



SOUTHWESTERN UNIVERSITY

CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2018 and 2017

And Report of Independent Auditor

SOUTHWESTERN UNIVERSITY

TABLE OF CONTENTS

REPORT OF INDEPENDENT AUDITOR 1-2

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statements of Financial Position3
Consolidated Statements of Activities..... 4-5
Consolidated Statements of Cash Flows6
Notes to Consolidated Financial Statements..... 7-30

Report of Independent Auditor

Board of Trustees
Southwestern University
Georgetown, Texas

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 statement of financial position as of June 30, 2018, and the related consolidated statements of activities and cash flows for the year 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 entity'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 entity'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, 2018, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the University as of and for the year ended June 30, 2017, were audited by other auditors whose report dated November 1, 2017 expressed an unmodified opinion on those statements.

Cherry Bekaert LLP

Charlotte, North Carolina
October 10, 2018

SOUTHWESTERN UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2018 AND 2017

	2018	2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 63,354,777	\$ 41,515,778
Receivables:		
Student accounts receivable, net	50,812	55,900
Unconditional promises receivable, net	2,473,060	1,450,441
Investment income	57,480	58,548
Other receivables	485,753	452,937
Prepays and other current assets	1,541,194	1,415,255
Total Current Assets	67,963,076	44,948,859
Unconditional promises receivable, net	6,242,954	474,779
Investments	267,607,020	242,349,354
Funds held in trusts by others (FHITBO)	4,861,197	4,739,199
Investment in plant, net	107,313,439	103,717,936
Student loans receivable, net	4,255,317	4,497,006
Other assets	21,260	23,917
Total Assets	\$ 458,264,263	\$ 400,751,050
LIABILITIES AND NET ASSETS		
Current Liabilities:		
Accounts payable, accrued and other liabilities	\$ 7,677,257	\$ 5,012,153
Bonds and notes payable	995,260	603,722
Capital lease payable	673,841	714,458
Accrued post-retirement benefits	680,265	657,054
Student deposits and advance payments	2,748,022	2,786,137
Total Current Liabilities	12,774,645	9,773,524
Bonds and notes payable, long-term portion	36,497,657	11,904,445
Capital lease payable, long-term portion	1,537,472	2,211,313
Accrued post-retirement benefits, long-term portion	6,776,482	7,513,658
Refundable advances	2,952,769	3,113,503
Deferred compensation and other long-term liabilities	425,293	554,079
Total Liabilities	60,964,318	35,070,522
Net Assets:		
Unrestricted	129,218,200	128,557,430
Temporarily restricted	155,812,425	147,277,422
Permanently restricted	112,269,320	89,845,676
Total Net Assets	397,299,945	365,680,528
Total Liabilities and Net Assets	\$ 458,264,263	\$ 400,751,050

SOUTHWESTERN UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2018 (WITH COMPARABLE TOTALS FOR 2017)

	2018			Total	2017
	Unrestricted	Temporarily Restricted	Permanently Restricted		
Operating Revenues:					
Tuition and fees	\$ 54,571,125	\$ -	\$ -	\$ 54,571,125	\$ 56,470,017
Less scholarships and grants	30,994,470	-	-	30,994,470	31,354,804
Net tuition and fees	23,576,655	-	-	23,576,655	25,115,213
Private gifts and grants	2,796,352	4,962,503	-	7,758,855	3,655,622
Government grants	249,457	463,198	-	712,655	657,944
Endowment income used for operations	1,242,383	10,095,966	-	11,338,349	11,441,631
Investment income from non-endowment	1,113,446	9,275	-	1,122,721	514,591
Distributions from FHITBO	127	151,207	-	151,334	123,108
Other income	1,278,402	11,059	-	1,289,461	1,565,075
Auxiliary enterprises	11,069,230	-	-	11,069,230	11,206,765
Net assets released from restrictions	12,636,684	(12,636,684)	-	-	-
Total Operating Revenues	53,962,736	3,056,524	-	57,019,260	54,279,949
Operating Expenses:					
Instructional services	23,562,470	-	-	23,562,470	23,038,615
Student services	10,826,844	-	-	10,826,844	10,447,539
Auxiliary services	8,331,558	-	-	8,331,558	8,057,051
Institutional support	8,990,582	-	-	8,990,582	8,446,515
Total Operating Expenses	51,711,454	-	-	51,711,454	49,989,720
Change in net assets from operating activities	2,251,282	3,056,524	-	5,307,806	4,290,229
Non-Operating Activities:					
Gifts for endowment & plant improvements	-	254,974	20,796,543	21,051,517	1,483,548
Net gain in excess of defined spending limit	962,814	7,388,342	21,987	8,373,143	13,892,734
Loss on disposal of fixed assets	(186,037)	-	-	(186,037)	(302,208)
Change in value of split-interest agreements	-	(8,739)	105,114	96,375	366,978
Post-retirement related changes other than net periodic pension costs	(3,038,149)	-	-	(3,038,149)	(4,053,133)
Net assets released from restrictions for plant improvements	656,098	(656,098)	-	-	-
Non-operating transfer	-	(1,500,000)	1,500,000	-	-
Other	14,762	-	-	14,762	4,238
Total Non-Operating Activities	(1,590,512)	5,478,479	22,423,644	26,311,611	11,392,157
Change in net assets	660,770	8,535,003	22,423,644	31,619,417	15,682,386
Net assets, beginning of year	128,557,430	147,277,422	89,845,676	365,680,528	349,998,142
Net assets, end of year	\$ 129,218,200	\$ 155,812,425	\$ 112,269,320	\$ 397,299,945	\$ 365,680,528

The accompanying notes to the consolidated financial statements are an integral part of this statement.

