

PALO ALTO UNIVERSITY, INC.

JULY 31, 2017 AND 2016

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

Palo Alto University, Inc.

Independent Auditors' Report and Financial Statements

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Independent Auditors' Report

THE BOARD OF TRUSTEES
PALO ALTO UNIVERSITY, INC.
Palo Alto, California

Report on the Financial Statements

We have audited the accompanying financial statements of **PALO ALTO UNIVERSITY, INC. (the University)** which comprise the statements of financial position as of July 31, 2017 and 2016, and the related statements of activities and change in net assets and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the University's preparation and fair presentation of the 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 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 financial statements referred to above present fairly, in all material respects, the financial position of the University as of July 31, 2017 and 2016 and the change in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary schedules of functional expense are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Hood & Strong LLP

San Francisco, California
November 17, 2017

Palo Alto University, Inc.

Statement of Financial Position

<i>July 31,</i>	2017	2016
Assets		
Current Assets:		
Cash and cash equivalents	\$ 6,878,652	\$ 5,650,209
Student receivables, net of allowance of \$586,556 for 2017 and \$548,417 for 2016	8,813,359	8,204,430
Contributions receivable, net	792,656	937,053
Grants receivable	433,609	453,128
Prepaid expenses and other assets	595,523	581,818
Total current assets	17,513,799	15,826,638
Long-Term Investments	2,651,924	1,432,817
Contributions Receivable, net	290,021	532,746
Property and Equipment, net	7,780,923	8,209,014
Total assets	\$ 28,236,667	\$ 26,001,215
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 2,160,964	\$ 2,359,103
Student payables	10,000	28,547
Deferred tuition revenue	9,333,922	8,275,140
Deferred grant revenue	206,907	302,364
Other liabilities		18,954
Deferred compensation	32,500	800,000
Total current liabilities	11,744,293	11,784,108
Net Assets:		
Unrestricted	14,885,488	12,472,114
Temporarily restricted	921,604	1,061,911
Permanently restricted	685,282	683,082
Total net assets	16,492,374	14,217,107
Total liabilities and net assets	\$ 28,236,667	\$ 26,001,215

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Activities and Change in Net Assets

For the Years Ended July 31, 2017 and 2016

	2017				2016			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:								
Gross tuition	\$ 25,961,529			\$ 25,961,529	\$ 26,195,485			\$ 26,195,485
Gross fees	3,896,778			3,896,778	3,913,013			3,913,013
	29,858,307			29,858,307	30,108,498			30,108,498
Less financial aid	(1,000,718)			(1,000,718)	(1,170,811)			(1,170,811)
Net tuition and fees	28,857,589			28,857,589	28,937,687			28,937,687
Contributions	2,048	\$ 12,225	\$ 2,200	16,473	46,250	\$ 418,479	\$ 287	465,016
Grants	990,139			990,139	840,168			840,168
Investment income	33,360	85,814		119,174	27,037	(9,436)		17,601
Sales and services of educational activities	201,639			201,639	181,267			181,267
Other	293,138			293,138	334,381			334,381
Net assets released from restrictions	238,346	(238,346)		-	344,318	(344,318)		-
Total revenues	30,616,259	(140,307)	2,200	30,478,152	30,711,108	64,725	287	30,776,120
Expenses:								
Program services:								
Instruction	18,790,394			18,790,394	19,360,268			19,360,268
Student services	3,728,445			3,728,445	3,575,836			3,575,836
Supporting services:								
Institutional support	5,487,481			5,487,481	6,955,348			6,955,348
Development	196,565			196,565	233,645			233,645
Total expenses	28,202,885	-	-	28,202,885	30,125,097	-	-	30,125,097
Change in Net Assets	2,413,374	(140,307)	2,200	2,275,267	586,010	64,725	287	651,022
Net Assets - beginning of period	12,472,114	1,061,911	683,082	14,217,107	11,886,104	997,186	682,795	13,566,085
Net Assets - end of period	\$ 14,885,488	\$ 921,604	\$ 685,282	\$ 16,492,374	\$ 12,472,114	\$ 1,061,911	\$ 683,082	\$ 14,217,107

See accompanying notes to financial statements.

Palo Alto University, Inc.

