

PALO ALTO UNIVERSITY, INC.

JULY 31, 2018 AND 2017

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 statement of financial position as of July 31, 2018 and 2017, and the related statements of activities and change in net assets, functional expenses 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, 2018 and 2017 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.

Hood & Strong LLP

San Francisco, California
November 12, 2018

Palo Alto University, Inc.

Statement of Financial Position

<i>July 31,</i>	2018	2017
Assets		
Current Assets:		
Cash and cash equivalents	\$ 9,056,102	\$ 6,878,652
Student receivables, net of allowance of \$761,238 for 2018 and \$586,556 for 2017	8,306,193	8,813,359
Contributions receivable, net	623,391	792,656
Grants receivable	596,074	433,609
Prepaid expenses and other assets	947,537	595,523
Total current assets	19,529,297	17,513,799
Investments	2,840,353	2,651,924
Contributions Receivable, net	134,015	290,021
Property and Equipment, net	8,119,405	7,780,923
Total assets	\$ 30,623,070	\$ 28,236,667
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 2,240,873	\$ 2,203,464
Deferred revenue	9,678,886	9,540,829
Other liabilities	148,104	
Total liabilities	12,067,863	11,744,293
Net Assets:		
Unrestricted	16,874,345	14,885,488
Temporarily restricted	988,626	921,604
Permanently restricted	692,236	685,282
Total net assets	18,555,207	16,492,374
Total liabilities and net assets	\$ 30,623,070	\$ 28,236,667

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Activities and Change in Net Assets

For the Years Ended July 31, 2018 and 2017

	2018				2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:								
Gross tuition	\$ 27,226,139			\$ 27,226,139	\$ 25,961,529			\$ 25,961,529
Gross fees	3,965,399			3,965,399	3,896,778			3,896,778
	31,191,538			31,191,538	29,858,307			29,858,307
Less financial aid	(991,322)			(991,322)	(1,000,718)			(1,000,718)
Net tuition and fees	30,200,216			30,200,216	28,857,589			28,857,589
Contributions	201	\$ 184,845	\$ 6,954	192,000	2,048	\$ 12,225	\$ 2,200	16,473
Grants	838,443			838,443	990,139			990,139
Investment income	92,921	128,368		221,289	33,360	85,814		119,174
Sales and services of educational activities	228,530			228,530	201,639			201,639
Other	211,669			211,669	293,138			293,138
Net assets released from restrictions	246,191	(246,191)		-	238,346	(238,346)		-
Total revenues	31,818,171	67,022	6,954	31,892,147	30,616,259	(140,307)	2,200	30,478,152
Expenses:								
Program services:								
Instruction	19,780,732			19,780,732	18,790,394			18,790,394
Student services	3,876,122			3,876,122	3,728,445			3,728,445
Supporting services:								
Institutional support	5,985,429			5,985,429	5,487,481			5,487,481
Development	187,031			187,031	196,565			196,565
Total expenses	29,829,314	-	-	29,829,314	28,202,885	-	-	28,202,885
Change in Net Assets	1,988,857	67,022	6,954	2,062,833	2,413,374	(140,307)	2,200	2,275,267
Net Assets, beginning of period	14,885,488	921,604	685,282	16,492,374	12,472,114	1,061,911	683,082	14,217,107
Net Assets, end of period	\$ 16,874,345	\$ 988,626	\$ 692,236	\$ 18,555,207	\$ 14,885,488	\$ 921,604	\$ 685,282	\$ 16,492,374

