

PALO ALTO UNIVERSITY, INC.

JULY 31, 2012 AND 2011

---

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

# **Palo Alto University, Inc.**

## **Independent Auditors' Report and Financial Statements**

---

<b>Independent Auditors' Report</b>	<b>1 - 2</b>
-------------------------------------	--------------

### **Financial Statements**

Statement of Financial Position	3
Statement of Activities and Changes in Net Assets	4
Schedule of Functional Expenses - 2012	5
Schedule of Functional Expenses - 2011	6
Statement of Cash Flows	7
Notes to Financial Statements	8 - 21



## Independent Auditors' Report

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

We have audited the accompanying statement of financial position of the **PALO ALTO UNIVERSITY, INC. (the University)** as of July 31, 2012 and 2011 and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2012 and 2011 and the change in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules of functional expense are presented for purposes of additional analysis and is 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.

*Consultants and*

*Business Advisors*

*100 First Street*

*14<sup>th</sup> Floor*

*San Francisco*

*CA 94105*

*415.781.0793*

*fax 415.421.2976*

*60 S. Market Street*

*Suite 200*

*San Jose*

*CA 95113*

*408.998.8400*

*fax 408.998.8485*



The information has been subjected to the auditing procedures applied in our 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 taken as a whole.

*Hood & Strong LLP*

San Francisco, California  
February 22, 2013

# Palo Alto University, Inc.

## Statement of Financial Position

<i>July 31,</i>	2012	2011
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 5,412,547	\$ 3,678,092
Student receivable, net of allowance of \$142,380 for 2012 and \$72,819 for 2011	5,351,477	3,726,079
Contributions receivable, net	428,372	488,779
Grant receivable	27,000	118,367
Prepaid expenses and other assets	169,720	395,845
Total current assets	11,389,116	8,407,162
<b>Long-Term Investments</b>	1,036,775	948,877
<b>Contributions Receivable, net</b>	529,218	708,371
<b>Property and Equipment, net</b>	8,377,751	7,088,260
Total assets	\$ 21,332,860	\$ 17,152,670
<b>Liabilities and Net Assets</b>		
<b>Liabilities:</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 1,608,951	\$ 1,234,390
Student payables	6,184	10,000
Deferred rent	43,149	65,480
Deferred tuition revenue	5,008,846	3,426,118
Deferred grant revenue	400	6,690
Deferred compensation	173,333	13,333
Total current liabilities	6,840,863	4,756,011
Note payable	1,559,185	1,622,508
Total liabilities	8,400,048	6,378,519
<b>Net Assets:</b>		
Unrestricted	11,611,962	9,132,630
Temporarily restricted	661,582	994,915
Permanently restricted	659,268	646,606
Total net assets	12,932,812	10,774,151
Total liabilities and net assets	\$ 21,332,860	\$ 17,152,670

The accompanying notes are an integral part of this statement.

# Palo Alto University, Inc.

## Statement of Activities and Changes in Net Assets

*For the Years Ended July 31, 2012 and 2011*

	2012				2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenues:</b>								
Gross tuition	\$ 18,794,642			\$ 18,794,642	\$ 16,485,868			\$ 16,485,868
Gross fees	3,112,459			3,112,459	2,586,119			2,586,119
	21,907,101			21,907,101	19,071,987			19,071,987
Less financial aid	(1,280,821)			(1,280,821)	(821,315)			(821,315)
Net tuition and fees	20,626,280			20,626,280	18,250,672			18,250,672
Contributions	175,394	\$ 186,317	\$ 12,662	374,373		\$ 141,443	\$ 6,814	148,257
Grants	450,017			450,017	707,983			707,983
Investment income	13,883			13,883	9,697	6,695		16,392
Sales and services of educational activities	193,015			193,015	186,030			186,030
Other	141,161			141,161	55,450	1,725		57,175
Net assets released from restrictions	519,650	(519,650)		-	344,391	(344,391)		-
Total revenues	22,119,400	(333,333)	12,662	21,798,729	19,554,223	(194,528)	6,814	19,366,509
<b>Expenses:</b>								
Program services:				-				
Instruction	12,187,789			12,187,789	10,984,736			10,984,736
Student services	2,799,244			2,799,244	1,987,881			1,987,881
Supporting services:								
Institutional support	4,066,867			4,066,867	3,189,068			3,189,068
Development	586,168			586,168	530,137			530,137
Total expenses	19,640,068	-	-	19,640,068	16,691,822	-	-	16,691,822
<b>Excess (Deficit) of Revenues over Expenses</b>	2,479,332	(333,333)	12,662	2,158,661	2,862,401	(194,528)	6,814	2,674,687
<b>Other Revenues &amp; Expenses:</b>								
Relocation expenses								
<b>Change in Net Assets</b>	2,479,332	(333,333)	12,662	2,158,661	2,862,401	(194,528)	6,814	2,674,687
<b>Net Assets - beginning of period</b>	9,132,630	994,915	646,606	10,774,151	6,270,229	1,189,443	639,792	8,099,464
<b>Net Assets - end of period</b>	\$ 11,611,962	\$ 661,582	\$ 659,268	\$ 12,932,812	\$ 9,132,630	\$ 994,915	\$ 646,606	\$ 10,774,151

