

PALO ALTO UNIVERSITY, INC.

JULY 31, 2014 AND 2013

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 the **PALO ALTO UNIVERSITY, INC. (the University)** which comprise the statements of financial position as of July 31, 2014 and 2013, and the related statements of activities and change in net assets and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the University's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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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, 2014 and 2013 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

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

Hood & Strong LLP

San Francisco, California
November 24, 2014

Palo Alto University, Inc.

Statement of Financial Position

<i>July 31,</i>	2014	2013
Assets		
Current Assets:		
Cash and cash equivalents	\$ 3,055,406	\$ 2,886,527
Student receivables, net of allowance of \$395,222 for 2014 and \$378,151 for 2013	7,630,582	6,021,905
Contributions receivable, net	754,375	580,278
Grants receivable	674,904	1,308,762
Prepaid expenses and other assets	585,936	495,043
Total current assets	12,701,203	11,292,515
Long-Term Investments	1,244,993	1,064,416
Contributions Receivable, net	636,334	725,977
Property and Equipment, net	8,480,190	8,454,025
Total assets	\$ 23,062,720	\$ 21,536,933
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 1,787,939	\$ 2,198,096
Student payables	13,388	19,943
Deferred tuition revenue	7,540,172	5,884,472
Other liabilities	46,612	60,221
Deferred compensation	493,333	333,333
Total liabilities	9,881,444	8,496,065
Net Assets:		
Unrestricted	11,476,517	11,428,017
Temporarily restricted	1,022,773	931,029
Permanently restricted	681,986	681,822
Total net assets	13,181,276	13,040,868
Total liabilities and net assets	\$ 23,062,720	\$ 21,536,933

The accompanying notes are an integral part of this statement.

Palo Alto University, Inc.

Statement of Activities and Change in Net Assets

For the Years Ended July 31, 2014 and 2013

	2014				2013			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:								
Gross tuition	\$ 22,637,421			\$ 22,637,421	\$ 20,628,946			\$ 20,628,946
Gross fees	3,573,260			3,573,260	3,452,703			3,452,703
	26,210,681			26,210,681	24,081,649			24,081,649
Less financial aid	(1,231,758)			(1,231,758)	(1,643,143)			(1,643,143)
Net tuition and fees	24,978,923			24,978,923	22,438,506			22,438,506
Contributions and grants	875,289	\$ 423,192	\$ 164	1,298,645	1,127,876	\$ 811,947	\$ 22,554	1,962,377
Investment income	13,649	53		13,702	9,665	4,617		14,282
Sales and services of educational activities	168,711			168,711	173,603			173,603
Other	153,262			153,262	104,219			104,219
Net assets released from restrictions	331,501	(331,501)		-	547,117	(547,117)		-
Total revenues	26,521,335	91,744	164	26,613,243	24,400,986	269,447	22,554	24,692,987
Expenses:								
Program services:								
Instruction	17,691,542			17,691,542	15,409,551			15,409,551
Student services	3,125,816			3,125,816	3,532,037			3,532,037
Supporting services:								
Institutional support	5,444,090			5,444,090	5,141,359			5,141,359
Development	211,387			211,387	501,984			501,984
Total expenses	26,472,835	-	-	26,472,835	24,584,931	-	-	24,584,931
Change in Net Assets	48,500	91,744	164	140,408	(183,945)	269,447	22,554	108,056
Net Assets - beginning of period	11,428,017	931,029	681,822	13,040,868	11,611,962	661,582	659,268	12,932,812
Net Assets - end of period	\$ 11,476,517	\$ 1,022,773	\$ 681,986	\$ 13,181,276	\$ 11,428,017	\$ 931,029	\$ 681,822	\$ 13,040,868

The accompanying notes are an integral part of this statement.

Palo Alto University, Inc.

