

LUTHER COLLEGE

Decorah, Iowa

CONSOLIDATED FINANCIAL STATEMENTS

Including Independent Auditors' Report

May 31, 2011 and 2010

LUTHER COLLEGE
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INDEPENDENT AUDITORS' REPORT

To the Board of Regents
Luther College
Decorah, Iowa

We have audited the accompanying consolidated statements of financial position of Luther College and subsidiary (the "College") as of May 31, 2011 and 2010 and the related consolidated 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 consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Luther College and subsidiary at May 31, 2011 and 2010 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Minneapolis, Minnesota
September 19, 2011

LUTHER COLLEGE

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION May 31, 2011 and 2010

ASSETS	2011	2010
Cash and cash equivalents	\$ 12,946,876	\$ 12,208,282
Student accounts receivable, net of allowance for doubtful accounts of \$171,000 in 2011 and \$226,000 in 2010	247,501	217,778
Accrued interest receivable	63,807	65,544
Government grants receivable	415,410	348,547
Contributions receivable, net	6,158,080	4,573,000
Other receivables	291,287	749,895
Inventories	451,058	493,003
Prepaid expenses and other assets	325,150	268,508
Cash surrender value of life insurance	4,111,827	3,702,757
Investments		
Short term investments	6,264,696	6,404,469
Marketable securities	11,561,353	10,829,599
Mortgages and contracts receivable	1,532,365	1,867,818
Real estate	455,035	455,035
Endowment investments	115,359,376	98,727,878
Beneficial interest in funds held in trust	2,031,374	1,826,626
Student notes receivable, net	7,320,251	7,386,196
Unamortized debt issuance costs	328,989	329,027
Cash restricted for plant acquisitions	3,451,908	2,283,601
Construction in progress	900,513	615,760
Property, plant and equipment, net	85,149,771	86,539,807
TOTAL ASSETS	\$ 259,366,627	\$ 239,893,130
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 2,471,459	\$ 2,214,995
Accrued liabilities	6,158,802	5,926,962
Deferred revenue	262,844	314,397
Other liabilities	4,954,698	4,693,208
Asset retirement obligations	2,530,706	2,442,471
Interest rate swap liability	2,274,543	1,861,068
Loans and bonds payable	30,084,638	31,502,569
Annuities payable	5,601,671	5,160,690
Deposits held in custody for others	525,654	472,420
Government grants refundable	5,640,867	5,721,730
Total Liabilities	60,505,882	60,310,510
NET ASSETS		
Unrestricted	84,998,311	80,524,996
Temporarily restricted	25,331,307	18,058,481
Permanently restricted	88,531,127	80,999,143
Total Net Assets	198,860,745	179,582,620
TOTAL LIABILITIES AND NET ASSETS	\$ 259,366,627	\$ 239,893,130

See accompanying notes to financial statements.

LUTHER COLLEGE

CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2011
(With Comparative Totals for 2010)

	2011			2010 Total	
	Operating	Long-Term Investment	Plant		Total
UNRESTRICTED NET ASSETS					
Revenues, Gains and Other Support					
Tuition and fees	\$ 80,714,560	\$ -	\$ -	\$ 80,714,560	\$ 79,184,768
Less: Scholarships and grants	(37,412,621)	-	-	(37,412,621)	(35,199,593)
Net tuition and fees	43,301,939	-	-	43,301,939	43,985,175
Government grants and contracts	1,861,498	-	100,000	1,961,498	2,826,605
Private gifts and grants	2,985,301	19,359	1,533,816	4,538,476	3,262,334
Endowment income	4,780,226	13,737	-	4,793,963	4,806,596
Investment income	113,024	-	8,397	121,421	187,046
Gain (loss) on investments	-	2,499,246	(126,102)	2,373,144	607,039
Other sources	1,295,956	-	7,033	1,302,989	1,981,884
Sales and services of educational activities	1,230,554	-	-	1,230,554	1,160,996
Sales and services of auxiliary enterprises	17,360,887	-	-	17,360,887	17,689,691
Loss on swap agreement valuation	-	-	(413,475)	(413,475)	(479,639)
Actuarial adjustment	-	151,457	-	151,457	53,716
	72,929,385	2,683,799	1,109,669	76,722,853	76,081,443
Net assets released from restrictions	858,146	725,000	661,451	2,244,597	1,310,849
Total Revenues, Gains and Other Support	73,787,531	3,408,799	1,771,120	78,967,450	77,392,292
Expenses					
Program Expenses					
Instruction	28,278,213	-	3,298,507	31,576,720	32,488,988
Research	291,528	-	42,005	333,533	323,374
Public service	1,058,988	-	2,760	1,061,748	954,891
Academic support	3,072,379	-	795,036	3,867,415	3,947,756
Student services	10,397,066	-	335,562	10,732,628	10,643,235
Auxiliary enterprises	14,042,927	-	2,323,997	16,366,924	16,519,016
Support Expenses					
Institutional support	9,888,298	-	666,869	10,555,167	10,320,158
Allocable Expenses					
Operation and maintenance of plant	8,177,945	-	-	8,177,945	9,040,527
Depreciation and amortization	-	-	6,019,181	6,019,181	5,824,689
Accretion	-	-	126,235	126,235	121,833
Interest	-	-	1,084,096	1,084,096	853,740
Less: Allocated expenses	(8,177,945)	-	(7,229,512)	(15,407,457)	(15,840,789)
Total Expenses	67,029,399	-	7,464,736	74,494,135	75,197,418
Change in Unrestricted Net Assets	6,758,132	3,408,799	(5,693,616)	4,473,315	2,194,874
TEMPORARILY RESTRICTED NET ASSETS					
Gifts and grants	484,787	(92,248)	957,335	1,349,874	1,405,214
Endowment income	291,819	38,040	-	329,859	327,027
Gain on investments	-	7,603,580	-	7,603,580	1,930,878
Actuarial adjustment	-	234,110	-	234,110	154,292
Net assets released from restrictions	(858,146)	(725,000)	(661,451)	(2,244,597)	(1,310,849)
Change in Temporarily Restricted Net Assets	(81,540)	7,058,482	295,884	7,272,826	2,506,562