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Functional Expenses

For the Year Ended July 31, 2018

	Student Services				Institutional Support				Total
	Instruction	Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance	Development	
Salaries and wages	\$ 11,273,939	\$ 363,348	\$ 302,900	\$ 1,558,915	\$ 2,245,933	\$ 673,003	\$ 116,008	\$ 117,605	\$ 16,651,651
Benefits	1,618,597	75,967	35,251	298,072	434,493	92,283	22,027	28,953	2,605,643
Consortium payments	3,330,922								3,330,922
Consultants	247,938		995	136,073	473,886	79,312	9,506		947,710
Rent	526,080				78,000	6,360	664,033		1,274,473
Professional dues and license	61,240	377	2,334	12,658	58,629	11	1,375	6,405	143,029
Building maintenance							166,447		166,447
Computer equipment	1,995		101,280		399				103,674
Digital material use fees	45,189	211,392	2,678						263,859
Audit services					126,000				126,000
Graduation				108,799					108,799
Recruiting and job fairs	5,049			33,419	64,550	390			103,408
Licensing fees				73,158	17,188			4,133	94,479
Travel and lodging	163,460	2,621	86	66,002	56,227	21,615	38,129	90	348,230
Meals and entertainment	88,721	276	187	112,302	107,352	10,032	29	2,735	321,634
Temporary agencies			65,072	2,500	74,993		45,564		188,129
Advertising and public relations	6,303			95,758	133,447	19,620		5,760	260,888
Bank and credit card charges	2,356				327,786	175		23	330,340
Bad debt					438,714				438,714
Community relations	26,156	495		29,542	33,617	8,307			98,117
Supplies	30,043	1,689	1,453	13,097	15,041	824	1,087	400	63,634
Utilities and telephone	13,836	1,445	2,624	15,917	28,272		88,052		150,146
Business insurance					178,974	1,494			180,468
Legal	3,092				55,474				58,566
Software site licenses	80,810	99	140,767	65,916	45,384	11,498	12,227		356,701
Other expenses	136,983	47,865	58,861	48,508	73,661	2,132	189,558	932	558,500
	17,662,709	705,574	714,488	2,670,636	5,068,020	931,656	1,354,042	167,036	29,274,161
Depreciation and amortization	3,299	84,450		1,072	43,201		423,131		555,153
Allocations	2,114,724	94,571	(714,488)	319,819	(168,973)	111,525	(1,777,173)	19,995	-
Total Expenses 2018	\$ 19,780,732	\$ 884,595	\$ -	\$ 2,991,527	\$ 4,942,248	\$ 1,043,181	\$ -	\$ 187,031	\$ 29,829,314

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Functional Expenses

For the Year Ended July 31, 2017

	Student Services				Institutional Support				Total
	Instruction	Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance	Development	
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
Professional dues and license	67,751	295	447	34,327	48,598	650	5,359	6,385	163,812
Building maintenance							84,610		84,610
Computer equipment	763	660	26,883	1,245					29,551
Digital material use fees	35,895	128,483	223			4,600	1,378	2,895	173,474
Audit services					139,600				139,600
Graduation	967			91,575	1,288				93,830
Recruiting and job fairs	1,323			44,756	35,480				81,559
Licensing fees				40,300	37,813			6,785	84,898
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
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	233,108	39,689	46,750	61,840	71,306	4,136	110,942	916	568,687
	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.

Statement of Cash Flows

<i>For the Year Ended July 31,</i>	2018	2017
Cash Flows from Operating Activities:		
Change in net assets	\$ 2,062,833	\$ 2,275,267
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation and amortization	555,153	676,385
Change in discount and allowance on contributions receivable	(38,178)	11,250
Net gains on investments	(33,612)	(35,097)
Changes in operating assets and liabilities:		
Student receivables	507,166	(608,929)
Contributions receivable	363,448	375,872
Grants receivable	(162,465)	19,519
Prepaid expenses and other assets	(352,014)	(13,705)
Accounts payable and accrued expenses	37,409	(1,003,140)
Deferred revenue	138,057	963,325
Other liabilities	148,104	
Net cash provided by operating activities	3,225,901	2,660,747
Cash Flows from Investing Activities:		
Purchase of investments	(639,641)	(1,535,265)
Proceeds from the sale of investments	484,824	351,254
Purchase of property and equipment	(893,634)	(248,431)
Proceeds from the sale property and equipment		138
Net cash used by investing activities	(1,048,451)	(1,432,304)
Net Change in Cash and Cash Equivalents	2,177,450	1,228,443
Cash and Cash Equivalents, beginning of the period	6,878,652	5,650,209
Cash and Cash Equivalents, end of the period	\$ 9,056,102	\$ 6,878,652

