

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Combined Financial Statements
With Independent Auditors' Report

June 30, 2012 and 2011

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Table of Contents

	<u>Page</u>
Independent Auditors' Report	1
Combined Financial Statements	
Combined Statements of Financial Position	2
Combined Statements of Activities	3
Combined Statements of Cash Flows	5
Notes to Combined Financial Statements	7
Supplemental Information	
Supplemental Combining Statement of Financial Position	32
Supplemental Combining Statement of Activities	33

INDEPENDENT AUDITORS' REPORT

Board of Trustees
Azusa Pacific University and Affiliate
Azusa, California

We have audited the accompanying combined statements of financial position of Azusa Pacific University and Affiliate (the University) as of June 30, 2012 and 2011, and the related combined statements of activities and cash flows for the years then ended. These combined financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these combined 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of management's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements, assessing the accounting principles used, and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2012 and 2011, and the changes in their net assets and their 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 combined financial statements as a whole. The supplemental combining statements of financial position and supplemental combining statements of activities 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.

Capin Crouse LLP

Brea, California
November 26, 2012

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Combined Statements of Financial Position

	June 30,	
	2012	2011
ASSETS:		
Cash and cash equivalents	\$ 20,894,310	\$ 19,965,825
Investments	77,318,204	78,837,823
Student accounts receivable, less allowance	10,412,142	9,965,115
Accounts receivable, less allowance	949,391	2,305,444
Beneficial interest in trusts held by others	1,200,000	-
Contributions receivable, less allowance	1,014,986	1,650,448
Loans to students, less allowance	6,640,744	6,776,637
Inventories	2,381,110	2,041,264
Notes receivable	620,000	620,000
Assets whose use is limited-debt service	5,631,344	5,127,659
Deposits and other assets	3,776,786	3,581,788
Land, buildings, and equipment, net	228,199,438	232,143,041
	\$ 359,038,455	\$ 363,015,044
LIABILITIES AND NET ASSETS:		
Liabilities:		
Accounts payable and accrued liabilities	\$ 13,560,320	\$ 13,099,763
Deferred revenue	3,912,612	4,682,102
Annuities payable	1,322,012	1,331,459
Trust liabilities due to others	336,590	443,508
Government grants refundable	4,072,503	4,072,503
Notes and bonds payable	134,939,480	138,058,000
Interest rate swap liability	25,002,658	13,611,621
Asset retirement obligation	1,032,634	1,171,557
Capital lease obligation	2,529,468	2,577,590
Other liabilities	2,164,553	1,296,058
	188,872,830	180,344,161
Net assets:		
Unrestricted	109,188,956	122,722,407
Temporarily restricted	32,627,512	32,568,211
Permanently restricted	28,349,157	27,380,265
	170,165,625	182,670,883
Total Net Assets	\$ 170,165,625	\$ 182,670,883
Total Liabilities and Net Assets	\$ 359,038,455	\$ 363,015,044

See notes to combined financial statements

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Combined Statement of Activities

Year Ended June 30, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT, REVENUE, AND RECLASSIFICATIONS:				
Tuition and fees	\$ 221,816,644	\$ -	\$ -	\$ 221,816,644
Less Tuition assistance	(\$52,104,190)	-	-	(\$52,104,190)
Net tuition and fees	169,712,454	-	-	169,712,454
Auxiliary enterprises	32,988,334	-	-	32,988,334
Government grants and contracts	427,913	489,509	-	917,422
Private gifts, grants, and contracts	4,659,643	2,943,721	819,669	8,423,033
Pledge income	-	1,000,848	-	1,000,848
Investment income	1,962,183	529,823	-	2,492,006
Net loss on investments	(258,515)	(231,917)	(4,501)	(494,933)
Outreach ministries	845,896	-	-	845,896
Other income	4,656,790	52,795	11,802	4,721,387
	214,994,698	4,784,779	826,970	220,606,447
Net assets released from restrictions and redesignation	4,723,385	(4,723,385)	-	-
Total Support, Revenue, and Reclassifications	219,718,083	61,394	826,970	220,606,447
OPERATING EXPENSES:				
Instruction	85,456,124	-	-	85,456,124
Auxiliary enterprises	17,583,433	-	-	17,583,433
Academic support	17,945,794	-	-	17,945,794
Student services	28,958,595	-	-	28,958,595
Institutional support	41,172,424	-	-	41,172,424
Fund-raising	3,888,205	-	-	3,888,205
Operation and maintenance of plant	7,642,018	-	-	7,642,018
Depreciation	10,920,176	-	-	10,920,176
Amortization	183,050	-	-	183,050
Interest on indebtedness	8,026,728	-	-	8,026,728
Total Operating Expenses	221,776,547	-	-	221,776,547
Change in Net Assets From Operations	(2,058,464)	61,394	826,970	(1,170,100)
Other Changes in Net Assets:				
Accretion for asset retirement obligation	(36,503)	-	-	(36,503)
Change in value of split-interest agreements	(47,447)	(2,093)	141,922	92,382
Unrealized loss on interest rate swap	(11,391,037)	-	-	(11,391,037)
Change in Net Assets	(13,533,451)	59,301	968,892	(12,505,258)
Net Assets, Beginning of Year	122,722,407	32,568,211	27,380,265	182,670,883
Net Assets, End of Year	\$ 109,188,956	\$ 32,627,512	\$ 28,349,157	\$ 170,165,625