SOUTHWESTERN UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating Revenues:				
Tuition and fees	\$ 56,470,017	\$ -	\$ -	\$ 56,470,017
Less scholarships and grants	31,354,804	-	-	31,354,804
Net tuition and fees	25,115,213	-	-	25,115,213
Private gifts and grants	2,772,184	883,438	-	3,655,622
Government grants	225,096	432,848	-	657,944
Endowment income used for operations	1,275,362	10,166,269	-	11,441,631
Investment income from non-endowment	495,173	19,418	-	514,591
Distributions from FHITBO	-	123,108	-	123,108
Other income	1,560,328	4,747	-	1,565,075
Auxiliary enterprises	11,206,765	-	-	11,206,765
Net assets released from restrictions	12,640,402	(12,640,402)	-	-
Total Operating Revenues	55,290,523	(1,010,574)	-	54,279,949
Operating Expenses:				
Instructional services	23,038,615	-	-	23,038,615
Student services	10,447,539	-	-	10,447,539
Auxiliary services	8,057,051	-	-	8,057,051
Institutional support	8,446,515	-	-	8,446,515
Total Operating Expenses	49,989,720	-	-	49,989,720
Change in net assets from operating activities	5,300,803	(1,010,574)	-	4,290,229
Non-Operating Activities:				
Gifts for endowment & plant improvements	-	239,534	1,244,014	1,483,548
Net gain in excess of defined spending limit	1,397,601	12,450,928	44,205	13,892,734
Loss on disposal of fixed assets	(302,208)	-	-	(302,208)
Change in value of split-interest agreements	-	(21,297)	388,275	366,978
Post-retirement related changes other than net periodic pension costs	(4,053,133)	-	-	(4,053,133)
Net assets released from restrictions for plant improvements	657,087	(657,087)	-	-
Non-operating transfer	-	(920,581)	920,581	-
Other	4,238	-	-	4,238
Total Non-Operating Activities	(2,296,415)	11,091,497	2,597,075	11,392,157
Change in net assets	3,004,388	10,080,923	2,597,075	15,682,386
Net assets, beginning of year	125,553,042	137,196,499	87,248,601	349,998,142
Net assets, end of year	<u>\$ 128,557,430</u>	<u>\$ 147,277,422</u>	<u>\$ 89,845,676</u>	<u>\$ 365,680,528</u>

The accompanying notes to the consolidated financial statements are an integral part of this statement.

SOUTHWESTERN UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Change in net assets	\$ 31,619,417	\$ 15,682,386
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation and amortization	4,283,386	4,146,324
Loss on disposal of assets	186,037	302,208
Addition of FHITBO	-	(8,005)
Net unrealized and realized gain on investments	(17,067,847)	(23,218,658)
Change in value of FHITBO	(121,998)	(271,870)
Gifts and grants restricted for endowment and plant improvements	(21,051,517)	(1,483,548)
Changes in operating assets and liabilities:		
Student accounts and loans receivable, net	246,777	198,393
Unconditional promises receivable	(6,790,794)	1,193,402
Investment income receivable	1,068	11,481
Other receivables	(32,816)	79,051
Other assets	(123,282)	(408,766)
Accounts payable, accrued and other liabilities	202,233	88,515
Accrued post-retirement benefits	(713,965)	(191,025)
Student deposits and advance payments	(38,115)	606,486
Refundable advances	(160,734)	(234,814)
Deferred compensation and other long-term liabilities	(128,786)	56,622
Net cash flow from operating activities	<u>(9,690,936)</u>	<u>(3,451,818)</u>
Cash flows from investing activities:		
Purchases of investments	(127,236,746)	(116,312,948)
Sales of investments	119,046,927	123,908,771
Purchases of fixed assets	(5,638,491)	(2,771,576)
Proceeds from sale of fixed assets	11,444	2,400
Net cash flow from investing activities	<u>(13,816,866)</u>	<u>4,826,647</u>
Cash flows from financing activities:		
Payment on notes payable	(999,758)	(656,118)
Bond proceeds	26,009,500	-
Payments on capital leases	(714,458)	(909,516)
Gifts and grants restricted for endowment and plant improvements	21,051,517	1,483,548
Net cash flow from financing activities	<u>45,346,801</u>	<u>(82,086)</u>
Net change in cash and cash equivalents	21,838,999	1,292,743
Cash and cash equivalents, beginning of year	41,515,778	40,223,035
Cash and cash equivalents, end of year	<u>\$ 63,354,777</u>	<u>\$ 41,515,778</u>
Supplemental disclosure of cash payments for:		
Interest paid	<u>\$ 406,684</u>	<u>\$ 404,003</u>
Supplemental disclosure of noncash transactions for:		
Fixed assets acquired under capital lease	<u>\$ -</u>	<u>\$ 3,391,038</u>
Additions to fixed assets in accounts payable	<u>\$ 2,462,871</u>	<u>\$ 179,437</u>

SOUTHWESTERN UNIVERSITY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

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 Rutersville 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 1,330 students and a current student-to-faculty ratio of 11:1. Students choose from 35 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 (the "USDE").

