

PALO ALTO UNIVERSITY, INC.

JULY 31, 2013 AND 2012

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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 statement of financial position as of July 31, 2013 and 2012, and the related statements of activities and changes 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, 2013 and 2012 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 26, 2013

# Palo Alto University, Inc.

## Statement of Financial Position

<i>July 31,</i>	2013	2012
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 2,886,527	\$ 5,412,547
Student receivables, net of allowance of \$ 378,151 for 2013 and \$142,380 for 2012	6,021,905	5,351,477
Federal contributions receivable, net	580,278	428,372
Grants receivable	708,458	27,000
Federal direct loan funds receivable	600,304	-
Prepaid expenses and other assets	495,043	169,720
Total current assets	11,292,515	11,389,116
<b>Long-Term Investments</b>	1,064,416	1,036,775
<b>Contributions Receivable, net</b>	725,977	529,218
<b>Property and Equipment, net</b>	8,454,025	8,377,751
Total assets	\$ 21,536,933	\$ 21,332,860
<b>Liabilities and Net Assets</b>		
<b>Liabilities:</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 2,198,096	\$ 1,608,951
Student payables	19,943	6,184
Deferred tuition revenue	5,884,472	5,009,246
Deferred rent	60,221	43,149
Deferred compensation	333,333	173,333
Total current liabilities	8,496,065	6,840,863
Note payable	-	1,559,185
Total liabilities	8,496,065	8,400,048
<b>Net Assets:</b>		
Unrestricted	11,428,017	11,611,962
Temporarily restricted	931,029	661,582
Permanently restricted	681,822	659,268
Total net assets	13,040,868	12,932,812
Total liabilities and net assets	\$ 21,536,933	\$ 21,332,860

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, 2013 and 2012*

	2013				2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenues:</b>								
Gross tuition	\$ 20,628,946			\$ 20,628,946	\$ 18,794,642			\$ 18,794,642
Gross fees	3,452,703			3,452,703	3,112,459			3,112,459
	24,081,649			24,081,649	21,907,101			21,907,101
Less financial aid	(1,643,143)			(1,643,143)	(1,280,821)			(1,280,821)
Net tuition and fees	22,438,506			22,438,506	20,626,280			20,626,280
Contributions and grants	1,127,876	\$ 811,947	\$ 22,554	1,962,377	625,411	\$ 186,317	\$ 12,662	824,390
Investment income	9,665	4,617		14,282	13,883			13,883
Sales and services of educational activities	173,603			173,603	193,015			193,015
Other	104,219			104,219	141,161			141,161
Net assets released from restrictions	547,117	(547,117)		-	519,650	(519,650)		-
Total revenues	24,400,986	269,447	22,554	24,692,987	22,119,400	(333,333)	12,662	21,798,729
<b>Expenses:</b>								
Program services:				-				
Instruction	15,409,551			15,409,551	12,187,789			12,187,789
Student services	3,532,037			3,532,037	2,799,244			2,799,244
Supporting services:								
Institutional support	5,141,359			5,141,359	4,066,867			4,066,867
Development	501,984			501,984	586,168			586,168
Total expenses	24,584,931	-	-	24,584,931	19,640,068	-	-	19,640,068
<b>Change in Net Assets</b>	(183,945)	269,447	22,554	108,056	2,479,332	(333,333)	12,662	2,158,661
<b>Net Assets - beginning of period</b>	11,611,962	661,582	659,268	12,932,812	9,132,630	994,915	646,606	10,774,151
<b>Net Assets - end of period</b>	\$ 11,428,017	\$ 931,029	\$ 681,822	\$ 13,040,868	\$ 11,611,962	\$ 661,582	\$ 659,268	\$ 12,932,812

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				Total
	Instruction	Library	Information Resources	Student Services	General & Administrative	Sponsored Programs	Operation & Maintenance	Development	
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
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
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
Other expenses	641,417	146,566	178,498	380,002	1,070,076	14,203	301,780	65,937	2,798,479
	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	-
<b>Total Expenses 2013</b>	\$ 15,409,551	\$ 695,596	\$ -	\$ 2,836,441	\$ 4,480,824	\$ 660,535	\$ -	\$ 501,984	\$ 24,584,931