See notes to combined financial statements

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Combined Statement of Activities

Year Ended June 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT, REVENUE, AND RECLASSIFICATIONS:				
Tuition and fees	\$ 198,642,250	\$ -	\$ -	\$ 198,642,250
Less Tuition assistance	(42,913,762)	-	-	(42,913,762)
Net tuition and fees	155,728,488	-	-	155,728,488
Auxiliary enterprises	32,237,808	-	-	32,237,808
Government grants and contracts	866,169	214,179	-	1,080,348
Private gifts, grants, and contracts	4,736,310	893,213	7,598,620	13,228,143
Pledge income	-	1,037,086	-	1,037,086
Investment income	3,896,514	601,319	217,707	4,715,540
Net gain (loss) on investments	5,000,545	(4,836)	27,168	5,022,877
Outreach ministries	678,403	-	-	678,403
Other income	794,416	4,530,660	459,010	5,784,086
	<u>203,938,653</u>	<u>7,271,621</u>	<u>8,302,505</u>	<u>219,512,779</u>
Net assets released from restrictions and redesignation	4,703,613	(4,463,500)	(240,113)	-
Total Support, Revenue, and Reclassifications	<u>208,642,266</u>	<u>2,808,121</u>	<u>8,062,392</u>	<u>219,512,779</u>
OPERATING EXPENSES:				
Instruction	80,172,385	-	-	80,172,385
Auxiliary enterprises	17,366,810	-	-	17,366,810
Academic support	17,933,522	-	-	17,933,522
Student services	25,255,061	-	-	25,255,061
Institutional support	40,097,783	-	-	40,097,783
Fund-raising	3,419,870	-	-	3,419,870
Operation and maintenance of plant	7,129,706	-	-	7,129,706
Depreciation	10,591,471	-	-	10,591,471
Interest on indebtedness	8,741,581	-	-	8,741,581
Total Operating Expenses	<u>210,708,189</u>	<u>-</u>	<u>-</u>	<u>210,708,189</u>
Change in Net Assets From Operations	(2,065,923)	2,808,121	8,062,392	8,804,590
Other Changes in Net Assets:				
Accretion for asset retirement obligation	(66,315)	-	-	(66,315)
Change in value of split-interest agreements	7,227	(973)	(98,266)	(92,012)
Unrealized loss on interest rate swap	(13,611,621)	-	-	(13,611,621)
Gain on early termination of swaps	20,588,307	-	-	20,588,307
Effect of change in accounting principle	819	-	(819)	-
Change in Net Assets	4,852,494	2,807,148	7,963,307	15,622,949
Net Assets, Beginning of Year	117,869,913	29,761,063	19,416,958	167,047,934
Net Assets, End of Year	<u>\$ 122,722,407</u>	<u>\$ 32,568,211</u>	<u>\$ 27,380,265</u>	<u>\$ 182,670,883</u>

See notes to combined financial statements

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Combined Statements of Cash Flows

