

PALO ALTO UNIVERSITY, INC.

JULY 31, 2019 AND 2018

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

Palo Alto University, Inc.

Independent Auditors' Report and Financial Statements

Independent Auditors' Report	1 - 2
Financial Statements	
Statement of Financial Position	3
Statement of Activities and Change in Net Assets	4
Statement of Functional Expenses	5
Statement of Cash Flows	6
Notes to Financial Statements	7 - 22



A Century Strong

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, 2019 and 2018, and the related statements of activities and change in net assets, and cash flows for the years then ended and the statement of functional expenses for the year ended July 31, 2019 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, 2019 and 2018 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.

Effect of Adopting New Accounting Standard

As described in Note 2, the University adopted the Financial Accounting Standards Board Accounting Standards Update (ASU) 2016-14, *Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Accordingly, the accounting change has been retrospectively applied to prior periods presented with the exception of the omission of certain information as permitted by the ASU. Our opinion is not modified with respect to that matter.

Hood & Strong LLP

San Francisco, California
November 26, 2019

Palo Alto University, Inc.

Statement of Financial Position

<i>July 31,</i>	2019	2018
Assets		
Current Assets:		
Cash and cash equivalents	\$ 10,939,827	\$ 9,056,102
Student receivables, net of allowance of \$796,723 for 2019 and \$761,238 for 2018	8,308,443	8,306,193
Contributions receivable, net	401,858	623,391
Grants receivable	516,402	596,074
Prepaid expenses and other assets	831,184	947,537
Total current assets	20,997,714	19,529,297
Investments	2,959,144	2,840,353
Contributions Receivable, net	78,720	134,015
Property and Equipment, net	8,646,668	8,119,405
Goodwill	573,000	-
Total assets	\$ 33,255,246	\$ 30,623,070
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 3,384,860	\$ 2,240,873
Deferred revenue	9,547,125	9,678,886
Contingent consideration	413,000	-
Other liabilities	188,097	148,104
Total liabilities	13,533,082	12,067,863
Net Assets:		
Without donor restrictions	18,195,141	16,874,345
With donor restrictions	1,527,023	1,680,862
Total net assets	19,722,164	18,555,207
Total liabilities and net assets	\$ 33,255,246	\$ 30,623,070

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Activities and Change in Net Assets

Years Ended July 31, 2019 and 2018

	2019			2018		
	Without Donor Restrictions	With Donor Restrictions	Total	Without Donor Restrictions	With Donor Restrictions	Total
Revenues:						
Gross tuition	\$ 27,823,186		\$ 27,823,186	\$ 27,226,139		\$ 27,226,139
Gross fees	3,964,550		3,964,550	3,965,399		3,965,399
	31,787,736		31,787,736	31,191,538		31,191,538
Less financial aid	(965,423)		(965,423)	(991,322)		(991,322)
Net tuition and fees	30,822,313		30,822,313	30,200,216		30,200,216
Contributions	14,812	\$ 53,639	68,451	201	\$ 191,799	192,000
Grants	484,480		484,480	838,443		838,443
Investment income	385,745	(104,347)	281,398	92,921	128,368	221,289
Sales and services of educational activities	661,896		661,896	228,530		228,530
Other	188,759		188,759	211,669		211,669
Net assets released from restrictions	103,131	(103,131)	-	246,191	(246,191)	-
Total revenues	32,661,136	(153,839)	32,507,297	31,818,171	73,976	31,892,147
Expenses:						
Program services:						
Instruction	20,300,498		20,300,498	19,780,732		19,780,732
Student services	4,094,025		4,094,025	3,876,122		3,876,122
Supporting services:						
Institutional support	6,945,817		6,945,817	5,985,429		5,985,429
Development				187,031		187,031
Total expenses	31,340,340	-	31,340,340	29,829,314	-	29,829,314
Change in Net Assets	1,320,796	(153,839)	1,166,957	1,988,857	73,976	2,062,833
Net Assets, beginning of period	16,874,345	1,680,862	18,555,207	14,885,488	1,606,886	16,492,374
Net Assets, end of period	\$ 18,195,141	\$ 1,527,023	\$ 19,722,164	\$ 16,874,345	\$ 1,680,862	\$ 18,555,207