Supplementary Information - Schedule of Functional Expenses

For the Year Ended July 31, 2014

	Instruction	Student Services			Institutional Support			Development	Total
		Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance		
Salaries and wages	\$ 9,723,848	\$ 311,635	\$ 184,997	\$ 1,040,750	\$ 2,007,957	\$ 235,340	\$ 126,529	\$ 115,351	\$ 13,746,407
Benefits	1,423,414	64,522	28,004	194,069	503,006	41,141	25,229	20,874	2,300,259
Consortium payments	2,887,415								2,887,415
Consultants	686,501		4,980	17,287	396,992	192,994	190	10,706	1,309,650
Rent expenses	209,129					7,460	421,077		637,666
Travel and lodging	257,761	1,588	2,529	28,434	133,489	3,265	5,786	2,743	435,595
Meals and entertainment	127,945	220	1,399	82,734	138,008	1,916		4,637	356,859
Temporary agencies	35,971	27,619		143,291	54,965		17,464		279,310
Advertising and public relations	7,295			552,586	71,096			3,660	634,637
Bank and credit card charges	420				244,173			4	244,597
Bad debt					26,981				26,981
Tutoring				22,863					22,863
Community relations	93,918	41		13,407	188,706	34,905		148	331,125
Supplies	71,036	2,981	1,414	14,538	47,674	902	8,072	684	147,301
Utilities and telephone	39,900	1,076	3,866	7,746	33,250		62,024	248	148,110
Business insurance					190,525				190,525
Legal					137,186				137,186
Software site licenses	118,118	13,098	50,060						181,276
Other expenses	465,827	75,220	100,729	247,331	638,139	9,028	304,002	34,735	1,875,011
	16,148,498	498,000	377,978	2,365,036	4,812,147	526,951	970,373	193,790	25,892,773
Depreciation and amortization	68,196			2,572	110,543		398,751		580,062
Allocations	1,474,848	45,220	(377,978)	214,988	(53,416)	47,865	(1,369,124)	17,597	-
Total Expenses 2014	\$ 17,691,542	\$ 543,220	\$ -	\$ 2,582,596	\$ 4,869,274	\$ 574,816	\$ -	\$ 211,387	\$ 26,472,835

The accompanying notes are an integral part of this statement.

Palo Alto University, Inc.

Supplementary Information - Schedule of Functional Expenses

For the Year Ended July 31, 2013

		Student Services			Institutional Support				
	Instruction	Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance	Development	Total
Salaries and wages	\$ 8,250,036	\$ 391,387	\$ 173,361	\$ 980,504	\$ 1,782,094	\$ 226,388	\$ 91,463	\$ 317,227	\$ 12,212,460
Benefits	1,282,391	72,901	28,359	180,529	460,502	30,851	21,087	41,800	2,118,420
Consortium payments	2,755,067								2,755,067
Consultants	437,430		3,630	70,572	414,807	301,458		17,525	1,245,422
Rent expenses	184,800				(1,326)	7,081	371,079		561,634
Travel and lodging	134,337	1,858	3,055	22,651	64,677	2,211	6,168	1,318	236,275
Meals and entertainment	108,121	3,466	671	35,386	116,152	3,269		4,448	271,513
Temporary agencies	18,491	7,264		210,107	210,796			560	447,218
Advertising and public relations	20,220			326,786	98,211			1,097	446,314
Bank and credit card charges					221,379				221,379
Bad debt					358,115				358,115
Tutoring				337,458					337,458
Community relations	78,608			9,801	159,233	12,568		3,208	263,418
Supplies	111,333	4,812	949	26,430	33,868	251	936	1,329	179,908
Utilities and telephone	22,662	1,336	3,838	21,888	30,990		88,256	1,820	170,790
Business insurance					167,597				167,597
Legal					65,343				65,343
Software site licenses	51,342		45,247	500	19,123				116,212
Other expenses	347,617	141,242	129,525	321,465	583,402	8,723	295,612	60,171	1,887,757
	13,802,455	624,266	388,635	2,544,077	4,784,963	592,800	874,601	450,503	24,062,300
Interest expense							14,627		14,627
Depreciation and amortization	26,918			1,500	102,446		377,140		508,004
Allocations	1,580,178	71,330	(388,635)	290,864	(406,585)	67,735	(1,266,368)	51,481	-
Total Expenses 2013	\$ 15,409,551	\$ 695,596	\$ -	\$ 2,836,441	\$ 4,480,824	\$ 660,535	\$ -	\$ 501,984	\$ 24,584,931

The accompanying notes are an integral part of this statement.

