

**Baylor Alumni Association
and Subsidiary**
Consolidated Financial Statements
May 31, 2016 and 2015
(With Independent Auditor's Report Thereon)



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INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Baylor Alumni Association and Subsidiary:

We have audited the accompanying consolidated financial statements of Baylor Alumni Association and Subsidiary (the Association), which comprise the consolidated statements of financial position as of May 31, 2016 and 2015, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated 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 Association'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 Association'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 Baylor Alumni Association and Subsidiary as of May 31, 2016 and 2015, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

October 20, 2016

**Baylor Alumni Association
and Subsidiary**

Consolidated Statements of Financial Position

May 31, 2016 and 2015

	2016	2015
Assets		
Cash	\$ 457,394	2,696
Accounts receivable	-	24,596
Due from Baylor University	24,829	27,434
Contributions receivable - restricted	390,000	490,000
Prepaid expenses	20,762	6,615
Cash restricted/designated for endowments	105,410	402,961
Investments	5,801,489	5,020,337
Restricted agency funds received for the benefit of others	36,343	41,213
Beneficial interest in trust	757,000	820,000
Equipment	331,311	343,871
Works of art and other historical treasures	160,273	160,273
Less accumulated depreciation	<u>(327,352)</u>	<u>(336,763)</u>
Total assets	<u>\$ 7,757,459</u>	<u>7,003,233</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 10,969	104,331
Bank overdraft	-	28,139
Accrued expenses	4,033	5,912
Agency funds received for benefit of others	36,343	41,213
Total liabilities	<u>51,345</u>	<u>179,595</u>
Net assets:		
Unrestricted:		
Designated for endowment	2,228,441	3,331,661
Undesignated	<u>3,019,830</u>	<u>1,166,004</u>
	5,248,271	4,497,665
Temporarily restricted	335,914	209,044
Permanently restricted	<u>2,121,929</u>	<u>2,116,929</u>
Total net assets	<u>7,706,114</u>	<u>6,823,638</u>
Total liabilities and net assets	<u>\$ 7,757,459</u>	<u>7,003,233</u>

See accompanying notes to consolidated financial statements.

**Baylor Alumni Association
and Subsidiary**

Consolidated Statement of Activities

Year Ended May 31, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues:				
Annual membership dues	\$ 37,393	-	-	37,393
Life membership dues	14,113	-	-	14,113
Sustaining membership gifts	17,445	-	-	17,445
Other contributions	49,498	126,870	5,000	181,368
Endowment losses allocated to operations	(156,268)	-	-	(156,268)
Royalties	3,874	-	-	3,874
Lifelong learning	1,884	-	-	1,884
Other events	74	-	-	74
Lawsuit settlement	2,000,000	-	-	2,000,000
Miscellaneous revenues	41,796	-	-	41,796
Total revenues	<u>2,009,809</u>	<u>126,870</u>	<u>5,000</u>	<u>2,141,679</u>
Expenses:				
Program:				
Membership services	285,817	-	-	285,817
Management and general	822,644	-	-	822,644
Fund-raising	52,742	-	-	52,742
Total expenses	<u>1,161,203</u>	<u>-</u>	<u>-</u>	<u>1,161,203</u>
Change in net assets before other changes	<u>848,606</u>	<u>126,870</u>	<u>5,000</u>	<u>980,476</u>
Other changes:				
Contribution of beneficial interest in trust	<u>(98,000)</u>	<u>-</u>	<u>-</u>	<u>(98,000)</u>
Total other changes	<u>(98,000)</u>	<u>-</u>	<u>-</u>	<u>(98,000)</u>
Change in net assets	750,606	126,870	5,000	882,476
Net assets at beginning of year	<u>4,497,665</u>	<u>209,044</u>	<u>2,116,929</u>	<u>6,823,638</u>
Net assets at end of year	<u>\$ 5,248,271</u>	<u>335,914</u>	<u>2,121,929</u>	<u>7,706,114</u>

See accompanying notes to consolidated financial statements.