LUTHER COLLEGE

CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2011
(With Comparative Totals for 2010)

	2011				2010 Total
	Operating	Long-Term Investment	Plant	Total	
PERMANENTLY RESTRICTED NET ASSETS					
Private gifts	\$ -	\$ 4,348,605	\$ -	\$ 4,348,605	\$ 2,795,987
Endowment income	-	161,612	-	161,612	145,446
Gain on investments	-	2,020,572	-	2,020,572	540,778
Actuarial adjustment	-	1,004,647	-	1,004,647	841,623
Other sources	(3,452)	-	-	(3,452)	(7,117)
Change in Permanently Restricted Net Assets	(3,452)	7,535,436	-	7,531,984	4,316,717
TRANSFERS					
Transfer for debt service	(2,596,061)	-	2,596,061	-	-
Nonmandatory transfers	(3,706,921)	276,572	3,430,349	-	-
Total Transfers	(6,302,982)	276,572	6,026,410	-	-
CHANGE IN NET ASSETS	370,158	18,279,289	628,678	19,278,125	9,018,153
NET ASSETS - Beginning of Year	10,151,860	112,218,550	57,212,210	179,582,620	170,564,467
NET ASSETS - END OF YEAR	<u>\$ 10,522,018</u>	<u>\$ 130,497,839</u>	<u>\$ 57,840,888</u>	<u>\$ 198,860,745</u>	<u>\$ 179,582,620</u>

LUTHER COLLEGE

CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2010

	Operating	Long-Term Investment	Plant	Total
UNRESTRICTED NET ASSETS				
Revenues, Gains and Other Support				
Tuition and fees	\$ 79,184,768	\$ -	\$ -	\$ 79,184,768
Less: Scholarships and grants	(35,199,593)	-	-	(35,199,593)
Net tuition and fees	43,985,175	-	-	43,985,175
Government grants and contracts	1,901,747	-	924,858	2,826,605
Private gifts and grants	2,360,026	5,304	897,004	3,262,334
Endowment income	4,763,696	42,900	-	4,806,596
Investment income	145,200	-	41,846	187,046
Gain (loss) on investments	9,268	943,927	(346,156)	607,039
Other sources	1,795,905	-	185,979	1,981,884
Sales and services of educational activities	1,160,996	-	-	1,160,996
Sales and services of auxiliary enterprises	17,689,691	-	-	17,689,691
Loss on swap agreement valuation	-	-	(479,639)	(479,639)
Actuarial adjustment	-	53,716	-	53,716
	73,811,704	1,045,847	1,223,892	76,081,443
Net assets released from restrictions	823,591	258,796	228,462	1,310,849
Total Revenues, Gains and Other Support	74,635,295	1,304,643	1,452,354	77,392,292
Expenses				
Program Expenses				
Instruction	29,480,488	-	3,008,500	32,488,988
Research	281,369	-	42,005	323,374
Public service	945,814	-	9,077	954,891
Academic support	3,185,717	-	762,039	3,947,756
Student services	10,314,552	-	328,683	10,643,235
Auxiliary enterprises	14,319,162	-	2,199,854	16,519,016
Support Expenses				
Institutional support	9,635,292	-	684,866	10,320,158
Allocable Expenses				
Operation and maintenance of plant	9,040,527	-	-	9,040,527
Depreciation and amortization	-	-	5,824,689	5,824,689
Accretion	-	-	121,833	121,833
Interest	-	-	853,740	853,740
Less: Allocated expenses	(9,040,527)	-	(6,800,262)	(15,840,789)
Total Expenses	68,162,394	-	7,035,024	75,197,418
Change in Unrestricted Net Assets	6,472,901	1,304,643	(5,582,670)	2,194,874
TEMPORARILY RESTRICTED NET ASSETS				
Gifts and grants	458,445	-	946,769	1,405,214
Endowment income	309,234	17,793	-	327,027
Gain (loss) on investments	-	1,930,878	-	1,930,878
Actuarial adjustment	-	154,292	-	154,292
Net assets released from restrictions	(823,591)	(258,796)	(228,462)	(1,310,849)
Change in Temporarily Restricted Net Assets	(55,912)	1,844,167	718,307	2,506,562