	Year Ended June 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ (12,505,258)	\$ 15,622,949
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Gift of land and building included in investments	-	(7,250,000)
Gifts of equipment	(166,607)	(116,223)
Gifts of investments	(442,783)	(8,134)
Gift of beneficial interest in trusts held by others	(1,200,000)	-
Depreciation expense	10,920,176	10,591,471
Amortization expense	183,050	-
Investment realized and unrealized (gain) loss	638,594	(4,995,739)
Change in value of interest rate swap	11,391,037	(13,306,686)
Gifts restricted for endowments and capital projects	(987,150)	(488,888)
Changes in assets and liabilities:		
Accounts receivable, net	909,026	487,930
Contributions receivable, net	635,462	1,142,393
Inventories	(339,846)	(47,279)
Deposits and other assets	(378,048)	(269,593)
Accounts payable and accrued liabilities	657,570	(1,883,725)
Deferred revenue	(769,490)	(130,072)
Annuities payable	(9,447)	43,152
Trust liabilities due to others	(106,918)	(5,421)
Asset retirement obligation	(138,924)	66,314
Other liabilities	868,495	874,570
Net Cash Provided by Operating Activities	<u>9,158,939</u>	<u>327,019</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(1,348,891)	(9,352,136)
Proceeds from sales of investments	2,672,699	13,562,170
Expenditures for facilities	(7,006,979)	(1,868,595)
Student loans:		
New loans made	(494,375)	(283,296)
Principal collected	630,268	1,871,927
Additions to assets whose use is limited	(503,685)	(1,095,498)
Net Cash Provided by (Used in) Investing Activities	<u>(6,050,962)</u>	<u>2,834,572</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment on debt	(3,118,520)	(138,030,000)
Proceeds from borrowing	-	137,685,000
Contributions restricted for endowments and capital projects	987,150	488,888
Payments on capital lease obligation	(48,122)	(22,410)
Net Cash Provided by (Used in) Financing Activities	<u>(2,179,492)</u>	<u>121,478</u>
Change in Cash and Cash Equivalents	928,485	3,283,069
Cash and Cash Equivalents, Beginning of Year	<u>19,965,825</u>	<u>16,682,756</u>
Cash and Cash Equivalents, End of Year	<u>\$ 20,894,310</u>	<u>\$ 19,965,825</u>

SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES: continued on next page

See notes to combined financial statements

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Combined Statements of Cash Flows

	Year Ended June 30,	
	<u>2012</u>	<u>2011</u>
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES, continued:		
Cash paid for interest (capitalized \$0 in 2012 and 2011)	<u>\$ 8,064,889</u>	<u>\$ 8,741,581</u>
Non-cash transactions:		
Acquisition of land and building through capital lease	<u>\$ -</u>	<u>\$ 2,600,000</u>
Acquisition of capital equipment in accounts payable	<u>\$ 197,013</u>	<u>\$ 702,940</u>

See notes to combined financial statements

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

1. Nature of Organization

Celebrating over 113 years of God First and excellence in higher education, Azusa Pacific University (APU) is a comprehensive Christian, evangelical university, located 26 miles northeast of Los Angeles. With an enrollment of more than 9,900 students, APU offers over 89 bachelor's, master's, and doctoral programs on campus, online, and at seven regional centers throughout Southern California.

APU is accredited by the Accrediting Commission for Senior Colleges and Universities of the Western Association of Schools and Colleges and is classified as a "Comprehensive University II" by the Carnegie Foundation for the Advancement of Teaching. APU admits students from around the world, with the largest concentration coming from California. Revenues are derived primarily from tuition and other student charges.

Azusa Pacific Online University (APOU) is an evangelical Christian university with a strong, clear, unswervingly worldview that permeates the university and guides its activity. It believes that Biblical-based truth, knowledge, and scholarship should be available to everyone, everywhere, who has a passion to learn and make a difference in the world. Therefore, Azusa Pacific Online University exists to deliver high quality, accessible Christ-centered education to learners everywhere.

2. Summary of Significant Accounting Policies

Basis of Presentation

The combined financial statements of the University have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and with the AICPA's Audit and Accounting Guide "Not-for-Profit Organizations."

The reporting entity includes Azusa Pacific University (APU) and Azusa Pacific Online University (APOU) and are together referred to as the University. APOU was incorporated in 2010 in California as a not-for-profit corporation exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code.) APOU has been classified as a publicly supported organization, which is not a private foundation, under Section 509(a) of the Code. It is also exempt from California state income taxes under Section 23701d of the California Revenue and Taxation Code. Contributions by the public are deductible for income tax purposes.

Contributions, including unconditional promises to give, are recognized as revenue in the period received and are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the University and changes therein are classified and reported as follows:

- *Unrestricted net assets* – Net assets that are not subject to donor-imposed stipulations and that may be expendable for any purpose in performing the primary objectives of the University and those resources invested land, buildings, and equipment.
- *Temporarily restricted net assets* – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the University and/or the passage of time. As the restrictions are satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying combined financial statements as net assets released from restrictions.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

2. Summary of Significant Accounting Policies, continued

Basis of Presentation, continued

- *Permanently restricted net assets* – Net assets for which the donor has stipulated that the principal be maintained in perpetuity. Generally, the donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes.

Expenses are recorded as incurred, reported as decreases in unrestricted net assets.

Expirations of donor-imposed stipulations that simultaneously increase one class of net assets and decrease another are reported as reclassifications between the applicable classes of net assets. Temporarily restricted contributions received and expended in the same fiscal year are recorded as unrestricted net assets.