**Baylor Alumni Association
and Subsidiary**

Consolidated Statement of Activities

Year Ended May 31, 2015

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues:				
Annual membership dues	\$ 22,549	-	-	22,549
Life membership dues	3,253	-	-	3,253
Sustaining membership gifts	23,015	-	-	23,015
Other contributions	26,961	209,044	10,000	246,005
Endowment earnings allocated to operations	320,427	-	-	320,427
Royalties	82,021	-	-	82,021
Lifelong learning	2,876	-	-	2,876
Other events	3,465	-	-	3,465
Miscellaneous revenues	249,826	-	-	249,826
Net assets released from restriction	550,000	-	(550,000)	-
Total revenues	<u>1,284,393</u>	<u>209,044</u>	<u>(540,000)</u>	<u>953,437</u>
Expenses:				
Program:				
Membership services	225,864	-	-	225,864
Management and general	850,264	-	-	850,264
Fund-raising	60,751	-	-	60,751
Total expenses	<u>1,136,879</u>	<u>-</u>	<u>-</u>	<u>1,136,879</u>
Change in net assets before other changes	<u>147,514</u>	<u>209,044</u>	<u>(540,000)</u>	<u>(183,442)</u>
Other changes:				
Contribution of beneficial interest in trust	(35,000)	-	-	(35,000)
Total other changes	<u>(35,000)</u>	<u>-</u>	<u>-</u>	<u>(35,000)</u>
Change in net assets	<u>112,514</u>	<u>209,044</u>	<u>(540,000)</u>	<u>(218,442)</u>
Net assets at beginning of year, as previously reported	4,391,347	-	2,656,929	7,048,276
Prior period adjustment	(6,196)	-	-	(6,196)
Net assets at beginning of year, as restated	<u>4,385,151</u>	<u>-</u>	<u>2,656,929</u>	<u>7,042,080</u>
Net assets at end of year	<u>\$ 4,497,665</u>	<u>209,044</u>	<u>2,116,929</u>	<u>6,823,638</u>

See accompanying notes to consolidated financial statements.

**Baylor Alumni Association
and Subsidiary**

Consolidated Statement of Functional Expenses

Year Ended May 31, 2016

	<u>Program</u>			
	<u>Membership</u>	Management	<u>Fund-raising</u>	<u>Total</u>
	<u>Services</u>	<u>and General</u>		
Computer charges	\$ -	15,129	-	15,129
Telephone	-	1,915	-	1,915
Insurance	-	10,154	-	10,154
Travel and meals	-	369	-	369
Contributions	-	500	-	500
Processing charges	-	8,867	-	8,867
Advertising and promotion	-	10,081	-	10,081
Catering for special events	5,000	2,368	-	7,368
Printing	29,474	3,290	-	32,764
Postage	22,510	553	-	23,063
Supplies	452	9,338	-	9,790
Professional fees:				
Baylor Line	65,428	-	-	65,428
Legal and accounting	-	645,965	-	645,965
Other	-	4,186	-	4,186
Rent/lease	8,071	8,071	4,036	20,178
Personnel costs	97,411	97,411	48,706	243,528
Depreciation	-	3,149	-	3,149
Scholarships	57,000	-	-	57,000
Event Services	471	676	-	1,147
Miscellaneous	-	622	-	622
	<u>\$ 285,817</u>	<u>822,644</u>	<u>52,742</u>	<u>1,161,203</u>

See accompanying notes to consolidated financial statements.

**Baylor Alumni Association
and Subsidiary**

Consolidated Statement of Functional Expenses

Year Ended May 31, 2015

	<u>Program</u>			
	<u>Membership</u>	<u>Management</u>	<u>Fund-raising</u>	<u>Total</u>
	<u>Services</u>	<u>and General</u>		
Computer charges	\$ 1,596	10,403	-	11,999
Telephone	-	1,052	-	1,052
Insurance	-	10,193	-	10,193
Travel and meals	1,215	6,242	-	7,457
Contributions	-	50,350		50,350
Processing charges	-	6,395	-	6,395
Advertising and promotion	120	48	-	168
Catering for special events	8,075	2,863	-	10,938
Printing	14,127	288	-	14,415
Postage	7,447	58	-	7,505
Supplies	41	1,933	-	1,974
Professional fees:				
Baylor Line	18,923	-	-	18,923
Legal and accounting	49,719	640,965	20,000	710,684
Other	-	22,761	-	22,761
Rent/lease	11,436	11,436	5,718	28,590
Personnel costs	70,065	70,065	35,033	175,163
Depreciation	-	10,268	-	10,268
Scholarships	43,100	-	-	43,100
Miscellaneous	-	4,944	-	4,944
	<u>\$ 225,864</u>	<u>850,264</u>	<u>60,751</u>	<u>1,136,879</u>

