

Consolidated Financial Statements and Report of Independent Certified Public
Accountants

Southwestern University

June 30, 2016 and 2015

Southwestern University

FINANCIAL STATEMENTS

Year ended June 30, 2016 and 2015

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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Report on the financial statements

We have audited the accompanying consolidated financial statements of Southwestern University and Southwestern Foundation (collectively, the "University"), which comprise the consolidated statements of financial position as of June 30, 2016 and 2015, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated 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 from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southwestern University and Southwestern Foundation as of June 30, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Houston, Texas
October 18, 2016

Southwestern University

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30,

	<u>2016</u>	<u>2015</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 40,103,208	\$ 34,260,848
Receivables:		
Student accounts receivable, net	114,361	128,712
Unconditional promises receivable, net, current portion	1,859,657	1,508,428
Investment income	189,856	178,317
Other	531,988	569,595
Prepays and other current assets	<u>1,003,831</u>	<u>881,583</u>
Total current assets	43,802,901	37,527,483
Unconditional promises receivable, net, long-term portion	1,258,965	1,512,071
Investments	226,726,519	243,293,564
Beneficial interests in funds held by others	4,459,324	4,766,353
Investment in plant, net	101,826,817	100,660,952
Student loans receivable, net	4,636,938	4,738,988
Other assets	<u>26,575</u>	<u>29,233</u>
Total	<u>\$382,738,039</u>	<u>\$392,528,644</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable, accrued and other liabilities	\$ 4,744,201	\$ 6,343,105
Notes payable, current portion	601,769	170,000
Capital lease payable, current portion	128,356	141,506
Accrued post-retirement benefits, current portion	615,425	521,248
Student deposits and advance payments	2,179,651	1,625,713
Deferred compensation, current portion	<u>-</u>	<u>583,292</u>
Total current liabilities	8,269,402	9,384,864
Notes payable, long-term portion	12,815,914	13,571,637
Capital lease payable, long-term portion	62,495	190,852
Accrued post-retirement benefits, long-term portion	7,746,312	7,596,498
Refundable advances	3,348,317	3,317,292
Deferred compensation and other long-term liabilities	<u>497,457</u>	<u>214,746</u>
Total liabilities	<u>32,739,897</u>	<u>34,275,889</u>
Net assets		
Unrestricted	125,553,042	118,275,525
Temporarily restricted	137,196,499	153,432,847
Permanently restricted	<u>87,248,601</u>	<u>86,544,383</u>
Total net assets	<u>349,998,142</u>	<u>358,252,755</u>
Total	<u>\$382,738,039</u>	<u>\$392,528,644</u>

The accompanying notes are an integral part of these consolidated financial statements.

Southwestern University

CONSOLIDATED STATEMENT OF ACTIVITIES

For the year ended June 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating Revenues:				
Tuition and fees	\$ 55,583,517	\$ -	\$ -	\$ 55,583,517
Less: Scholarships and grants	<u>30,388,806</u>	<u>-</u>	<u>-</u>	<u>30,388,806</u>
Net tuition and fees	25,194,711	-	-	25,194,711
Private gifts and grants	2,511,643	2,344,249	-	4,855,892
Government grants	250,691	332,808	-	583,499
Endowment income used for operations	1,707,436	13,251,600	-	14,959,036
Investment income from non-endowment	531,080	8,004	-	539,084
Distributions from funds held in trust by others used for operations (FHITBO)	-	177,523	-	177,523
Other income	1,226,039	10,964	-	1,237,003
Auxiliary enterprises	10,829,437	-	-	10,829,437
Net assets released from restrictions	<u>15,025,073</u>	<u>(15,025,073)</u>	<u>-</u>	<u>-</u>
Total operating revenues	57,276,110	1,100,075	-	58,376,185
Operating Expenses:				
Instructional services	22,012,384	-	-	22,012,384
Student services	9,980,529	-	-	9,980,529
Auxiliary services	7,757,856	-	-	7,757,856
Institutional support	<u>8,100,483</u>	<u>-</u>	<u>-</u>	<u>8,100,483</u>
Total operating expenses	<u>47,851,252</u>	<u>-</u>	<u>-</u>	<u>47,851,252</u>
Change in net assets from operating activities	9,424,858	1,100,075	-	10,524,933
Non-Operating Activities:				
Gifts for endowment & plant improvements	-	1,589,189	1,018,438	2,607,627
Net loss in excess of defined spending limit	(1,989,799)	(14,980,206)	(6,149)	(16,976,154)
Loss on disposal of fixed assets	(74,973)	-	-	(74,973)
Change in value of split-interest agreements	-	(21,257)	(308,071)	(329,328)
Post-retirement related changes other than net periodic pension costs	(4,057,604)	-	-	(4,057,604)
Net assets released from restrictions for plant improvements	3,924,149	(3,924,149)	-	-
Other	<u>50,886</u>	<u>-</u>	<u>-</u>	<u>50,886</u>
Total non-operating activities	<u>(2,147,341)</u>	<u>(17,336,423)</u>	<u>704,218</u>	<u>(18,779,546)</u>
Change in net assets	7,277,517	(16,236,348)	704,218	(8,254,613)
Net assets - Beginning of year	<u>118,275,525</u>	<u>153,432,847</u>	<u>86,544,383</u>	<u>358,252,755</u>
Net assets - End of year	<u>\$125,553,042</u>	<u>\$137,196,499</u>	<u>\$87,248,601</u>	<u>\$349,998,142</u>

The accompanying notes are an integral part of these consolidated financial statements.

Southwestern University

CONSOLIDATED STATEMENT OF ACTIVITIES

For the year ended June 30, 2015

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating Revenues:				
Tuition and fees	\$ 53,825,511	\$ -	\$ -	\$ 53,825,511
Less: Scholarships and grants	<u>29,419,805</u>	<u>-</u>	<u>-</u>	<u>29,419,805</u>
Net tuition and fees	24,405,706	-	-	24,405,706
Private gifts and grants	2,816,403	475,588	-	3,291,991
Government grants	221,584	309,249	-	530,833
Endowment income used for operations	1,658,568	13,045,190	-	14,703,758
Investment income from non-endowment	972,467	14,964	-	987,431
Distributions from funds held in trust by others used for operations (FHITBO)	-	158,195	-	158,195
Other income	1,645,168	4,979	-	1,650,147
Auxiliary enterprises	11,303,257	-	-	11,303,257
Net assets released from restrictions	<u>15,639,505</u>	<u>(15,639,505)</u>	<u>-</u>	<u>-</u>
Total operating revenues	58,662,658	(1,631,340)		57,031,318
Operating Expenses:				
Instructional services	23,705,391	-	-	23,705,391
Student services	9,584,074	-	-	9,584,074
Auxiliary services	7,606,143	-	-	7,606,143
Institutional support	<u>9,273,879</u>	<u>-</u>	<u>-</u>	<u>9,273,879</u>
Total operating expenses	<u>50,169,487</u>	<u>-</u>	<u>-</u>	<u>50,169,487</u>
Change in net assets from operating activities	8,493,171	(1,631,340)	-	6,861,831
Non-Operating Activities:				
Gifts for endowment & plant improvements	-	998,818	6,195,490	7,194,308
Net loss in excess of defined spending limit	(1,884,758)	(14,185,607)	(2,537)	(16,072,902)
Loss on disposal of fixed assets	(26,333)	-	-	(26,333)
Change in value of split-interest agreements	-	199,479	(103,166)	96,313
Post-retirement related changes other than net periodic pension costs	(1,730,308)	-	-	(1,730,308)
Net assets released from restrictions for plant improvements	9,227,292	(9,227,292)	-	-
Other non-operating transfers	<u>-</u>	<u>(133,228)</u>	<u>133,228</u>	<u>-</u>
Total non-operating activities	<u>5,585,893</u>	<u>(22,347,830)</u>	<u>6,223,015</u>	<u>(10,538,922)</u>
Change in net assets	14,079,064	(23,979,170)	6,223,015	(3,677,091)
Net assets - Beginning of year	<u>104,196,461</u>	<u>177,412,017</u>	<u>80,321,368</u>	<u>361,929,846</u>
Net assets - End of year	<u>\$118,275,525</u>	<u>\$153,432,847</u>	<u>\$86,544,383</u>	<u>\$358,252,755</u>

The accompanying notes are an integral part of these consolidated financial statements.