LUTHER COLLEGE

CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended May 31, 2010

	Operating	Long-Term Investment	Plant	Total
PERMANENTLY RESTRICTED NET ASSETS				
Private gifts	\$ -	\$ 2,795,987	\$ -	\$ 2,795,987
Endowment income	-	145,446	-	145,446
Gain on investments	-	540,778	-	540,778
Actuarial adjustment	-	841,623	-	841,623
Other sources	(7,117)	-	-	(7,117)
Change in Permanently Restricted Net Assets	(7,117)	4,323,834	-	4,316,717
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
NET ASSETS - Beginning of Year	9,956,692	104,188,469	56,419,306	170,564,467
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>

LUTHER COLLEGE

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended May 31, 2011 and 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 19,278,125	\$ 9,018,153
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	6,019,181	5,824,689
Accretion	126,235	121,833
Loss on disposal of property	2,319	-
Loss on interest rate swap valuation	413,475	479,639
Gains on endowment investments, net	(15,264,742)	(6,660,479)
Gains on other investments, net	(1,367,652)	(634,066)
Gain on sale of real estate	-	(4,343)
Increase in beneficial interest in funds held in trust	(204,748)	(122,561)
Actuarial adjustment of annuities payable	401,057	144,883
Loan cancellations, reinstatements and write-offs	128,092	121,352
Change in allowance on student notes receivable	15,300	20,600
Change in allowance on student accounts receivable	(55,000)	21,000
Changes in assets and liabilities		
Student accounts receivable	25,277	(96,508)
Accrued interest receivable	1,737	88,634
Government grants receivable	(66,863)	(51,585)
Contributions receivable for operations	(550,000)	15,000
Other receivables	458,608	(663,574)
Inventories	41,945	37,446
Prepaid expenses and other assets	(56,642)	99,339
Cash surrender value of life insurance	(409,070)	(261,795)
Accounts payable	197,388	238,518
Accrued liabilities	231,840	462,310
Deferred revenue	(51,553)	(334,459)
Other liabilities	261,490	854,070
Deposits held in custody for others	53,234	62,410
Asset retirement obligation remediation	(38,000)	(12,000)
Contributions restricted for loans, long-term investment and plant	(6,747,507)	(4,639,760)
Contributions under split-interest agreements	(127,177)	(6,057)
Investment income restricted for reinvestment	(161,612)	(145,446)
Cash Flows from Operating Activities	<u>2,554,737</u>	<u>3,977,243</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of endowment investments	(8,429,876)	(20,604,150)
Sales of endowment investments	7,063,120	21,976,509
Purchases of marketable securities	(10,504,441)	(15,576,334)
Sales of marketable securities	11,280,112	19,024,457
Proceeds on sale of real estate	-	762,899
Decrease in mortgages and contracts receivable	335,453	139,509
Purchases of property, plant and equipment	(4,839,997)	(7,706,874)
Withdrawals from deposits held by trustee for construction, net	-	2,493,772
Disbursements of loans to students	(915,791)	(970,481)
Repayments of loans from students	838,344	689,683
Cash Flows from Investing Activities	<u>(5,173,076)</u>	<u>228,990</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt draws	50,562	-
Repayments of principal on indebtedness	(1,468,493)	(1,436,318)
Bond issuance costs	(17,106)	-
Receipt of investment income restricted for reinvestment	161,612	145,446
Contributions received restricted for loans, long-term investment and plant	5,712,427	4,789,760
Increase in cash held for plant acquisitions	(1,168,307)	(30,272)
Decrease in government grants refundable	(80,863)	(9,744)
Proceeds from issuance of split-interest agreements	308,120	21,500
Payments to annuitants	(141,019)	(160,426)
Cash Flows from Financing Activities	<u>3,356,933</u>	<u>3,319,946</u>
Change in Cash and Cash Equivalents	738,594	7,526,179
CASH AND CASH EQUIVALENTS - Beginning of year	<u>12,208,282</u>	<u>4,682,103</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 12,946,876</u>	<u>\$ 12,208,282</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid, net of capitalized amounts of \$907 in 2011 and \$294,156 in 2010	\$ 1,086,941	\$ 861,244
Payments on swap settlements	806,992	830,531
NONCASH INVESTMENT AND FINANCING ACTIVITIES		
Property, plant and equipment acquired through accounts payable	342,808	283,732