See accompanying notes to consolidated financial statements.

**Baylor Alumni Association
and Subsidiary**

Consolidated Statements of Cash Flows

Years Ended May 31, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Change in net assets	\$ 882,476	(218,442)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Contributions to permanent endowments	(5,000)	(10,000)
Depreciation expense	3,248	10,367
Net realized and unrealized gain on investments	1,218,848	29,994
Beneficial interest in trust contributions	63,000	35,000
Decrease (increase) in accounts receivable	24,596	(22,565)
Decrease (increase) in due from Baylor University	2,605	(9)
Decrease (increase) in contribution receivable	100,000	(200,000)
Increase in prepaid expenses	(14,147)	(763)
(Decrease) increase in accounts payable	(93,362)	55,372
Decrease in accrued expenses	(1,879)	(3,045)
Net cash provided by (used in) operating activities	2,180,385	(324,091)
Cash flows from investing activities:		
Net change in cash restricted /designated for endowments	297,551	(221,763)
Sales (purchases) of investments	(2,000,000)	416,166
Net proceeds from sale of property	3,190	3,000
Capital expenditures	(3,289)	-
Net cash provided by (used in) investing activities	(1,702,548)	197,403
Cash flows from financing activities:		
Decrease in cash overdraft	(28,139)	28,139
Proceeds from contributions to permanent endowments	5,000	10,000
Net cash provided by financing activities	(23,139)	38,139
Net increase (decrease) in cash	454,698	(88,549)
Cash at beginning of year	2,696	91,245
Cash at end of year	\$ 457,394	2,696

See accompanying notes to consolidated financial statements.

**Baylor Alumni Association
and Subsidiary**

Notes to Consolidated Financial Statements

May 31, 2016 and 2015

(1) Summary of Significant Accounting Policies

(a) Organization

Baylor Alumni Association and Subsidiary (collectively, the Association) was organized to provide support for benevolent, charitable, and educational undertakings by extending financial and other aid to Baylor University and to students thereof, by generally encouraging sentiments favorable to education and by promoting union of and good fellowship among former students. The Association was organized to serve as the general alumni organization of Baylor University, and to coordinate all alumni activities and maintain the administrative agency and executive personnel needed to provide for continuity of alumni activity and interest. As described in Note 11, during 2016 the Association settled its litigation with Baylor University, and is now in the process of determining what role the Association will serve in supporting Baylor University. Revenues are derived mainly from annual and life membership dues, royalties, charitable contributions and investment income.

Baylor Alumni Association is a non-profit Texas corporation without capital stock. Baylor Alumni Association's wholly-owned subsidiary, Baylor Alumni Service Enterprises, Inc. (the Corporation), was incorporated by Baylor Alumni Association with an initial capital contribution on September 12, 1980 under the Texas Nonprofit Corporation Act. The officers and directors of the Corporation serve in the same capacity as officers and directors of the Baylor Alumni Association.

(b) Principals of Consolidation

The consolidated financial statements include the accounts of Baylor Alumni Association and its wholly-owned subsidiary, Baylor Alumni Service Enterprises, Inc. All significant intercompany transactions and accounts have been eliminated in consolidation.

(c) Cash Equivalents

For purposes of the consolidated statements of cash flows, the Association considers all highly liquid assets with original maturities of three months or less to be cash equivalents. Cash and cash equivalents designated for long-term purposes or received with donor-imposed restrictions limiting their use to long-term purposes are not considered cash and cash equivalents for purposes of the statement of cash flows. There were no cash equivalents at May 31, 2016 and 2015.