Southwestern University

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended June 30,

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Change in net assets	\$ (8,254,613)	\$ (3,677,091)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation	3,090,087	3,044,191
Amortization of premiums and issuance costs on bonds	-	-
Loss on disposal of assets	84,169	26,333
Termination of FHTBO	-	133,228
Net unrealized and realized (gain) loss on investments	4,841,721	4,108,082
Change in value of split-interest agreements	307,029	(21,629)
Gifts and grants restricted for endowment	(1,106,853)	(6,298,765)
(Increase) decrease in operating assets:		
Student accounts and loans receivable	116,401	269,867
Unconditional promises receivable	(98,123)	3,147,378
Investment income receivable	(11,539)	(21,274)
Other receivables	37,607	132,832
Prepays and other assets	(119,590)	251,196
Increase (decrease) in operating liabilities:		
Accounts payable, accrued and other liabilities	(1,633,964)	250,713
Accrued post-retirement benefits	243,991	(1,786,657)
Student deposits and advance payments	553,938	(92,127)
Refundable advances	31,025	37,932
Deferred compensation and other long-term liabilities	<u>(300,581)</u>	<u>97,754</u>
Net cash (used in) operating activities	(2,219,295)	(398,037)
Cash flows from investing activities:		
Purchases of investments	(84,907,414)	(83,623,469)
Sales of investments	96,632,738	92,836,260
Purchases of fixed assets	<u>(4,305,061)</u>	<u>(7,922,600)</u>
Net cash provided by investing activities	7,420,263	1,290,191
Cash flows from financing activities:		
Payment on notes payable	(323,954)	(323,363)
Proceeds from notes payable	-	-
Payments on capital leases	(141,507)	(82,427)
Gifts and grants restricted for endowment	<u>1,106,853</u>	<u>6,298,765</u>
Net cash provided by financing activities	<u>641,392</u>	<u>5,892,975</u>
Net increase in cash and cash equivalents	5,842,360	6,785,129
Cash and cash equivalents - Beginning of year	<u>34,260,848</u>	<u>27,475,719</u>
Cash and cash equivalents - End of year	<u>\$ 40,103,208</u>	<u>\$ 34,260,848</u>
Supplemental cash flow information:		
Interest paid	\$ 326,922	\$ 327,597
Noncash information:		
Fixed assets acquired under capital lease	-	\$ 250,091
Additions to fixed assets in accounts payable	\$ 35,060	\$ 711,797

The accompanying notes are an integral part of these consolidated financial statements.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016 and 2015

NOTE 1 - NATURE OF OPERATIONS

Southwestern University (the "University"), located in Georgetown, Texas, is the oldest chartered institution of higher learning in the state. It traces its roots to the 1840 founding of Rutgersville College in the Republic of Texas near La Grange. A nationally recognized, independent, undergraduate liberal arts college affiliated with the United Methodist Church, the University has an enrollment of 1,463 students and a current student-to-faculty ratio of 11.7:1. Students choose from 37 major programs in the University's two academic areas, The Brown College of Arts and Sciences and the Sarofim School of Fine Arts.

The revenues generated by the University consist primarily of tuition and fees paid by students. Many students rely on funds received from federal financial aid programs under Title IV of the Federal Higher Education Act of 1965 (HEA), as amended, to pay for a substantial portion of their tuition. As an educational institution, the University is subject to licensure from various accrediting and state authorities and other regulatory requirements of the United States Department of Education (USDE).

Southwestern Foundation (the "Foundation"), a Texas non-profit corporation, was founded in 1993. The Foundation is organized and operated to maintain real or personal property and to use and apply the income therefrom and the principal thereof exclusively for charitable, scientific, literary and educational purposes. The Foundation is administered solely for the benefit and support of Southwestern University. For reporting purposes, the Foundation is consolidated in Southwestern University's consolidated financial statements. Inter-entity transactions have been eliminated in the consolidated financial statements. Hereinafter the "University" will refer to the consolidated entity including both Southwestern University and Southwestern Foundation.

Tax-Exempt Status - The University claims exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The University files unrelated business income tax and other information returns as required by government authorities. The University has concluded that it does not have any unrecognized tax benefits resulting from current or prior period tax positions. Accordingly, no additional disclosures have been made on the consolidated financial statements regarding uncertain tax provisions.

Student Financial Assistance Programs - The University participates in various student financial aid programs. These programs are subject to periodic review by the USDE pursuant to the HEA, as amended. In order to continue to participate in Title IV Programs, the University must comply with the standards set forth in the HEA and the regulations promulgated thereunder (the "Regulations"). Among other things, these Regulations require the University to exercise due diligence in approving and disbursing funds and servicing loans, and to exercise financial responsibility related to maintaining certain financial ratios and requirements, all of which have been met at June 30, 2016 and 2015.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation - The consolidated financial statements of the University have been prepared on the accrual basis of accounting.

The three net asset categories as reflected in the accompanying consolidated financial statements are as follows:

Unrestricted - Unrestricted net assets are assets that are free of donor-imposed restrictions, including all revenues, expenses, gains, and losses that are not changes in permanently or temporarily restricted net assets. Since this category includes realized and unrealized gains on endowment and other long-term investments, the University's policy is to reinvest a portion of such earnings for future growth.

Temporarily Restricted - Temporarily restricted net assets are assets for which use by the University is limited by donor-imposed stipulations that either expire by passage of time or that can be fulfilled or removed by actions of the University pursuant to those stipulations. Such uses for temporarily restricted net assets as of June 30, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Scholarships	\$ 29,868,915	\$ 33,390,346
Professorships and faculty development	33,704,274	36,769,346
Plant	4,464,962	6,921,444
Academic support	6,846,229	6,726,536
Annuities & living trusts	102,498	127,313
Other	7,207,997	7,853,768
Restricted for use in future periods	<u>55,001,624</u>	<u>61,644,094</u>
Total	<u>\$137,196,499</u>	<u>\$153,432,847</u>

Permanently Restricted - Permanently restricted net assets are assets for which use by the University is limited by donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the University.

The corpus of permanently restricted net assets is required to be invested in perpetuity, with the income from such net assets as of June 30, 2016 and 2015, being expendable to support the following:

	<u>2016</u>	<u>2015</u>
Unrestricted	\$28,374,397	\$28,367,128
Scholarships	30,710,802	30,007,061
Professorships and faculty development	9,873,263	9,831,511
Plant	1,516,546	1,513,545
Academic support	10,818,243	10,505,079
Annuities & living trusts	4,607,570	4,972,279
Other	<u>1,347,780</u>	<u>1,347,780</u>
Total	<u>\$87,248,601</u>	<u>\$86,544,383</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Cash and Cash Equivalents - The University considers all highly liquid assets with a maturity of three months or less when purchased as cash and cash equivalents. Cash and cash equivalents held in transition for investment are included in investments. The University places its cash and cash equivalents with high quality financial institutions, which at times may exceed federally insured limits. The University has not experienced any losses on such accounts.

Loans Receivable - The Federal Perkins Loan Program consists primarily of funds advanced to students by the U.S. government. Under the terms of the program, these loans are subject to forgiveness or assignment back to the federal government under certain circumstances. The amount to be forgiven or assigned is based on the occurrence of certain future events that cannot be anticipated.