Palo Alto University, Inc.

Statement of Cash Flows

<i>For the Year Ended July 31,</i>	2014	2013
Cash Flows from Operating Activities:		
Change in net assets	\$ 140,408	\$ 108,056
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation and amortization	580,062	508,004
Change in discount and allowances for contributions receivable	7,060	(37,162)
Realized and unrealized loss (gain) on investment securities	6,914	(1,979)
Changes in operating assets and liabilities:		
Student receivables	(1,608,677)	(670,428)
Contributions receivable, net	(91,515)	(311,508)
Grants receivable	289,997	(681,458)
Federal direct loan funds receivable	343,861	(600,304)
Prepaid expenses and other assets	(90,893)	(325,323)
Accounts payable and accrued expenses	(435,958)	606,217
Student payables	(6,555)	13,759
Deferred tuition revenue	1,667,892	875,226
Deferred compensation	160,000	160,000
Net cash provided (used) by operating activities	962,596	(356,900)
Cash Flows from Investing Activities:		
Purchase of long-term investments	(294,243)	(237,221)
Proceeds from the sale of long-term investments	106,753	211,563
Purchase of property and equipment	(606,227)	(584,277)
Net cash used by investing activities	(793,717)	(609,935)
Cash Flows from Financing Activities:		
Principal payments on note payable		(1,559,185)
Net cash used by financing activities	-	(1,559,185)
Net Change in Cash and Cash Equivalents	168,879	(2,526,020)
Cash and Cash Equivalents at beginning of the period	2,886,527	5,412,547
Cash and Cash Equivalents at end of the period	\$ 3,055,406	\$ 2,886,527
Supplemental Disclosures:		
Cash paid for interest	\$	\$ 14,626

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

The Pacific Graduate School of Psychology (PGSP) was founded in 1975 as an independent, professional school. PGSP was re-incorporated as Palo Alto University in August 2009. Palo Alto University (PAU or the University) is a private, nonprofit educational institution. The University was first accredited in 1986 by the regional accrediting body, the Western Association of Schools and Colleges and has been continuously accredited since then. PAU is dedicated to education with an emphasis in the behavioral and social sciences; to promoting future innovators and leaders for the benefit of society; to generating knowledge through research and scholarship of the highest level; and to providing services to the community informed by science and scholarship.

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

b. Basis of Accounting

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

c. Basis of Presentation

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

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

Palo Alto University, Inc.

Notes to the Financial Statements

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

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

d. Use of Estimates

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

e. Cash and Cash Equivalents

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

f. Investments

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

g. Student and Grant Receivables

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

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

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 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 utilizing a 3.6% factor for 2014 and 2013, respectively, based on prior experience. The financial statements reflect these pledges net of the discount and allowance reserve.

Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. In the absence of donor stipulations about how long those long-lived assets must be maintained, the University reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. Contributions of assets other than cash are recorded at their estimated fair value.

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

i. Property and Equipment

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

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. Advertising Expenses

The University's policy is to expense advertising costs as they are incurred. Advertising costs for the year ended July 31, 2014 and 2013 were \$634,638 and \$446,314, respectively.

l. Functional Expense Allocations

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

m. Income Taxes

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

As of July 31, 2014 and 2013, 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, as of July 31, 2014, the University is no longer subject to income tax examinations by the Federal or State authorities for the tax years before 2010 and 2009, respectively.