Supplementary Information - Schedule of Functional Expenses

For the Year Ended July 31, 2017

	Instruction	Student Services			Institutional Support			Development	Total
		Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance		
Salaries and wages	\$ 11,001,397	\$ 347,359	\$ 318,310	\$ 1,422,727	\$ 1,803,722	\$ 765,951	\$ 143,332	\$ 128,810	\$ 15,931,608
Benefits	1,537,361	73,353	43,979	259,325	365,380	120,228	34,193	29,843	2,463,662
Consortium payments	3,249,240								3,249,240
Consultants	268,502		24,165	150,876	277,633	125,005	5,830		852,011
Rent	340,047				96,500	6,240	417,333		860,120
Travel and lodging	126,018	2,512	2,045	77,734	47,279	61,364	8,539		325,491
Meals and entertainment	107,251	484	1,085	70,488	129,342	3,915	1,710	2,554	316,829
Temporary agencies	1,293		905	90,132	115,547		3,840		211,717
Advertising and public relations	17,552			234,170	55,500			1,293	308,515
Bank and credit card charges	1,914				277,273	56		19	279,262
Bad debt					347,804				347,804
Tutoring				505					505
Community relations	26,246	486	404	25,472	44,505	2,165		101	99,379
Supplies	37,224	3,313	248	16,559	18,704	821	2,199	187	79,255
Utilities and telephone	16,675	1,478	3,615	13,962	25,127		82,653		143,510
Business insurance					167,994	3,720			171,714
Legal	10,227				106,811				117,038
Software site licenses	65,252	8,014	109,223	83,823	61,916	21,096			349,324
Other expenses	339,807	169,127	74,303	273,538	334,085	9,386	202,289	16,981	1,419,516
	17,146,006	606,126	578,282	2,719,311	4,275,122	1,119,947	901,918	179,788	27,526,500
Depreciation and amortization	40,576	82,203		2,572	142,090		408,944		676,385
Allocations	1,603,812	64,233	(578,282)	254,000	(154,189)	104,511	(1,310,862)	16,777	-
Total Expenses 2017	\$ 18,790,394	\$ 752,562	\$ -	\$ 2,975,883	\$ 4,263,023	\$ 1,224,458	\$ -	\$ 196,565	\$ 28,202,885

See accompanying notes to financial statements.

Palo Alto University, Inc.

Supplementary Information - Schedule of Functional Expenses

For the Year Ended July 31, 2016

	Student Services				Institutional Support				Total
	Instruction	Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance	Development	
Salaries and wages	\$ 11,269,574	\$ 334,855	\$ 236,813	\$ 1,410,856	\$ 2,371,268	\$ 316,318	\$ 139,405	\$ 140,019	\$ 16,219,108
Benefits	1,482,194	68,172	34,856	284,246	610,313	51,077	31,861	22,348	2,585,067
Consortium payments	3,095,145								3,095,145
Consultants	504,719		880	96,524	376,709	164,540	12,057	10,420	1,165,849
Rent	390,764				16,500	6,060	417,819		831,143
Travel and lodging	172,257	3,771	3,999	70,311	176,141	46,447	8,315	2,050	483,291
Meals and entertainment	136,705	1,126	2,337	177,052	211,317	1,740	1,834	11,618	543,729
Temporary agencies				60,563	64,993		32,135		157,691
Advertising and public relations	15,870			241,217	530,874			3,380	791,341
Bank and credit card charges	1,253				276,810	25		12	278,100
Bad debt					122,314				122,314
Tutoring				3,189					3,189
Community relations	124,020	672	457	37,882	290,982	4,449		3,277	461,739
Supplies	43,603	3,156	3,523	27,722	45,257	867	6,457	855	131,440
Utilities and telephone	14,899	1,027	2,414	21,314	28,914		75,392		143,960
Business insurance					178,815	3,095			181,910
Legal					102,781				102,781
Software site licenses	112,701	8,331	89,053	3,972	52,697	430			267,184
Other expenses	424,609	92,817	74,292	268,377	786,610	9,339	177,037	21,619	1,854,700
	17,788,313	513,927	448,624	2,703,225	6,243,295	604,387	902,312	215,598	29,419,681
Depreciation and amortization	76,538	79,909		2,572	144,386		402,011		705,416
Allocations	1,495,417	49,708	(448,624)	226,495	(87,312)	50,592	(1,304,323)	18,047	-
Total Expenses 2016	\$ 19,360,268	\$ 643,544	\$ -	\$ 2,932,292	\$ 6,300,369	\$ 654,979	\$ -	\$ 233,645	\$ 30,125,097