Principles of Combination

The combined financial statements include the financial resources and activities of Azusa Pacific University and Azusa Pacific Online University. All material transactions and balances between APU and APOU have been eliminated in the combined financial statements.

Cash and Cash Equivalents

Short-term investments with an original maturity of three months or less at the time of purchase are considered to be cash equivalents. Cash and cash equivalents are reported at cost which approximates market value. The University maintains cash in various financial institutions that periodically, and as of year-end, exceeded federally insured limits.

Investments

Marketable Securities

Investments in marketable securities are comprised of equity securities, corporate debt, and U.S. government obligations, and are stated at fair value based on quoted market prices.

Other Investments

Investments in real estate represent land and buildings owned by the University which are presently not being used for operating purposes. Such investments have been recorded at historical cost at their respective dates of acquisition or fair value at date of gift.

Investments also include mortgages and notes receivable from faculty and staff. Additionally, the University maintains investments in limited partnerships, the fair value of which is based on information provided by external investment managers at the most recent valuation date prior to fiscal year-end. Management monitors the activity of the external investment managers and performs reconciliations and other procedures to assure that the valuations used in the financial statements are fairly stated. The net realized and unrealized appreciation (depreciation) in fair value of investments is reflected in the combined statements of activities.

Certificate of deposits are carried at historical cost, which approximates their fair value.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

2. Summary of Significant Accounting Policies, continued

Investments, continued

Other Investments, continued

In order to offset the effect of lower current yields for current operations, the board of trustees (the Board), has adopted a spending policy for pooled endowment investments whereby the amount of investment return available for current operations is determined by applying a specific percentage range not to exceed 5% to the average market value of pooled endowment investments for the three immediately preceding calendar years. If the investment income of pooled endowment investments is insufficient to provide the full amount of investment return specified, the balance may be appropriated from accumulated realized and unrealized gains of the pooled endowment investments.

Accounts Receivable and Notes Receivable

Accounts and notes receivable are reported net of any anticipated losses due to uncollectible accounts. Student accounts receivables include amounts due to the University for tuition and fees. Student delinquent accounts are reported as additions to the allowance for bad debts when it is determined the amounts will become uncollectible. The University monitors student collections and when deemed necessary the University will assign the account to a collection agency. The University may assess a 1% interest on non-current accounts.

The allowance for doubtful accounts is maintained at a level which, in management's judgment, is adequate to absorb potential losses inherent in the receivable portfolio. An allowance for doubtful accounts is recorded annually based on historical experience and management's evaluation of receivables at the end of each year. The allowance for doubtful students accounts receivable was \$1,782,901 and \$2,181,316 for the years ended June 30, 2012 and 2011, respectively.

However, for student loans under the Perkins loan program, the allowance for doubtful accounts is based on management's evaluation of the collectability of the loan portfolio and trends in historical loss experience. Loans assigned to the Department of Education are charged to the allowance in the year they are assigned.

Contributions Receivable

Unconditional promises to give that are expected to be collected in future periods are recorded at net present value using a risk-free rate applicable to the years in which the promises were received. Amortization of the discount is recorded as contribution revenue. Conditional promises to give are recognized as revenue when the conditions are substantially met. The discount rate used during the years ended June 30, 2012 and 2011, was 6%.

Inventories

Inventories, consisting primarily of textbooks, supplies, and computers held for resale at the campus bookstore and computer store are stated at the lower of cost or market using the first-in, first-out basis of accounting.

Assets Whose Use is Limited

Assets whose use is limited are comprised of bond proceeds reserved for future use and bond reserve funds amounting to \$5,631,344 and \$5,127,659 as of June 30, 2012 and 2011, respectively. Such funds were invested in U.S. Treasury securities as of June 30, 2012, and cost approximates market value.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

2. Summary of Significant Accounting Policies, continued

Fixed Assets and Depreciation

Fixed assets are recorded at cost if purchased or if donated, at fair value at date of donation. The University's policy is to capitalize fixed asset expenditures when such assets benefit multiple years. Purchases of equipment and vehicles are capitalized when expenditures are equal to or in excess of \$5,000. Buildings and improvements are capitalized when equal to or in excess of \$25,000.

Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	5 to 58 years
Equipment	3 to 10 years
Library books	10 years

The University reviews fixed assets for impairment whenever events or changes in circumstances indicate that the carrying value of the fixed assets may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the asset to future net cash flows, undiscounted and without interest, expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The special collections, works of art, and historical items consist of Dead Sea Scroll fragments, early edition King James Bibles, Hebrew Sefer Torah Scrolls, and various other biblical artifacts that are held for educational and curatorial purposes. Each of the items is cataloged, preserved, and cared for, and activities verifying their existence and assessing their condition are performed continuously. Collection items were capitalized at cost if purchased and at fair value at the date of accession if donated. Furthermore, the items are not depreciated because the items individually have a cultural, aesthetic, or historical value that is worth preserving perpetually and the University has the technological and financial ability to protect and preserve essentially undiminished the service potential of the items and is doing that.