Southwestern Foundation (the "Foundation"), a Texas non-profit corporation, was founded in 1993. The foundation board is composed of members selected and approved by the Board of Trustees. 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, 2018 and 2017.

Note 2—Summary of significant accounting policies

Basis of Financial Statement Presentation - The consolidated financial statements of the University have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"), which require it to report information regarding its financial position and activities according to the following net asset classifications:

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.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 2—Summary of significant accounting policies (continued)

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, 2018 and 2017 are as follows:

	2018	2017
Scholarships	\$ 36,583,539	\$ 33,852,542
Professorships and faculty development	37,888,699	36,131,570
Plant	3,045,414	4,214,303
Academic support	5,791,685	6,200,506
Annuities & living trusts	132,710	117,258
Other	10,359,745	7,162,843
Restricted for use in future periods	62,010,633	59,598,400
Total	<u>\$ 155,812,425</u>	<u>\$ 147,277,422</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, 2018 and 2017, being expendable to support the following:

	2018	2017
Unrestricted	\$ 28,404,166	\$ 28,384,875
Scholarships	35,822,051	31,639,037
Professorships and faculty development	23,702,815	10,106,275
Plant	1,547,045	1,521,545
Academic support	12,138,281	12,009,770
Annuities and living trusts	4,963,496	4,836,394
Other	5,691,466	1,347,780
Total	<u>\$ 112,269,320</u>	<u>\$ 89,845,676</u>

Measure of Operations - The Statement of Activities reports all changes in net assets, including changes in net assets from operating and nonoperating activities. Operating activities consist of those items attributable to the University's ongoing education activities and supporting services. Nonoperating activities are limited to resources that generate return from investment and other activities considered to be of a more unusual or nonrecurring nature.

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.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 2—Summary of significant accounting policies (continued)

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 mineral rights are reported at either cost or the fair value at the date the gift was received.

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.

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.

Debt issuance costs - Debt issuance costs are amortized by the straight-line method over the remaining terms of the related debt and are included in bonds and notes payable on the Statements of Financial Position. The University believes the use of the straight-line method does not differ significantly from the use of the effective interest method.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 2—Summary of significant accounting policies (continued)

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.

Revenue Recognition - The University recognizes revenues from student tuition and fees within the fiscal year in which the academic term is predominantly conducted. Deferred tuition and fees are reported as deferred revenue and are included in student deposits and advance payments on the Statements of Financial Position. Tuition and fees revenue, which is included as student income on the Statements of Activities, is generated from an enrolled student population of approximately 1,330.

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 \$4,258,394 and \$4,146,324 for 2018 and 2017. 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 (Prior to July 2012)	40 years

Starting in July 2012, 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

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 2—Summary of significant accounting policies (continued)

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.

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:

	2018		2017	
	Amount	Discount Rate to Tuition	Amount	Discount Rate to Tuition
Scholarships and grants supported by endowments and gifts	\$ 3,305,639	6.1%	\$ 3,000,742	5.3%
Scholarships and grants supported by general operations	<u>27,688,831</u>	50.7%	<u>28,354,062</u>	50.2%
Total scholarships and grants	<u>\$ 30,994,470</u>	56.8%	<u>\$ 31,354,804</u>	55.5%

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. Uncapitalized plant expenses are allocated to the specific operating expense lines that the expenses relate to. 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 U.S. 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.

Future Accounting Pronouncements – In May 2014, the FASB issued ASU 2014-09. The amendments in this update create Topic 606, *Revenue from Contracts with Customers*, and supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. In addition, the amendments supersede the cost guidance in Subtopic 605-35, *Revenue Recognition – Construction-Type and Production-Type Contracts*, and create new Subtopic 340-40, *Other Assets and Deferred Costs – Contracts with Customers*. The core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of the ASU 2014-09 one year, making it effective for the University's fiscal year 2019 with early adoption permitted in certain circumstances.

SOUTHWESTERN UNIVERSITY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 2—Summary of significant accounting policies (continued)

On August 18, 2016, Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-14, Not-for-Profit Entities (Topic 958) - *Presentation of Financial Statements for Not-for-profit Entities*. This standard changes presentation and disclosure requirements of not-for-profit entities. The primary changes are a decrease in the number of net asset classes from three to two, requiring disclosures of qualitative and quantitative information on how the University manages its liquid available resources and liquidity risks and requiring reporting of expenses by function and nature, as well as enhanced net asset disclosures. This standard is effective for all fiscal years beginning after December 15, 2017.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the statement of financial position for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classifications affecting the pattern of expense recognition in the statement of activities. The new standard is effective for fiscal years beginning after December 15, 2018. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

The FASB has also issued ASU 2018-08, Not-for-Profit Entities (Topic 958) – *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU clarifies and improves the scope and the accounting guidance for contributions received and contributions made. This ASU is effective for annual periods beginning after June 15, 2018.

