

LUTHER COLLEGE
Decorah, Iowa

FINANCIAL STATEMENTS

May 31, 2009 and 2008

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, 2009 and 2008 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, 2009 and 2008 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 2 to the financial statements, Luther College adopted the provisions of FASB Statement No. 157, *Fair Value Measurements* and FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*; as of June 1, 2008. As described in Note 13 to the financial statements, Luther College adopted the provisions of 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.

Baker Tilly Virchow Krause, LLP

Minneapolis, Minnesota
September 28, 2009

LUTHER COLLEGE

STATEMENTS OF FINANCIAL POSITION

May 31, 2009 and 2008

ASSETS	<u>2009</u>	<u>2008</u>
Cash and cash equivalents	\$ 4,682,103	\$ 6,425,399
Student accounts receivable, net of allowance for doubtful accounts of \$205,000 in 2009 and \$253,000 in 2008	142,270	163,140
Accrued interest receivable	154,178	316,024
Government grants receivable	296,962	182,356
Contributions receivable	4,738,000	5,567,000
Other receivables	86,321	100,356
Inventories	530,449	607,197
Prepaid expenses and other assets	367,847	173,899
Cash surrender value of life insurance	3,440,962	3,543,321
Investments		
Short term investments	9,335,336	9,754,484
Marketable securities	10,712,789	14,382,569
Mortgages and contracts receivable	2,007,327	2,522,853
Real estate	1,383,321	1,343,401
Endowment investments	93,439,758	116,689,768
Deposits held by trustee	2,493,772	-
Beneficial interest in funds held in trust	1,704,065	2,193,575
Student notes receivable, net of allowance for doubtful accounts of \$340,200 in 2009 and \$346,600 in 2008	7,247,350	7,194,842
Unamortized debt issuance costs	344,461	151,330
Cash restricted for plant acquisitions	2,253,329	1,977,583
Construction in progress	8,401,788	18,678,082
Property, plant and equipment, net	<u>77,318,312</u>	<u>59,112,085</u>
TOTAL ASSETS	<u>\$ 231,080,700</u>	<u>\$ 251,079,264</u>
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 2,438,629	\$ 4,047,436
Accrued liabilities	5,464,652	5,258,362
Deferred revenue	648,856	155,708
Other liabilities	3,839,138	3,898,093
Asset retirement obligations	2,332,638	2,485,874
Interest rate swap liability	1,381,429	560,775
Notes, loans and bonds payable	32,938,887	23,337,557
Annuities payable	5,330,520	7,073,769
Deposits held in custody for others	410,010	521,435
Government grants refundable	5,731,474	5,756,387
Total Liabilities	<u>60,516,233</u>	<u>53,095,396</u>
NET ASSETS		
Unrestricted	78,330,122	97,114,659
Temporarily restricted	15,551,919	20,529,282
Permanently restricted	76,682,426	80,339,927
Total Net Assets	<u>170,564,467</u>	<u>197,983,868</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 231,080,700</u>	<u>\$ 251,079,264</u>

See accompanying notes to financial statements.

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
 Year Ended May 31, 2009
 (With Comparative Totals for 2008)