See accompanying notes to financial statements.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Luther 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:

Consolidation – The consolidated financial statements include the accounts of Luther College and Luther College Ventures, Inc. (collectively referred to as the "College"). Luther College owns 100% interest in Luther College Ventures, Inc. Luther College Ventures, Inc. was formed on November 3, 2010 and is the sole member of Luther College Wind Energy Project, LLC. Luther College Wind Energy Project, LLC was formed on July 13, 2005 to construct a wind turbine, but had no activity until fiscal 2011. All material transactions and balances between the entities have been eliminated in the consolidated financial statements.

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 had conditional promises to give of \$1,200,000 and \$1,900,000 at May 31, 2011 and 2010, respectively.

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.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

Net Asset Classifications (cont.) – 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.

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.

Student Accounts Receivable and Other Receivables – Student accounts receivable are carried at the unpaid balance of the original amount billed to students less an estimate made for doubtful accounts which is 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 are written off when deemed uncollectible. Recoveries of student accounts previously written off are recorded when received. Receivables are generally unsecured. Other receivables include campus charges of \$6,500 and \$9,100 due from employees at May 31, 2011 and 2010, respectively.

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.

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.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

Asset Retirement Obligations – The College recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, the cost of the retirement obligation is capitalized by increasing the carrying value of the related asset. Over time, the liability is accreted to its present value each year and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the statement of activities. The College reviews its estimates annually and adjusts the recorded liability as needed.

Substantially all of the College's asset retirement obligations relate to estimated costs to remove asbestos from campus facilities. The estimate of the losses that are probable 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.

Changes in the accrual for asset retirement obligations during the years ended May 31, 2011 and 2010 are as follows:

	2011	2010
Balance, Beginning of the year	\$ 2,442,471	\$ 2,332,638
Abatements	(38,000)	(12,000)
Accretion expense	126,235	121,833
Balance, End of the year	<u>\$ 2,530,706</u>	<u>\$ 2,442,471</u>

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 \$2,162,000 and \$2,048,000 for the years ended May 31, 2011 and 2010, respectively. Advertising expenses totaled approximately \$636,000 and \$523,000 for the years ended May 31, 2011 and 2010, 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.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

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. Luther College Ventures, Inc. is organized as a C corporation pursuant to the provisions of the Internal Revenue code. As of May 31, 2011, Luther College Ventures, Inc. did not generate an income tax liability. Accordingly, no provision for federal or state income taxes has been made in the accompanying consolidated financial statements.

The College follows the accounting standards for contingencies in evaluating uncertain tax positions. This guidance prescribes recognition threshold principles for the financial statement recognition of tax positions taken or expected to be taken on a tax return that are not certain to be realized. No liability has been recognized by the College for uncertain tax positions as of May 31, 2011. The College's tax returns are subject to review and examination by federal and state authorities. The tax returns for the current year as well as fiscal years 2008 through 2010 are open to examination by federal and state authorities.

Impairment of Long-Lived Assets - The College reviews long-lived assets, including property and equipment and intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be fully recoverable. An impairment loss would be recognized when the estimated future cash flows from the use of the asset are less than the carrying amount of that asset. To date, there have been no such losses.

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 prior year amounts have been reclassified to conform with the May 31, 2011 financial statement presentation. These reclassifications, however, had no effect on total net assets or change in net assets.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 2 – FAIR VALUE MEASUREMENTS

The College follows the accounting 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, 2011:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
ASSETS				
Privately held securities	\$ 539,352	\$ 5,000	\$ -	\$ 534,352
Fixed income securities	5,338,082	-	5,338,082	-
Mutual funds	89,824,973	89,824,973	-	-
Alternative investments				
Hedge funds	2,113,075	-	2,113,075	-
Private equity funds	4,166,257	-	-	4,166,257
Real estate partnerships	1,552,595	-	-	1,552,595
Real estate funds (REIT)	868,918	-	-	868,918
Funds of funds	9,252,400	-	-	9,252,400
Partnerships, real assets	3,159,883	-	-	3,159,883
Beneficial interest in funds held in trust	<u>2,031,374</u>	<u>-</u>	<u>-</u>	<u>2,031,374</u>
Total	<u>\$ 118,846,909</u>	<u>\$ 89,829,973</u>	<u>\$ 7,451,157</u>	<u>\$ 21,565,779</u>
LIABILITIES				
Interest rate exchange agreements	<u>\$ 2,274,543</u>	<u>\$ -</u>	<u>\$ 2,274,543</u>	<u>\$ -</u>

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

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, 2010:

	Total	Level 1	Level 2	Level 3
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>\$ 102,515,727</u>	<u>\$ 72,569,614</u>	<u>\$ 10,555,028</u>	<u>\$ 19,391,085</u>
LIABILITIES				
Interest rate exchange agreements	\$ 1,861,068	\$ -	\$ 1,861,068	\$ -

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

Privately held securities – Investments in privately held securities that are traded in an active market for which closing stock prices are readily available are classified as Level 1. Other 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 are comprised of commingled trust funds which are not actively traded, however the underlying assets are marketable. 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. 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 CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

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. 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, 2011.