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 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.

q. Recent Accounting Pronouncements

Adopted

In October 2012, FASB issued the Accounting Standard Update (ASU) 2012-05 - Statement of Cash Flows (Topic 230) *Not-for-Profit Entities – Classifications of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows*. The update requires a not-for-profit entity to classify sale proceeds of donated financial assets consistent with cash donations as an operating activity, if such assets were converted nearly immediately into cash, unless the donor restricted the use of the proceeds to long-term purposes, in which case those cash receipts should be classified as a financing activity. If those assets were not immediately converted to cash, the proceeds upon sale should be classified as an investing activity. This guidance is effective prospectively for annual periods, beginning after June 15, 2013. The University's accounting policy is consistent with this guidance.

Palo Alto University, Inc.

Notes to the Financial Statements

Recent Accounting Pronouncements

In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* which affects any entity (public, private and not-for-profit) that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. This ASU will supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance, and creates Topic 606 as indicated above. 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. To achieve the core principle, an entity follows a five step process. The guidance is effective for annual reporting periods beginning after December 15, 2017. 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.

r. Subsequent Events

The management of the University evaluated subsequent events with respect to the financial statements for the year ended July 31, 2014 through November 24, 2014, the date these financial statements were available to be issued and has determined 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, 2014 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds	\$ 91,511	\$ 91,511		
Bonds and fixed income funds	848,859	848,859		
Equity funds	78,828	78,828		
Alternative investment funds	30,795	30,795		
Common stock – privately held companies	195,000			\$ 195,000
Total	\$1,244,993	\$1,049,993		\$ 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, 2013 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and money market funds	\$ 564,630	\$ 564,630		
Fixed income	304,786	304,786		
Common stock – privately held companies	195,000			\$ 195,000
Total	\$1,064,416	\$ 869,416		\$ 195,000

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

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, 2014 and 2013.

There were no changes in Level 3 assets and liabilities measured on a recurring basis for the year ended July 31, 2014 and 2013.

Note 3 - Contributions Receivable, net:

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

	2014	2013
Unconditional promises to be collected in the short-term:		
Less than one year (net of allowance for uncollectible contributions of \$35,262 and \$51,379, respectively)	\$ 754,375	\$ 580,278
Unconditional promises to be collected in the long-term:		
Two to five years	\$ 644,250	\$ 782,049
More than five years	60,000	13,500
	704,250	795,549
Less discount to present value	(67,916)	(69,572)
Net long-term contributions receivable	\$ 636,334	\$ 725,977

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:

	2014	2013
Land	\$ 2,950,000	\$ 2,950,000
Building	4,557,104	4,498,136
Furniture and equipment	2,052,119	1,604,324
Library books	860,085	761,750
Software	665,968	664,838
	11,085,276	10,479,048
Less accumulated depreciation and amortization	2,605,086	2,025,023
	\$ 8,480,190	\$ 8,454,025

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

Note 5 - Leases:

The University leases classroom and clinical space under non-cancelable operating leases with monthly payments ranging from \$8,679 to \$44,837 expiring July 31, 2017. One lease provides the University with an option to extend the lease for five years.

The University entered into a facilities use agreement with the San Mateo Community College District on January 1, 2013. The agreement grants the University a non-exclusive permit for the use and occupancy of certain classroom space and administrative offices. Monthly payments over the lease term, which ends June 30, 2016, range from \$3,315 to \$3,539. The University began use of the classroom space pursuant to the agreement, on September 23, 2013.

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

2015	\$ 698,100
2016	693,100
2017	671,200
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Total minimum lease payments	\$ 2,062,400

Total rent expense was \$637,666 and \$561,634 for the years ended July 31, 2014 and 2013, respectively.

Note 6 - Credit Agreements:

The University's \$2,000,000 line of credit with Comerica Bank for working capital purposes was renegotiated on January 30, 2009 under a loan modification agreement reducing the line of credit to \$1,500,000 million and included terms for a construction loan and modifications to other provisions of the agreement. The construction loan was due on December 28, 2012 and was repaid in full on December 3, 2012. Related to the construction loan, the University entered into an International Swaps and Derivatives Association master agreement with Comerica Bank which terminated on December 1, 2012.