	2009				2008 Total
	Operating	Long-Term Investment	Plant	Total	
UNRESTRICTED NET ASSETS					
Revenues, Gains and Other Support					
Tuition and fees	\$ 73,845,811	\$ -	\$ -	\$ 73,845,811	\$ 69,433,289
Less: Scholarships and grants	(31,377,659)	-	-	(31,377,659)	(28,819,021)
Net tuition and fees	42,468,152	-	-	42,468,152	40,614,268
Government grants and contracts	1,940,972	-	-	1,940,972	1,671,113
Private gifts and grants	2,874,978	-	-	2,874,978	2,716,853
Endowment income	4,758,043	22,191	-	4,780,234	4,788,815
Investment income	221,404	-	104,875	326,279	1,012,855
Loss on investments	(3,892)	(5,694,550)	(36,336)	(5,734,778)	(2,756,474)
Other sources	2,736,871	-	(240)	2,736,631	3,827,857
Sales and services of educational activities	871,544	-	-	871,544	723,594
Sales and services of auxiliary enterprises	13,532,266	-	-	13,532,266	12,980,847
Loss on swap agreement valuation	-	-	(820,654)	(820,654)	(755,567)
Actuarial adjustment	-	(68,648)	-	(68,648)	61,546
	69,400,338	(5,741,007)	(752,355)	62,906,976	64,885,707
Net assets released from restrictions	667,528	-	17,254,329	17,921,857	964,445
Total Revenues, Gains and Other Support	70,067,866	(5,741,007)	16,501,974	80,828,833	65,850,152
Expenses					
Program Expenses					
Instruction	28,027,169	-	2,662,733	30,689,902	27,193,871
Research	253,046	-	40,532	293,578	316,160
Public service	917,626	-	15,678	933,304	588,155
Academic support	3,141,691	-	656,137	3,797,828	3,449,985
Student services	10,455,813	-	327,765	10,783,578	9,812,628
Auxiliary enterprises	10,959,253	-	2,096,767	13,056,020	12,471,405
Support Expenses					
Institutional support	9,498,912	-	727,132	10,226,044	9,415,732
Allocable Expenses					
Operation and maintenance of plant	9,251,502	-	-	9,251,502	7,349,701
Depreciation and amortization	-	-	5,218,856	5,218,856	4,248,576
Accretion	-	-	116,355	116,355	112,416
Interest	-	-	874,609	874,609	878,834
Less: Allocated expenses	(9,251,502)	-	(6,209,820)	(15,461,322)	(12,589,527)
Total Expenses	63,253,510	-	6,526,744	69,780,254	63,247,936
Change in Unrestricted Net Assets					
Prior to Reclassification	6,814,356	(5,741,007)	9,975,230	11,048,579	2,602,216
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)	2,602,216
TEMPORARILY RESTRICTED NET ASSETS					
Gifts and grants	218,259	-	1,342,955	1,561,214	4,135,517
Endowment income	324,501	50,897	-	375,398	315,693
Loss on investments	-	(18,677,777)	-	(18,677,777)	-
Actuarial adjustment	-	(392,360)	-	(392,360)	(121,013)
Reclassification due to change in donor restriction	-	245,490	-	245,490	-
Net assets released from restrictions	(667,528)	-	(17,254,329)	(17,921,857)	(964,445)
Change in Temporarily Restricted Net					
Assets Prior to Reclassification	(124,768)	(18,773,750)	(15,911,374)	(34,809,892)	3,365,752
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)	3,365,752

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
 Year Ended May 31, 2009
 (With Comparative Totals for 2008)

	2009				2008 Total
	Operating	Long-Term Investment	Plant	Total	
PERMANENTLY RESTRICTED NET ASSETS					
Private gifts	\$ -	\$ 2,966,736	\$ -	\$ 2,966,736	\$ 4,894,635
Endowment income	-	71,819	-	71,819	585,375
Loss on investments	-	(5,567,395)	-	(5,567,395)	(934,825)
Actuarial adjustment	-	(883,956)	-	(883,956)	107,201
Other sources	198	-	-	198	8,784
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)	4,661,170
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)	4,661,170
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)	10,629,138
NET ASSETS - Beginning of Year	9,492,319	132,066,042	56,425,507	197,983,868	187,354,730
NET ASSETS - END OF YEAR	<u>\$ 9,956,692</u>	<u>\$ 104,188,469</u>	<u>\$ 56,419,306</u>	<u>\$ 170,564,467</u>	<u>\$ 197,983,868</u>

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
Year Ended May 31, 2008

	Operating	Long-Term Investment	Plant	Total
UNRESTRICTED NET ASSETS				
Revenues, Gains and Other Support				
Tuition and fees	\$ 69,433,289	\$ -	\$ -	\$ 69,433,289
Less: Scholarships and grants	(28,819,021)	-	-	(28,819,021)
Net tuition and fees	40,614,268	-	-	40,614,268
Government grants and contracts	1,671,113	-	-	1,671,113
Private gifts and grants	2,703,408	10,108	3,337	2,716,853
Endowment income	4,465,183	323,632	-	4,788,815
Investment income	688,390	993	323,472	1,012,855
Gain (loss) on investments	42	(2,763,253)	6,737	(2,756,474)
Other sources	3,823,101	-	4,756	3,827,857
Sales and services of educational activities	723,594	-	-	723,594
Sales and services of auxiliary enterprises	12,980,847	-	-	12,980,847
Loss on swap agreement	-	-	(755,567)	(755,567)
Actuarial adjustment	-	61,546	-	61,546
	67,669,946	(2,366,974)	(417,265)	64,885,707
Net assets released from restrictions	964,445	-	-	964,445
Total Revenues, Gains and Other Support	68,634,391	(2,366,974)	(417,265)	65,850,152
Expenses				
Program Expenses				
Instruction	25,404,493	-	1,789,378	27,193,871
Research	280,725	-	35,435	316,160
Public service	582,229	-	5,926	588,155
Academic support	2,837,022	-	612,963	3,449,985
Student services	9,481,385	-	331,243	9,812,628
Auxiliary enterprises	10,386,064	-	2,085,341	12,471,405
Support Expenses				
Institutional support	8,857,727	-	558,005	9,415,732
Allocable Expenses				
Operation and maintenance of plant	7,349,701	-	-	7,349,701
Depreciation and amortization	-	-	4,248,576	4,248,576
Accretion	-	-	112,416	112,416
Interest	-	-	878,834	878,834
Less: Allocated expenses	(7,349,701)	-	(5,239,826)	(12,589,527)
Total Expenses	57,829,645	-	5,418,291	63,247,936
Change in Unrestricted Net Assets	10,804,746	(2,366,974)	(5,835,556)	2,602,216
TEMPORARILY RESTRICTED NET ASSETS				
Private gifts and grants	402,967	994,532	2,738,018	4,135,517
Endowment income	315,693	-	-	315,693
Actuarial adjustment	-	(121,013)	-	(121,013)
Net assets released from restrictions	(964,445)	-	-	(964,445)
Change in Temporarily Restricted Net Assets	(245,785)	873,519	2,738,018	3,365,752