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Cash Flows

<i>For the Year Ended July 31,</i>	2017	2016
Cash Flows from Operating Activities:		
Change in net assets	\$ 2,275,267	\$ 651,022
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	676,385	705,416
Change in discount and allowances for contributions receivable	11,250	(31,450)
Realized and unrealized (gain) loss on investment securities	(35,097)	2,721
Donation of closely held stock		(60,000)
Pledges write off	202,186	
Changes in operating assets and liabilities:		
Student receivables	(608,929)	(1,546,656)
Contributions receivable, net	173,686	32,073
Grants and federal funds receivable	19,519	49,414
Prepaid expenses and other assets	(13,705)	(192,198)
Accounts payable and other accrued expenses	(217,093)	954,326
Student payables	(18,547)	13,931
Deferred tuition revenue	1,058,782	1,541,564
Deferred grant revenue	(95,457)	290,172
Deferred compensation	(767,500)	146,667
Net cash provided by operating activities	2,660,747	2,557,002
Cash Flows from Investing Activities:		
Purchase of long-term investments	(1,535,265)	(346,313)
Proceeds from the sale of long-term investments	351,254	311,909
Purchase of property and equipment	(248,431)	(534,920)
Proceeds from the sale property and equipment	138	
Net cash used by investing activities	(1,432,304)	(569,324)
Net Change in Cash and Cash Equivalents	1,228,443	1,987,678
Cash and Cash Equivalents at beginning of the period	5,650,209	3,662,531
Cash and Cash Equivalents at end of the period	\$ 6,878,652	\$ 5,650,209

See accompanying notes to financial statements.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 1 - The University and Summary of Significant Accounting Policies:

a. The University

Palo Alto University (PAU or the University) is a private, nonprofit educational institution. The University was founded in 1975 and was first accredited in 1986 by the regional accrediting body, the Western Association of Schools and Colleges and has been continuously accredited since then. PAU is dedicated to education with an emphasis in the behavioral and social sciences; to promoting future innovators and leaders for the benefit of society; to generating knowledge through research and scholarship of the highest level; and to providing services to the community informed by science and scholarship.

PAU maintains several international collaborations, supporting local, clinical practicum training in China and Latin America for students who participate in PAU's online Master of Arts in Counseling or Counseling Psychology programs. The University is also in collaborative partnerships with many community organizations, including Stanford School of Medicine, the Department of Veterans Affairs, Palo Alto Medical Center, and other mental health care organizations. The Gronowski Center delivers low-cost mental health services while also providing valuable, supervised training to PAU graduate students. In addition, PAU sponsors several academic centers devoted to child mental health, evidence-based care for Lesbian, Gay, Bisexual, Transgender, and Questioning clients, excellence in diversity and community care, and internet-based global healthcare.

b. Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and, accordingly, reflect all significant receivables, payables, and other liabilities and include the activities of the Gronowski Center.

c. Basis of Presentation

The University's resources are classified according to the existence or absence of donor-imposed restrictions. The net assets are classified as permanently restricted, temporarily restricted, or unrestricted.

Permanently Restricted Net Assets – Net assets whose use is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by action of the University. Income on such funds is available to support activities of the University as designated by such donors.

Palo Alto University, Inc.

Notes to the Financial Statements

Temporarily Restricted Net Assets – Net assets subject to donor-imposed stipulations that may or will be met by actions of the University and/or the passage of time and the portion of donor-restricted funds that are not classified as permanently restricted net assets. Also included in temporarily restricted net assets are earnings on endowment funds that have not been appropriated for expenditure.