	Balances May 31, 2010	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, 2011
Assets					
Privately held and equity securities	\$ 675,208	\$ (140,856)	\$ -	\$ -	\$ 534,352
Private equity funds	3,548,603	(192,012)	809,666	-	4,166,257
Real estate partnerships	1,313,573	93,110	145,912	-	1,552,595
Real estate funds (REIT)	675,622	193,296	-	-	868,918
Funds of funds	8,919,495	332,905	-	-	9,252,400
Partnerships, real assets	2,431,958	133,796	594,129	-	3,159,883
Beneficial interest in funds held in trust	1,826,626	204,748	-	-	2,031,374
Total	<u>\$ 19,391,085</u>	<u>\$ 624,987</u>	<u>\$ 1,549,707</u>	<u>\$ -</u>	<u>\$ 21,565,779</u>

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, 2011.

\$ (8,931)

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

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, 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 CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

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:

	<u>Private Equity Funds</u>	<u>Real Assets</u>	<u>Hedge Funds and Funds of Funds</u>
Fair value, May 31, 2011	\$4,166,257	\$5,581,396	\$11,365,475
Significant Investment Strategy	Venture and buyout, in the U.S. and international	Real estate and natural resources, primarily in the U.S.	Long/short equity funds with absolute returns
Remaining Life	3 to 10 years	2 to 10 years	N.A.
Dollar Amount of Unfunded Commitments	\$5,247,704	\$3,026,727	None
Timing to Draw Down Commitments	1 to 14 years	1 to 14 years	N.A.
Redemption Terms	Over 1 year	Quarterly and over 1 year	Quarterly and yearly
Redemption Restrictions	N.A.	N.A.	Ranges between quarterly with 60 days notice and calendar year end with 100 days notice
Redemption Restrictions in Place at Year End	N.A.	Redemptions currently suspended in 2 of 9 funds	None

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 3 – RESTRICTIONS AND LIMITATIONS ON NET ASSET BALANCES

At May 31, 2011 and 2010, the College's unrestricted net assets were allocated as follows:

	2011	2010
Operations	\$ 6,255,166	\$ 6,164,215
Long-term investment (board designated endowment funds less underwater donor restricted endowment funds)	18,276,318	14,649,508
Annuity, life income and similar funds	1,300,081	1,241,519
Loans to students	2,420,807	2,434,584
Replacement of plant facilities	1,348,730	1,942,441
Net investment in plant	55,397,209	54,092,729
Totals	\$ 84,998,311	\$ 80,524,996

Temporarily restricted net assets consist of the following at May 31, 2011 and 2010:

Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other support – Operating	\$ 836,555	\$ 956,095
Scholarships, instruction and other support – Endowment	21,217,651	14,393,279
Acquisition of buildings and equipment	804,924	792,040
	22,859,130	16,141,414
Annuity, life income and similar funds	1,441,618	1,223,385
Beneficial interest in funds held in trust	159,559	143,682
Contributions receivable	871,000	550,000
Totals	\$ 25,331,307	\$ 18,058,481

Permanently restricted net assets consist of the following at May 31, 2011 and 2010:

Endowment funds	\$ 76,676,399	\$ 70,679,162
Beneficial interest in funds held in trust - Endowment	1,410,828	1,238,421
Beneficial interest in funds held in trust - Deferred Gifts	460,987	444,524
Student loan funds	428,515	431,966
Annuity, life income and similar funds	6,898,318	6,301,070
Contributions receivable	2,656,080	1,904,000
Totals	\$ 88,531,127	\$ 80,999,143

NOTE 4 – NET ASSETS RELEASED FROM RESTRICTIONS

Net assets were released from temporary donor restrictions during the years ended May 31, 2011 and 2010 by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors as follows:

	2011	2010
Scholarships, instruction and other departmental support	\$ 725,000	\$ 823,591
Matured deferred gifts	858,146	258,796
Acquisition of land, building, and equipment	661,451	228,462
Totals	\$ 2,244,597	\$ 1,310,849

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable include the following unconditional promises to give at May 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Unrestricted – completed plant projects	\$ 3,136,000	\$ 2,357,000
Temporarily restricted – operations	228,000	188,000
Temporarily restricted – plant projects	745,000	431,000
Permanently restricted – endowment	<u>2,904,080</u>	<u>2,150,000</u>
Gross unconditional promises to give	7,013,080	5,126,000
Less: Unamortized discount	(312,000)	(313,000)
Less: Allowance for uncollectible accounts	<u>(543,000)</u>	<u>(240,000)</u>
Net unconditional promises to give	<u>\$ 6,158,080</u>	<u>\$ 4,573,000</u>
Amounts due in:		
Less than one year	\$ 2,913,000	
One to five years	<u>3,245,080</u>	
Totals	<u>\$ 6,158,080</u>	

At May 31, 2011, promises due in one to five years were discounted using interest rates ranging between 2.68% and 6.0%. At May 31, 2010, promises due in one to five years were discounted using interest rates ranging between 3.10% and 6.0%. Promises due in less than one year were not discounted.