The accompanying notes are an integral part of this statement.

# Palo Alto University, Inc.

## Schedule of Functional Expenses

*For the Year Ended July 31, 2012*

	Instruction	Student Services			Institutional Support				Total
		Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance	Development	
Salaries and wages	\$ 6,519,245	\$ 341,758	\$ 144,867	\$ 702,773	\$ 1,613,738	\$ 86,435	\$ 104,749	\$ 245,401	\$ 9,758,966
Benefits	954,121	51,661	20,853	117,143	388,090	16,727	22,280	34,733	1,605,608
Consortium payments	2,439,265								2,439,265
Consultants	240,126	2,652	12,125	131,218	314,915			12,123	713,159
Advertising and public relations	36,141			621,397	82,250	260		16,278	756,326
Temporary agencies	64,719		16,062	100,679	165,694			48,470	395,624
Rent Expense	146,657						249,371		396,028
Business insurance					146,062				146,062
Supplies	101,877	4,438	325	29,451	39,869	3,617	3,292	14,806	197,675
Utilities and telephone	25,323	1,487	3,524	8,208	23,554	453	79,954	2,183	144,686
Other expenses	542,514	135,125	135,910	296,852	886,912	217,607	351,236	158,496	2,724,652
	11,069,988	537,121	333,666	2,007,721	3,661,084	325,099	810,882	532,490	19,278,051
Interest expense							75,516		75,516
Depreciation and amortization	(3,285)						289,786		286,501
Allocations	1,121,086	50,277	(333,666)	204,125	70,755	9,929	(1,176,184)	53,678	-
<b>Total Expenses 2012</b>	<b>\$ 12,187,789</b>	<b>\$ 587,398</b>	<b>\$ -</b>	<b>\$ 2,211,846</b>	<b>\$ 3,731,839</b>	<b>\$ 335,028</b>	<b>\$ -</b>	<b>\$ 586,168</b>	<b>\$ 19,640,068</b>
<b>Total Expenses 2011</b>	<b>\$ 10,984,736</b>	<b>\$ 556,418</b>	<b>\$ -</b>	<b>\$ 1,431,463</b>	<b>\$ 2,812,627</b>	<b>\$ 376,441</b>	<b>\$ -</b>	<b>\$ 530,137</b>	<b>\$ 16,691,822</b>