Unrestricted Net Assets – Net assets not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by the Board of Trustees of the University (see Note 8).

d. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

e. Cash and Cash Equivalents

Cash and cash equivalents consist of cash and money market funds excluding those held for investment purposes.

f. Investments

Investments are recorded at fair value. Investments received through gifts are recorded at estimated fair value at the date of donation. All debt and equity securities with readily determinable market values are carried at estimated fair value based on closing market prices. Investments in privately held companies are held at values as determined by the management of those companies. Gains and losses that result from market fluctuations are recognized in the statement of activities and change in net assets in the period such fluctuations occur. Dividend and interest income are accrued when earned.

g. Student and Grant Receivables

Student receivables include tuition and fees due from students, and grants receivable include reimbursements due from sponsors of externally funded research, and amounts due from federal agencies for student financial aid programs. These receivables are carried at cost, which represents fair value.

Palo Alto University, Inc.

Notes to the Financial Statements

The University grants credit primarily to individuals for the purpose of paying for their tuition and fees. Student receivables are payable by a certain date each quarter and are stated at amounts due, net of an allowance for doubtful accounts, if any. The allowance is established as losses are estimated to have occurred, through a charge to expense. Receivables are charged against the allowance when management believes that collectability is unlikely. Should a student not pay their tuition amounts by the due date for the quarter, his/her classes are dropped and he/she is charged a reinstatement fee before being allowed to attend classes.

Grants are expected to be fully collectible in the upcoming year.

h. Revenue Recognition

Student receivable accounts are recorded when students are billed. Tuition and fees revenues are recorded as earned, on a pro rata basis over the applicable teaching period. Tuition and fees for future periods are reported as deferred revenue. Collection or development of payment plans for tuition and fees is required prior to registration for the following term.

All contributions and grants, whether or not restricted, are recognized as revenues when they are received by, or unconditionally pledged to, the University. The University classifies gifts of cash and other assets as temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When such donor restrictions expire, that is, when stipulated time restrictions end or purpose restrictions are accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities and change in net assets as net assets released from restrictions. When the restriction is met in the same period as the contribution is received, contributions are reported as increases in unrestricted net assets.

Contributions that are promised in one year but are expected to be received after the end of that year (or over a number of years) are discounted at an appropriate discount rate. An allowance for uncollectible pledges has been established based on prior experience. The financial statements reflect these pledges net of the discount and allowance reserve.

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. In the absence of donor stipulations about how long those long-lived assets must be maintained, the University reports expirations of donor restrictions when the donated, or acquired, long-lived assets are placed in service. Contributions of assets other than cash are recorded at their estimated fair value.

Palo Alto University, Inc.

Notes to the Financial Statements

Contributions of services, if any, are recorded as revenue and recognized when received if the services create or enhance non-financial assets, or if they require specialized skills, and are provided by individuals possessing those skills, and would typically need to be purchased if not donated. Corresponding amounts are also recorded as expenses.

i. Property and Equipment

Property and equipment are stated at cost at the date of acquisition or fair value at the date of donation in the case of gifts in kind. The University capitalizes all expenses for property and equipment, with the exception of library books, in excess of \$1,000; library books of any amount are capitalized. Depreciation is computed using the straight-line method based upon the estimated useful lives of the assets, generally 3 to 40 years.

j. Deferred Revenue

Deferred revenue consists primarily of tuition and fees of students registered in advance of the forthcoming quarter and grant proceeds received in advance of grant expenditures. Tuition and fee revenue is recognized as earned, on a pro rata basis over the applicable teaching period. Grant revenues are recognized as grant expenditures are incurred.

k. Advertising Expenses

The University's policy is to expense advertising costs as they are incurred. Advertising costs for the year ended July 31, 2017 and 2016 were \$308,514 and \$791,341, respectively.

l. Functional Expense Allocations

Certain expenses, such as depreciation and amortization expense, building services including information technology, and personnel, are allocated among program services and supporting services based primarily on direct payroll charges and other direct expenses.

m. Income Taxes

The University is recognized by the Internal Revenue Service as an organization exempt from income taxes on related activities under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code.

As of July 31, 2017 and 2016, management evaluated the University's tax positions and concluded that the University had maintained its tax-exempt status and had taken no uncertain tax positions that require adjustment to the financial statements. Therefore, no provision or liability for income taxes has been included in the financial statements.

Palo Alto University, Inc.

Notes to the Financial Statements

n. Concentrations of Risk

Financial instruments which potentially subject the University to concentrations of credit risk consist principally of cash and student receivables.