Investments - Investments with readily determinable fair values are stated at fair value. Fair value is 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. Investments in securities traded on a national securities exchange are valued at the last reported sales price on the last business day of the fiscal year. Investments in government obligations are valued at the bid price or the average of the bid and asked price on the last business day of the year from published sources where available and, if not available, from other sources considered reliable. Purchases and sales of securities are recorded as of the trade date. Realized gains and losses on sales of securities are determined on the basis of average cost. Interest income is recognized on the accrual basis. Dividend income is recognized on the ex-dividend date. Investments in real estate and other investments are reported at either cost or the fair value at the date the gift was received.

Investments held in privately managed institutional funds are valued at redemption values that represent the net asset values of units held at year-end in accordance with ASU 2010-12, *Investments in Certain Entities that Calculate Net Asset Value Per Share (or Its Equivalent)*, as discussed in Note 6.

Alternative investments consist of the University's investments in hedge funds, private equity, venture capital, real estate, and other alternative investments that are not publicly traded. Participation in these funds is achieved via ownership of shares in limited partnerships and limited liability companies. Some of these alternative investments may entail liquidity risks to the extent that they are difficult to sell or cannot be converted readily to cash at favorable prices. The University's alternative investments are not traded in an active market; however, the net asset value (NAV) of the shares is reported by the fund manager on a monthly or quarterly basis.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Contributions - All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. The University reclassifies to unrestricted net assets contributions recognized as temporarily restricted due to donor-imposed restrictions upon fulfilling the donor's restrictions. However, if a restriction is fulfilled in the same time period in which the contribution is received, the University reports the support as unrestricted. Unconditional promises receivable are recorded at the present value of their estimated future cash flows, net of allowances. An allowance for uncollectible promises receivable is determined by a specific review based upon management's judgment, including such factors as prior collection history and currently available information relating to the donor's intent and ability to satisfy the pledge. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are expected to be received. Amortization of the discounts is included in contribution revenue. Conditional promises to give are not included as support until the likelihood of not fulfilling the condition is remote.

Bequests in Probate and Conditional Promises Receivable - The University considers unconditional bequests, as declared valid by probate court, to be unconditional promises receivable. Unconditional bequests that are not in probate are considered to be intentions to give and are not recognized in the consolidated financial statements.

Investment in Plant - Additions are generally recorded at cost at the date of acquisition or at fair value at the date of donation. Normal replacements of movable plant assets are charged to expense as maintenance. The University's asset capitalization threshold is \$2,500 for individual asset acquisitions.

Depreciation of physical plant and equipment was \$3,090,087 and \$3,044,191 for 2016 and 2015, respectively. Depreciation is computed using the straight-line method for all depreciable assets over their estimated useful lives as follows:

Computers and software	5 years
Automobiles	5 years
Furniture and equipment	7 years
Grounds improvements	15 years
Library books	25 years
Buildings	70 years

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Depreciation for new physical plant building renovations and construction is computed using the straight-line method for all depreciable assets over the following useful lives:

Building Shell	70 years
Elevator System	20 years
Fire Protection System	20 years
Fixed Equipment Assets	20 years
Plumbing System	20 years
Electrical and Lighting System	20 years
Floor Coverings	15-30 years
HVAC	15 years
Interior Finish	15 years
Miscellaneous	15 years
Roof Covering	10-30 years

Split-Interest Agreements - The University is the income or remainder beneficiary for various perpetual and charitable remainder trusts held by third-party trustees where the trustee has no discretion regarding the beneficiaries' participation in the trust. The University's beneficial interest in these agreements and related contribution revenue is recognized at the fair value at the date of donation. Changes from year to year in the fair value of the University's beneficial interest are reported as a change in value of split-interest agreements in the appropriate net asset class according to the trust restrictions.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Scholarships and Grants - The consolidated statements of activities present financial assistance provided to students in the form of institutional scholarships and grants as a reduction to tuition and fees revenues. Scholarships and grants include programs supported by donor-restricted endowments, donor-restricted gifts and grants and programs supported by general operations of the University. The following table presents the amount of scholarships and grants revenue reduction, and the related percentage of tuition and fee revenues supported by donor-restricted and general operation support scholarships and grants revenue reductions:

	2016		2015	
	<u>Amount</u>	<u>Discount Rate to Tuition</u>	<u>Amount</u>	<u>Discount Rate to Tuition</u>
Scholarships and grants supported by endowments and gifts	\$ 3,652,214	6.6%	\$ 3,513,684	6.5%
Scholarships and grants supported by general operations	<u>26,736,592</u>	48.1%	<u>25,906,121</u>	<u>48.1%</u>
Total scholarships and grants	<u>\$30,388,806</u>	54.7%	<u>\$29,419,805</u>	<u>54.6%</u>

Allocation of Certain Expenses - The consolidated statements of activities present expenses by functional classification. The University's primary program services are instruction and student services. Expenses reported as institutional support and auxiliary services are incurred in support of these primary program services. As of June 30, 2016, the University changed the allocation method used for its uncapitalized plant expenses reported on the statement of activities. Uncapitalized plant expenses are allocated to the specific operating expense lines that the expenses relate to and the remaining plant expense that are general in nature are allocated as follows. Depreciation, interest expense, the cost of operation and maintenance of plant facilities, and general plant expenses are allocated to functional categories based on building square footage dedicated to that specific function.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America (US GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes. Actual results could differ from those estimates.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 3 - STUDENT ACCOUNTS AND LOANS RECEIVABLE

Student Accounts

Student accounts receivable are reported net of allowances for doubtful accounts of \$579,136 and \$508,002 for the years ended June 30, 2016 and 2015, respectively. Allowance for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence collectability of the balance outstanding. For student accounts the allowance percentage is 100% for accounts over 181 days past due but still undergoing collection procedures. For institutional loans, the allowance percentage ranges from 25% for accounts past due 31 days to 100% for accounts past due over five years. Balances are written off only when they are deemed permanently uncollectible. Amounts due under the Perkins loan program are guaranteed by the government and, therefore, no reserves are placed on any past due balances under the program.

Loans Receivable

The University makes uncollateralized loans to students based on financial need. Student loans are funded through Federal government loan programs or institutional resources. At June 30, 2016 and 2015, student loans represent 1.21% and 1.21% of total assets, respectively.

At June 30, student loans consisted of the following:

	<u>2016</u>	<u>2015</u>
Federal government programs	\$3,407,536	\$3,553,482
Institutional programs	<u>1,886,203</u>	<u>1,690,709</u>
	<u>5,293,739</u>	<u>5,244,191</u>
Less allowance for doubtful accounts:		
Beginning of year	(505,203)	(390,586)
Increases	<u>(151,598)</u>	<u>(114,617)</u>
End of year	<u>(656,801)</u>	<u>(505,203)</u>
Student loans receivable, net	<u>\$4,636,938</u>	<u>\$4,738,988</u>

The University participates in the Perkins federal revolving loan program. The availability of funds for loans under the program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the Federal government and net accumulations in the revolving loan fund were \$3,340,185 and \$3,310,340 at June 30, 2016 and 2015, respectively, and are ultimately refundable to the government and are classified as refundable advances in the consolidated statements of financial position. Outstanding loans cancelled under the program result in a reduction of the funds available for loan and a decrease in the liability to the government.

At June 30, 2016 and 2015, the following amounts were past due under the student loan programs:

<u>June 30,</u>	<u>Currently due</u>	<u>31-90 days past due</u>	<u>90+ days past due</u>	<u>Total due</u>
2016	1,788,131	338,716	1,797,057	3,923,904
2015	1,854,533	380,605	1,523,637	3,758,775

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 4 - UNCONDITIONAL PROMISES RECEIVABLE

Unconditional promises receivable at June 30, 2016 and 2015, consist of the following:

	<u>2016</u>	<u>2015</u>
Restricted for scholarships	\$ 205,133	\$ 242,984
Restricted for plant	6,831,124	6,013,957
Restricted for other uses	878,527	1,491,044
Restricted for use in future periods	<u>210,258</u>	<u>278,399</u>
	8,125,042	8,026,384
 Present Value Discount	 (6,420)	 (5,885)
Allowance for uncollectable promises receivable	<u>(5,000,000)</u>	<u>(5,000,000)</u>
 Unconditional promises receivable, net	 <u>\$ 3,118,622</u>	 <u>\$ 3,020,499</u>

As of June 30, 2016 and 2015, the expected gross amounts to be received from unconditional promises receivable are as follows:

	<u>2016</u>	<u>2015</u>
Less than one year	\$6,859,657*	\$1,508,428
One to five years	1,265,385	6,517,956
More than five years	<u>-</u>	<u>-</u>
 Total unconditional promises receivable	 <u>\$8,125,042</u>	 <u>\$8,026,384</u>

* The amount of the allowance for uncollectable promises receivable is related to a gift that is due to be collected in fiscal year 2016-17; thus, the amount reported for less than one year is unusually high without considering the off-setting allowance of \$5,000,000 when analyzing the unconditional promises due to be received in less than one year.