LUTHER COLLEGE

STATEMENT OF ACTIVITIES
Year Ended May 31, 2008

	Operating	Long-Term Investment	Plant	Total
PERMANENTLY RESTRICTED NET ASSETS				
Private gifts	\$ -	\$ 4,894,635	\$ -	\$ 4,894,635
Endowment income	-	585,375	-	585,375
Loss on investments	-	(934,825)	-	(934,825)
Actuarial adjustment	-	107,201	-	107,201
Other sources	8,784	-	-	8,784
	<u>8,784</u>	<u>-</u>	<u>-</u>	<u>8,784</u>
Change in Permanently Restricted Net Assets	8,784	4,652,386	-	4,661,170
TRANSFERS				
Transfer for debt service	(5,288,109)	-	5,288,109	-
Nonmandatory transfers	(4,500,548)	1,768,253	2,732,295	-
Total Transfers	(9,788,657)	1,768,253	8,020,404	-
	<u>(9,788,657)</u>	<u>1,768,253</u>	<u>8,020,404</u>	<u>-</u>
CHANGE IN NET ASSETS	779,088	4,927,184	4,922,866	10,629,138
NET ASSETS - Beginning of Year	8,713,231	127,138,858	51,502,641	187,354,730
	<u>8,713,231</u>	<u>127,138,858</u>	<u>51,502,641</u>	<u>187,354,730</u>
NET ASSETS - END OF YEAR	\$ 9,492,319	\$ 132,066,042	\$ 56,425,507	\$ 197,983,868
	<u>\$ 9,492,319</u>	<u>\$ 132,066,042</u>	<u>\$ 56,425,507</u>	<u>\$ 197,983,868</u>

LUTHER COLLEGE

STATEMENTS OF CASH FLOWS
Years Ended May 31, 2009 and 2008

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ (27,419,401)	\$ 10,629,138
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	5,218,856	4,248,576
Accretion	116,355	112,416
Loss on disposal of property	40,875	-
Loss on interest rate swap valuation	820,654	755,567
Losses on endowment investments, net	26,535,864	1,089,890
Losses on other investments, net	7,306,643	1,193,842
Decrease in beneficial interest in funds held in trust	489,510	272,866
Increase in investment real estate	(39,920)	(353,903)
Actuarial adjustment of annuities payable	(1,638,561)	(807,696)
Loan cancellations, reinstatements and write-offs	109,122	110,438
Change in allowance on student notes receivable	(6,400)	1,100
Change in allowance on student accounts receivable	(48,000)	(72,000)
Changes in assets and liabilities		
Student accounts receivable	68,870	94,636
Accrued interest receivable	161,846	141,252
Government grants receivable	(114,606)	(72,920)
Contributions receivable for operations	57,000	73,000
Other receivables	14,035	8,756
Inventories	76,748	201,527
Prepaid expenses and other assets	(193,948)	(86,613)
Cash surrender value of life insurance	102,359	(182,866)
Accounts payable	82,658	177,642
Accrued liabilities	206,290	441,888
Deferred revenue	493,148	11,722
Other liabilities	(58,955)	(2,669,536)
Deposits held in custody for others	(111,425)	(996)
Asset retirement obligation remediation	(269,591)	(70,402)
Contributions restricted for loans, long-term investment and plant	(4,309,691)	(8,630,522)
Contributions under split-interest agreements	(153,766)	(343,361)
Investment income restricted for reinvestment	(71,819)	(585,375)
Cash Flows from Operating Activities	<u>7,464,750</u>	<u>5,688,066</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of endowment investments, net	(3,285,854)	(4,712,213)
Purchases of marketable securities, net	(3,217,715)	(4,003,687)
Decrease in mortgages and contracts receivable	515,526	515,525
Purchases of property, plant and equipment	(14,862,369)	(16,356,766)
Withdrawals from deposits held by trustee for construction, net	8,300,492	-
Disbursements of loans to students	(853,337)	(1,069,039)
Repayments of loans from students	698,107	707,298
Cash Flows from Investing Activities	<u>(12,705,150)</u>	<u>(24,918,882)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of principal on indebtedness	(1,398,670)	(237,762)
Bond issuance costs	(6,155)	-
Receipt of investment income restricted for reinvestment	71,819	585,375
Contributions received restricted for loans, long-term investment and plant	5,081,691	9,776,522
(Increase) decrease in cash held for plant acquisitions	(275,746)	8,575,705
Decrease in government grants refundable	(24,913)	(51,188)
Proceeds from issuance of split-interest agreements	212,024	704,938
Payments to annuitants	(162,946)	(140,393)
Cash Flows from Financing Activities	<u>3,497,104</u>	<u>19,213,197</u>
Change in Cash and Cash Equivalents	<u>(1,743,296)</u>	<u>(17,619)</u>
CASH AND CASH EQUIVALENTS - Beginning of year	<u>6,425,399</u>	<u>6,443,018</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 4,682,103</u>	<u>\$ 6,425,399</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid, net of capitalized amounts of \$134,282 in 2009	\$ 899,495	\$ 912,890
Payments on swap settlements	438,341	13,532
NONCASH INVESTMENT AND FINANCING ACTIVITIES		
Property, plant and equipment acquired through accounts payable	745,884	2,437,349
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, 2009 and 2008