Management is currently evaluating the impact that these standards will have on University’s financial statements.

Note 3—Student accounts and loans receivable

Student Accounts - Student accounts receivable are reported net of allowances for doubtful accounts of \$571,576 and \$576,570 for the years ended June 30, 2018 and 2017, 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, 2018 and 2017, student loans represent 0.93% and 1.12% of total assets respectively.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 3—Student accounts and loans receivable (continued)

At June 30 student loans consisted of the following:

	<u>2018</u>	<u>2017</u>
Federal government programs	\$ 3,204,505	\$ 3,328,505
Institutional programs	1,906,667	1,885,236
	<u>5,111,172</u>	<u>5,213,741</u>
Less allowance for doubtful accounts:		
Beginning of year	(716,735)	(656,801)
Increases	(139,120)	(59,934)
End of year	<u>(855,855)</u>	<u>(716,735)</u>
Student loans receivable, net	<u>\$ 4,255,317</u>	<u>\$ 4,497,006</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 \$2,946,877 and \$3,107,361 at June 30, 2018 and 2017 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, 2018 and 2017, the following amounts were past due under the student loan programs:

<u>June 30,</u>	<u>Deferrals</u>	<u>Currently due</u>	<u>31-90 days past due</u>	<u>90+ days past due</u>	<u>Total due</u>
2018	\$ 1,626,111	\$ 1,928,524	\$ 193,403	\$ 1,363,134	\$ 5,111,172
2017	1,241,107	1,888,799	318,559	1,765,276	5,213,741

Note 4—Unconditional promises receivable

Unconditional promises receivable at June 30, 2018 and 2017, consist of the following:

	<u>2018</u>	<u>2017</u>
Restricted for scholarships	\$ 497,390	\$ 270,721
Restricted for plant	5,276,235	6,074,517
Restricted for other uses	8,022,009	346,475
Restricted for use in future periods	172,784	240,387
	<u>13,968,418</u>	<u>6,932,100</u>
Present Value Discount	(252,404)	(6,880)
Allowance for uncollectable promises receivable	(5,000,000)	(5,000,000)
Unconditional promises receivable, net	<u>\$ 8,716,014</u>	<u>\$ 1,925,220</u>

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 4—Unconditional promises receivable (continued)

As of June 30, 2018 and 2017, the expected gross amounts to be received from unconditional promises receivable are as follows:

	2018	2017
Less than one year*	\$ 7,473,060	\$ 6,450,441
One to five years	6,494,883	481,659
More than five years	475	-
Total unconditional promises receivable	<u>\$ 13,968,418</u>	<u>\$ 6,932,100</u>

* The amount of the allowance for uncollectable promises receivable is related to a gift that is past due; 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 associated 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 4.9% for 2018 and 0.3% to 0.9% for 2017.

At June 30, 2018, the University held a conditional promise receivable of \$1,132,000 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.

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, 2018 and 2017 is as follows:

	2018	2017
At fair value:		
Cash equivalents	\$ 2,229,160	\$ 1,246,644
Equities, equity mutual funds and co-mingled equity funds	124,708,687	117,537,151
Fixed income and co-mingled fixed income funds	35,175,994	25,066,155
Alternative investments	96,972,036	89,978,261
Total at fair value	259,085,877	233,828,211
At cost or market at date of acquisition:		
Real estate	8,356,045	8,356,045
Mineral interests	165,098	165,098
Total at cost or market at date of acquisition	8,521,143	8,521,143
Total investments	<u>\$ 267,607,020</u>	<u>\$ 242,349,354</u>

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 5—Investments (continued)

Investment income earned by the University is as follows:

	2018	2017
Investment income	\$ 6,719,242	\$ 5,652,850
Net realized and unrealized gain	17,067,847	23,218,658
Other income	993,444	402,054
Investment fees and expenses	<u>(3,946,320)</u>	<u>(3,424,606)</u>
Total investment income, net	20,834,213	25,848,956
Less: Endowment income used for operations	11,338,349	11,441,631
Less: Investment income from non-endowment	<u>1,122,721</u>	<u>514,591</u>
Net gain in excess of defined spending limit	<u>\$ 8,373,143</u>	<u>\$ 13,892,734</u>

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

	2018	2017
Management, direct fund and custodial fees	\$ 1,289,604	\$ 1,145,763
Commingled fund and partnership expenses	1,573,611	1,344,744
Incentive fees*	<u>1,083,105</u>	<u>934,099</u>
Total investment fees, net	<u>\$ 3,946,320</u>	<u>\$ 3,424,606</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.

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.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 6—Fair value measurement (continued)

Level 3 - Valuations based on inputs that are unobservable and supported by little or no market activity. The University holds Level 3 inputs investments, which included collateralized debt obligations 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 and completed or pending third-party transactions in the investment, or comparable issuers. 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.