**Baylor Alumni Association
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Notes to Consolidated Financial Statements
(Continued)

(1) Summary of Significant Accounting Policies (continued)

(d) Investments

Investments are measured at fair value in the consolidated statements of financial position. Investment income (including gains and losses on investments, interest, and dividends) is included in the consolidated statements of activities as increases or decreases in unrestricted net assets unless the income or loss is restricted by donor or law.

(e) Equipment, Works of Art and Other Historical Treasures

Purchased equipment, works of art and other historical treasures are stated at cost as of the date of acquisition. Assets which are received from donations are recorded at fair value at the date of the gift. Equipment is depreciated on the straight-line method over the estimated useful lives of the assets. Depreciation on works of art and other historical treasures is not recorded. The Association capitalizes all acquisitions with a value greater than \$1,000. Costs of maintenance and repairs are charged to operations as incurred.

(f) Temporarily Restricted Net Assets

At May 31, 2016 and 2015, temporarily restricted net assets of \$335,914 and \$209,044 were donor restricted for scholarships and legal defense expenses, respectively.

(g) Permanently Restricted Net Assets

Permanently restricted net assets are restricted to investment in perpetuity, the income of which is expendable. The endowment funds are maintained with other investments administered by an independent trustee.

The Association has established a permanently restricted endowment fund in conjunction with its Sesquicentennial fund-raising campaign. The purpose of the campaign is to raise enough contributions to “endow” various employment positions as well as programs sponsored by the Association so that they will be self-sustaining in future years through income earned on the restricted net assets. The Abner V. McCall endowment fund was established so that investment income of the permanently restricted net assets would be available for general operations of the Association. Various other donors have made contributions to establish endowed scholarship funds so that the investment income earned from the permanently restricted net assets would be available for scholarships provided by the Association.

**Baylor Alumni Association
and Subsidiary**

Notes to Consolidated Financial Statements
(Continued)

(1) Summary of Significant Accounting Policies (continued)

(h) Designated Net Assets

Certain assets received by the Association, which are unrestricted in nature, have been designated by the Board of Directors for a particular purpose. These commitments are presented separately in the net assets of the Association as being designated.

The Board has designated \$1 per membership from the annual membership dues for the scholarship fund of Baylor University. The scholarship amounts for 2016 and 2015 of \$577 and \$455, respectively, were paid and/or accrued to Baylor University as of May 31, 2016 and 2015. In addition, all of the life membership dues and investment income not used for current year operations are designated for the unrestricted endowment fund of the Association.

(i) Fair Value Hierarchy

Generally accepted accounting principles establish a fair value hierarchy that prioritizes the inputs to valuation techniques used for fair value measurements of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the consolidated financial statements. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Association has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

(j) Support and Expenses

Contributions received and unconditional promises to give are measured at their fair values and are reported as an increase in net assets. The Association reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets, or if they are designated as support for future periods. When a donor restriction expires, that is, when a

**Baylor Alumni Association
and Subsidiary**

Notes to Consolidated Financial Statements
(Continued)

(1) Summary of Significant Accounting Policies (continued)

(j) Support and Expenses (continued)

stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions. Donor restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

The Association reports gifts of land and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Association reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

(k) Advertising

Advertising costs, except for costs associated with direct-response advertising, are charged to operations when incurred. Advertising costs charged to operations were \$10,081 and \$168 for the years ended May 31, 2016 and 2015, respectively.

(l) Income Taxes

Baylor Alumni Association qualifies as a non-profit organization under Section 501(c)(3) of the Internal Revenue Code. Therefore, the Association is generally exempt from federal and state income taxes.

The Association recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

The Association records interest related to unrecognized tax benefits and penalties in management and general expenses. There were no interest and penalties for 2016 or 2015.

**Baylor Alumni Association
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Notes to Consolidated Financial Statements
(Continued)

(1) Summary of Significant Accounting Policies (continued)

(m) Fund-Raising Expenses

Fund-raising expenses consist primarily of membership development and solicitation activities through direct mail and telephone initiatives, as well as personnel costs.