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 generally accepted accounting principles. The more significant accounting policies are summarized below:

General – The College maintains its accounts in accordance with the principles and practices of fund accounting. Fund accounting is the procedure by which resources for various purposes are classified for accounting purposes in accordance with activities or objectives specified by donors.

These financial statements, which are presented on the accrual basis of accounting, have been prepared to focus on the College as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of fund balances and transactions into three classes of net assets – permanently restricted, temporarily restricted or unrestricted, as follows:

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 are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. 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 reclassifications between the applicable classes of net assets.

Tuition revenue is recognized in the period the classes are provided. Revenue from auxiliary enterprises is recognized when goods or services are provided. Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met.

Income and net gains on investments of endowment and similar funds are reported as follows:

- as increases in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanent endowment fund;
- as increases in temporarily restricted net assets if the terms of the gift or state law impose restrictions on the use of the income;
- as increases in unrestricted net assets in all other cases.

Losses from investments on permanently restricted endowment funds are reported as reductions in temporarily restricted assets to the extent of prior accumulated earnings reported as such, if any, with the remaining net losses reported as reductions in the unrestricted endowment funds.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

Temporarily Restricted Net Assets – With respect to temporarily restricted net assets, the College has adopted the following accounting policies:

Reporting as Temporarily Restricted Revenues – Contributions and 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.

Release of Restrictions on Net Assets for Acquisition of Land, Buildings and Equipment – Contributions of land, buildings and equipment are reported as revenues of the unrestricted net asset class. Contributions of cash or other assets to be used to acquire land, buildings and equipment are reported as revenues of the temporarily restricted net asset class; the restrictions are considered to be released at the time such long-lived assets are placed in service.

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 \$16,500 and \$15,900 due from employees at May 31, 2009 and 2008, 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 – Cash, short-term investments and government securities held by trustee include amounts restricted for construction, debt service and renewal and replacement 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.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (cont.)

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.

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.

Interest Rate Swaps – 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. The interest rate exchange agreements were not entered into for trading or 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.

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.

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 \$2,026,000 and \$1,903,000 for the years ended May 31, 2009 and 2008, respectively. Advertising expenses totaled approximately \$592,000 and \$524,500 for the years ended May 31, 2009 and 2008, 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 taxes. However, any unrelated business income may be subject to taxation.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS

May 31, 2009 and 2008

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 2008 financial statements have been reclassified to conform with the 2009 presentation. The reclassifications have no effect on reported amounts of total net assets or change in total net assets

New Accounting Pronouncements – In March 2008, the FASB issued Statement on Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133* (SFAS 161). This Statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under Statement 133 and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2008. As of May 31, 2009, the College does not believe the adoption of SFAS 161 will materially impact the financial statement amounts. However, additional footnote disclosures may be required regarding the use of derivative instruments and hedging items.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS

May 31, 2009 and 2008

NOTE 2 – FAIR VALUE MEASUREMENTS

Effective June 1, 2008, the College adopted the provisions of FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value. SFAS 157 establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of the asset or liability as of the measurement date. SFAS 157 expands disclosures about instruments measured at fair value. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements and, according, SFAS 157 does not require any new fair value measurements.