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, 2018:

	Assets at Fair Value as of June 30, 2018				
	Level 1	Level 2	Level 3	Investments Measured at NAV ¹	Total
Cash and Cash Equivalents:	\$ 2,229,160	\$ -	\$ -	\$ -	\$ 2,229,160
Equities:					
Large cap equity, mutual funds and co-mingled funds	28,986,415	-	-	144,694	29,131,109
International co-mingled funds	-	-	-	95,577,578	95,577,578
Fixed Income:					
Mutual Funds	-	-	-	409,395	409,395
Core bonds co-mingled funds	-	-	-	34,748,126	34,748,126
U.S. Treasury and agency co-mingled funds	-	-	-	18,473	18,473
Alternative Investments:					
Hedge strategies co-mingled funds	-	-	-	27,379,700	27,379,700
Natural resources stock index co-mingled funds and limited partnerships	-	-	-	18,715,795	18,715,795
Distressed debt limited partnerships	-	-	-	1,241,089	1,241,089
Private capital limited partnerships	-	-	-	36,463,665	36,463,665
Private capital loan fund	-	-	8,971,985	-	8,971,985
Private credit	-	-	-	2,828,828	2,828,828
Private equity	-	-	1,370,974	-	1,370,974
Total investments valued at fair value	31,215,575	-	10,342,959	217,527,343	259,085,877
Funds held in trust by others	-	-	4,861,197	-	4,861,197
Total	\$ 31,215,575	\$ -	\$ 15,204,156	\$ 217,527,343	\$ 263,947,074

1 Investments that are measured the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

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, 2017.

	Assets at Fair Value as of June 30, 2017				Total
	Level 1	Level 2	Level 3	Investments Measured at NAV ¹	
Cash and Cash Equivalents:	\$ 1,246,644	\$ -	\$ -	\$ -	\$ 1,246,644
Equities:					
Large cap equity, mutual funds and co-mingled funds	30,258,517	-	-	136,482	30,394,999
International co-mingled funds	-	-	-	87,142,152	87,142,152
Fixed Income:					
Mutual Funds	-	-	-	416,093	416,093
Core bonds co-mingled funds	-	-	-	24,047,649	24,047,649
U.S. Treasury and agency co-mingled funds	-	-	-	602,413	602,413
Alternative Investments:					
Hedge strategies co-mingled funds	-	-	-	25,443,647	25,443,647
Natural resources stock index co-mingled funds and limited partnerships	-	-	-	17,090,812	17,090,812
Distressed debt limited partnerships	-	-	-	1,826,490	1,826,490
Inflation-protected U.S. Treasury co-mingled funds	-	-	-	4,080,686	4,080,686
Private capital limited partnerships	-	-	-	29,487,544	29,487,544
Private capital loan fund	-	-	9,377,387	-	9,377,387
Private credit	-	-	-	1,300,721	1,300,721
Private equity	-	-	1,370,974	-	1,370,974
Total investments valued at fair value	31,505,161	-	10,748,361	191,574,689	233,828,211
Funds held in trust by others	-	-	4,739,199	-	4,739,199
Total	\$ 31,505,161	\$ -	\$ 15,487,560	\$ 191,574,689	\$ 238,567,410

1 Investments that are measured the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy.

The following provides additional disclosures required by ASC 820 for alternative investment strategies included in Level 3:

Private Capital – Loan Fund - The University holds an investment at a private foundation, which is reported at fair market value. 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 began in fiscal year 2014, and there are no future commitments. Its redemption relates to a note payable with the private foundation.

Private Equity - The University received a donation of common stock shares in a bank holding company in 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, 2017 to the same ratio for December 31, 2012. No change was made to the shares market value at June 30, 2018 since the difference was immaterial.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 6—Fair value measurement (continued)

The following provides additional disclosures required by ASC 820 for alternative investments in funds valued based on net asset value as a practical expedient for fair value.

Equities

Large Cap Equity, Mutual Funds and Co-mingled Funds - This category includes domestic mutual funds.

International Co-mingled Funds - This category includes funds with investments in global equity securities.

Fixed Income

Mutual Funds - This category includes mutual funds with fixed income securities.

Core Bonds Co-mingled Funds - This category includes a fund of fixed income securities.

US Treasury and Agency Co-mingled Funds - This category includes a fund that invests primarily in obligations issued or guaranteed as to principal or interest by U.S. government securities.

Alternative Investments

Hedge Strategies Co-Mingled Funds - This category includes third party investment funds invested in four broad investment categories: event-driven, credit, equity market neutral and absolute return multi-strategy. Some or all of the marketable alternative strategies may be deployed across U.S and non-U.S. markets.

Natural Resources Co-Mingled Fund and Limited Partnerships - This category includes a fund and limited partnerships invested primarily in oil, gas and other natural resources-related investments.

Distressed Debt - This category includes a fund invested in performing restructured debt, stressed debt, distressed debt, "special situation" debt and mezzanine debt investments.

Inflation Protected U.S. Treasury Co-mingled Fund - This category includes a fund invested in securities that are indexed to inflation in order to protect investors from the negative effects of inflation.

Private Capital Limited Partnerships - This category includes limited partnerships invested in equity securities, warrants or other options, real estate, and international emerging growth companies.