The University uses discount rates commensurate with the risks involved to discount anticipated cash flows for unconditional promises receivable. The rates used to discount the anticipated cash flows ranged from 0.3% to 0.8% for 2016 and 0.3% to 5.2% for 2015.

At June 30, 2016, the University held a conditional promise receivable of \$3,512,000 which is not recognized in the consolidated financial statements because, in the judgment of management, the likelihood of meeting the condition is remote. The conditional promise receivable is scheduled to be received in annual installments through fiscal 2019, but is terminated upon the death of the promisor.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 5 - INVESTMENTS

Investments consist of long-term assets controlled by the University. Investment securities are exposed to various risks such as interest rate, liquidity, market, currency and credit. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the consolidated statements of financial position.

A summary of investments at June 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
At fair value:		
Cash equivalents	\$ 4,442,343	\$ 5,571,026
Equities, equity mutual funds and co-mingled equity funds	103,987,288	121,150,567
Fixed income and co-mingled fixed income funds	23,155,008	26,038,601
Alternative investments	<u>86,620,737</u>	<u>82,012,227</u>
Total at fair value	218,205,376	234,772,421
At cost or market at date of acquisition:		
Real estate	8,356,045	8,356,044
Other	<u>165,098</u>	<u>165,099</u>
Total at cost or market at date of acquisition	<u>8,521,143</u>	<u>8,521,143</u>
Total investments	<u>\$226,726,519</u>	<u>\$243,293,564</u>

Investment income earned by the University is as follows:

	<u>2016</u>	<u>2015</u>
Investment income	\$ 6,855,076	\$ 6,524,421
Net (losses) on investments reported at fair value	(4,840,316)	(4,107,031)
Other income	617,946	1,088,838
Investment fees and expenses	<u>(3,933,217)</u>	<u>(3,729,746)</u>
Total investment (expense), net	<u>\$(1,300,511)</u>	<u>\$ (223,518)</u>

Investment fees and expenses netted against investment income are comprised of the following components:

	<u>2016</u>	<u>2015</u>
Management, direct fund and custodial fees	\$1,342,369	\$1,681,298
Commingled fund and partnership expenses	1,358,253	1,047,575
Incentive fees*	<u>1,252,595</u>	<u>1,000,873</u>
Total investment fees and expenses	<u>\$3,933,217</u>	<u>\$3,729,746</u>

*Incentive fees depicted above are only fees charged as of the report date. Management is aware future amounts could differ based on unknown fee amounts for funds in which the University was invested.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT

The University measures the fair value of investments using a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1 - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the University has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

Level 2 - Valuations based on quoted prices in markets that are not active and for which all significant inputs are observable, either directly or indirectly. The University holds Level 2 inputs investments, which included certain co-mingled equity funds, co-mingled debt funds and most government agency securities, investment-grade corporate bonds, certain mortgage products, less-liquid equities, and state and municipal obligations.

Level 3 - Valuations based on inputs that are unobservable. The University holds Level 3 inputs investments, which included certain hedge funds, private equity, venture capital, real estate investments, less liquid corporate debt securities (including distressed debt instruments), collateralized debt obligations, and less liquid mortgage securities (backed by either commercial or residential real estate), and some privately held currently non-marketable common stock. When observable prices are not available for these securities, the University uses one or more valuation techniques for which sufficient and reliable data is available. The degree of judgment exercised in determining fair value is greatest for securities categorized in Level 3, due to the inherent uncertainty of these valuations. Level 3 estimated values may differ significantly from the values that would have been used had a ready market for the investment existed, and the differences could be material.

The inputs used by the University in estimating the value of Level 3 investments include the original transaction price, recent transactions in the same or similar instruments, completed or pending third-party transactions in the investment or comparable issuers, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows. Level 3 investments may also be adjusted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the University in the absence of market information. The fair value measurement of Level 3 investments does not include transaction costs that may have been capitalized as part of the security's cost basis.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table presents the financial instruments carried on the consolidated statements of financial position by caption and by level within the valuation hierarchy as of June 30, 2016.

The natural resource public fund and the relative value and event-driven co-mingled fund were reclassified from level 3 to level 2 for June 30, 2016. These funds were classified as level 3 in the prior year. As more information was available in 2016, management determined that a Level 2 classification was more appropriate.

	Assets at Fair Value as of June 30, 2016			
	Level 1	Level 2	Level 3	Total
Investments carried at fair value:				
Equities:				
Large cap equity, mutual funds and co-mingled funds	\$30,576,747	\$ 121,440	\$ -	\$ 30,698,187
International co-mingled funds	-	73,289,101	-	73,289,101
Total equities	30,576,747	73,410,541	-	103,987,288
Fixed income:				
Mutual funds	-	434,680	-	434,680
Core bonds co-mingled funds	-	20,495,884	-	20,495,884
U.S. Treasury and agency co-mingled funds	-	2,224,444	-	2,224,444
Total fixed income	-	23,155,008	-	23,155,008
Alternative investments:				
Natural resources stock index co-mingled funds and limited partnerships	-	13,879,872	5,945,980	19,825,852
Commodities co-mingled funds	-	3,655,148	-	3,655,148
Distressed debt limited partnerships	-	-	2,322,570	2,322,570
Directional strategies co-mingled funds	-	11,733,284	-	11,733,284
Inflation-protected U.S. Treasury co-mingled funds	-	4,106,488	-	4,106,488
Relative value and event-driven co-mingled funds	-	10,230,038	-	10,230,038
Private capital, limited partnerships	-	-	33,376,383	33,376,383
Private equity	-	-	1,370,974	1,370,974
Total alternative investments	-	43,604,830	43,015,907	86,620,737
Total investments valued at fair value	30,576,747	140,170,379	43,015,907	213,763,033
Beneficial interest in funds held by others	-	-	4,459,324	4,459,324
Total	\$30,576,747	\$140,170,379	\$47,475,231	\$218,222,357

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table includes additional disclosures required by Accounting Standards Codification (ASC) 820 for the fair value measurements of investments valued at net asset value at June 30, 2016.