Subsequent to the issuance of SFAS 157, the FASB issued additional Financial Staff Positions (FSP) which provide implementation guidance related to fair value measurements. The College has adopted the applicable FSPs as appropriate during fiscal year 2009.

Effective June 1, 2008, the College adopted FASB Statement No. 159, *The Fair Value Option for Financial Assets and Liabilities, including an amendment of FASB Statement No. 115*, which among other things, provides 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 asset or liability that is not currently required to be measured at fair value.

As noted above, SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to 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.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS

May 31, 2009 and 2008

NOTE 2 – FAIR VALUE MEASUREMENTS (cont.)

The following table presents financial instruments that are measured at fair value on a recurring basis by the SFAS 157 hierarchy as of May 31, 2009:

	Total	Level 1	Level 2	Level 3
ASSETS				
Short term investments	\$ 2,031,203	\$ –	\$ 2,031,203	\$ –
Equity securities	11,754,689	659,496	–	11,095,193
Fixed Income securities	5,558,085	–	–	5,558,085
Mutual funds	58,195,450	58,195,450	–	–
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
Total	\$ 97,562,745	\$ 58,854,946	\$ 2,031,203	\$ 36,676,596
LIABILITIES				
Interest rate exchange agreements	\$ 1,381,429	\$ –	\$ 1,381,429	\$ –

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.

Equity securities – Investments in equity securities are measured at fair value using quoted market prices. They are classified as Level 1 if they are traded in an active market for which closing stock prices are readily available. They are classified as Level 3 when the investment is not traded in active markets, however, the underlying assets are marketable securities.

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.

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

Alternative investments – Investments in hedge funds, private equity funds, real estate partnerships, real estate funds, funds of funds, and real assets partnerships for which there is no readily determinable fair value are classified as level 3 as the valuation 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.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 2 – FAIR VALUE MEASUREMENTS (cont.)

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, 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					
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	<u>2,193,575</u>	<u>(484,430)</u>	<u>-</u>	<u>(5,080)</u>	<u>1,704,065</u>
Total	<u>\$ 46,482,464</u>	<u>\$ (10,212,789)</u>	<u>\$ 412,001</u>	<u>\$ (5,080)</u>	<u>\$ 36,676,596</u>

The amount of total gains or losses for the period 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, 2009 and 2008

NOTE 3 – RESTRICTIONS AND LIMITATIONS ON NET ASSET BALANCES

At May 31, 2009 and 2008, the College's unrestricted net assets were allocated as follows:

	2009	2008
Operations	\$ 7,076,405	\$ 6,524,793
Long-term investment (board designated endowment funds less underwater donor restricted endowment funds)	12,692,324	47,902,328
Annuity, life income and similar funds	1,336,624	1,405,272
Loans to students	1,279,609	1,242,278
Replacement of plant facilities	6,743,687	6,621,085
Net investment in plant	49,201,473	33,418,903
 Totals	 \$ 78,330,122	 \$ 97,114,659

Temporarily restricted net assets consist of the following at May 31, 2009 and 2008:

Gifts and other unexpended revenues and gains available for:		
Scholarships, instruction and other support – Operating	\$ 981,595	\$ 1,049,363
Scholarships, instruction and other support – Endowment	12,444,608	993,469
Acquisition of buildings and equipment	368,144	11,971,519
	13,794,347	14,014,351
Annuity, life income and similar funds	1,340,422	1,711,294
Beneficial interest in funds held in trust	131,150	152,637
Contributions receivable	286,000	4,651,000
 Totals	 \$ 15,551,919	 \$ 20,529,282

Permanently restricted net assets consist of the following at May 31, 2009 and 2008:

Endowment funds	\$ 67,096,858	\$ 69,521,732
Beneficial interest in funds held in trust	1,572,915	2,040,938
Student loan funds	439,084	438,885
Annuity, life income and similar funds	6,112,569	7,454,372
Contributions receivable	1,461,000	884,000
 Totals	 \$ 76,682,426	 \$ 80,339,927

NOTE 4 – NET ASSETS RELEASED FROM RESTRICTIONS

Net assets were released from temporary donor restrictions during the years ended May 31, 2009 and 2008 by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors as follows:

	2009	2008
Scholarships, instruction and other departmental support	\$ 667,528	\$ 964,445
Acquisition of land, building, and equipment	17,254,329	-
 Totals	 \$ 17,921,857	 \$ 964,445