Net unconditional promises to give at May 31, 2011 and 2010 include \$40,000 and \$20,000, respectively, due from Cabinet members and \$825,000 and \$1,297,000, respectively due from Board members. The College received total contributions from board members and officers of \$903,000 and \$549,000, respectively, for the years ended May 31, 2011 and 2010.

NOTE 6 – MARKETABLE SECURITIES

The following summarizes the College's marketable securities in funds other than endowment at May 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Equity securities	\$ 496,936	\$ 624,327
Mutual funds	<u>11,064,417</u>	<u>10,205,272</u>
Totals	<u>\$ 11,561,353</u>	<u>\$ 10,829,599</u>

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 7 – ENDOWMENT INVESTMENTS

The following summarizes the College's endowment investments at May 31, 2011 and 2010:

	2011	2010
Cash and short-term investments	\$ 9,284,510	\$ 8,823,876
Equity securities	54,140	2,454,632
Fixed income securities	5,338,082	4,786,361
Mutual / Commingled funds	78,760,557	63,986,024
Real estate	807,227	221,942
Notes receivable	1,732	7,127
Alternative investments	21,113,128	18,447,916
Totals	\$ 115,359,376	\$ 98,727,878

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 – CREDIT QUALITY OF STUDENT LOAN RECEIVABLES

The College issues uncollateralized loans to students based on financial need. Student loans are funded through federal government loan programs or institutional resources. Student loans receivable are carried at the amount of unpaid principal less an estimate for doubtful accounts. Allowances for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. At May 31, 2011 and 2010, student loans represented 2.82% and 3.08% of total assets, respectively.

At May 31, 2011 and 2010, student loans consisted of the following:

	2011	2010
Federal government programs	\$ 6,672,645	\$ 6,908,541
Institutional programs	1,023,706	838,455
	7,696,351	7,746,996
Less allowance for doubtful accounts		
Beginning of year	(360,800)	(340,200)
Increases	(23,854)	(25,065)
Write-offs	8,554	4,465
End of year	(376,100)	(360,800)
Student loans receivable, net	\$ 7,320,251	\$ 7,386,196

Funds advanced by the federal government of \$5,640,867 and \$5,721,730 at May 31, 2011 and 2010, respectively, are ultimately refundable to the government and are classified as liabilities in the statement of financial position.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

NOTE 8 – CREDIT QUALITY OF STUDENT LOAN RECEIVABLES (cont.)

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

At May 31, 2011 and 2010, the following amounts were past due under student loan programs:

<u>May 31</u>	Amounts Past Due			
	1-59 days	60-89 days	90+ days	Total
2011	\$ 89,476	\$ 122,938	\$ 559,013	\$ 771,427
2010	106,740	90,473	502,167	699,380

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, 2011 and 2010:

	2011	2010
Evangelical Lutheran Church in America	\$ 624,082	\$ 541,556
U.S. Bank	477,920	423,635
Bank of America	103,079	87,172
Northern Trust	348,616	312,455
Windsor Investment	431,101	415,232
Other trusts	46,576	46,576
Totals	\$ 2,031,374	\$ 1,826,626

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

NOTE 10 – CONSTRUCTION IN PROGRESS

At May 31, 2011, the following construction projects were in progress:

	Estimated Total Cost	Cost To Date	Funding Source
Main windows	\$ 42,000	\$ 15,121	Operations and gifts
Brandt tile roof	100,000	46,310	Operations
Miller remodel	4,250,000	224,067	Operations and external debt
Dieseth remodel	4,250,000	189,023	Operations and external debt
611 Center renovation	35,000	12,755	Operations
IT server upgrade	140,000	18,882	Operations
Sampson-Hoffland artwork	25,000	11,076	Gifts
Spectrometer	169,000	90,000	Private grant
Renewable wind energy	3,500,000	273,989	Operations, external debt and grant
Aquatic center design plans	20,000	19,290	Operations and gifts
Totals	\$ 12,531,000	\$ 900,513	

Outstanding commitments on construction contracts totaled \$8,000,000 at May 31, 2011.