The University grants credit to students in the normal course of operations and the credit risk with respect to these receivables is generally considered minimal due to the wide dispersion of receivables among individual students.

During the year, the University regularly maintains cash balances in excess of federally insured limits.

o. Fair Value Measurements

The University carries certain assets and liabilities 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. The University classifies its financial assets and liabilities that the University has the ability to access at the measurement date based on a valuation method using three levels. Level 1 values are based on quoted prices (unadjusted) in active markets for identical securities. Level 2 values are based on significant observable market inputs, such as quoted prices in inactive markets. Level 3 values are based on significant unobservable inputs that reflect the University's determination of assumptions that market participants might reasonably use in valuing the securities.

p. Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40)*. This ASU requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, which is currently performed by the external auditors. Management is required to perform this assessment for both interim and annual reporting periods and must make certain disclosures if it concludes that substantial doubt exists. The guidance is effective for annual periods ending after December 15, 2016, and for annual periods thereafter. The adoption of this standard by management on August 1, 2016 did not have any effect on the financial statements.

Palo Alto University, Inc.

Notes to the Financial Statements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* which affects any entity that enters into contracts with customers to transfer goods or services. The core principle of the guidance is that an entity should recognize 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. The guidance is effective for annual reporting periods beginning after December 15, 2018. Early adoption is not permitted. The University does not believe the effect of adoption of this standard will have a material impact on its financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-For-Profit Entities*. The amendments in this ASU are designed to improve the current net asset classification requirements and the information presented in the financial statements about a not-for-profit entity's liquidity, financial performance, and cash flows. The amendments in the ASU are effective for annual financial statements issued for fiscal years beginning after December 15, 2017. Early application of the ASU is permitted. The University is currently evaluating the impact of this pronouncement on its financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Under the ASU, a lessee will be required to recognize right-to-use assets and liabilities on their statement of financial position for all leases with lease terms of more than twelve months. The ASU is effective for fiscal years beginning after December 15, 2019. Early application will be permitted for all organizations. The University is currently assessing the impact the adoption of this ASU will have on its financial statements.

q. Subsequent Events

The management of the University evaluated subsequent events with respect to the financial statements for the year ended July 31, 2017 through November 17, 2017, the date these financial statements were available to be issued. Except as discussed in Note 5, there were no material subsequent events that required recognition or additional disclosure in these financial statements.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 2 - Investments and Fair Value Measurements:

The table below presents the balances of assets measured at fair value at July 31, 2017 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds	\$ 196,083	\$ 196,083		
Bonds and fixed income funds	607,110	607,110		
Equity funds	1,228,685	1,228,685		
Alternative strategy funds	355,521	355,521		
Common stock – privately held companies	264,525			\$ 264,525
Total	\$2,651,924	\$2,387,399		\$ 264,525

The table below presents the balances of assets measured at fair value at July 31, 2016 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds	\$ 102,246	\$ 102,246		
Bonds and fixed income funds	373,814	373,814		
Equity funds	595,908	595,908		
Alternative strategy funds	105,849	105,849		
Common stock – privately held companies	255,000			\$ 255,000
Total	\$1,432,817	\$1,177,817		\$ 255,000

An investment's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. There has been no change in the methodology used for July 31, 2017 and 2016.

Level 3 assets and liabilities measured on a recurring basis increased by \$9,525 and \$60,000 through donation of shares for the year ended July 31, 2017 and 2016, respectively.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 3 - Contributions Receivable, Net:

Contributions receivable as of July 31, consisted of the following:

	2017	2016
Unconditional promises to be collected in the short-term:		
Less than one year (net of allowance for uncollectible contributions of \$57,158 and \$34,015, respectively)	\$ 792,656	\$ 937,053
Unconditional promises to be collected in the long-term:		
Two to five years	349,650	581,100
More than five years	26,085	49,252
	375,735	630,352
Less discount to present value	(85,714)	(97,606)
Net long-term contributions receivable	\$ 290,021	\$ 532,746

Note 4 - Property and Equipment:

Property and equipment as of July 31 consisted of the following:

	2017	2016
Land	\$ 2,950,000	\$ 2,950,000
Building	4,723,667	4,687,324
Furniture and equipment	2,649,986	2,492,732
Library books	1,207,767	1,154,259
Software	890,298	890,298
	12,421,718	12,174,613
Less accumulated depreciation and amortization	(4,640,795)	(3,965,599)
	\$ 7,780,923	\$ 8,209,014

Palo Alto University, Inc.