<u>Category</u>	<u>Level 2 Fair Value</u>	<u>Level 3 Fair Value</u>	<u>Unfunded Commitment</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Equity mutual funds	\$ 121,440	\$ -	\$ -	Daily	N/A
International equity co-mingled funds	73,289,101	-	-	Monthly	5 days
Fixed income mutual funds	434,680	-	-	Daily	N/A
Core bonds co-mingled funds	20,495,884	-	-	Weekly	5 days
U.S. Treasury and agency co-mingled funds	2,224,444	-	-	Daily	N/A
Natural resources stock index co-mingled funds	5,879,273	-	-	Daily	2 days
Natural resources public co-mingled funds	8,000,599	-	-	Daily	Same day
Natural resources limited partnership	-	5,945,980	12,517,500	No redemption capability until partnership liquidation in August 2023, December 2026 & December 2029	-
Commodities co-mingled funds	3,655,148	-	-	Monthly	5 days
Distressed debt limited partnerships	-	2,322,570	803,200	No redemption capability until partnership liquidation in Dec 2017	-
Directional strategies co-mingled funds	11,733,284	-	-	Quarterly	95 days
Inflation-protected U.S. Treasury co-mingled funds	4,106,488	-	-	Daily	5 days
Relative value and event-driven co-mingled funds	10,230,038	-	-	Quarterly	95 day
Private capital LP's - Strategic Core Real Estate Fund	-	3,238,891	-	Quarterly	120
Private capital LP's - Realty Opportunity Funds 2011 & 2014	-	5,427,943	3,048,767	No redemption except as approved by GP	
Private equity - Loan Fund	-	9,689,165	-	Redemption relates to Note Payable	
Private capital LP's partnerships	-	15,020,384	13,076,500	No redemption capability until partnership liquidation in December 2023, January 2024, January 2026, February 2027, May 2029 & September 2029	
Private equity - Non Marketable	-	1,370,974	-	No redemption	
Total	<u>\$140,170,379</u>	<u>\$43,015,907</u>	<u>\$29,445,967</u>		

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT - Continued

Certain investments valued at net asset value were classified as Level 2 because substantially all of the holdings of each fund are in securities traded in an active market; however, the University's ownership in the co-mingled fund itself is valued at the net asset value of the fund as of June 30. The University believes these investments can be readily liquidated at values approximating fair value as of the balance sheet date.

Certain investments valued at net asset value were classified as Level 3 in the preceding table, including multi-manager funds using long-short and directional equity, distressed debt and private equity strategies.

The following provides additional disclosures required by ASC 820 for alternative investment strategies included in Level 3 and valued at net asset value:

Natural resources limited partnership. These limited partnerships invest primarily in limited partnerships, which in turn make oil, gas and other natural resources-related investments with the objective of obtaining long-term growth of capital. Commitments made by the University include \$5 million in 2008, \$5 million in 2012, and \$10 million in 2015. Remaining commitments at June 30, 2016 are \$12,517,500. Of this total, \$1,800,000 is expected to be funded by the University during fiscal year 2017. The partnership agreements are expected to terminate August 2023, December 2026 and December 2029, respectively unless they are terminated earlier by the general partner in accordance with the provisions of the partnership agreements.

Distressed debt. This fund invests in restructured debt, stressed debt, distressed debt, "special situation" debt and mezzanine debt instruments and seeks to provide a net internal rate of return in the mid-teens. During fiscal year 2015, fund managers disclosed they would not call 9.5% of the capital committed to the fund. This percentage is based on the current assessment of the remaining amount of capital managers can call along with an estimate of fund level fees and expenses compared to the amount of undrawn capital in the series. This announcement reduces the University's remaining commitment to \$803,200, of which \$224,000 is estimated to be funded by the University during fiscal year 2017.

Core real estate fund. This limited liability company invests in a diversified portfolio of open-end funds that focus on core real estate investing. A \$2 million commitment was made by the University to this fund in 2012, with funding completed during fiscal 2013.

Realty opportunity fund. This limited partnership invests in value-add, distressed and opportunistic private real estate funds. The University made a \$3,000,000 commitment to this fund in fiscal year 2012 and an additional commitment of \$5,000,000 in fiscal year 2015. The total remaining commitment is \$3,048,767 as of June 30, 2016. The University expects to fund \$860,000 of this amount during fiscal year 2017.

Private equity loan. This private foundation invests in a Methodist loan portfolio, which provides loans to members of the constituent community for building programs and other capital investments. This fixed rate investment started in fiscal year 2014 and there are no future commitments. Its redemption relates to a note payable with the private foundation.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT - Continued

Private equity. Shares of common stock in a bank holding company were donated to the University during fiscal year 2013. At that time, a third party report of per share valuation was reviewed along with public financial reports for the bank. The University has discounted this value until the shares become marketable. The University compared equity per share of the bank holding company at December 31, 2015 to the same ratio for December 31, 2012. No change was made to the shares market value at June 30, 2016 since the difference was immaterial. The University also holds an investment at a private foundation, which is reported at fair market value.

Private capital LP's partnerships. These limited partnerships invest in a diversified portfolio of international private capital funds with the objective of generating higher returns than those generally available on the foreign listed securities exchanges over a long-term horizon. The partnerships are scheduled to terminate in December 2023, January 2024, January 2026, February 2027, May 2029, and September 2029. The University has remaining commitments to these funds totaling \$13,076,500 as of June 30, 2016. The University expects to fund \$2,750,000 of this amount during fiscal 2017. The fair value of these investments is determined using net asset values.

The following table includes a roll forward for the year ended June 30, 2016 of amounts for all financial instruments classified within Level 3. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement. The unobservable inputs and valuation techniques are not disclosed due to all information being provided by third parties.

	Level 3 <u>Investments</u>
Balance - June 30, 2015	\$ 60,742,349
Change in classification to Level 2	(18,663,090)
Purchases	5,393,648
Sales	(1,956,068)
Withdrawals	(233,191)
Net investment income	79,123
Net realized and unrealized gains	2,419,490
Change in value of split-interest agreements	<u>(307,030)</u>
Balance - June 30, 2016	<u>\$ 47,475,231</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table presents the financial instruments carried on the consolidated statements of financial position by caption and by level within the valuation hierarchy as of June 30, 2015.

	Assets at Fair Value as of June 30, 2015			
	Level 1	Level 2	Level 3	Total
Investments carried at fair value:				
Equities:				
Large cap equity, mutual funds and co-mingled funds	\$36,878,594	\$ 133,514	\$ -	\$ 37,012,108
All cap co-mingled funds	-	19,225,227	-	19,225,227
International co-mingled funds	-	57,439,342	-	57,439,342
Emerging markets co-mingled funds	-	7,473,890	-	7,473,890
Total equities	36,878,594	84,271,973	-	121,150,567
Fixed income:				
Mutual funds	-	408,495	-	408,495
Core bonds co-mingled funds	-	21,308,743	-	21,308,743
Global bonds co-mingled funds	-	4,154,068	-	4,154,068
U.S. Treasury and agency co-mingled funds	-	167,295	-	167,295
Total fixed income	-	26,038,601	-	26,038,601
Alternative investments:				
Natural resources stock index co-mingled funds and limited partnerships	-	7,192,840	8,371,253	15,564,093
Commodities co-mingled funds	-	4,161,738	-	4,161,738
Distressed debt limited partnerships	-	-	3,148,929	3,148,929
Directional strategies co-mingled funds	-	10,745,456	-	10,745,456
Inflation-protected U.S. Treasury co-mingled funds	-	3,936,197	-	3,936,197
Relative value and event-driven co-mingled funds	-	-	15,261,569	15,261,569
Private capital, limited partnerships	-	-	27,823,271	27,823,271
Private equity	-	-	1,370,974	1,370,974
Total alternative investments	-	26,036,231	55,975,996	82,012,227
Total investments valued at fair value	36,878,594	136,346,805	55,975,996	229,201,395
Beneficial interest in funds held by others	-	-	4,766,353	4,766,353
Total	<u>\$36,878,594</u>	<u>\$136,346,805</u>	<u>\$60,742,349</u>	<u>\$233,967,748</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table includes additional disclosures required by Accounting Standards Codification (ASC) 820 for the fair value measurements of investments valued at net asset value at June 30, 2015.