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), founded in 1975 as Pacific Graduate School of Psychology, is a private, not-for-profit educational institution dedicated to improving the human condition through excellence in teaching, research and scholarship in the fields of psychology and counseling. With an unwavering commitment to diversity and to the communities it serves, PAU offers doctorate, master's and bachelor's programs, as well as hands-on clinical training. PAU is accredited by the Western Association of Schools and Colleges (WASC).

PAU has many collaborative partnerships with community organizations and institutions, including Stanford School of Medicine, the Department of Veterans Affairs, Palo Alto Medical Center, and other mental health care organizations. PAU's Gronowski Center teaching clinic 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.

Unrestricted Net Assets – The portion of net assets that is neither temporarily restricted nor permanently restricted by donor-imposed stipulations.

Temporarily Restricted Net Assets – The portion of net assets whose use by the University is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the University. Also included in temporarily restricted net assets are earnings on endowment-type funds that have not been appropriated for expenditure.

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

Palo Alto University, Inc.

Notes to the Financial Statements

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 Grants Receivable

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.

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.

Palo Alto University, Inc.

Notes to the Financial Statements

h. Revenue Recognition

Student receivable accounts are recorded when students are billed. Tuition and fee 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.

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 are recognized as earned, on a pro rata basis over the applicable teaching period. Grant revenues are recognized as grant expenditures are incurred.

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. Advertising Expenses

The University's policy is to expense advertising costs as they are incurred. Advertising costs for the year ended July 31, 2018 and 2017 were \$260,888 and \$308,515, respectively.

Palo Alto University, Inc.

Notes to the Financial Statements

k. 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.

l. 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, 2018 and 2017, 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.

m. 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.

n. 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.

Palo Alto University, Inc.

Notes to the Financial Statements

o. Reclassifications

Certain prior year amounts in the accompanying financial statements and notes have been reclassified to conform to the 2018 presentation. These reclassifications had no effect on the University's change in net assets as previously reported.

p. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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 University evaluated subsequent events from July 31, 2018 through November 12, 2018, the date these financial statements were available to be issued. Except as follows, there were no material subsequent events that required recognition or additional disclosure in these financial statements.

On November 1, 2018, the University agreed to acquire Consolidated Continuing Education and Professional Training, LLC dba CONCEPT, LLC. whereby the University obtained sole ownership of CONCEPT, LLC for an initial payment of \$750,000 which will be paid on or before December 1, 2018. Future payments will be made based upon the entity's performance.

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, 2018 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds	\$ 169,889	\$ 169,889		
Bonds and fixed income funds	710,282	710,282		
Equity funds	1,364,999	1,364,999		
Alternative strategy funds	330,658	330,658		
Common stock – privately held companies	264,525			\$ 264,525
Total	\$ 2,840,353	\$ 2,575,828		\$ 264,525

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

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, 2018 and 2017.

The change in level 3 assets and liabilities measured on a recurring basis for the year ended July 31, 2018 was immaterial. There was a \$9,525 increase for the year ended July 31, 2017.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 3 - Contributions Receivable:

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

	2018	2017
Unconditional promises to be collected in the short-term:		
Less than one year (net of allowance for uncollectible contributions of \$57,158)	\$ 623,391	\$ 792,656
Unconditional promises to be collected in the long-term:		
Two to five years	167,426	349,650
More than five years	14,126	26,085
	181,552	375,735
Less discount to present value	(47,537)	(85,714)
Net long-term contributions receivable	\$ 134,015	\$ 290,021

Note 4 - Property and Equipment:

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

	2018	2017
Land	\$ 2,950,000	\$ 2,950,000
Building	4,807,249	4,723,667
Furniture and equipment	3,347,103	2,649,986
Library books	1,262,642	1,207,767
Software	948,359	890,298
	13,315,353	12,421,718
Less accumulated depreciation and amortization	(5,195,948)	(4,640,795)
	\$ 8,119,405	\$ 7,780,923

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 \$97,703 expiring at various times through October 2024. One classroom space lease provides the University with an option to extend the lease for three years.