# Palo Alto University, Inc.

## Schedule of Functional Expenses

*For the Year Ended July 31, 2011*

		Student Services			Institutional Support				Total
		Instruction	Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance	Development
Salaries and wages	\$ 5,432,059	\$ 249,626	\$ 91,728	\$ 495,597	\$ 1,130,718	\$ 213,509	\$ 66,617	\$ 63,368	\$ 7,743,222
Benefits	723,758	38,952	13,344	99,054	241,097	19,505	14,219	14,929	1,164,858
Consortium payments	2,630,399								2,630,399
Consultants	173,976	102,491	23,494	256,921	174,730	99,683	2,582	157,552	991,429
Advertising and public relations	22,047			79,709	59,320			12,815	173,891
Temporary agencies	309,701		24,726	56,094	173,304		28,054		591,879
Rent expenses	161,247			1,260	19,186		150,354		332,047
Business insurance					95,000				95,000
Supplies	69,674	5,571	384	18,308	24,387	1,363	1,364	1,447	122,498
Utilities and telephone	21,060	1,343	2,335	4,985	16,663	-	67,719	3,251	117,356
Other expenses	578,982	115,247	101,613	308,469	626,846	13,107	337,556	235,626	2,317,446
	10,122,903	513,230	257,624	1,320,397	2,561,251	347,167	668,465	488,988	16,280,025
Interest expense					72,987				72,987
Depreciation and amortization	9,354						329,456		338,810
Allocations	852,479	43,188	(257,624)	111,066	178,389	29,274	(997,921)	41,149	-
<b>Total Expenses 2011</b>	<b>\$ 10,984,736</b>	<b>\$ 556,418</b>	<b>\$ -</b>	<b>\$ 1,431,463</b>	<b>\$ 2,812,627</b>	<b>\$ 376,441</b>	<b>\$ -</b>	<b>\$ 530,137</b>	<b>\$ 16,691,822</b>



# Palo Alto University, Inc.

## Statement of Cash Flows

<i>For the Year Ended July 31,</i>	2012	2011
<b>Cash Flows from Operating Activities:</b>		
Change in net assets	\$ 2,158,661	\$ 2,674,687
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	286,501	338,810
Change in present value discount for contributions receivable	(66,492)	(2,680)
Loss on disposal of equipment		29,131
Realized and unrealized loss (gain) on investment securities	5,483	(4,584)
Contributions receivable write offs	62,973	40,000
Contributions received for endowment	(5,000)	(6,734)
Changes in operating assets and liabilities:		
Student accounts receivable	(1,542,927)	2,009,021
Contributions receivable, net	243,079	130,399
Grant receivable	91,367	(3,198)
Prepaid expenses and other assets	226,125	(168,812)
Accounts payable and accrued expenses	429,759	659,914
Student payables	(3,816)	
Deferred tuition revenue	1,576,438	(2,606,491)
Net cash provided by operating activities	3,462,151	3,089,463
<b>Cash Flows from Investing Activities:</b>		
Purchase of long-term investments	(94,098)	(136,225)
Proceeds from the sale of long-term investments	717	132,657
Purchase of property and equipment	(1,575,992)	(1,386,061)
Net cash used by investing activities	(1,669,373)	(1,389,629)
<b>Cash Flows from Financing Activities:</b>		
Contributions received for endowment	5,000	6,734
Principal payments on note payable	(63,323)	(42,753)
Net cash used by financing activities	(58,323)	(36,019)
<b>Net Change in Cash and Cash Equivalents</b>	1,734,455	1,663,815
<b>Cash and Cash Equivalents</b> at beginning of the period	3,678,092	2,014,277
<b>Cash and Cash Equivalents</b> at end of the period	\$ 5,412,547	\$ 3,678,092

**Supplemental Disclosures:**

Cash paid for interest	\$ 75,516	\$ 72,987
------------------------	-----------	-----------

The accompanying notes are an integral part of this statement.

# Palo Alto University, Inc.

## Notes to the Financial Statements

---

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

#### a. The University

Founded in 1975 as the Pacific Graduate School of Psychology, Palo Alto University, Inc. (PAU or the University) is dedicated to reducing suffering and improving lives through education and research anchored in psychology, clinical training and practice in a diversity of cultures, and service to communities around the world. Originally a PhD program for Clinical Psychology, the university has expanded to include a consortium with Stanford's Department of Psychiatry and Behavioral Sciences for a clinical doctorate degree (Psy.D.), and a joint program with Golden Gate University for dual JD/PhD degrees.

In Fall 2009, the new Business Psychology program at Foothill College admitted its first class. Subsequent to the end of fiscal year 2011, several more programs were added to the Masters in Mental Health Counseling program, including a Master of Arts in Counseling in Marriage and Family Therapy, and a Masters program located in China. The undergraduate programs were also expanded to include an evening hybrid option. All programs are Western Association of Schools and Colleges (WASC) accredited, along with American Psychological Association (APA) accreditation for the doctoral programs.

#### 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. The net assets are classified as permanently restricted, temporarily restricted, or unrestricted.