<u>Category</u>	<u>Level 2 Fair Value</u>	<u>Level 3 Fair Value</u>	<u>Unfunded Commitment</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Equity mutual funds	\$ 133,514	\$ -	\$ -	Daily	N/A
All cap equity co-mingled funds	19,225,227	-	-	Monthly	5 days
International equity co-mingled funds	14,826,917	-	-	Weekly	5 days
International equity co-mingled funds	42,612,425	-	-	Monthly	5 days
Emerging markets equity co-mingled funds	7,473,890	-	-	Weekly	5 days
Fixed income mutual funds	408,495	-	-	Daily	N/A
Core bonds co-mingled funds	21,308,743	-	-	Weekly	5 days
Global bonds co-mingled funds	4,154,068	-	-	Monthly	5 days
U.S. Treasury and agency co-mingled funds	167,295	-	-	Daily	N/A
Natural resources stock index co-mingled funds	7,192,840	-	-	Daily	2 days
Natural resources public co-mingled funds	-	3,401,521	-	Daily	Same day
Natural resources limited partnership	-	4,969,732	14,012,500	No redemption capability until partnership liquidation in August 2023, December 2026 & December 2029	-
Commodities co-mingled funds	4,161,738	-	-	Monthly	5 days
Distressed debt limited partnerships	-	3,148,929	803,200	Annually	95 days
Directional strategies co-mingled funds	10,745,456	-	-	Quarterly	95 days
Inflation-protected U.S. Treasury co-mingled funds	3,936,197	-	-	Monthly	5 days
Relative value and event-driven co-mingled funds	-	15,261,569	-	Annually	95 days
Private capital LP's - Strategic Core Real Estate Fund	-	2,868,498	-	Quarterly	120
Private capital LP's - Realty Opportunity Funds 2011 & 2014	-	4,019,230	4,382,415	No redemption except as approved by GP	
Private equity - Loan Fund	-	9,843,233	-	Redemption relates to Note Payable	
Private capital LP's partnerships	-	11,092,310	15,641,500	No redemption capability until partnership liquidation in December 2023, January 2024, January 2026, February 2027, May 2029 & September 2029	
Private equity - Non Marketable	-	<u>1,370,974</u>	-	No redemption	
Total	<u>\$136,346,805</u>	<u>\$55,975,996</u>	<u>\$34,839,615</u>		

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 6 - FAIR VALUE MEASUREMENT - Continued

The following table includes a roll forward for the year ended June 30, 2015 of amounts for financial instruments classified within Level 3. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement. The unobservable inputs and valuation techniques are not disclosed due to all information being provided by third parties.

	<u>Level 3 Investments</u>
Balance - June 30, 2014	\$55,651,329
Purchases	10,179,000
Sales	(7,452,473)
Withdrawals	(411,573)
Net investment income	153,639
Net realized gains	2,600,798
Change in value of split-interest agreements	<u>21,629</u>
Balance - June 30, 2015	<u>\$60,742,349</u>

NOTE 7 - ENDOWMENTS

The University's endowment consists of approximately 450 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Adoption and Interpretation of Relevant Law - The University interprets the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) enacted in the State of Texas as allowing the University, absent explicit donor stipulations to the contrary as stated in the gift instrument, to appropriate as much of a donor-restricted endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment is established. However, during the years ended June 30, 2016 and 2015, the University continued to preserve the fair value of the original gift as of the gift date of the donor-restricted endowment funds. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 7 - ENDOWMENTS - Continued

In accordance with UPMIFA, the University considers the following seven factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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

Endowment Net Asset Composition

By Type of Fund

As of June 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (253,439)	\$127,713,578	\$86,895,700	\$214,355,839
Board-designated endowment funds	<u>25,587,051</u>	<u>-</u>	<u>-</u>	<u>25,587,051</u>
Total endowment net assets	<u>\$25,333,612</u>	<u>\$127,713,578</u>	<u>\$86,895,700</u>	<u>\$239,942,890</u>

Endowment Net Asset Composition

By Type of Fund

As of June 30, 2015

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (83,175)	\$142,445,652	\$86,095,877	\$228,458,354
Board-designated endowment funds	<u>27,497,052</u>	<u>-</u>	<u>-</u>	<u>27,497,052</u>
Total endowment net assets	<u>\$27,413,877</u>	<u>\$142,445,652</u>	<u>\$86,095,877</u>	<u>\$255,955,406</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 7 - ENDOWMENTS - Continued

The University endowment net assets and changes in endowment nets assets for the years ended June 30, 2016 and 2015 are reported in the following table. The University's beneficial interest in funds held in trust by others of \$4,459,324, \$4,766,353, and \$4,877,952, for June 30, 2016, 2015, and 2014, respectively, is included in endowment net asset balances within the table. Changes in the fair value of the University's beneficial interest in funds held in trust by others is reported as change in value of split-interest agreements within the table.

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets at June 30, 2014	\$ 29,223,067	\$156,576,698	\$79,790,801	\$265,590,566
Investment return:				
Investment income	(143,390)	(1,136,101)	-	(1,279,491)
Change in value of split-interest agreements	<u>-</u>	<u>101,241</u>	<u>(79,612)</u>	<u>21,629</u>
Total net investment return	(143,390)	(1,034,860)	(79,612)	(1,257,862)
Contributions	-	-	6,251,460	6,251,460
Appropriated for expenditure	(14,703,758)	-	-	(14,703,758)
Net assets released from restrictions	13,045,190	(13,045,190)	-	-
Funds with deficiencies reclassification	(7,232)	7,232	-	-
Transfers to/from other funds	<u>-</u>	<u>(58,228)</u>	<u>133,228</u>	<u>75,000</u>
Endowment net assets at June 30, 2015	27,413,877	142,445,652	86,095,877	255,955,406
Investment return:				
Investment loss	(203,255)	(1,725,048)	-	(1,928,303)
Change in value of split-interest agreements	<u>-</u>	<u>-</u>	<u>(307,030)</u>	<u>(307,030)</u>
Total net investment return	(203,255)	(1,725,048)	(307,030)	(2,235,333)
Contributions	-	-	1,056,365	1,056,365
Appropriated for expenditure	(14,959,036)	-	-	(14,959,036)
Net assets released from restrictions	13,251,600	(13,251,600)	-	-
Funds with deficiencies reclassification	(169,574)	169,574	-	-
Transfers to/from other funds	<u>-</u>	<u>75,000</u>	<u>50,488</u>	<u>125,488</u>
Endowment net assets at June 30, 2016	<u>\$ 25,333,612</u>	<u>\$127,713,578</u>	<u>\$86,895,700</u>	<u>\$239,942,890</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 7 - ENDOWMENTS - Continued

Endowment Funds With Deficiencies - From time-to-time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level required by the donor-restriction to retain as a fund of perpetual duration. These deficiencies typically result from unfavorable market fluctuations that occur shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. Deficiencies of this nature are reported as a reduction of unrestricted net assets and totaled \$253,439 and \$83,175 as of June 30, 2016 and 2015, respectively.

Return Objectives and Risk Parameters - The University 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 over time. Endowment assets include those assets of donor-restricted funds that the University must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds.

The University seeks an average total annual return that exceeds the spending/payout rate plus inflation, as measured over 5- and 10-year periods in order to preserve, over time, the principal value of the assets as measured in real, inflation-adjusted terms. The endowment is a long-term pool of funds with an indefinite time horizon that runs concurrent with the endurance of the institution, in perpetuity. As such, the endowment assets are invested with a time horizon that extends well beyond a normal market cycle, and can assume an above-average level of risk as measured by the standard deviation of weighted annual returns. The University seeks to minimize portfolio risk through use of professional asset management and sufficient portfolio diversification to smooth volatility and help ensure reasonable consistency of return over time.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the University 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 University targets a diversified asset allocation among both equity and fixed income strategies. As a long-term policy guideline, endowment assets are allocated between equity classes, 70% (with ranges of 60%-80%), and fixed income asset class investments, 30% (with ranges of 20%-40%). The University's policy statement restricts investment in non-traditional (alternative) asset classes to no more than 50% of the portfolio, and restricts the total amount of illiquid investments to 30% or less of the portfolio. An illiquid investment is defined by the policy statement to mean "investments that could not be converted to cash in an orderly market over a period of twelve months or in a shorter period of time by accepting a discount of more than 10%."