(n) Functional Allocation of Expenses

The costs of providing the membership programs, fund-raising and other activities have been summarized on a functional basis in the statements of functional expenses. Expenses that can be identified with a specific program or supporting service are charged directly to that program or supporting service. Costs common to multiple functions have been allocated based upon the various functions benefited.

(o) Agency Transactions

The Association recognizes an asset and corresponding liability for funds received in connection with agency transactions. The financial effects of transactions related to agency funds are recorded as changes in the funds held for agency liability and are not included in the consolidated statements of activities.

(p) Reclassifications

Certain reclassifications have been made to the 2015 financial statements to make them comparable to the 2016 financial statements.

(q) Use of Estimates

Management has made estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities in the preparation of these consolidated financial statements. Significant items subject to such estimates and assumptions include the useful lives of equipment, allowance for contribution receivables, and valuation of investments and beneficial interest in trust. Actual results could differ from those estimates and assumptions.

**Baylor Alumni Association
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Notes to Consolidated Financial Statements
(Continued)

(2) Investment

At May 31, 2016 and 2015, the Association's investment consisted entirely of an investment in the Group Investment Fund II of the Baptist Foundation of Texas (the Fund). The Fund is measured at fair value using a Level 2 input (as defined in Note 1(i)). This input consists of the net asset value per share of the Fund. The Fund is designed specifically to meet the unique needs of endowment funds. This is done by maintaining a highly diversified and balanced portfolio to seek maximum total return within reasonable risk levels, consistent with the long-term nature of endowment accounts. The Funds are socially screened to eliminate companies whose business activities are inconsistent with Baptist faith and beliefs. The fund's long-term asset allocation is well diversified, investing in global equities, energy, marketable alternatives, fixed income, real estate and private equity.

The Fund is valued daily and contributions and withdrawals may be made twice a month at the current net asset value. Income distributions can be made monthly, quarterly or annually.

Following is a summary of the allocation of the Fund's investments relative to the Association at May 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Equity securities - domestic	\$ 776,264	1,552,459
Equity securities - international	817,701	1,586,929
Debt securities	515,102	1,009,088
Real estate	162,704	207,842
Private equity	173,348	261,058
Money market	<u>3,356,370</u>	<u>402,961</u>
	<u>\$ 5,801,489</u>	<u>5,020,337</u>

Endowment gains (losses) allocated to operations is comprised of realized and unrealized gains (losses) of \$(241,594) and \$205,727, and interest and dividends of \$85,326 and \$114,700 as May 31, 2016 and 2015, respectively.

(3) Beneficial Interest in Trust

During 2009, a perpetual charitable trust (the Trust) was established by an outside grantor, whereby, the Association, along with four other organizations, was named a beneficiary. Each year 50% of the Trust income will be distributed to the beneficiaries based on their stated proration and the remaining 50% will be reinvested into the corpus of the Trust. The Association's pro-rata share is 20%.

**Baylor Alumni Association
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Notes to Consolidated Financial Statements
(Continued)

(3) Beneficial Interest in Trust (continued)

The Trust term is 50 years and at the end of the term all mineral and royalty assets of the Trust will be distributed to Baylor University and the remainder of all assets will be distributed to all the beneficiaries based on the same proportionate share as the income distributions.

Funding of the Trust came from the estate of the grantor upon death, which occurred in December 2010 and the estate was settled during 2013. The fair value of the Trust was determined to be \$3,787,150 and \$4,102,020 at May 31, 2016 and 2015, respectively. Accordingly, management recognized 20% of the fair value of the trust at May 31, 2016 and 2015 of \$757,000 and \$820,000, respectively.

Because there is no market in which the beneficial interest in the Trust can trade, there are no observable inputs available to establish the fair value. Therefore, the inputs used are considered Level 3 inputs (as defined in Note 1(i)). The following table presents a roll-forward of the fair value of Level 3 assets and liabilities for the years ended May 31, 2016 and 2015.