Notes to the Financial Statements

Note 5 - Leases:

The University leases classroom and clinical space under non-cancelable operating leases with monthly payments ranging from \$868 to \$44,837 expiring at various times through May 2020. In 2017, the University entered into a new lease commencing August 2017 for classroom and clinical space under a noncancelable operating lease, expiring in October 2024, with monthly payments ranging from \$79,441 to 97,703. This lease provides the University with an option to extend the lease for three years

The University's academic and facility agreement with Foothill-De Anza Community College, grants the University a non-exclusive permit for the use and occupancy of certain classroom space and administrative offices. Monthly payments over the lease term, which ends July 31, 2018, range from \$13,141 to \$13,942.

The future minimum lease payments under the above leases are as follows:

Year ending July 31,	
2018	\$ 972,100
2019	992,300
2020	1,020,000
2021	1,041,700
2022	1,072,900
Thereafter	2,536,500
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Total minimum lease payments	\$ 7,635,500

Total rent expense was \$879,444 and \$846,752 for the years ended July 31, 2017 and 2016, respectively.

Note 6 - Credit Agreements:

As of July 31, 2017 and 2016, there was no outstanding balance on the \$1,500,000 line of credit with Comerica Bank. The agreement requires, among other things, compliance with covenants including a certain positive change in net assets, and timely submission of internal and external financial statements. The agreement is secured by investments and real and personal property, can expire on demand and is to be reviewed on an annual basis. At July 31, 2017 and 2016, the University was in compliance with all of the covenants.

The University has no outstanding debt at July 31, 2017 and therefore its maximum annual debt service would be zero for the year ending in 2018.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 7 - Related Party Transactions:

Contributions receivable, prior to discounts or allowances, from employees of the University and members of its Board of Trustees totaled \$895,131 and \$1,128,950 at July 31, 2017 and 2016, respectively. The contributions received from employees of the University and members of its Board of Trustees totaled \$1,475 and \$210,093 at July 31, 2017 and 2016, respectively.

Note 8 - Unrestricted Net Assets:

Unrestricted net assets as of July 31 are comprised of the following:

	2017	2016
Board designated - endowment	\$ 1,933,148	\$ 745,589
Undesignated	12,952,340	11,726,525
	<hr/>	<hr/>
	\$ 14,885,488	\$ 12,472,114

Note 9 - Temporarily Restricted Net Assets:

Temporarily restricted net assets are available for the following purposes as of July 31:

	2017	2016
Project and program purpose restriction:		
Student fellowships	\$ 418,935	\$ 597,291
Faculty chair	107,000	128,000
Other programs	306,461	116,194
Time restricted	89,208	220,426
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	\$ 921,604	\$ 1,061,911

Palo Alto University, Inc.

Notes to the Financial Statements

Temporarily restricted net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors for the fiscal year ended July 31 as follows:

	2017	2016
Expiration of time restrictions	\$ 224,312	\$ 304,646
Purpose restriction met:		
Student fellowship	12,034	36,672
Faculty chair	2,000	3,000
	<hr/>	<hr/>
	\$ 238,346	\$ 344,318

Note 10 - Endowment:

The University's endowments consist of eight individual funds, all established to generate support for the University's general operations, tuition assistance and programs. Its endowment includes donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments.

Consistent with the State Prudent Management of Institutional Funds Act (SPMIFA) and Board policy, the University classifies as permanently restricted net assets the original value of gifts of donor-restricted endowment funds and, if applicable, accumulations of donor-restricted endowment funds as required by the donor. Accumulated earnings of donor-restricted endowment funds are classified as temporarily restricted net assets until distributed in accordance with SPMIFA and Board policy.

In accordance with SPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) The duration and preservation of the fund, (2) the purposes of the University and the donor-restricted endowment fund, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the University, (7) the investment policies of the University.

The University has adopted investment and spending policies for endowment assets that will ultimately provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets.