Spending Policy - The University has adopted a spending formula for determining that part of the total return on endowment funds which can be expended annually. The spending formula determines spendable endowment return as a percentage of the 20-quarter average endowment market value, excluding investments in real estate, as of June 30 of the preceding fiscal year. The spending rate was 6.75% for fiscal year 2016 and 6.95% for fiscal year 2015. The University plans to adopt a 5.0% spending rate for fiscal year 2017. Spending on endowments with a market value less than \$25,000 is retained in the endowment unless distribution is specifically required by the donor.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 7 - ENDOWMENTS - Continued

The University employs a reduced spending rate for endowments with deficiencies of market value to permanently restricted net asset value as of the date of the spending calculation. For endowments with deficiencies less than 10%, the spending rate is reduced to 4%. For endowments with deficiencies greater than 10% but less than 20%, the spending rate is reduced to 3%. Endowments with deficiencies greater than 20% have no spending appropriation for the year.

In establishing this policy, the University considered the long-term expected return on its endowment. Accordingly, over the long term, the University expects the current spending policy, and planned changes to that policy, to allow its endowment to grow at an average rate that equals or exceeds inflation.

NOTE 8 - INVESTMENT IN PLANT - NET

At June 30, 2016 and 2015, investment in plant - net consists of the following:

	<u>2016</u>	<u>2015</u>
Land	\$ 111,509	\$ 111,509
Buildings	150,244,620	139,108,897
Furniture and equipment and computers and software	20,855,588	20,678,397
Library books	10,615,586	10,689,285
Automobiles	839,405	847,259
Ground improvements	17,311,378	17,311,378
Leased equipment under capital leases	<u>427,083</u>	<u>427,083</u>
Total property	200,405,169	189,173,808
Less accumulated depreciation	<u>(99,581,187)</u>	<u>(96,731,619)</u>
	100,823,982	92,442,189
Construction in progress	<u>1,002,835</u>	<u>8,218,763</u>
Investment in plant - net	<u>\$101,826,817</u>	<u>\$100,660,952</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 9 -NOTES PAYABLE

The University's notes and bonds payable as of June 30, 2016 and 2015, consisted of the following:

	<u>2016</u>	<u>2015</u>
City of Riesel Education Facilities Corporation 2006 Note	\$ 3,735,000	\$ 3,905,000
Texas Methodist Foundation Note	<u>9,682,683</u>	<u>9,836,637</u>
Total	<u>\$13,417,683</u>	<u>\$13,741,637</u>

On August 1, 2006, the University entered into a loan agreement whereby Wachovia Bank, National Association (Bank) loaned \$5,000,000 to the University through the City of Riesel Education Facilities Corporation, a nonprofit education facilities corporation, for the purpose of financing a portion of the construction cost of a new residential apartment complex for students consisting of 32 two-bedroom suites in three residential buildings, as well as an apartment for a residential assistant and related recreational facilities, community facilities, parking and to pay costs of issuance (\$53,150). The loan is secured by the unrestricted net assets of the University. The cost of issuance was capitalized and will be amortized over the life of the loan agreement. Principal repayment is due annually beginning February 15, 2008, payable over a 20 year period based on a 25 year amortization schedule, with a balloon payment of \$1,815,000 due on February 15, 2026. The loan has a fixed rate of 4.76% with interest to be paid in arrears on February 15 and August 15 each year. In fiscal years 2017, 2018, 2019, 2020, 2021 and thereafter principal payments of \$175,000, 185,000, \$195,000, \$200,000, \$210,000, and \$2,770,000, respectively, will become due. Subsequent to issuance of the loan, the University, the Bank and the issuer amended the net assets-to-debt ratio of the debt covenant provisions to conform the calculation and related debt covenant requirement to the net asset classifications of ASC 958-205 Not-For-Profit Entities Presentation of Financial Statements.

On June 17, 2014, the University entered into a loan agreement whereby Texas Methodist Foundation (TMF) loaned \$10,000,000 to the University for the purpose of replenishing the funds provided by the endowment fiscal year 2013 withdrawals from unrestricted funds functioning as endowment for expenses associated with re-initiating the football program and beginning the woman's lacrosse program. The loan is unsecured. Principal repayment is due monthly beginning July 7, 2016, payable over a 20 year period based on a 22 year amortization schedule. Final payment is due on June 7, 2036. The loan has a variable interest rate equal to the rate of interest as stated by TMF as its Methodist Loan Fund rate (MLF rate) plus one-half percent, to be adjusted monthly with the MLF Rate in effect as of the first business day of the calendar month. In fiscal years 2017, 2018, 2019, 2020, 2021, and thereafter, principal payments of \$426,769, \$432,294, \$437,947, \$443,385, \$449,473, and \$7,492,815, respectively, will become due.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 10 - CAPITAL LEASE OBLIGATION

The University leases certain computer equipment and a specialized golf cart under capital leases. The leased equipment is amortized on a straight line basis over 5 years. Total cost of the leased equipment is \$427,083. Total accumulated amortization related to the leased equipment is \$142,695 and \$57,278 at June 30, 2016 and 2015, respectively. The following is a schedule showing the future minimum lease payments under capital leases by years and the present value of the minimum lease payments as of June 30, 2016. The interest rates and maturity dates related to the computer leases are variable and range from 9.05% to 9.19% for March 31, 2017 and May 31, 2018, respectively. The interest rates and maturity dates related to the golf cart lease are 8.46% and March 31, 2018, respectively.

Year ending June 30,

2017	\$140,357
2018	<u>67,778</u>
Total minimum lease payments	208,135
Less: amount representing interest	<u>(17,284)</u>
Present value of minimum lease payments	<u>\$190,851</u>

At June 30, 2016, the present value of minimum lease payments due within one year is \$128,357.

Total rental expense, excluding payments on capital leases, totaled \$9,473 and \$5,470 in fiscal years 2016 and 2015, respectively. As of June 30, 2016, the University has operating lease commitments for future periods as follows:

Year ending June 30,

2017	\$ 9,473
2018	9,473
2019	3,925
2020	<u>2,616</u>
Total	<u>\$25,487</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 11 - BENEFIT PLANS

The University has defined contribution retirement plans for eligible faculty members and non-faculty employees. Contributions equal to various percentages of each eligible participant's regular salary are contributed to the plan and allocated among the plan fiduciary selected list of investment options based on the fund allocation directed by the participant. Teachers Insurance and Annuity Association and/or College Retirement Equities Fund maintains custody of all plan assets. Such contributions totaling \$1,574,675 and \$1,620,650 for fiscal years 2016 and 2015, respectively, were expensed.

The University has a contributory health and welfare plan (the "Health Plan") that became self-funded beginning January 1, 1999. The University and employee contributions are used to provide various medical benefits to eligible active employees and their dependents. The Health Plan has excess loss insurance that, in general, limits the amount of total claims paid by the University during the current plan year to approximately \$4,177,447 and claims paid per employee by the University during a plan year to \$150,000. The University recognized expenses related to the Health Plan of \$3,698,471 and \$4,561,172 in fiscal years 2016 and 2015, respectively.

The University also provides post-retirement health care benefits for eligible retirees and their spouses. The plan is structured as a defined contribution plan. Eligible retirees (age 65 and over) have access to Medicare supplemental plans and receive a subsidy from the University which may be used to pay for supplemental health insurance premiums or eligible medical expenses. The University will subsidize 100% of the cost of the "benchmark" plan premiums through 2018. Beginning on January 1, 2019, the subsidy is capped at the 2018 rate. The "benchmark" plan is defined as Medicare Supplemental (Medigap) Plan L and the average premiums of the Medicare Part D prescription drug programs available in Travis and Williamson counties.

The University will make contributions annually to the retirees' health reimbursement arrangement account.

All active employees who were hired on or before July 1, 1996, who meet the eligibility criteria to officially retire from the University will be eligible for the above schedule of benefits at the time of their retirement. An employee who retires before age 65 and is an Early Retiree or a Faculty Phased Retiree continues coverage (and their spouse, if applicable) under the University's group medical plan or equivalent coverage and the University will subsidize 100% of the premium cost for the retiree and spouse (if age 65). If the spouse is not yet age 65, the retiree continues to pay premiums for the spouse until the spouse attains age 65. If a retiree is not an Early Retiree or a Faculty Phased Retiree, then the retiree pays 100% of the premiums for the University's group medical plan (and their spouse's premium, if applicable). All employees hired after July 1, 1996, are not eligible for retiree medical benefits.