*Permanently Restricted Net Assets* – The portion of net assets resulting from contributions 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 action of the University. Income on such funds is available to support activities of the University as designated by such donors.

*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.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

---

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.

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, money market funds and municipal bonds with original maturities of three months or less.

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 Company's management. Gains and losses that result from market fluctuations are recognized in the statement of activities and changes in net assets in the period such fluctuations occur. Dividend and interest income are accrued when earned.

g. Student and Grant Receivables

Student receivables and grants receivable include tuition and fees due from students and reimbursements due from sponsors of externally funded research. These receivables are carried at cost, which represent fair value.

The University grants credit primarily to individuals for the purpose of paying for their tuition and fees. Accounts receivable 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 for doubtful accounts is established as losses are estimated to have occurred, through a charge to expense. Receivables are charged against the allowance for doubtful accounts 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.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

---

### **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 changes 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 (4.5% at July 31, 2012 and 2011). An allowance for uncollectible pledges has been established utilizing a 3.6% factor for 2012 and 7.1% for 2011. 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.

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 4 to 40 years.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

---

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. Interest Rate Swap Agreement

The fair value of the interest rate swap is accrued as market rates change. The change in fair value of the derivative during the year, if material, is recognized within non-operating activities.

l. Advertising Expenses

The University's policy is to expense advertising costs as they are incurred. Advertising cost for the year ended July 31, 2012 and 2011 were \$756,327 and \$173,891, respectively.

m. 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.

n. 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, 2012 and 2011, 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. With few exceptions, the University is no longer subject to income tax examinations by the Internal Revenue Service for the tax years ending July 31, 2008 and before and by the California Franchise Tax Board for tax years ending July 31, 2007 and before.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

---

o. Concentrations of Risk

Financial instruments which potentially subject the University to concentrations of credit risk consist principally of demand deposits and accounts receivable.

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.

p. 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.

Some of the University's financial instruments are not measured at fair value on a recurring basis but, nevertheless, are recorded at amounts that approximate fair value due to their liquid or short-term nature. Such assets and liabilities include cash and cash equivalents, receivables, and payables. Notes payable are recorded at amounts approximating fair value.

q. Reclassifications

Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or net assets.

# Palo Alto University, Inc.

## Notes to the Financial Statements

### r. Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued an update with amendments that change the wording used to describe the requirements in U. S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include clarification of the Board's intent about the application of existing fair value measurement and disclosure requirements and some changes of a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. Some of the disclosures required by the amendments in this update are not required for nonpublic entities. The amendments are to be applied prospectively and are effective for annual periods beginning after December 15, 2011 for nonpublic entities. The University is assessing the impact of the adoption of this update on its financial statements.

The FASB has issued amendments that require a not-for-profit entity (NFP) to classify cash receipts from the sale of donated financial assets consistently with cash donations received in the statement of cash flows if those cash receipts were from the sale of donated financial assets that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash. Accordingly, the cash receipts from the sale of those financial assets should be classified as cash inflows from operating activities, unless the donor restricted the use of the contributed resources to long-term purposes, in which case those cash receipts should be classified as cash flows from financing activities. Otherwise, cash receipts from the sale of donated financial assets should be classified as cash flows from investing activities by the NFP. The amendments are required for the year ended June 30, 2014.

### s. Subsequent Events

The University evaluated subsequent events through February 22, 2013, 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, 2012 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds \$	538,977	\$ 538,977		
Fixed income	302,798	302,798		
Common stock – privately held companies	195,000			\$ 195,000
Total	\$ 1,036,775	\$ 841,775		\$ 195,000

# Palo Alto University, Inc.

## Notes to the Financial Statements

The table below presents the balances of assets measured at fair value at July 31, 2011 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds	\$ 446,884	\$ 446,884		
Fixed income	306,993	306,993		
Common stock – privately held companies	195,000			\$ 195,000
Subtotal	948,877	753,877		195,000
Charitable trust	140,750		140,750	
Total	\$ 1,089,627	\$ 753,777	\$ 140,750	\$ 195,000

Investments are collateral for the loan agreement (see Note 6).

There were no changes in Level 3 assets and liabilities measured on a recurring basis for the year ended July 31, 2012 and 2011. The ending balance was \$195,000 in both years.