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Functional Expenses

Year Ended July 31, 2019

	Student Services				Institutional Support		Total Supporting Services	Total
	Instruction	Library	Student Services	Total Program Expenses	General & Administrative	Sponsored Programs		
Salaries and wages	\$ 12,121,834	\$ 384,291	\$ 1,678,934	\$ 14,185,059	\$ 2,561,949	\$ 515,270	\$ 3,077,219	\$ 17,262,278
Benefits	1,700,334	66,541	267,659	2,034,534	436,477	54,126	490,603	2,525,137
Consortium payments	3,314,238			3,314,238				3,314,238
Consultants	865,301		232,380	1,097,681	634,484	47,976	682,460	1,780,141
Rent	670,108		26,590	696,698	572,851	19,254	592,105	1,288,803
Professional dues and license	73,173	261	22,003	95,437	73,537	597	74,134	169,571
Building maintenance	144,719			144,719				144,719
Computer equipment	4,689			4,689	58,878	1,658	60,536	65,225
Digital material use fees	29,195	155,467		184,662	926	3,425	4,351	189,013
Audit services			100	100	136,300		136,300	136,400
Graduation			120,748	120,748	4,415		4,415	125,163
Recruiting and job fairs	4,991		94,334	99,325	92,864		92,864	192,189
Licensing fees	2,498		48,637	51,135	45,505		45,505	96,640
Travel and lodging	222,808	6,883	64,093	293,784	68,112	13,258	81,370	375,154
Meals and entertainment	101,521	562	130,730	232,813	133,538	4,063	137,601	370,414
Temporary agencies	78,364		15,643	94,007	150,879		150,879	244,886
Advertising and public relations	11,669		52,083	63,752	60,636	500	61,136	124,888
Bank and credit card charges	13,235			13,235	363,725		363,725	376,960
Bad debt					352,270		352,270	352,270
Community relations	13,571	220	13,236	27,027	22,515	1,064	23,579	50,606
Supplies	25,581	3,641	26,191	55,413	19,324		19,324	74,737
Utilities and telephone	95,531	2,356	15,469	113,356	28,700		28,700	142,056
Business insurance					156,572		156,572	156,572
Legal					72,126		72,126	72,126
Software site licenses	186,023	60,533	176,479	423,035	20,359	40,683	61,042	484,077
Depreciation and amortization	370,262	293,249	5,772	669,283	9,620	9,619	19,239	688,522
Other expenses	250,853	36,947	91,993	379,793	121,304	36,458	157,762	537,555
Total Expenses	\$ 20,300,498	\$ 1,010,951	\$ 3,083,074	\$ 24,394,523	\$ 6,197,866	\$ 747,951	\$ 6,945,817	\$ 31,340,340

See accompanying notes to financial statements.

Palo Alto University, Inc.

Statement of Cash Flows

<i>For the Year Ended July 31,</i>	2019	2018
Cash Flows from Operating Activities:		
Change in net assets	\$ 1,166,957	\$ 2,062,833
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	688,522	555,153
Change in discount and allowance on contributions receivable	(32,663)	(38,178)
Net (loss) gain on investments	(26,746)	(33,612)
Changes in operating assets and liabilities:		
Student receivables	(2,250)	507,166
Contributions receivable	309,491	363,448
Grants receivable	79,672	(162,465)
Prepaid expenses and other assets	116,353	(352,014)
Accounts payable and accrued expenses	1,143,987	37,409
Deferred revenue	(131,761)	138,057
Contingent consideration	413,000	-
Other liabilities	39,993	148,104
Net cash provided by operating activities	3,764,555	3,225,901
Cash Flows from Investing Activities:		
Purchase of investments	(1,200,111)	(639,641)
Proceeds from the sale of investments	1,108,066	484,824
Purchase of property and equipment	(1,215,785)	(893,634)
Goodwill from acquisition	(573,000)	-
Net cash used by investing activities	(1,880,830)	(1,048,451)
Net Change in Cash and Cash Equivalents	1,883,725	2,177,450
Cash and Cash Equivalents, beginning of the period	9,056,102	6,878,652
Cash and Cash Equivalents, end of the period	\$ 10,939,827	\$ 9,056,102

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.

c. Basis of Presentation

The University's resources are classified according to the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the University and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions are not subject to donor-imposed restrictions and include board-designated funds functioning as endowments which have been set aside for special programs, capital projects, and to act as endowment funds.