NOTE 11 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following as of May 31, 2011 and 2010:

	2011	2010
Land	\$ 594,581	\$ 594,581
Buildings	124,350,321	122,399,147
Improvements other than buildings	14,182,547	12,878,442
Equipment and library books	29,155,907	27,970,793
	168,283,356	163,842,963
Less: Accumulated depreciation	(83,133,585)	(77,303,156)
Totals	\$ 85,149,771	\$ 86,539,807

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 12 – LOANS AND BONDS PAYABLE

Loans and bonds payable outstanding at May 31, 2011 and 2010 are as follows:

	2011	2010
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 1998B	\$ 3,175,340	\$ 3,507,092
Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2002	13,635,000	14,060,000
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 2004	2,057,142	2,571,429
Alliant Energy loan payable	167,094	364,048
Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2008	11,000,000	11,000,000
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 2010	50,062	-
Totals	\$ 30,084,638	\$ 31,502,569

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 bonds are unsecured. 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 \$570,000 to \$1,110,000 from 2011 through 2027. The interest rate is variable and at May 31, 2011 was 0.15%. The bonds are secured by a letter of credit totaling \$13,803,103 which expires November 1, 2013. 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 and a liquidity ratio. As of May 31, 2011, 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 2011 through 2014. The bonds are unsecured. The interest rate is variable and at May 31, 2011 was 1.2021%. The loan agreement includes certain financial and other covenants which include meeting a cash flow coverage ratio and a liquidity ratio. As of May 31, 2011, 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, 2011 was 0.15%. The bonds are secured by a letter of credit totaling \$11,102,466 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, 2011, the College is in compliance with these covenants.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 12 – LOANS AND BONDS PAYABLE (cont.)

In December 2010, the City of Decorah, Iowa sold its Private College Facility Revenue Bonds, Series 2010, in the amount of \$7,500,000. The proceeds will be used to renovate Miller and Dieseth residence halls during the summers of 2011 and 2012. The funds are drawn down as needed. As of May 31, 2011, \$50,062 has been drawn. The bonds are unsecured. The interest rate on the proceeds is 4.1% and is fixed until June 30, 2021. Annual principal payments if the full \$7,500,000 is drawn down will be \$326,000 and begin in June 2013 with a balloon payment of \$4,892,000 in June 2021. The loan agreement includes certain financial and other covenants which include meeting a cash flow coverage ratio and a liquidity ratio. As of May 31, 2011, the College is in compliance with these covenants. The purchaser of the Series 2010 bonds is First Citizens National Bank whose Chief Executive Officer is a Luther College board member.

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 \$157,271. 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 \$1,084,096 and \$853,740 for the years ended May 31, 2011 and 2010, respectively. Interest totaling \$907 and \$294,155 was capitalized for the years ended May 31, 2011 and 2010, respectively.

Total scheduled maturities of loans and bonds payable (excluding the scheduled maturities on the Series 2010 bonds) for each of the five years subsequent to May 31, 2011 are: 2012 – \$1,591,000; 2013 – \$1,483,000; 2014 – \$1,518,000; 2015 – \$1,579,000 and 2016 – \$1,107,000.

NOTE 13 – ENDOWMENT

The College's endowment consists of approximately 750 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. See Note 1 for further information on net asset classification.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

NOTE 13 – ENDOWMENT (cont.)

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

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (599,647)	\$ 21,217,651	\$ 76,676,399	\$ 97,294,403
Donor-restricted funds held in trust	-	-	1,410,828	1,410,828
Board-designated endowment funds	18,875,965	-	-	18,875,965
Contributions receivable	-	-	2,656,080	2,656,080
	<u>\$ 18,276,318</u>	<u>\$ 21,217,651</u>	<u>\$ 80,743,307</u>	<u>\$ 120,237,276</u>

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>

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 13 – ENDOWMENT (cont.)

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2010	\$ 14,649,508	\$ 14,393,279	\$ 73,821,583	\$ 102,864,370
Investment return:				
Investment income, net of investment fees of \$85,600	1,897,980	38,040	161,612	2,097,632
Net appreciation – realized and unrealized	5,670,169	7,603,580	1,831,703	15,105,452
Net appreciation – realized and unrealized funds held in trust	-	-	172,407	172,407
Total investment return	7,568,149	7,641,620	2,165,722	17,375,491
Contributions	-	-	3,226,385	3,226,385
Matured deferred gifts	-	-	685,289	685,289
Change in contributions receivable	-	-	752,080	752,080
Appropriation of endowment assets for expenditure	(5,055,166)	(725,000)	-	(5,780,166)
Other changes:				
Change in donor guidelines		(92,248)	92,248	-
Transfers to board / college designated endowment funds	1,113,827	-	-	1,113,827
Total other changes	1,113,827	-	-	1,113,827
Endowment net assets, May 31, 2011	\$ 18,276,318	\$ 21,217,651	\$ 80,743,307	\$ 120,237,276

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

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 appreciation – 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

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 \$599,647 and \$2,184,511 as of May 31, 2011 and 2010, 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 CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

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, 2011 and 2010.

