831,214
Investment return:				
Investment income, net of investment fees of \$78,000	1,743,742	17,793	145,446	1,906,981
Net appreciation – realized and unrealized	4,298,853	1,930,878	430,748	6,660,479
Net depreciation – realized and unrealized funds held in trust	-	-	101,997	101,997
Total investment return	6,042,595	1,948,671	678,191	8,669,457
Contributions	-	-	2,315,660	2,315,660
Matured deferred gifts	-	-	690,450	690,450
Change in contributions receivable	-	-	443,000	443,000
Appropriation of endowment assets for expenditure	(5,055,768)	-	-	(5,055,768)
Other changes:				
Transfers to board /college designated endowment funds	970,357	-	-	970,357
Endowment net assets, May 31, 2010	\$ 14,649,508	\$ 14,393,279	\$ 73,821,583	\$ 102,864,370

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 13 - ENDOWMENT (cont.)

Changes in endowment net assets for the year ended May 31, 2009 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2008	\$ 47,902,328	\$ 993,469	\$ 71,916,608	\$ 120,812,405
Net asset reclassification based on:				
Change in law	(29,833,116)	29,832,529	587	-
Change in donor guidelines	-	245,490	(245,490)	-
Endowment net assets after reclassifications	18,069,212	31,071,488	71,671,705	120,812,405
Investment return:				
Investment income, net of investment fees of \$86,000	2,149,726	50,897	71,819	2,272,442
Net depreciation – realized and unrealized	(2,758,714)	(18,677,777)	(5,099,372)	(26,535,863)
Net depreciation – realized and unrealized funds held in trust	-	-	(374,452)	(374,452)
Total investment return	(608,988)	(18,626,880)	(5,402,005)	(24,637,873)
Contributions	-	-	2,069,931	2,069,931
Matured deferred gifts	-	-	777,651	777,651
Change in contributions receivable	-	-	577,000	577,000
Appropriation of endowment assets for expenditure	(5,063,370)	-	-	(5,063,370)
Other changes:				
Transfers to board designated endowment funds	295,470	-	-	295,470
Endowment net assets, May 31, 2009	\$ 12,692,324	\$ 12,444,608	\$ 69,694,282	\$ 94,831,214

Funds with Deficiencies – From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the College to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$2,184,511 and \$2,973,449 as of May 31, 2010 and 2009, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the governing board. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

Return Objectives and Risk Parameters – The College has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the College must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the governing board, the endowment assets are invested in a manner that is intended to produce returns to meet needs of the spending rate, inflation, and portfolio fees while assuming a moderate level of investment risk. The College expects its endowment funds, over time, to provide an average annual rate of approximately 8.75%. Actual returns in any year may vary from this amount.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 13 - ENDOWMENT (cont.)

Strategies Employed for Achieving Objectives – To satisfy its long-term rate-of-return objectives, the College relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The College targets a diversified asset allocation that is weighted in equity based investments and balanced with fixed income and alternative investments to achieve its long-term return objectives within prudent risk constraints. The alternative investments were entered into to diversify the College's portfolio, to provide predictability in overall earnings and to provide market neutral holdings. The College monitors its portfolio mix to ensure that it is in accordance with Board policy. For the majority of alternative investments, the College utilizes fund of funds to diversify the risk inherent in alternative investments.

Spending Policy and How the Investment Objectives Relate to Spending Policy – The College has a policy of appropriating for distribution each year 5% of its endowment fund's average of the fair value of endowment investments for the preceding 12 calendar quarters. In establishing this policy, the College considered the long-term expected return on its endowment. Accordingly, over the long term, the College expects the current spending policy to allow its endowment to grow at an average of 3% annually. This is consistent with the College's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

NOTE 14 – DEFERRED GIFT AGREEMENTS

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

When a gift is received under one of these arrangements, it is split into the amount representing the actuarial present value of future distributions back to the donor and the remaining gift value to be retained for the benefit of the College or third-party beneficiaries. The actuarial liability is adjusted annually using actuarial tables appropriate for the type of arrangement, number of lives covered and age of the donor. The College used interest rates ranging from 3.2% to 10.2% in making the calculation at May 31, 2010 and 2009.

During the years ended May 31, 2010 and 2009, the College received gift income relating to deferred gift agreements of approximately \$6,000 and \$154,000, respectively. Total assets held by the College under deferred gift agreements approximated \$14,268,000 and \$14,985,000 at May 31, 2010 and 2009, respectively.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 15 – EMPLOYEE BENEFIT PLANS

The College has a 403(b) retirement plan. Contributions for employees are determined on a percentage of annual compensation. The cost of the retirement plan is paid currently and amounted to approximately \$2,627,000 and \$2,578,000 for the years ended May 31, 2010 and 2009, respectively.

An early retirement plan is available to faculty members. The estimated accrued liability for this benefit is calculated using historical participation rates, current faculty membership and projected salary increases, discounted at a rate of 5.50% and 6.75% for May 31, 2010 and 2009, respectively. The plan is unfunded. Total accrued liability for this benefit is \$336,710 and \$333,510 for May 31, 2010 and 2009, respectively.