**Palo Alto University, Inc.**

**Supplementary Information - Schedule of Functional Expenses**

*For the Year Ended July 31, 2012*

	Student Services				Institutional Support				Total
	Instruction	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
Rent Expense	146,657						249,371		396,028
Temporary agencies	64,719		16,062	100,679	165,694			48,470	395,624
Advertising and public relations	36,141			621,397	82,250	260		16,278	756,326
Bad debt					77,831				77,831
Tutoring				59,198					59,198
Community relations	55,098			255	116,805	1,075		14,466	187,698
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
Business insurance					146,062				146,062
Other expenses	487,416	135,125	135,910	237,399	692,276	216,532	351,236	144,030	2,399,925
	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>



# Palo Alto University, Inc.

## Statement of Cash Flows

<i>For the Year Ended July 31,</i>	2013	2012
<b>Cash Flows from Operating Activities:</b>		
Change in net assets	\$ 108,056	\$ 2,158,661
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	508,004	286,501
Change in present value discount for contributions receivable	(65,735)	(66,492)
Realized and unrealized (gain) loss on investment securities	(1,979)	5,483
Contributions receivable write offs	28,573	62,973
Contributions received for endowment	-	(5,000)
Changes in operating assets and liabilities:		
Student receivable	(670,428)	(1,625,397)
Contributions receivable, net	(311,508)	243,079
Grants receivable	(681,458)	91,367
Federal direct loan funds receivable	(600,304)	
Prepaid expenses and other assets	(325,323)	226,125
Accounts payable and accrued expenses	606,217	352,229
Student payables	13,759	(3,816)
Deferred tuition revenue	875,226	1,576,438
Deferred compensation	160,000	160,000
Net cash (used) by operating activities	(356,900)	3,462,151
<b>Cash Flows from Investing Activities:</b>		
Purchase of long-term investments	(237,221)	(94,098)
Proceeds from the sale of long-term investments	211,563	717
Purchase of property and equipment	(584,277)	(1,575,992)
Net cash used by investing activities	(609,935)	(1,669,373)
<b>Cash Flows from Financing Activities:</b>		
Contributions received for endowment	-	5,000
Principal payments on note payable	(1,559,185)	(63,323)
Net cash used by financing activities	(1,559,185)	(58,323)
<b>Net Change in Cash and Cash Equivalents</b>	<b>(2,526,020)</b>	<b>1,734,455</b>
<b>Cash and Cash Equivalents at beginning of the period</b>	<b>5,412,547</b>	<b>3,678,092</b>
<b>Cash and Cash Equivalents at end of the period</b>	<b>\$ 2,886,527</b>	<b>\$ 5,412,547</b>
<b>Supplemental Disclosures:</b>		
Cash paid for interest	\$ 14,626	\$ 75,516

The accompanying notes are an integral part of this statement.

# Palo Alto University, Inc.

## Notes to the Financial Statements

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### 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 Doctor of Philosophy (PhD) program for Clinical Psychology, the university has expanded to include a consortium with Stanford's Department of Psychiatry and Behavioral Sciences for a Doctor of Psychology (PsyD) degree, and a joint program with Golden Gate University for dual Juris Doctor (JD)/PhD degrees.

In Fall 2009, the new Business Psychology program at Foothill College admitted its first class. 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. Accreditations are required for participation in federal and state student financial aid programs and the University is subject to periodic accreditation review by WASC and the APA.

#### 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.

# Palo Alto University, Inc.

## Notes to the Financial Statements

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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.

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 Company's management. 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 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

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### 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 2013 and 2012 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

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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, 2013 and 2012 were \$446,314 and \$756,327, 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, 2013 and 2012, 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 Federal or State authorities for the tax years before 2009 and 2008, respectively.

o. Concentrations of Risk

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

# Palo Alto University, Inc.

## Notes to the Financial Statements

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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.

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.

r. Recent Accounting Pronouncements

*Adopted*

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 adoption of this pronouncement did not have a significant impact on these financial statements.

# Palo Alto University, Inc.

## Notes to the Financial Statements

### *Pronouncements effective in the future*

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. The University is assessing the impact of the adoption of this update on its financial statements

s. Subsequent Events

The management of the University evaluated subsequent events with respect to the financial statements for the year ended July 31, 2013 through November 26, 2013, 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, 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
<b>Total</b>	<b>\$1,064,416</b>	<b>\$ 869,416</b>		<b>\$ 195,000</b>

# Palo Alto University, Inc.

## Notes to the Financial Statements

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
<b>Total</b>	<b>\$ 1,036,775</b>	<b>\$ 841,775</b>		<b>\$ 195,000</b>

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, 2013 and 2012.