As of July 31, 2014 and 2013, there was no outstanding balance on the line of credit with Comerica Bank. The agreement requires, among other things, compliance with covenants including a certain positive change in net assets, and timely submission of internal and external financial statements. The agreement is secured by investments and real and personal property, can expire on demand and is to be reviewed on an annual basis. At July 31, 2014 and 2013, the University was not in compliance with all of the covenants and has received a waiver from the bank.

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 \$1,237,219 and \$1,182,977 at July 31, 2014 and 2013, respectively.

Palo Alto University, Inc.

Notes to the Financial Statements

Note 8 - Unrestricted Net Assets:

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

	2014	2013
Board designated - endowment	\$ 639,509	\$ 479,190
Undesignated	10,837,008	10,948,827
	<hr/>	<hr/>
	\$ 11,476,517	\$ 11,428,017

Note 9 - Temporarily Restricted Net Assets:

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

	2014	2013
Project and program purpose restriction:		
Student fellowships	\$ 565,547	\$ 385,267
Faculty chair	133,762	46,134
Other programs	50,604	74,161
Time restricted	272,860	425,467
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	\$ 1,022,773	\$ 931,029

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:

	2014	2013
Expiration of time restrictions	\$ 142,020	\$ 243,347
Purpose restriction met:		
Student fellowship	72,094	256,025
Other programs	117,387	47,745
	<hr/>	<hr/>
	\$ 331,501	\$ 547,117

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 and, if applicable, accumulations of donor-restricted endowment as required by the donor. Accumulated earnings of donor-restricted endowment are classified as temporarily restricted net assets until distributed in accordance with UPMIFA 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, 2014 and 2013, there were no such amounts.

Endowment net asset composition as of July 31, 2014 was:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted		\$ 681,986	\$ 681,986
Board designated:			
Earnings available for general use	\$ 639,509		639,509
<u>Total Funds</u>	<u>\$ 639,509</u>	<u>\$ 681,986</u>	<u>\$ 1,321,495</u>

Changes in endowment net assets for the year ended July 31, 2014 were as follows:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 479,190	\$ 681,822	\$ 1,161,012
Investment income	5,888		5,888
Net gain (realized and unrealized)	4,778		4,778
Contributions	146,653	164	149,817
<u>Change in endowment net assets</u>	<u>160,319</u>	<u>164</u>	<u>160,483</u>
Endowment Net Assets, end of year	\$ 639,509	\$ 681,986	\$ 1,321,495

Endowment net asset composition as of July 31, 2013 was:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted		\$ 681,822	\$ 681,822
Board designated:			
Earnings available for general use	\$ 479,190		479,190
<u>Total Funds</u>	<u>\$ 479,190</u>	<u>\$ 681,822</u>	<u>\$ 1,161,012</u>

Palo Alto University, Inc.

Notes to the Financial Statements

Changes in endowment net assets for the year ended July 31, 2013 were as follows:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, beginning of year	\$ 451,530	\$ 659,268	\$ 1,110,798
Investment income	5,985		5,985
Net gain (realized and unrealized)	21,675		21,675
Contributions		22,554	22,554
Change in endowment net assets	27,660	22,554	50,214
Endowment Net Assets, end of year	\$ 479,190	\$ 681,822	\$ 1,161,012

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

	2014	2013
Gronowski Clinic	\$ 394,304	\$ 393,867
Library	272,416	272,541
Florence Furst Memorial Student Short-Term Loan Fund	10,000	10,000
Scholarships	5,266	5,414
Total permanently restricted	\$ 681,986	\$ 681,822

At July 31, 2014 and 2013, \$79,500, and \$99,596, respectively, of permanently restricted net assets was represented by pledges receivable, net of present value discounts.

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 \$17,500 for calendar years 2014 and 2013. The University's contributions were \$520,019 and \$459,372 for the periods ended July 31, 2014 and 2013, 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 2014 and 2013.

Note 12 - Other 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.