### Note 3 - Contributions Receivable, net:

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

	2012	2011
Unconditional promises to be collected in the short-term:		
Less than one year (net of allowance for uncollectible contributions of \$40,867 and \$106,916, respectively)	\$ 428,372	\$ 488,779
Unconditional promises to be collected in the long-term:		
Two to five years	\$ 375,525	\$ 586,454
More than five years	289,000	323,716
	664,525	910,170
Less discount to present value	(135,307)	(201,799)
Net long-term contributions receivable	\$ 529,218	\$ 708,371



# Palo Alto University, Inc.

## Notes to the Financial Statements

Contributions receivable, prior to discounts or allowances, from employees of the University and members of its Board of Trustees totaled \$960,375 and \$1,108,320 at July 31, 2012 and 2011, respectively.

### Note 4 - Property and Equipment:

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

	2012	2011
Land	\$ 2,950,000	\$ 2,950,000
Building	4,284,171	3,633,941
Furniture and equipment	1,481,332	1,418,603
Library books	736,782	1,245,226
Software	442,487	
	9,894,772	9,247,770
Less accumulated depreciation and amortization	1,517,021	2,427,375
	8,377,751	6,820,395
CIP – furniture and equipment		267,865
	\$ 8,377,751	\$ 7,088,260

The property and equipment of the University are collateral for the loan agreement (see Note 6).

As of July 31, 2012, software costs relates to the implementation a new ERP system that will be utilized by the University's Finance, Financial Aid, Admissions, Registrar, Development and Academic offices. The system was placed in service on August 1, 2012.

### Note 5 - Leases:

The University leases classroom and clinical space under a non-cancelable operating lease. The original lease, dated May 24, 2004, was amended on April 29, 2011 increasing the leased space to a total of 12,603 square feet with monthly payments ranging from \$25,946 to \$36,862 over the term of the lease (April 1, 2011 through March 31, 2016). The lease provides the tenant with an option to extend the lease for five years.

The University executed an equipment lease on May 19, 2010. The terms of the agreement require monthly payments of \$2,238 through May 2015.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

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

2013	\$ 449,033
2014	456,595
2015	457,444
2016	294,896
<hr/>	
Total minimum lease payments	\$ 1,657,968

Total rent expense was \$396,028 and \$327,199 for the years ended July 31, 2012 and 2011, respectively.

### **Note 6 - Credit Agreements:**

The University's \$2,000,000 line of credit with Comerica for working capital purposes was renegotiated on January 30, 2009 under a loan modification agreement reducing the line of credit to \$1.5 million which also included terms for a construction loan and modifications to other provisions of the agreement. As of July 31, 2012 and 2011, there was no outstanding balance on the line of credit with Comerica Bank. The agreement can expire on demand and is to be reviewed on an annual basis.

On February 27, 2009, the University entered into a construction note, under the loan modification, for \$1,700,000. The note is due on December 28, 2012 and is amortized over twenty years and carries a variable interest rate with payments due monthly.

On October 27, 2009, the University entered into an International Swaps and Derivatives Association master agreement with Comerica Bank. On December 15, 2009, the University signed a Swap transaction for an original notional amount of \$1,700,000, the amount of the construction loan that reduces as debt principal payments are made. The effect of this swap agreement is to fix the interest reference rate on the notional amount at 2.2%, effectively fixing the rate on the construction loan at 4.7%. Payments are due on the 1<sup>st</sup> of each month commencing January 1, 2010 through and including the termination date, December 1, 2012. As of July 31, 2012, the outstanding balance on this loan was \$1,559,185. The derivative liability was \$13,184 as of July 31, 2012.

The agreement requires, among other things, compliance with covenants including debt service coverage ratio, 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. The University is in compliance with the required covenants, except for the year end audited financial statement requirement. The University received a waiver from the Bank for this requirement.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

---

### **Note 7 - Unrestricted Net Assets:**

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

	2012	2011
Board designated - endowment	\$ 451,530	\$ 449,439
Undesignated	11,210,432	8,683,191
	<hr/>	<hr/>
	\$ 11,661,962	\$ 9,132,630

### **Note 8 - Temporarily Restricted Net Assets:**

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

	2012	2011
Project and program purpose restriction:		
Student fellowships	\$ 444,900	\$ 501,665
Faculty chair	60,097	217,343
Other programs	46,743	7,922
Time restricted	109,842	267,985
	<hr/>	<hr/>
	\$ 661,582	\$ 994,915