Net Assets With Donor Restrictions are subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or by satisfying restrictions specified by the donor. Other donor restrictions are perpetual in nature, where by the donor has stipulated the funds be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Net assets with donor restrictions consist primarily of restricted grants, pledges, and contributions, together with income specifically restricted by 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. 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.

i. Goodwill

Goodwill represents the excess of the cost of net assets acquired over the fair value of identifiable net assets at the date of acquisition. Goodwill acquired and determined to have an indefinite useful life is not amortized but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. Goodwill impairment tests consist of a comparison of the reporting unit's fair value with its carrying value. Impairment exists when the carrying amount of goodwill exceeds the implied fair value for the reporting unit. The evaluation of impairment requires the University to make assumptions about future cash flows over the life of the asset being evaluated. These assumptions require significant judgment and are subject to change as future events and circumstances change. Actual results may differ from assumed and estimated amounts. Management determined that no impairment write-downs were required as of July 31, 2019.

j. Revenue Recognition

Student receivables are recorded when students are billed. Tuition and fee revenues are recorded as earned, on a pro rata basis over the applicable teaching period. 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 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, net assets with donor restrictions are reclassified to net assets without donor restrictions 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 net assets without donor restrictions.

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.

Palo Alto University, Inc.

Notes to the Financial Statements

Grant revenues are recognized as grant expenditures are incurred.

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.

k. Advertising Expenses

The University's policy is to expense advertising costs as they are incurred. Advertising costs for the year ended July 31, 2019 and 2018 were \$124,888 and \$260,888, respectively.

l. Functional Expense Allocations

The costs of providing various programs and activities have been summarized on a functional basis in the statement of activities and change in net assets. 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. Allocations for other information technology and operations and maintenance are based on a percentage of the total expenses. The remaining expenses are allocated based on a direct identification methodology.

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, 2019 and 2018, 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.

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.

Palo Alto University, Inc.

Notes to the Financial Statements

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. Reclassifications

Certain prior year amounts in the accompanying financial statements and notes have been reclassified to conform to the 2019 presentation. These reclassifications had no effect on the University's change in net assets as previously reported.

q. Recent Accounting Pronouncements

Pronouncements Adopted

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958) Presentation of Financial Statements of Not-for-Profit Entities*, which changes presentation and disclosure requirements for nonprofit entities to provide more relevant information about their resources (and the changes in those resources) to donors, granters, creditors, and other users. These include qualitative and quantitative requirements in the following areas: net asset classes, investment return, expenses, and liquidity. This ASU was adopted as of August 1, 2018. Accordingly, the accounting change has been retrospectively applied to all periods presented with the exception of the omission of prior year liquidity and availability of resource information and functional expenses as permitted by the ASU.

Palo Alto University, Inc.

Notes to the Financial Statements

Pronouncements effective in the future

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* related to revenue recognition. The new guidance sets forth a new five-step revenue recognition model which replaces the prior revenue recognition guidance in its entirety and is intended to eliminate numerous industry-specific pieces of revenue recognition guidance that have historically existed in U.S. GAAP. Under the ASU, revenue will be recognized to depict the transfer of promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. The ASU requires more detailed disclosures and is effective for annual periods beginning after December 15, 2018. Early adoption 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)*. The amendments in this update will supersede much of the existing authoritative guidance for leases. This guidance requires lessees, among other things, to recognize right-of-use assets and liabilities on their balance sheet for all leases with lease terms longer than twelve months. The standard will be effective for the University for its fiscal year beginning after December 15, 2019 with early application permitted. Entities are required to use the modified retrospective application for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements with the option to elect certain transition reliefs. The University is currently evaluating the impact of this pronouncement on its financial statements.

r. Subsequent Events

The University evaluated subsequent events from July 31, 2019 through November 26, 2019, the date these financial statements were available to be issued. There were no material subsequent events that required recognition or additional disclosure in these financial statements.

Note 2 - Investments and Fair Value Measurements:

The table below presents the balances of assets measured at fair value at July 31, 2019 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds	\$ 240,727	\$ 240,727		
Bonds and fixed income funds	849,986	849,986		
Equity funds	1,484,304	1,484,304		
Alternative strategy funds	314,602	314,602		
Common stock – privately held companies	69,525			\$ 69,525
Total	\$ 2,959,144	\$ 2,889,619	\$ -	\$ 69,525

Palo Alto University, Inc.

Notes to the Financial Statements

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

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, 2019 and 2018.