	<u>2016</u>	<u>2015</u>
Balance, beginning of year	\$ 820,000	855,000
Investment losses	(63,000)	(35,000)
Distributions to beneficiaries	<u>-</u>	<u>-</u>
Balance, end of year	<u>\$ 757,000</u>	<u>820,000</u>

During 2014, certain distributions from the Trust made payable to the Association were instead delivered to Baylor University by the Trustee. The Association requested payment from Baylor University and recorded an account receivable of \$24,829. During 2015, the Trustee filed an injunction with the Courts to seek instructions regarding the administration of the Trust and modification of the Trust instrument. No distributions will be made from the Trust pending final directions from the Courts. The Association, as a beneficiary, has continued to record their share of the Trust's assets in accordance with the Trust document.

(4) Endowment

The Association's endowment consists of approximately 22 individual funds established for a variety of purposes. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. As a result, the Association classifies

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Notes to Consolidated Financial Statements
(Continued)

(4) Endowment (continued)

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 (decrements) to the permanent endowment made in accordance with the direction of the applicable donor gift instrument.

The Association has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Association must hold in perpetuity as well as board-designated funds. Under this policy the endowment assets are invested in a manner that is intended to produce a real rate of return of at least 5% net of expenses, on an annualized basis. Actual returns in any given year may vary from this amount. Investment income from permanent endowments for non-scholarship funds, which includes interest and dividends as well as realized and unrealized gains and losses, are included in unrestricted net assets. Investment losses from permanent endowments for scholarship funds are charged to permanently restricted net assets, while investment income in excess of accumulated investment losses is included in temporarily restricted net assets for the use of scholarships.

Investment income (loss) from the designated endowment (including unrealized gains and losses) in 2016 and 2015 was \$(156,268) and \$320,427, respectively. Additionally, transfers to operations, based on the Association's spending policy discussed above, was \$(961,065) and \$(555,253) in 2016 and 2015, respectively.

The following is the composition of endowment net assets by type of fund as of May 31, 2016 and 2015:

	<u>Unrestricted, Designated</u>	<u>Permanently Restricted</u>	<u>Total</u>
At May 31, 2016:			
Donor-restricted endowments	\$ -	2,121,929	2,121,929
Board designated endowment	<u>2,228,441</u>	<u>-</u>	<u>2,228,441</u>
	<u>\$ 2,228,441</u>	<u>2,121,929</u>	<u>4,350,370</u>
At May 31, 2015:			
Donor-restricted endowments	\$ -	2,116,929	2,116,929
Board designated endowment	<u>3,331,661</u>	<u>-</u>	<u>3,331,661</u>
	<u>\$ 3,331,661</u>	<u>2,116,929</u>	<u>5,448,590</u>

**Baylor Alumni Association
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Notes to Consolidated Financial Statements
(Continued)

(4) Endowment (continued)

	<u>Unrestricted, Designated</u>	<u>Permanently Restricted</u>	<u>Total</u>
For the year ended May 31, 2016:			
Endowment net assets, beginning of year	\$ 3,331,661	2,116,929	5,448,590
Contributions and additions	14,113	5,000	19,113
Released from designation by the Board	(1,117,333)	-	(1,117,333)
Investment gains (losses)	(156,268)	-	(156,268)
Distributed losses	156,268	-	156,268
	<u>2,228,441</u>	<u>2,121,929</u>	<u>4,350,370</u>
Endowment net assets, end of year	<u>\$ 2,228,441</u>	<u>2,121,929</u>	<u>4,350,370</u>
For the year ended May 31, 2015:			
Endowment net assets, beginning of year	\$ 3,563,236	2,656,929	6,220,165
Contributions and additions	3,251	10,000	13,251
Released from restriction by the donor	-	(550,000)	(550,000)
Released from designation by the Board	(234,826)	-	(234,826)
Investment gains	320,427	-	320,427
Distributed earnings	(320,427)	-	(320,427)
	<u>3,331,661</u>	<u>2,116,929</u>	<u>5,448,590</u>
Endowment net assets, end of year	<u>\$ 3,331,661</u>	<u>2,116,929</u>	<u>5,448,590</u>

(5) Related Party Transactions

As described in Note 8, the Association leases its office space from a related party under operating leases on a short-term basis. Rent expense paid to this related party for the years ended May 31, 2016 and 2015 totaled \$12,000 and 12,000, respectively.