Private Credit - This category includes a fund that invests on a leveraged basis, in whole or in part, in collateralized and unsecured commercial loans and debt securities of corporations, partnerships, companies or other securities.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 6—Fair value measurement (continued)

The following table includes additional disclosures required by Accounting Standards Codification (“ASC”) 820, *Fair Value Measurements and Disclosures*, for investments measured at fair value and ASU 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)*, which amends the disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, for the fair value measurements of investments valued at net asset value at June 30, 2018.

Category	Level 3 Fair Value	Investments measured as NAV	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Equity mutual funds	\$ -	\$ 144,694	\$ -	Daily	N/A
International equity co-mingled funds	-	95,577,578	-	Daily	N/A
Fixed Income mutual funds	-	409,395	-	Daily	N/A
Core bonds co-mingled funds	-	34,748,126	-	Weekly	5 days
U.S. Treasury and agency co-mingled funds	-	18,473	-	Daily	N/A
Hedge strategies co-mingled funds	-	27,379,700	-	May redeem 25% of their shares on any calendar quarter	65 days
Natural resources stock index co-mingled funds	-	5,902,939	-	Daily	2 days
Natural resources limited partnership	-	12,812,856	10,730,000	No redemption capability until respective partnership liquidation	
Distressed debt limited partnerships	-	1,241,089	803,200	No redemption capability until respective partnership liquidation	
Private capital LP - Harrison Street Core Property Fund	-	6,152,944	-	Quarterly	45 days
Private capital LP's - Realty Opportunity Funds 2011 & 2014	-	5,766,945	2,241,352	No redemption except as approved by GP	
Private capital - Loan Fund	8,971,985	-	-	Redemption relates to Notes Payable	
Private capital limited partnerships	-	24,543,776	17,730,750	No redemption capability until respective partnership liquidation	
Private Credit	-	2,828,828	3,224,187	No redemption capability until fund liquidation	
Private equity - Non-Marketable	1,370,974	-	-	No redemption	
Total	\$ 10,342,959	\$ 217,527,343	\$ 34,729,489		

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 6—Fair value measurement (continued)

The following table includes a roll forward for the year ended June 30, 2018 and 2017 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.

	<u>2018</u>	<u>2017</u>
Beginning Balance	\$ 15,487,560	\$ 18,758,354
Change in classification to NAV	-	(3,238,891)
Purchases	-	8,006
Withdrawals	(519,299)	(396,115)
Net investment income	113,897	84,337
Change in value of split-interest agreements	121,998	271,869
Ending Balance	<u>\$ 15,204,156</u>	<u>\$ 15,487,560</u>

Note 7—Endowments

The University's endowment consists of approximately 480 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, 2018 and 2017, 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 THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

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

The following is the endowment net asset composition by type of fund as of June 30:

As of June 30, 2018	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (80,801)	\$ 146,591,352	\$ 107,333,723	\$ 253,844,274
Board-designated endowment funds	27,631,612	-	-	27,631,612
Total endowment net assets	\$ 27,550,811	\$ 146,591,352	\$ 107,333,723	\$ 281,475,886

As of June 30, 2017	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (87,997)	\$ 139,238,611	\$ 89,479,360	\$ 228,629,974
Board-designated endowment funds	26,915,734	-	-	26,915,734
Total endowment net assets	\$ 26,827,737	\$ 139,238,611	\$ 89,479,360	\$ 255,545,708

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 7—Endowments (continued)

The University endowment net assets and changes in endowment nets assets for the year ended June 30, 2018 and 2017 are reported in the following table. The University's funds held by others in trust of \$4,861,197 and \$4,739,199 for June 30, 2018 and 2017 respectively are included in endowment net asset balances within the table. Changes in the fair value of the University's funds held by others in trust 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, 2016	\$ 25,333,612	\$ 127,713,578	\$ 86,895,700	\$ 239,942,890
Investment return:				
Investment gain	2,601,501	22,581,140	-	25,182,641
Change in value of split-interest agreements	-	-	271,870	271,870
Total net investment return	2,601,501	22,581,140	271,870	25,454,511
Contributions	-	-	1,179,548	1,179,548
Appropriated for expenditure	(11,441,631)	-	-	(11,441,631)
Net assets released from restrictions	10,166,270	(10,166,270)	-	-
Funds with deficiencies reclassification	167,985	(167,985)	-	-
Transfers to/from other funds	-	(721,852)	1,132,242	410,390
Endowment net assets at June 30, 2017	26,827,737	139,238,611	89,479,360	255,545,708
Investment return:				
Investment gain	1,956,597	17,457,567	-	19,414,164
Change in value of split-interest agreements	-	-	121,998	121,998
Total net investment return	1,956,597	17,457,567	121,998	19,536,162
Contributions	-	-	17,732,365	17,732,365
Appropriated for expenditure	(11,338,349)	-	-	(11,338,349)
Net assets released from restrictions	10,095,965	(10,095,965)	-	-
Funds with deficiencies reclassification	8,861	(8,861)	-	-
Transfers to/from other funds	-	-	-	-
Endowment net assets at June 30, 2018	<u>\$ 27,550,811</u>	<u>\$ 146,591,352</u>	<u>\$ 107,333,723</u>	<u>\$ 281,475,886</u>