The change in level 3 assets and liabilities measured on a recurring basis for the year ended July 31, 2019 was a \$195,000 realized loss on the write off of private common stock (Avantis Medical). The change for the year ended July 31, 2018 was immaterial.

Note 3 - Contributions Receivable:

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

	2019	2018
Unconditional promises to be collected in the short-term:		
Less than one year (net of allowance for uncollectible contributions of \$57,158)	\$ 401,858	\$ 623,391
Unconditional promises to be collected in the long-term:		
Two to five years	80,634	167,426
More than five years	12,960	14,126
Less discount to present value	(14,874)	(47,537)
Net long-term contributions receivable	\$ 78,720	\$ 134,015

Palo Alto University, Inc.

Notes to the Financial Statements

Note 4 - Property and Equipment:

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

	2019	2018
Land	\$ 2,950,000	\$ 2,950,000
Building	4,956,599	4,807,249
Furniture and equipment	3,668,212	3,347,103
Library books	1,345,321	1,262,642
Software	1,611,003	948,359
	<hr/>	<hr/>
	14,531,135	13,315,353
Less accumulated depreciation and amortization	(5,884,467)	(5,195,948)
	<hr/>	<hr/>
	\$ 8,646,668	\$ 8,119,405

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,	
2020	\$ 1,152,200
2021	1,041,700
2022	1,072,900
2023	1,105,100
2024	1,138,300
Thereafter	293,100
	<hr/>
Total minimum lease payments	\$ 5,803,300

Total rent expense under the above operating leases was \$1,214,083 and \$1,203,760 for the years ended July 31, 2019 and 2018, respectively.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 6 - Credit Agreements:

The University has a \$1,500,000 line of credit with Comerica Bank. As of July 31, 2019 and 2018, 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, 2019 and 2018, the University was in compliance with all of the covenants.

The University has no outstanding debt at July 31, 2019 and therefore its maximum annual debt service would be zero for the year ending in 2020.

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 \$465,124 and \$618,174 at July 31, 2019 and 2018, respectively. The contributions received from employees of the University and members of its Board of Trustees totaled \$52,989 and \$108,444 at July 31, 2019 and 2018, respectively.

Note 8 - Net Assets Without Donor Restrictions:

Net assets without donor restriction as of July 31 are comprised of the following:

	2019	2018
Board designated	\$ 10,464,161	\$ 2,098,213
Undesignated	7,730,980	14,776,132
	<hr/>	<hr/>
	\$ 18,195,141	\$ 16,874,345

PAU's governing board has designated net assets without donor restrictions for the following purposes as of July 31:

	2019	2018
Quasi-endowment	\$ 2,240,602	\$ 2,098,213
Liquidity reserve	8,223,559	
	<hr/>	<hr/>
	\$ 10,464,161	\$ 2,098,213

Palo Alto University, Inc.

Notes to the Financial Statements

Note 9 - Net Assets With Donor Restrictions:

Net assets with donor restrictions are available for the following purposes as of July 31:

	2019	2018
Endowments restricted in perpetuity by donors subject to spending policy and appropriation	\$ 594,739	\$ 692,236
Project and program purpose restriction:		
Student fellowships	163,802	319,427
Faculty chair	15,625	33,959
Other programs	752,857	626,198
Time restricted		9,042
	932,284	988,626
	\$ 1,527,023	\$ 1,680,862

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction, by the passage of time, or by the occurrence of other specific events by donors for the fiscal year ended July 31 as follows:

	2019	2018
Expiration of time restrictions	\$ 90,798	\$ 233,191
Purpose restriction met:		
Student fellowship	11,333	12,000
Faculty chair	1,000	1,000
Private common stock write-off	150,000	
	\$ 253,131	\$ 246,191

Palo Alto University, Inc.

Notes to the Financial Statements

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 net assets with donor restrictions 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 net assets with donor restrictions 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.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the amount to be maintained in perpetuity. In accordance with U.S. GAAP, deficiencies of this nature are reported in net assets with donor restrictions. At July 31, 2019 and 2018, there were no such amounts.

Endowment net asset composition as of July 31, 2019 was:

	Without Donor <u>Restrictions</u>	With Donor <u>Restrictions</u>	<u>Total</u>
Donor restricted		\$ 594,739	\$ 594,739
Board designated	\$ 2,240,602		2,240,602
Total funds	\$ 2,240,602	\$ 594,739	\$ 2,835,341

Palo Alto University, Inc.