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

Year ending July 31,	
2019	\$ 1,062,000
2020	1,020,000
2021	1,041,700
2022	1,072,900
2023	1,105,100
Thereafter	1,431,400
<hr/>	
Total minimum lease payments	\$ 6,733,100

Total rent expense under the above operating leases was \$1,299,261 and \$879,444 for the years ended July 31, 2018 and 2017, respectively.

Note 6 - Credit Agreements:

The University has a \$1,500,000 line of credit with Comerica Bank. As of July 31, 2018 and 2017, there was no outstanding balance on the line of credit. 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, 2018 and 2017, the University was in compliance with all of the covenants.

The University has no outstanding debt at July 31, 2018 and therefore its maximum annual debt service would be zero for the year ending in 2019.

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 \$618,174 and \$895,131 at July 31, 2018 and 2017, respectively. The contributions received from employees of the University and members of its Board of Trustees totaled \$108,444 and \$1,475 at July 31, 2018 and 2017, respectively.

Note 8 - Unrestricted Net Assets:

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

	2018	2017
Board designated - endowment	\$ 2,098,213	\$ 1,933,148
Undesignated	14,776,132	12,952,340
	<hr/>	<hr/>
	\$ 16,874,345	\$ 14,885,488

Note 9 - Temporarily Restricted Net Assets:

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

	2018	2017
Project and program purpose restriction:		
Student fellowships	\$ 319,427	\$ 418,935
Faculty chair	33,959	107,000
Other programs	626,198	306,461
Time restricted	9,042	89,208
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	\$ 988,626	\$ 921,604

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:

	2018	2017
Expiration of time restrictions	\$ 233,191	\$ 224,312
Purpose restriction met:		
Student fellowship	12,000	12,034
Faculty chair	1,000	2,000
	<hr/>	<hr/>
	\$ 246,191	\$ 238,346

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, 2018 and 2017, there were no such amounts.

Endowment net asset composition as of July 31, 2018 was:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted		\$ 692,236	\$ 692,236
Board designated:			
Earnings available for general use	\$ 2,098,213		2,098,213
Total Funds	\$ 2,098,213	\$ 692,236	\$ 2,790,449

Changes in endowment net assets for the year ended July 31, 2018 were as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 1,933,148		\$ 685,282	\$ 2,618,430
Investment income	44,022	\$ 23,363		67,385
Net gain (realized and unrealized)	109,058			109,058
Transfers	11,985			11,985
Contributions			6,954	6,954
Appropriated for expenditure		(23,363)		(23,363)
Change in endowment net assets	165,065	-	6,954	172,019
Endowment Net Assets, end of year	\$ 2,098,213	\$ -	\$ 692,236	\$ 2,790,449

Palo Alto University, Inc.

Notes to the Financial Statements

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

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted		\$ 685,282	\$ 685,282
Board designated:			
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

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

	2018	2017
Gronowski Clinic	\$ 402,976	\$ 397,277
Library	273,821	272,566
Florence Furst Memorial Student Short-Term Loan Fund	10,000	10,000
Scholarships	5,439	5,439
Total permanently restricted	\$ 692,236	\$ 685,282

Permanently restricted net assets represented by pledges receivable totaled \$38,750 and \$58,750 at July 31, 2018 and 2017, respectively.

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 \$18,500 and \$18,000 for calendar years 2018 and 2017, respectively. The University's contributions were \$685,621 and \$642,470 for the periods ended July 31, 2018 and 2017, 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 are \$30,000 and \$32,500 as of July 31, 2018 and 2017, respectively, and are included in the accompanying statement of financial position. 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 accounts payable and accrued expenses in the accompanying statement of financial position.

Palo Alto University, Inc.

Notes to the Financial Statements

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.