These assets were reclassified to unrestricted net assets.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable include the following unconditional promises to give at May 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Unrestricted – completed plant projects	\$ 3,503,000	\$ 36,000
Temporarily restricted – operations	210,000	276,000
Temporarily restricted – plant projects	124,000	5,108,000
Permanently restricted – endowment	<u>1,699,000</u>	<u>995,000</u>
Gross unconditional promises to give	5,536,000	6,415,000
Less: Unamortized discount	(549,000)	(555,000)
Less: Allowance for uncollectible accounts	<u>(249,000)</u>	<u>(293,000)</u>
Net unconditional promises to give	<u>\$ 4,738,000</u>	<u>\$ 5,567,000</u>
Amounts due in:		
Less than one year	\$ 1,605,000	
One to five years	<u>3,133,000</u>	
Totals	<u>\$ 4,738,000</u>	

Promises due in one to five years received prior to June 1, 2008 were discounted at interest rates of 6.0% at May 31, 2009 and 2008. Promises due in one to five years received after May 31, 2008 were discounted at interest rates of 3.34% at May 31, 2009. Promises due in less than one year were not discounted. Net unconditional promises to give at May 31, 2009 and 2008 from related parties were \$1,217,000 and \$1,024,000, respectively.

NOTE 6 – MARKETABLE SECURITIES

The following summarizes the College's marketable securities in funds other than endowment at May 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Equity securities	\$ 965,085	\$ 1,022,400
Mutual funds	<u>9,747,704</u>	<u>13,360,169</u>
Totals	<u>\$ 10,712,789</u>	<u>\$ 14,382,569</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 7 – ENDOWMENT INVESTMENTS

The following summarizes the College's endowment investments at May 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Cash and short-term investments	\$ 10,051,714	\$ 6,712,776
Equity securities	10,789,604	17,234,512
Fixed income securities	5,558,085	5,151,863
Mutual / Commingled funds	48,447,746	64,776,249
Real estate	221,942	221,936
Notes receivable	51,414	98,628
Alternative investments	<u>18,319,253</u>	<u>22,493,804</u>
Totals	<u>\$ 93,439,758</u>	<u>\$ 116,689,768</u>

As of May 31, 2009, the College has commitments to make further investments in several of its alternative investments totaling approximately \$6,820,000.

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, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Money market funds	\$ 462,568	\$ -
Short-term investments	<u>2,031,203</u>	<u>-</u>
Totals	<u>\$ 2,493,771</u>	<u>\$ -</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

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, 2009 and 2008:

	2009	2008
Evangelical Lutheran Church in America	\$ 471,929	\$ 651,963
U.S. Bank	402,231	533,972
Bank of America	77,860	99,326
Northern Trust	297,712	372,993
Windsor Investment	410,866	491,854
Other trusts	43,467	43,467
	<u>\$ 1,704,065</u>	<u>\$ 2,193,575</u>

NOTE 10 – CONSTRUCTION IN PROGRESS

At May 31, 2009 the following construction projects were in progress:

	Estimated Total Cost	Cost To Date	Funding Source
Campus landscaping	\$ 175,000	\$ 114,380	Operations and gifts
Valders renovation	10,000,000	8,062,493	External debt and government grant
Brandt tile roof	100,000	46,310	Operations
Dieseth/Miller renovation plans	70,000	53,560	Operations
Street renovation	600,000	19,084	Operations
Dahl Centennial Union HVAC	100,000	80,815	Operations
Main windows	100,000	23,213	Operations
All weather outdoor track	560,000	1,933	Operations and gifts
	<u>\$ 11,705,000</u>	<u>\$ 8,401,788</u>	

Outstanding commitments on construction contracts totaled \$1,623,000 at May 31, 2009.

NOTE 11 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following as of May 31, 2009 and 2008:

	2009	2008
Land	\$ 594,581	\$ 594,581
Buildings	111,351,790	91,653,165
Improvements other than buildings	11,541,308	10,211,352
Equipment and library books	25,814,069	23,690,464
	<u>149,301,748</u>	<u>126,149,562</u>
Less: Accumulated depreciation	(71,983,436)	(67,037,477)
	<u>\$ 77,318,312</u>	<u>\$ 59,112,085</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 12 – NOTES, LOANS AND BONDS PAYABLE

Notes, loans and bonds payable outstanding at May 31, 2009 and 2008 are as follows:

	2009	2008
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 1998B	\$ 3,821,748	\$ 3,951,873
Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2002	14,465,000	15,000,000
City of Decorah, Iowa Private College Facility Revenue Bonds, Series 2004	3,085,714	3,600,000
Alliant Energy loan payable	566,425	785,684
Iowa Higher Education Loan Authority Private College Facility Revenue Bonds, Series 2008	11,000,000	-
Totals	\$ 32,938,887	\$ 23,337,557