Notes to the Financial Statements

Changes in endowment net assets for the year ended July 31, 2019 were as follows:

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions Time or Purpose</u>	<u>Perpetuity</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 2,098,213		\$ 692,236	\$ 2,790,449
Investment income	46,738	\$ 12,295		59,033
Net gain (realized and unrealized)	20,399		(150,000)	(129,601)
Transfers	75,252			75,252
Contributions			52,503	52,503
Appropriated for Expenditure		(12,295)		(12,295)
 Change in endowment net assets	 142,389	 -	 (97,497)	 44,892
 Endowment Net Assets, end of year	 \$ 2,240,602	 \$ -	 \$ 594,739	 \$ 2,835,341

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

	<u>With Donor Restrictions</u>	<u>Without Donor Restrictions</u>	<u>Total</u>
Donor restricted		\$ 692,236	\$ 692,236
Board designated	\$ 2,098,213		2,098,213
 Total funds	 \$ 2,098,213	 \$ 692,236	 \$ 2,790,449

Palo Alto University, Inc.

Notes to the Financial Statements

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

	<u>Without Donor Restrictions</u>		<u>With Donor Restrictions</u>	
			<u>Time or Purpose</u>	<u>Perpetuity</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

Net assets with perpetuity restrictions as of July 31, for which earnings are to be used for the following purposes are as follows:

	2019	2018
Gronowski Clinic	\$ 403,976	\$ 402,976
Library	124,021	273,821
Florence Furst Memorial Student Short-Term Loan Fund	10,000	10,000
Scholarships	5,439	5,439
Christine Blasey Endowed Scholarship	51,303	
Total net assets with perpetuity restrictions	\$ 594,739	\$ 692,236

Net assets with donor restrictions represented by pledges receivable totaled \$38,750 at July 31, 2019 and 2018.

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 University employees after completing consecutive three months of eligible service. Under the terms of the plan, the University has the option to make discretionary contributions to the plan. Eligible participants may contribute amounts not to exceed \$19,000 and \$18,500 for calendar years 2019 and 2018, respectively. The University's contributions were \$697,491 and \$685,621 for the periods ended July 31, 2019 and 2018, 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 as of July 31, 2019 and 2018. 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.

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.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 13 - Availability of Financial Assets and Liquidity:

The University's financial assets available within one year at July 31, 2019 for general expenditures are as follows:

Financial assets at year-end:	
Cash and cash equivalents	\$ 10,939,827
Student receivables, net of allowance	8,308,443
Contributions receivable	480,578
Grants receivable	516,402
Investments	2,959,144
<hr/>	
Total financial assets	23,204,394
<hr/>	
Less amounts not available to be used within one year:	
Net assets with donor restrictions	(1,527,023)
Net assets designated by the board	(10,464,161)
Long term contributions receivable	(78,720)
<hr/>	
	(12,069,904)
<hr/>	
Financial assets available to meet general expenditures within one year	\$ 11,134,490

The University's goal is generally to maintain financial assets to meet 3 months (90 days) of operating expenses (approximately \$7,800,000). As part of its liquidity plan, excess cash is invested in the short-term reserve fund. The University has a \$1,500,000 line of credit available for use.

Note 14 - Acquisition:

On December 1, 2018, the University acquired all assets in Consolidated Continuing Education and Professional Training, LLC d/b/a CONCEPT, LLC for a total purchase price of \$750,000 in cash, and \$413,000 in contingent consideration. The results of CONCEPT, LLC are included in the University's financial statements since the date of acquisition.

CONCEPT, LLC is a world-class provider of premium online professional training for mental health professionals, with a reputation for excellence in forensic psychology. CONCEPT, LLC adds to the University's post-graduate education and training. The goodwill from the acquisition will provide the foundation for continuing and professional studies, a new program at the University.

Palo Alto University, Inc.

Notes to the Financial Statements

Assets acquired at the date of acquisition consisted of:

Property and equipment	\$ 590,000
Goodwill	573,000
<hr/>	
Purchase price	\$ 1,163,000
<hr/>	

The contingent consideration is based on the University achieving certain revenue goals measured in the trailing fiscal years ending July 31, 2020, 2021, 2022 and 2023, successively. At the date of acquisition, the University assessed the probability of payout on the contingent portion of the purchase price consideration and determined the fair value estimate of the payouts at \$466,000, before net of present value discount of \$53,000.