There were no changes in Level 3 assets and liabilities measured on a recurring basis for the year ended July 31, 2013 and 2012. The ending balance was \$195,000 in both years.

### Note 3 - Contributions Receivable, net:

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

	2013	2012
Unconditional promises to be collected in the short-term:		
Less than one year (net of allowance for uncollectible contributions of \$51,379 and \$40,867, respectively)	\$ 580,278	\$ 428,372
Unconditional promises to be collected in the long-term:		
Two to five years	\$ 782,049	\$ 375,525
More than five years	13,500	289,000
	795,549	664,525
Less discount to present value	(69,572)	(135,307)
<b>Net long-term contributions receivable</b>	<b>\$ 725,977</b>	<b>\$ 529,218</b>

Contributions receivable, prior to discounts or allowances, from employees of the University and members of its Board of Trustees totaled \$1,182,977 and \$960,375 at July 31, 2013 and 2012, respectively.



# Palo Alto University, Inc.

## Notes to the Financial Statements

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### Note 4 - Property and Equipment:

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

	2013	2012
Land	\$ 2,950,000	\$ 2,950,000
Building	4,498,136	4,284,171
Furniture and equipment	1,604,324	1,481,332
Library books	761,750	736,782
Software	664,838	442,487
	10,479,048	9,894,772
Less accumulated depreciation and amortization	2,025,023	1,517,021
	\$ 8,454,025	\$ 8,377,751

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 a non-cancelable operating leases with monthly payments ranging from \$8,679 to \$44,837 expiring at various times through 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 \$3,518. 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:

2014	\$ 670,692
2015	585,216
2016	562,379
2017	533,002
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Total minimum lease payments	\$ 2,351,289

Total rent expense was \$561,634 and \$396,028 for the years ended July 31, 2013 and 2012, 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 \$1.5 million which also included terms for a construction loan and modifications to other provisions of the agreement. As of July 31, 2013 and 2012, 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.

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 1st 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 construction note was due on December 28, 2012 and it was repaid in full on December 3, 2012.

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. The University has received a waiver from the bank.

# Palo Alto University, Inc.

## Notes to the Financial Statements

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### Note 7 - Unrestricted Net Assets:

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

	2013	2012
Board designated - endowment	\$ 479,190	\$ 451,530
Undesignated	10,948,827	11,210,432
	<hr/>	<hr/>
	\$ 11,428,017	\$ 11,661,962

### Note 8 - Temporarily Restricted Net Assets:

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

	2013	2012
Project and program purpose restriction:		
Student fellowships	\$ 385,267	\$ 444,900
Faculty chair	46,134	60,097
Other programs	74,161	46,743
Time restricted	425,467	109,842
	<hr/>	<hr/>
	\$ 931,029	\$ 661,582

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:

	2013	2012
Expiration of time restrictions	\$ 243,347	\$ 344,043
Purpose restriction met:		
Student fellowship	256,025	81,997
Other programs	47,745	93,610
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	\$ 547,117	\$ 519,650

# Palo Alto University, Inc.

## Notes to the Financial Statements

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### 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, 2013 and 2012, 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).

# Palo Alto University, Inc.

## Notes to the Financial Statements

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

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
<b>Total Funds</b>	<b>\$ 479,190</b>	<b>\$ 681,822</b>	<b>\$ 1,161,012</b>

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
<b>Change in endowment net assets</b>	<b>27,660</b>	<b>22,554</b>	<b>50,214</b>
<b>Endowment Net Assets, end of year</b>	<b>\$ 479,190</b>	<b>\$ 681,822</b>	<b>\$ 1,161,012</b>

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
<b>Total Funds</b>	<b>\$ 451,530</b>	<b>\$ 659,268</b>	<b>\$ 1,110,798</b>

# Palo Alto University, Inc.

## Notes to the Financial Statements

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

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

	2013	2012
Gronowski Clinic	\$ 393,867	\$ 392,175
Library	272,541	251,653
Florence Furst Memorial Student Short-Term Loan Fund	10,000	10,000
Scholarships	5,414	4,440
Total permanently restricted	\$ 681,822	\$ 659,268

At July 31, 2013 and 2012, \$99,596, and \$99,023, 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 \$17,500 and \$17,500 for calendar years 2013 and 2012, respectively. The University's contributions were \$459,372 and \$374,945 for the periods ended July 31, 2013 and 2012, respectively.

# **Palo Alto University, Inc.**

## **Notes to the Financial Statements**

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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 2013 and 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.