In December 1998, the City of Decorah, Iowa sold its Private College Facility Revenue Bonds (Luther College Project), Series 1998B, totaling \$4,000,000 and loaned the proceeds to the College. The proceeds were 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 \$405,000 to \$1,110,000 from 2009 through 2027. The interest rate is variable and at May 31, 2009 was 0.32%. 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, 2009, 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 and loaned the proceeds to the College. The proceeds were 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 2009 through 2014. The interest rate is variable and at May 31, 2009 was 1.82%. 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, 2009, 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, 2009 was 0.32%. 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, 2009, the College is in compliance with these covenants.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS

May 31, 2009 and 2008

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 \$202,375. 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. Under the swap agreements, the College either pays or receives interest depending on the relationship between the variable rate and the fixed rate.

During fiscal year 2005, the College entered into an interest rate exchange agreement with an effective date of June 15, 2004. The interest rate exchange agreement has the effect of converting \$15,000,000 of the variable rate Iowa Higher Education Loan Authority Revenue Bonds, Series 2002 from variable to fixed rate. Under the agreement, the College pays interest at a 3.045% fixed rate and receives interest at 67% of USD-LIBOR-BBA. The agreement terminates on June 15, 2009.

During fiscal year 2008, the College entered into a forward interest rate exchange agreement with an effective date of June 15, 2009. The interest rate exchange agreement has the effect of converting \$15,000,000 of the the variable rate Iowa Higher Education Loan Authority Revenue Bonds, Series 2002 from variable to fixed rate to begin when the first swap expires. Under the agreement, the College pays interest at a 3.624% fixed rate and receives interest at 67% of USD-LIBOR-BBA. The agreement terminates on September 1, 2027.

During fiscal year 2005, the College entered into an interest rate exchange agreement with an effective date of December 15, 2004. The interest rate exchange agreement has the effect of converting \$3,600,000 of the variable rate Private College Facilities Revenue Bonds from variable to fixed rate. Under the agreement, the College pays interest at a 4.09% fixed rate and receives interest at 67.044% of the sum of USD-LIBOR-BBA plus 1.45%. The agreement terminates on December 31, 2014.

During fiscal year 2009, the College entered into an interest rate exchange agreement with an effective date of December 12, 2008. The interest rate exchange agreement has the effect of converting \$11,000,000 of the variable rate Iowa Higher Education Loan Authority Revenue Bonds, Series 2008 from variable to fixed rate. Under the agreement, the College pays interest at a 2.71% fixed rate and receives interest at the SIFMA Municipal Swap Index. The agreement terminates on December 3, 2018.

At May 31, 2009 and 2008, the College has recorded an interest rate swap liability of \$1,381,429 and \$560,775, respectively in the statements of financial position. The College recorded a loss of \$820,654 and \$755,567 relating to the swap agreements for the years ended May 31, 2009 and 2008, respectively. In fiscal year 2009, the College paid \$438,300 more than it received in interest under the swap agreements. In fiscal year 2008, the College paid \$13,500 more than it received in interest under the swap agreements. The difference between interest received and interest paid under the swap agreements is included with interest expense.

Total interest expense amounted to \$874,609 and \$878,834 for the years ended May 31, 2009 and 2008, respectively. Interest totaling \$134,282 was capitalized for the year ended May 31, 2009. No interest was capitalized for the year ended May 31, 2008.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

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

Total scheduled maturities of notes, loans and bonds payable for each of the five years subsequent to May 31, 2009 are: 2010 – \$1,436,000; 2011 – \$1,468,000; 2012 – \$1,591,000; 2013 – \$1,483,000 and 2014 – \$1,518,000.

NOTE 13 – ENDOWMENT

Effective June 1, 2008, the College adopted the provisions of 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 all Endowment Funds*. The FSP provides 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). A key component of the FSP is a requirement to classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure. Another key component of the FSP is a requirement for expanded disclosures about all endowment funds. The State of Iowa adopted a version of UPMIFA effective July 1, 2008. As a result of adopting the FSP, the College reclassified approximately \$29,800,000 out of unrestricted net assets and into temporarily restricted net assets.

The College's endowment consists of approximately 690 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 College's governing board has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) enacted in the State of Iowa as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the College classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified 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, 2009 and 2008

NOTE 13 – ENDOWMENT (cont.)