SOUTHWESTERN UNIVERSITY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

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. The University also has an endowment fund consisting of real estate related to a private foundation. Expenses incurred on behalf of this fund are paid by the University. The accumulation of these expenses are considered to be deficiencies and included in the following amount. Deficiencies of this nature are reported as a reduction of unrestricted net assets and totaled \$80,801 and \$87,997 as of June 30, 2018 and 2017, 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 second preceding fiscal year. The spending rate was 5% for fiscal years 2018 and 2017. The University plans to adopt a 5% spending rate for fiscal year 2019. 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 THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

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, 2018 and 2017, investment in plant - net consists of the following:

	2018	2017
Land	\$ 111,509	\$ 111,509
Buildings	151,938,461	151,251,616
Furniture and equipment and computers and software	20,612,103	20,642,286
Library books	10,547,214	10,654,940
Automobiles	954,542	837,405
Ground improvements	17,929,575	17,612,383
Leased equipment under capital leases	3,391,037	3,818,121
Total property	205,484,441	204,928,260
Less accumulated depreciation	(106,281,554)	(102,859,486)
	99,202,887	102,068,774
Construction in progress	8,110,552	1,649,162
Investment in plant - net	<u>\$ 107,313,439</u>	<u>\$ 103,717,936</u>

Note 9—Bonds and notes payable

The University's notes and bonds payable as of June 30, 2018 and 2017, consisted of the following:

	2018	2017
City of Riesel Education Facilities Corporation 2006 Note	\$ 3,375,000	\$ 3,560,000
Texas Methodist Foundation Note	8,133,409	8,948,167
Clifton Higher Education Finance Corporation 2017 Revenue Bonds	24,510,000	-
	36,018,409	12,508,167
Plus: Bond premium	1,807,160	-
Less: Net debt issuance costs	(332,652)	-
Total	<u>\$ 37,492,917</u>	<u>\$ 12,508,167</u>

SOUTHWESTERN UNIVERSITY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 9—Bonds and notes payable (continued)

On August 1, 2006, the University entered into a bond agreement whereby Wachovia Bank, National Association (the “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 had a fixed rate of 4.76% until January 1, 2018, when the fixed rate increased to 5.79% as a result of the Tax Cuts and Jobs Act passed in December 2017. Interest is paid in arrears on February 15 and August 15 each year. In fiscal years 2019, 2020, 2021, 2022, 2023 and thereafter, principal payments of \$195,000, \$200,000, \$210,000, 220,000 \$235,000 and \$2,315,000, 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 2019, 2020, 2021, 2022, 2023 and thereafter, principal payments of \$405,260, \$414,004, \$421,887, \$429,544, \$437,340, and \$6,025,375, respectively, will become due.

On December 1, 2017, the University issued bonds whereby U.S. Bank National Association (the “Bank”) loaned \$24,510,000 to the University through the Clifton Higher Education Finance Corporation, a public nonprofit education facilities corporation, for the purpose of financing Phase II construction of the Fondren-Jones Science Hall, the related conversion of the existing Soule Drive into a pedestrian promenade to achieve better integration into the existing main Academic Mall. The bonds are unsecured. The cost of issuance of \$338,290 was capitalized and will be amortized over the life of the loan agreement. The bond was issued at a premium of \$1,837,790 which will also be amortized over the life of the bonds. Principal repayment is due annually beginning August 15, 2018, payable over a 30 year period based on a 30 year amortization schedule. Final payment is due August 15, 2047. The loan has a variable rate of interest, ranging from 3.00% to 5.00%. In fiscal years 2019, 2020, 2021, 2022, 2023 and thereafter, principal payments of \$395,000, \$410,000, \$430,000, \$450,000, \$475,000, and \$22,350,000, respectively, will become due.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 10—Capital lease obligation

The University leases certain wireless internet and residential video equipment under capital leases. The leased equipment is amortized on a straight line basis over 5 years. Total cost of the leased equipment is \$3,391,037 at June 30, 2018. Total accumulated amortization related to the leased equipment is \$1,243,380 and \$793,284 at June 30, 2018 and 2017, 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, 2018. The leases have an interest rate of 3% and an August 31, 2021 maturity date.

Years Ending June 30,

2019	\$ 736,804
2020	736,804
2021	736,804
2022	<u>121,792</u>
Total minimum lease payments	2,332,204
Less amount representing interest	<u>(120,891)</u>
Present value of minimum lease payments	<u><u>\$ 2,211,313</u></u>

At June 30, 2018, the present value of minimum lease payments due within one year is \$673,841.

Note 11—Operating leases

Total rental expense from operating leases, totaled \$9,473 and \$12,269 in fiscal years 2018 and 2017, respectively. As of June 30, 2018, the University has operating lease commitments for future periods as follows:

Years Ending June 30,

2019	\$ 3,925
2020	<u>2,616</u>
Present value of minimum lease payments	<u><u>\$ 6,541</u></u>

Note 12—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 \$1,538,477 and \$1,459,803 for fiscal years 2018 and 2017, 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 \$4,676,710 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 \$3,484,929 and \$4,251,786 in fiscal years 2018 and 2017, respectively.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 12—Benefit plans (continued)

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.