The Association receives investment income on certain endowment funds administered by Baylor University. No investment income was received by the Association from these endowments for the year ended May 31, 2016. Investment income received by the Association from these endowments for the year ended May 31, 2015 was \$31,198.

In 1994, the Association and Baylor University entered into an agreement which allowed the Association the exclusive use of the Hughes-Dillard Alumni Center building for an indefinite term. As discussed in Note 11, during 2014 Baylor University terminated the Association's right to use the office building and, under mutual agreement, the Association vacated the building.

**Baylor Alumni Association
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Notes to Consolidated Financial Statements
(Continued)

(6) Intentions to Give

During 2016 and 2015, the Association maintains contributions from various donors for the Sesquicentennial Campaign, as more fully described in Note 1(g). In addition, various donors have made pledges (intentions to give) for future contributions to the campaign. These intentions to give are not reflected as contributions in the accompanying consolidated statements of activities until the pledges are collected.

(7) Contributions Receivable

Contributions receivable are recognized at fair value when the donor makes a promise to give to the Association that is, in substance, unconditional. Contributions receivable of \$290,000 at May 31, 2016 and 2015 represent amounts that are pledged to establish funds for scholarships. The remaining \$100,000 and \$200,000 at May 31, 2016 and 2015, respectively, is pledged for litigation costs. The \$390,000 contributions receivable at May 31, 2016 is due in 2017.

(8) Leases

The Association has a noncancelable operating lease for postage equipment that expires in one year and a noncancelable operating lease for a copier that expires in 4 years. Also, the Association has a short-term lease agreement for office space beginning in January 2014 for \$1,000 per month, based on a ninety day rolling commitment. The Association also leased other equipment, storage space, and facilities for special events throughout the year. Rental expenses for 2016 and 2015 were \$20,178 and \$28,590, respectively. Future minimum lease payments under the noncancelable operating leases are as follows: 2017, \$5,159 and 2018, \$978.

(9) Employee Benefit Plan

The Association sponsors a 403(b)(9) defined contribution plan. All employees who have attained the age of 21, are not a student, are full-time employees, and have one year of service are eligible for the plan. The plan allows employees to make voluntary pre-tax salary contributions up to an annually defined maximum as allowed by the Internal Revenue Code. Employer contributions to the plan were suspended in 2012.

(10) Business and Credit Concentrations

At May 31, 2016 and 2015, and periodically throughout the years then ended, the Association maintained balances in deposit accounts at a financial institution in excess of federally insured limits.

**Baylor Alumni Association
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Notes to Consolidated Financial Statements
(Continued)

(11) Lawsuit Settlement and Relationship with Baylor University

After many years of litigation with Baylor University (Baylor), generally regarding the use of the name “Baylor Alumni Association” and the publication of a magazine called the “Baylor Line”, the Association and Baylor reached a settlement on March 7, 2016. In general, the parties agreed (1) to dismiss the lawsuit and all claims arising out of the agreements made the basis of the lawsuit; (2) to provide for the election of Alumni Regents to the Baylor Board of Regents; (3) to reform the name and functions of the Association and provide new intellectual property licenses from Baylor; (4) that all prior agreements between the parties were terminated; and (5) that Baylor would make a \$2,000,000 payment to the Association. The Court entered a final order of dismissal with prejudice on June 7, 2016. The \$2,000,000 payment was received from Baylor and recorded as income in May 2016.

(12) Prior Period Adjustment

An adjustment was made to reduce unrestricted net assets at the beginning of 2014 by \$6,196 to reflect the reduction in land that was disposed of by the Association in a prior year.

(12) Subsequent Events

During July 2016, as part of the settlement agreement with Baylor University, the Association changed its name to The Baylor Line Foundation. Their updated mission is “to tell the stories of the Baylor family; help future alumni write their own Baylor stories; and speak with an independent voice committed to preserving the timeless values of Baylor’s founders”.

Subsequent events have been evaluated through October 10, 2016, which is the date the consolidated financial statements were available to be issued, and determined there are no additional items to disclose.