During the years ended May 31, 2011 and 2010, the College received gift income relating to deferred gift agreements of approximately \$124,000 and \$6,000, respectively. Total assets held by the College under deferred gift agreements approximated \$15,650,000 and \$14,268,000 at May 31, 2011 and 2010, respectively.

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS May 31, 2011 and 2010

NOTE 15 – EMPLOYEE BENEFIT PLANS

The College has a 403(b) defined contribution 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 \$2,551,000 and \$2,627,000 for the years ended May 31, 2011 and 2010, respectively.

An early retirement plan is available to faculty members. In addition, in fiscal year 2011, a one-time early retirement package was offered to faculty. Twelve faculty members accepted the package. The estimated accrued liability for the early retirement benefits is calculated using historical participation rates, current faculty membership and projected salary increases, discounted at a rate of 5.25% and 5.50% for May 31, 2011 and 2010, respectively. The plan is unfunded. The total accrued liability for the early retirement benefits is \$878,260 and \$336,710 for May 31, 2011 and 2010, 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, 2011 and 2010:

	2011	2010
Total expected benefit obligation earned to date, based on service		
Current retirees and dependents		
Pre-65 payments	\$ 287,000	\$ 299,000
Post-65 payments	1,128,000	1,522,000
Active employees		
Eligible for post-65 coverage		
Pre-65 payments	150,000	158,000
Post-65 payments	663,000	752,000
Not eligible for post-65 coverage	458,000	472,000
Benefit obligation at end of year	\$ 2,686,000	\$ 3,203,000
Change in projected benefit obligation		
Benefit obligation at beginning of year	\$ 3,203,000	\$ 2,303,000
Net benefits earned	216,000	197,000
Total (gain) loss	(568,000)	836,000
Expected benefit payments	(165,000)	(133,000)
Benefit obligation at end of year	\$ 2,686,000	\$ 3,203,000
Change in plan assets		
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contribution	165,000	133,000
Participant contribution	-	-
Benefits paid	(165,000)	(133,000)
Fair value of plan assets at end of year	\$ -	\$ -
Funded status		
Underfunded status at year end	\$ (2,686,000)	\$ (3,203,000)

LUTHER COLLEGE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
May 31, 2011 and 2010

NOTE 15 – EMPLOYEE BENEFIT PLANS (cont.)

	2011	2010
Amounts recognized in the statements of financial position consist of:		
Noncurrent assets	\$ –	\$ –
Current liabilities	(160,000)	(165,000)
Noncurrent liabilities	(2,526,000)	(3,038,000)
Net amount recognized	\$ (2,686,000)	\$ (3,203,000)

Weighted average assumptions used to calculate the benefit obligation at May 31

Discount rate	5.25%	5.50%
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	6.5%	7.4%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.7%	4.7%
Year that the rate reaches the ultimate trend rate	2085	2085

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, 2011	\$ 275,000	\$ (237,000)

Annual premium payments were approximately \$96,900 and \$112,700 for the years ended May 31, 2011 and 2010, respectively. During the fiscal year ending May 31, 2012, the College expects to contribute \$160,000 in benefit payments for the postretirement medical plan.

Estimated future postretirement medical payments (which reflect expected future service, as appropriate) as of May 31, 2011 are as follows:

Years Ending May 31	
2012	\$ 160,000
2013	166,000
2014	170,000
2015	174,000
2016	167,000
2017-2030	3,175,000

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 CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

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 75% of its cash and cash equivalents in a well capitalized bank with a tier I risk-based capital ratio of 13.36 and a total risk-based capital ratio of 14.63. 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 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. 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 2011 and 2010, the College paid \$806,992 and \$830,531, 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 CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2011 and 2010

NOTE 17 – DERIVATIVES (cont.)

The following is a summary of the outstanding positions under these interest rate exchange agreements as of May 31, 2011 and 2010:

Instrument Type	Effective Date	Notional Amount	Maturity Date	Rate Paid	Rate Received
Variable to fixed rate swap	December 14, 2004	\$ 2,057,143	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	\$ 13,635,000	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, 2011 and 2010 as follows:

Derivatives Not Designated as Hedging Instruments	Statement of Financial Position Location	Liabilities Derivative	
		Fair Value	
		2011	2010
Interest rate swap	Interest rate swap liability	\$ 2,274,543	\$ 1,861,068

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

Derivatives Not Designated as Hedging Instruments	Location of Loss on Derivatives Recognized in the Statement of Changes in Net Assets	Amount of Loss on Derivatives Recognized in the Statement of Changes in Net Assets	
		2011	2010
		Interest rate swap	Loss on swap agreement valuation

NOTE 18 – SUBSEQUENT EVENTS

Luther College has evaluated subsequent events through September 19, 2011 which is the date that the financial statements were issued.