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:

	Beginning balance of unamortized amounts	Amount amortized into net periodic benefit costs	Current year gains/losses	Ending balance of unamortized amounts
Net gains/losses	\$ 14,547,103	\$ (2,218,921)	\$ (592,681)	\$ 11,735,501
Prior service costs	(16,172,934)	5,849,751	-	(10,323,183)

In fiscal year 2019, the University expects to recognize as net periodic benefit approximately \$2,113,500 and \$5,850,000 of previously unamortized net gain and net prior service cost, respectively.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 12—Benefit plans (continued)

The status of the University's accrued post-retirement benefit cost at June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Reconciliation of benefit obligation:		
Obligation at beginning of year	\$ 8,170,712	\$ 8,361,737
Service cost including expenses	11,427	15,437
Interest cost	271,987	269,263
Actuarial loss (gain)	(592,681)	321,140
Benefit payments and actual expenses	<u>(404,698)</u>	<u>(796,865)</u>
Obligation at end of year	7,456,747	8,170,712
Reconciliation of fair value of plan assets:		
Employer contributions	404,698	796,865
Benefit payments and estimated expenses	(404,698)	(796,865)
Fair value of plan assets at end of year	<u>-</u>	<u>-</u>
Funded status at end of year	<u>\$ 7,456,747</u>	<u>\$ 8,170,712</u>

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

	<u>2018</u>	<u>2017</u>
Current liabilities	\$ (680,265)	\$ (657,054)
Noncurrent liabilities	<u>(6,776,482)</u>	<u>(7,513,658)</u>
Total	<u>\$ (7,456,747)</u>	<u>\$ (8,170,712)</u>

Net periodic post-retirement benefit cost recognized during fiscal year 2018 and 2017, is as follows:

	<u>2018</u>	<u>2017</u>
Service cost	\$ 11,427	\$ 15,437
Interest cost	271,987	269,263
Amortization of prior actuarial loss	2,218,921	2,117,758
Amortization of prior service gain from plan amendment	<u>(5,849,751)</u>	<u>(5,849,751)</u>
Total	<u>\$ (3,347,416)</u>	<u>\$ (3,447,293)</u>

The University used a weighted average discount rate of 3.93% and 3.46% to determine the post-retirement benefit obligation at June 30, 2018 and 2017, respectively. An average discount rate of 3.46% and 3.10% was used to determine the net periodic benefit cost for fiscal years 2018 and 2017, respectively. The increase in the discount rate from 3.46% to 3.93% decreased the accrued post-retirement liability by approximately \$714,000.

SOUTHWESTERN UNIVERSITY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 12—Benefit plans (continued)

In determining the net periodic benefit cost, the assumed pre-Medicare health care cost trend rate was 6.5% for fiscal year 2018, declining gradually to 4.5%. There is no trend on the post Medicare benefits as the HRA values are now capped. 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, 2018, by \$63,000 and the aggregate of service cost and interest cost components of net periodic post-retirement benefit cost for the year then ended by \$3,000. 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, 2018, by \$55,000 and the aggregate of service cost and interest cost components of net periodic post-retirement benefit cost for the year then ended by \$2,000.

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

	<u>2018</u>	<u>2017</u>
Net loss (gain)	\$ (592,681)	\$ 321,140
Amortization of net gain	(2,218,921)	(2,117,758)
Amortization of prior service cost	5,849,751	5,849,751
Total recognized in unrestricted net assets	<u>3,038,149</u>	<u>4,053,133</u>
Total recognized in net periodic benefit cost and unrestricted net assets	<u>\$ (309,267)</u>	<u>\$ 605,840</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 June 30,

2019	\$ 666,000
2020	602,000
2021	581,000
2022	560,000
2023	520,000
2024-2028	<u>2,397,000</u>
	<u>\$ 5,326,000</u>

Note 13—Line of credit

The University had an unsecured line of credit on June 30, 2018 and 2017 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, 2019. The University did not draw on this line of credit in either fiscal year 2018 or 2017.

SOUTHWESTERN UNIVERSITY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

Note 14—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, 2018 and 2017, 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 and 2017 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 \$3,375,000 and \$3,560,000 and has an estimated fair value of \$3,375,000 and \$3,560,000 at June 30, 2018 and 2017, respectively. The 2006 note amount is valued using current market yields. The University's 2017 note payable totaled \$24,510,000 and has an estimated fair value of \$26,048,143 at June 30, 2018.

Note 15—Commitments

The University has contracts for the construction of building and classroom improvements. At June 30, 2018, the remaining commitments under these contracts approximated \$15,437,978.

Note 16—Transactions with related parties

One member of the Board of Trustees of the University also serves as Vice Chairman of the Board of Trustees of a financial institution where the University has a significant banking relationship. Three voting members of the Board of Trustees also served as directors of a private foundation during the fiscal year where the University has an outstanding investment and loan. 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. Further there was one material pledge made by a board member during the year ended June 30, 2018 of \$5,000,000 and no material related party pledges during the year ended June 30, 2017.

Note 17—Subsequent events

The University has evaluated subsequent events through October 10, 2018, 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.