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:

	2012	2011
Expiration of time restrictions	\$ 344,043	\$ 216,596
Purpose restriction met:		
Student fellowship	81,997	73,500
Other programs	93,610	54,295
	<hr/>	<hr/>
	\$ 519,650	\$ 344,391

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

---

### **Note 9 - 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.

#### *Interpretation of Relevant Law*

The Board of Trustees, on the advice of legal counsel, has determined that the University holds net assets that meet the definition of endowment funds under State Prudent Management of Institutional Funds Act (SPMIFA).

The corpus value of funds subject to SPMIFA is classified as permanently restricted in cases where the donor indicated that a portion of the fund be retained permanently. The corpus of these funds represents the fair value of the original gift as of the gift date and the original value of subsequent gifts where the donor indicated that a portion of the fund be retained permanently. The balance is classified as temporarily restricted until appropriated, at which time the appropriation is reclassified to unrestricted net assets.

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.

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, 2012 and 2011, there were no such amounts.

#### *Investment and Spending Policies*

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. The University's spending and investment policies work together to achieve this objective.

To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends).

The University is reinvesting all unspent interest and gain associated with its endowments.

# Palo Alto University, Inc.

## Notes to the Financial Statements

Endowment net asset composition as of July 31, 2012 was:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted		\$ 659,268	\$ 659,268
Board designated:			
Earnings available for general use	\$ 451,530		451,530
Total Funds	\$ 451,530	\$ 659,268	\$ 1,110,798

Changes in endowment net assets for the year ended July 31, 2012 were as follows:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 449,439	\$ 646,606	\$ 1,096,045
Investment income	7,480		7,480
Net loss (realized and unrealized)	(5,389)		(5,389)
Contributions		12,662	12,662
Change in endowment net assets	2,091	12,662	14,753
Endowment Net Assets, end of year	\$ 451,530	\$ 659,268	\$ 1,110,798

Endowment net asset composition as of July 31, 2011 was:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted		\$ 646,606	\$ 646,606
Board designated:			
Earnings available for general use	\$ 449,439		449,439
Total Funds	\$ 449,439	\$ 646,606	\$ 1,096,045

# Palo Alto University, Inc.

## Notes to the Financial Statements

Changes in endowment net assets for the year ended July 31, 2011 were as follows:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 441,018	\$ 639,792	\$ 1,080,810
Investment income	6,696		6,696
Net loss (realized and unrealized)	1,725		1,725
Contributions		6,814	6,814
Change in endowment net assets	8,421	6,814	15,235
Endowment Net Assets, end of year	\$ 449,439	\$ 646,606	\$ 1,096,045

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

	2012	2011
Gronowski Clinic	\$ 392,175	\$ 426,301
Library	251,653	200,500
Florence Furst Memorial Student Short-Term Loan Fund	10,000	10,000
Scholarships	5,440	9,805
Total permanently restricted	\$ 659,268	\$ 646,606

At July 31, 2012 and 2011, \$99,023, and \$136,240, respectively, of permanently restricted net assets was represented by pledges receivable, net of present value discounts.

### Note 10 - 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 \$16,500 for calendar years 2011 and 2010. The University's contributions were \$374,945 and \$300,894 for the periods ended July 31, 2012 and 2011, respectively.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

---

The University has a 457(f) deferred compensation plan that covers one employee. The plan's assets are held by a trustee under the terms of the agreement but remain under legal ownership of the University and are reflected in cash on the financial statements. Contributions totaling \$160,000 were made to the plan during 2012.

### **Note 11 - Commitments and Contingencies:**

On May 2, 2011, 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 term of the agreement is for five academic years starting September 1, 2011 through August 31, 2016. According to the new agreement, fees to Stanford will be paid three 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.

### **Note 12 - Subsequent Event**

On February 27, 2009, the University entered into a construction note, under a loan modification dated January 30, 2009, for \$1,700,000 (see Note 6). As of July 31, 2012, the outstanding balance on this loan was \$1,559,185. The note was due on December 28, 2012 but it was repaid in full on December 3, 2012, making the university "debt free".