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

Faculty members who retired by May 31, 2005 with emeriti status, and their spouses, and faculty members who completed 25 years of service by May 31, 2005 and who may be granted emeriti status upon retirement, and their spouses, are eligible to receive health insurance coverage that supplements Medicare coverage. The plan is unfunded. The following tables set forth the postretirement healthcare benefit plan's status with amounts reported in the College's financial statements at May 31, 2010 and 2009:

	2010	2009
Total expected benefit obligation earned to date, based on service		
Current retirees and dependents		
Pre-65 payments	\$ 299,000	\$ 107,000
Post-65 payments	1,522,000	1,064,000
Active employees		
Eligible for post-65 coverage		
Pre-65 payments	158,000	226,000
Post-65 payments	752,000	511,000
Not eligible for post-65 coverage	472,000	395,000
Benefit obligation at end of year	\$ 3,203,000	\$ 2,303,000
Change in projected benefit obligation		
Benefit obligation at beginning of year	\$ 2,303,000	\$ 2,462,000
(Gain) loss	1,033,000	(36,000)
Expected benefit payments	(133,000)	(123,000)
Benefit obligation at end of year	\$ 3,203,000	\$ 2,303,000
Change in plan assets		
Fair value of plan assets at beginning of year	\$ –	\$ –
Employer contribution	133,000	123,000
Participant contribution	–	–
Benefits paid	(133,000)	(123,000)
Fair value of plan assets at end of year	\$ –	\$ –
Funded status		
Underfunded status at year end	\$ (3,203,000)	\$ (2,303,000)

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 15 – EMPLOYEE BENEFIT PLANS (cont.)

	2010	2009
Amounts recognized in the statements of financial position consist of:		
Noncurrent assets	\$ -	\$ -
Current liabilities	(165,000)	(133,000)
Noncurrent liabilities	(3,038,000)	(2,170,000)
Net amount recognized	\$ (3,203,000)	\$ (2,303,000)
 Weighted average assumptions used to calculate the benefit obligation at May 31		
Discount rate	5.50%	6.75%
Expected return on plan assets	-	-
Rate of compensation increase	-	-
 Assumed health care cost trend rates at May 31		
Health care cost trend rate assumed for next year	7.4%	Pre-65 – 9.5% Post-65 – 5.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.7%	Pre-65 – 5.0%
Year that the rate reaches the ultimate trend rate	2085	2018

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

	One-Percentage Point	
	Increase	Decrease
Effect on postretirement benefit obligation at May 31, 2010	\$ 328,000	\$ (283,000)

Annual premium payments were approximately \$112,700 and \$104,800 for the years ended May 31, 2010 and 2009, respectively. During the fiscal year ending May 31, 2011, the College expects to contribute \$165,000 in benefit payments for the postretirement medical plan.

Estimated future postretirement medical payments (which reflect expected future service, as appropriate) as of May 31, 2010 are as follows:

Years Ending May 31		
2011		\$ 165,000
2012		178,000
2013		185,000
2014		189,000
2015		195,000
2015-2030		3,509,000

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

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS

May 31, 2010 and 2009

NOTE 16 – CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the College to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments, marketable securities and other investments, accounts receivable and notes, mortgages and contracts for deed. Cash and cash equivalents in excess of FDIC and similar coverages is subject to the usual risks of balances in excess of those limits. The College currently has 98% of its cash and cash equivalents in a well capitalized bank with a tier I risk-based capital ratio of 11.94 and a total risk-based capital ratio of 13.2. Investments are generally placed in a variety of managed funds administered by different investment managers in order to limit credit risk. Concentrations of credit risk with respect to the notes and mortgages and contracts for deed are limited due to the College holding a secured position in agreements. Student notes and receivables and other receivables are due from a variety of sources concentrated primarily in the Midwestern United States. For the years ended May 31, 2010 and 2009, the College received total contributions from board members and officers of \$549,000 and \$1,360,000, respectively. In addition, the College's students receive a substantial amount of support from state and federal student financial assistance programs which are subject to audit by governmental agencies. A significant reduction in the level of this support, if this were to occur, could have an adverse effect on the College's programs and activities.

NOTE 17 – DERIVATIVES

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

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

In fiscal years 2010 and 2009, the College paid \$830,531 and \$438,341, respectively, more than it received in interest under the swap agreements. The difference between interest received and interest paid under the swap agreements is recorded as interest expense in the statements of activities.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2010 and 2009

NOTE 17 – DERIVATIVES (cont.)

The following is a summary of the outstanding positions under these interest rate exchange agreements as of May 31, 2010 and 2009:

Instrument Type	Effective Date	Notional Amount	Maturity Date	Rate Paid	Rate Received
Variable to fixed rate swap	June 14, 2004	\$ 14,465,000	June 15, 2009	3.045%	67.0% of USD-LIBOR-BBA
Variable to fixed rate swap	December 14, 2004	\$ 2,571,429	December 31, 2014	4.09%	67.044% of the sum of USD-LIBOR-BBA plus 1.45%
Variable to fixed rate swap	December 12, 2008	\$ 11,000,000	December 3, 2018	2.71%	SIFMA Municipal Swap Index
Variable to fixed rate swap	June 15, 2009	\$ 14,060,000	September 1, 2027	3.624%	67.0% of USD-LIBOR-BBA

Derivative instruments are reported in the statements of financial position at fair value as of May 31, 2010 and 2009 as follows:

Derivatives Not Designated as Hedging Instruments	Statement of Financial Position Location	Liabilities Derivative	
		Fair Value	
		2010	2009
Interest rate swap	Interest rate swap liability	\$ 1,861,068	\$ 1,381,429

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

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) on Derivatives Recognized in the Statement of Changes in Net Assets	Amount of Gain (Loss) on Derivatives Recognized in the Statement of Changes in Net Assets	
		2010	2009
		Interest rate swap	Loss on swap agreement valuation

NOTE 18 – SUBSEQUENT EVENTS

Luther College has evaluated subsequent events through September 23, 2010 which is the date that the financial statements were issued.