To achieve a long-term investment rate-of-return, 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 is reinvesting all unspent interest and gain associated with its endowments.

Palo Alto University, Inc.

Notes to the Financial Statements

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level classified as permanently restricted net assets. In accordance with U.S. GAAP, deficiencies of this nature are reported in unrestricted net assets. At July 31, 2017 and 2016, there were no such amounts.

Endowment net asset composition as of July 31, 2017 was:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted Board designated:		\$ 685,282	\$ 685,282
Earnings available for general use	\$ 1,933,148		1,933,148
Total Funds	\$ 1,933,148	\$ 685,282	\$ 2,618,430

Changes in endowment net assets for the year ended July 31, 2017 were as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 745,589		\$ 683,082	\$ 1,428,671
Investment income	17,791	\$ 22,023		39,814
Net gain (realized and unrealized)	69,665			69,665
Transfers	1,084,251			1,084,251
Contributions	15,852		2,200	18,052
Appropriated for Expenditure		(22,023)		(22,023)
Change in endowment net assets	1,187,559	-	2,200	1,189,759
Endowment Net Assets end of year	\$ 1,933,148	\$ -	\$ 685,282	\$ 2,618,430

Palo Alto University, Inc.

Notes to the Financial Statements

Endowment net asset composition as of July 31, 2016 was:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted		\$ 683,082	\$ 683,082
Board designated:			
Earnings available for general use	\$ 745,589		745,589
Total Funds	\$ 745,589	\$ 683,082	\$ 1,428,671

Changes in endowment net assets for the year ended July 31, 2016 were as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 719,819		\$ 682,795	\$ 1,402,614
Investment income	16,883			16,883
Net gain (realized and unrealized)	8,887			8,887
Contributions			287	287
Change in endowment net assets	25,770		287	26,057
Endowment Net Assets end of year	\$ 745,589	\$ -	\$ 683,082	\$ 1,428,671

Earnings on permanently restricted net assets are expendable to support the following:

	2017	2016
Gronowski Clinic	\$ 397,277	\$ 395,077
Library	272,566	272,566
Florence Furst Memorial Student Short-Term Loan Fund	10,000	10,000
Scholarships	5,439	5,439
Total permanently restricted	\$ 685,282	\$ 683,082

Permanently restricted net assets represented by pledges receivable totaled \$58,750 and \$59,500 at July 31, 2017 and 2016, respectively.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 11 - Retirement Plan:

Retirement benefits are provided through a defined contribution plan under the Internal Revenue Code, Section 403(b) for the University employees after completing consecutive three months of eligible service. Under the terms of the plan, the University has the option to make contributions to the plan but may choose not to make those contributions in certain years. Eligible participants may contribute amounts not to exceed \$18,000 for calendar years 2017 and 2016, respectively. The University's contributions were \$642,470 and \$638,990 for the periods ended July 31, 2017 and 2016, respectively.

The University also has 457(b) and 457(f) deferred compensation plans which provide eligible employees with the opportunity to defer a portion of their compensation and the University to make contributions for certain employees. For the 457(b) plan, deferrals are made at the discretion of the participants, subject to certain limitations. For the 457(f) plan, the contributions are made by the University on behalf of key employees. Total participant deferrals and employer contributions reflected in the accompanying statements of financial position are \$32,500 and \$146,667 as of July 31, 2017 and 2016, respectively. The assets related to participant deferrals and employer contributions are available to the general creditors of the University and are included in cash and cash equivalents and deferred compensation in the accompanying statements of financial position.

Note 12 - Other Commitments and Contingencies:

On August 30, 2016, the University renewed its agreement with Leland Stanford Junior University (Stanford) whereby Stanford faculty will provide certain instruction to students enrolled in the University's PsyD Program, which began in the fall of 2002. The agreement commenced on September 1, 2016. By consent of both parties, this is an "evergreen contract" with no specific end date. According to the agreement, fees to Stanford are paid four times per academic year based on the number of students enrolled in the program and the University-Stanford faculty sharing of teaching load.

The University receives funds from and administers various federal government funded programs which are subject to audit by the cognizant governmental agencies. The University management believes that the outcome of any such audits will not have a significant effect on the financial position or results of activities of the University.