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>

Endowment net asset composition by type of fund consists of the following as of May 31, 2008:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 29,795,393	\$ 993,469	\$ 69,521,732	\$ 100,310,594
Donor-restricted funds held in trust	-	-	1,510,876	1,510,876
Board-designated endowment funds	18,106,935	-	-	18,106,935
Contributions receivable	-	-	884,000	884,000
	<u>\$ 47,902,328</u>	<u>\$ 993,469</u>	<u>\$ 71,916,608</u>	<u>\$ 120,812,405</u>

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

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	385,520	1,527,562	359,360	2,272,442
Net depreciation – realized and unrealized	(5,386,986)	(16,641,231)	(4,507,646)	(26,535,863)
Net depreciation – realized and unrealized funds held in trust	-	-	(374,452)	(374,452)
Total investment return	(5,001,466)	(15,113,669)	4,522,738)	(24,637,873)
Contributions	-	-	2,847,582	2,847,582
Change in contributions receivable	-	-	577,000	577,000
Appropriation of endowment assets for expenditure	(670,892)	(3,513,211)	(879,267)	(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

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 13 - ENDOWMENT (cont.)

Changes in endowment net assets for the year ended May 31, 2008 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2007	\$ 48,562,992	\$ -	\$ 67,131,196	\$ 115,694,188
Investment return:				
Investment income, net of investment fees of \$92,000	2,749,820	-	539,058	3,288,878
Net appreciation (depreciation) – realized and unrealized	(1,265,219)	-	175,329	(1,089,890)
Net depreciation – realized and unrealized funds held in trust	-	-	(76,678)	(76,678)
Total investment return	1,484,601	-	637,709	2,122,310
Contributions		993,469	5,286,905	6,280,374
Change in contributions receivable	-	-	(301,000)	(301,000)
Appropriation of endowment assets for expenditure	(3,924,435)	-	(838,202)	(4,762,637)
Other changes:				
Transfers to board designated endowment funds	1,779,170	-	-	1,779,170
Endowment net assets, May 31, 2008	\$ 47,902,328	\$ 993,469	\$ 71,916,608	\$ 120,812,405

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 \$2,973,449 and \$37,723 as of May 31, 2009 and 2008, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly 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% annually. Actual returns in any year may vary from this amount.

LUTHER COLLEGE

NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

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, 2009 and 2008.

During the years ended May 31, 2009 and 2008, the College received gift income relating to deferred gift agreements of approximately \$154,000 and \$343,000, respectively. Total assets held by the College under deferred gift agreements approximated \$14,985,000 and \$18,735,000 at May 31, 2009 and 2008, respectively.

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NOTES TO FINANCIAL STATEMENTS May 31, 2009 and 2008

NOTE 15 – EMPLOYEE BENEFIT PLANS

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.

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 \$2,578,000 and \$2,472,000 for the years ended May 31, 2009 and 2008, respectively.

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. During fiscal year 2008, the College changed plan providers at a significant cost savings to the College. The resulting gain was reported in the Other Sources revenue line on the Statements of Activities. The following table sets forth the plan's status with amounts reported in the College's financial statements at May 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Accumulated postretirement benefit obligation	\$ 2,303,000	\$ 2,462,000
Fair value of plan assets	<u> -</u>	<u> -</u>
Underfunded status	<u>\$ 2,303,000</u>	<u>\$ 2,462,000</u>
Accrued benefit cost recognized	<u>\$ 2,303,000</u>	<u>\$ 2,462,000</u>
Net postretirement benefit cost (gain)	<u>\$ (159,000)</u>	<u>\$ (2,684,000)</u>

Annual premium payments were approximately \$104,800 and \$110,300 for the years ended May 31, 2009 and 2008, respectively. Benefits expected to be paid for each of the five years subsequent to May 31, 2009 are estimated to range between \$133,000 and \$171,000 each year.

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. A 9.5% pre-65 and 5% post-65 rate of increase in per capita costs of covered health care benefits was assumed for the year ended May 31, 2009, with the pre-65 rate gradually decreasing to an ultimate rate of 5.0% by the year 2018. A discount rate of 6.75% and 6.5% was used to determine the accumulated postretirement benefit obligation as of May 31, 2009 and 2008, respectively. 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 this estimate could occur in the near term and that actual results could differ from this estimate and could have a material impact on the financial statements.

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 6.75% and 6.5% for May 31, 2009 and 2008, respectively. The plan is unfunded. Total accrued liability for this benefit is \$333,510 and \$412,860 for May 31, 2009 and 2008, respectively.

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NOTES TO FINANCIAL STATEMENTS

May 31, 2009 and 2008.

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. 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, 2009 and 2008, the College received total contributions from board members and officers of \$1,360,000 and \$1,517,000, 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.