Upon attaining age 65, all eligible retirees are required to enroll into the Extend Health program and discontinue participation in the University's group medical plan. If the retiree's spouse is not yet age 65, then the retiree pays 100% of the spouse's premium for the University's group medical plan. When the spouse attains age 65, the spouse enrolls in Extend Health program as the retiree's spouse and discontinues participation in the University's group medical plan.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 11 - BENEFIT PLANS - CONTINUED

Pursuant to the provisions of ASC 715-60 *Defined Benefits Plans - Other Post-Retirement*, and 715-20 *Defined Benefit Plans - General*, unamortized costs are reflected in the consolidated statements of activities as a net change in unrestricted net assets apart from operating expenses. The University amortizes a portion of these costs each year and reclassifies these amounts into net periodic benefit costs. Amounts amortized and the changes in balances of unamortized costs are as follows:

	<u>Beginning balance of unamortized amounts</u>	<u>Amount amortized into net periodic benefit costs</u>	<u>Current year gains/losses</u>	<u>Ending balance of unamortized amounts</u>
Net gains/losses	\$ 18,135,867	\$(2,118,430)	\$326,283	\$ 16,343,720
Prior service costs	(27,872,436)	5,849,751	-	(22,022,685)

In fiscal year 2016, the University expects to recognize as net periodic benefit approximately \$2,118,000 and \$5,850,000 of previously unamortized net gain and net prior service cost, respectively.

The status of the University's accrued post-retirement benefit cost at June 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Reconciliation of benefit obligation:		
Obligation at beginning of year	\$ 8,117,746	\$ 9,904,403
Service cost including expenses	16,094	43,410
Interest cost	305,057	290,310
Actuarial (gain)/loss	326,284	(1,746,123)
Benefit payments and expected expenses	<u>(403,444)</u>	<u>(374,254)</u>
Obligation at end of year	8,361,737	8,117,746
Reconciliation of fair value of plan assets:		
Employer contributions	403,444	374,254
Benefit payments and actual expenses	<u>(403,444)</u>	<u>(374,254)</u>
Fair value of plan assets at end of year	<u>-</u>	<u>-</u>
Funded status at end of year	<u>\$(8,361,737)</u>	<u>\$(8,117,746)</u>

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 11 - BENEFIT PLANS - Continued

Amounts recognized in the consolidated statements of financial position are as follows:

	<u>2016</u>	<u>2015</u>
Current liabilities	\$ (615,425)	\$ (521,248)
Noncurrent liabilities	<u>(7,746,312)</u>	<u>(7,596,498)</u>
Total	<u>\$ (8,361,737)</u>	<u>\$ (8,117,746)</u>

Net periodic post-retirement benefit cost recognized during fiscal year 2016 and 2015, is as follows:

	<u>2016</u>	<u>2015</u>
Service cost	\$ 16,095	\$ 43,410
Interest cost	305,057	290,310
Amortization of prior actuarial loss	2,118,430	2,373,320
Amortization of prior service gain from plan amendment	<u>(5,849,751)</u>	<u>(5,849,751)</u>
Total	<u>\$ (3,410,169)</u>	<u>\$ (3,142,711)</u>

The University used a weighted average discount rate of 3.10% and 3.88% to determine the post-retirement benefit obligation at June 30, 2016 and 2015, respectively. An average discount rate of 3.88% and 3.80% was used to determine the net periodic benefit cost for fiscal years 2016 and 2015, respectively. The decrease in the discount rate from 3.88% to 3.10% increased the accrued post-retirement liability by approximately \$244,000.

In determining the net periodic benefit cost the assumed pre-Medicare health care cost trend rate was 7.5% for fiscal year 2016, declining gradually to 4.5%. In determining the post-retirement benefit obligation at June 30, 2016, the assumed health care cost trend rate was 3.0% for 2016 declining gradually to 0.0% by 2019 since university contributions are capped in that year. These health care cost trend rate assumptions have a significant effect on the amount of the obligation and periodic cost reported. For example, an increase in the assumed health care cost trend rate by one percentage point in each year would increase the amount of the obligation at June 30, 2016, by \$231,000 and the aggregate of service cost and interest cost components of net periodic post-retirement benefit cost for the year then ended by \$8,000. Alternatively, a decrease in the assumed health care cost trend rate by one percentage point in each year would decrease the obligation at June 30, 2016, by \$226,000 and the aggregate of service cost and interest cost components of net periodic post-retirement benefit cost for the year then ended by \$8,000.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 11 - BENEFIT PLANS - Continued

Other changes in plan assets and benefit obligations recognized in unrestricted net assets:

	<u>2016</u>	<u>2015</u>
Net (gain) loss	\$ 326,284	\$(1,746,123)
Amortization of net gain	(2,118,430)	(2,373,320)
Amortization of prior service cost	<u>5,849,751</u>	<u>5,849,751</u>
Total recognized in unrestricted net assets	<u>4,057,605</u>	<u>1,730,308</u>
Total recognized in net periodic benefit cost and unrestricted net assets	<u>\$ 647,436</u>	<u>\$(1,412,403)</u>

The following post-retirement benefit payments, which reflect expected future service, as appropriate, are expected to be paid, net of the estimated Medicare prescription drug subsidies expected to be received:

Years ending <u>June 30,</u>	
2017	\$ 606,000
2018	626,000
2019	625,000
2020	569,000
2021	552,000
2022-2026	2,388,000

NOTE 12 - LINE OF CREDIT

The University had an unsecured line of credit on June 30, 2016 and 2015 for \$1,500,000 with First Texas Bank, Georgetown, at the bank's prime rate. The line of credit expires annually on June 30th. The University has obtained approval to renew this line of credit through June 30, 2017. The University did not draw on this line of credit in either fiscal year 2016 or 2015.

Southwestern University

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE 13 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the University using available market information and appropriate valuation methodologies. Considerable judgment is required in developing these estimates, however, and accordingly, no assurance can be given that the estimated values presented herein are indicative of the amounts that would be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a material effect on the estimated fair value amounts.

As of June 30, 2016 and 2015, the carrying amounts of the University's assets and liabilities which are considered to be financial instruments approximate their fair value except for student loans receivable (Note 3) and the 2006 notes payable (Note 9). Based on the nature of the federal loan program and the privately contributed loan funds representing student loans receivable, such financial instruments may not be sold. Accordingly, determining fair value is not practical. The University's 2006 note payable totaled \$3,735,000 and \$3,905,000 and have an estimated fair value of \$4,284,062 and \$4,145,463 at June 30, 2016 and 2015, respectively. The 2006 note amount is valued using current market yields.

NOTE 14 - COMMITMENTS

The University has contracts for the construction of infrastructure projects and for other building and classroom improvements. At June 30, 2016, the remaining commitments under these contracts approximated \$599,523.

NOTE 15 - TRANSACTIONS WITH RELATED PARTIES

One member of the Board of Trustees of the University also serves as director of a financial institution where the University has a significant banking relationship. Eleven members of the Board of Trustees and one University senior management member also served as directors of a private foundation during the fiscal year where the University has an outstanding investment and loan. One member of the Board of Trustees also served as an officer of this same private foundation during part of this fiscal year. The University has a conflict of interest policy that is regularly updated by all members of the Board of Trustees. The relationship with the financial institution and the private foundation has been consistently reported as a conflict of interest. In all matters related to business decisions at the meetings of the Board of Trustees, the parties refrain from participating in any votes on these matters. The abstention is reflected in the official minutes of the meetings.

NOTE 16 - SUBSEQUENT EVENTS

The University has evaluated subsequent events through October 18, 2016, the date when consolidated financial statements were available to be issued, and has determined there are no material subsequent events or transactions that would require additional disclosure in the University's consolidated financial statements.