Split-Interest Agreements

The University is the charitable remainder beneficiary of 49 trusts for which it also serves as trustee. The combined assets are valued at \$15,670,531 and \$15,260,431 as of June 30, 2012 and 2011, respectively. The current use of these assets is restricted to earn income for the individual income beneficiaries named. Upon the occurrence of certain conditions specified in the charitable remainder trust agreements, the assets will be distributed to the University for the specified purposes. The fair value of trust assets held for third parties has been included in investments in the University's combined statements of financial position.

Liabilities totaling \$336,590 and \$443,508 as of June 30, 2012 and 2011, respectively, have been recorded and classified as "Trust liabilities due to others" which represents the remainderman share of trust balances, if matured, due to third parties.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

2. Summary of Significant Accounting Policies, continued

Split-Interest Agreements, continued

The University is licensed by the State of California Department of Insurance (the Department) as an “Annuity Society.” Under this designation, the Department requires that the University maintain a reserve adequate to meet future payments under the annuity contracts. The reserve included in investments totaled \$1,322,012 and \$1,331,459 as of June 30, 2012 and 2011, respectively. The reserve amount is based upon the most current annuity mortality table from the State of California Department of Insurance on the date of the agreement. The range of annuity rates for existing agreements is 5% to 9.6%.

Beneficial Interest in Trust Held By Others

Trust assets held by third parties consists of the University's beneficial interest in an irrevocable trust received during the year ended June 30, 2012. Under the terms of the trust, the University has an irrevocable right to receive the trust assets at the end of 25 years, or the passing of the settlors if sooner. During the trust period the settlors have rights to distribution of the net earnings of the trust assets. The fair value of the beneficial interest was \$1,200,000 at June 30, 2012.

Asset Retirement Obligations

The University has recorded asset retirement obligations associated with the legally required removal and disposal of certain hazardous materials, primarily asbestos, present in its facilities. When an asset retirement obligation is identified, the University records the fair value of the obligation as a liability. The fair value of the obligation is also capitalized as property, plant, and equipment and then amortized over the estimated useful life of the associated asset. The fair value of the asset retirement obligations was estimated using a discounted cash flow model. The present value of future estimated cash flows was calculated using the credit-adjusted, risk-free rate applicable to the University in order to determine the fair value of the asset retirement obligations.

Government Grants Refundable

Government grants refundable are funds provided by the federal government for the purpose of providing loans to qualified students through the Federal Perkins Loan Program.

Income Taxes

The University, as an educational organization, is exempt from federal income taxes under Internal Revenue Code Section 501(c)(3) and from California income taxes under Section 23701d of the California Revenue and Taxation Code.

Revenue Recognition

Student tuition and fees are recorded as revenues in the period during which the academic services are rendered. Student tuition and fees received prior to when services are rendered are recorded as deferred revenues.

Gifts from donors are recorded as revenue in the year received. Contributions receivable are reported at their discounted present value.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

2. Summary of Significant Accounting Policies, continued

Functional Expenses

Expenses that can be specifically identified with a specified program or supporting activity are charged directly to the related program or supporting activity. Expenses that are associated with more than one program or supporting activity are allocated based on an evaluation by management. Depreciation expense is allocated to the functional categories based upon the square foot occupancy. Interest expense is allocated to the functional categories based on the purpose of the related debt. Plant operations and maintenance represent space-related costs that are primarily allocated to the functional categories based on square foot occupancy. See note 10 for the functional allocation of expenses.

Advertising

Advertising expense was \$6,892,314 and \$4,111,310 for the years ended June 30, 2012 and 2011, respectively. Advertising costs are used to promote the University and are expensed as incurred.

Fair Value of Financial Instruments

A financial instrument is defined as a contractual obligation that ultimately ends with the delivery of cash or an ownership interest in an entity. Disclosures included in these notes regarding the fair value of financial instruments have been derived using external market sources or other valuation techniques. Determination of the fair value of student notes receivable, which are primarily federally sponsored loans with U.S. government mandated interest rates and repayment terms and subject to significant restrictions as to their transfer or disposition, and certain other notes receivable could not be made without incurring excessive costs.

The estimated fair value of the University's Series 2011 bonds payable approximates fair value as these instruments of financial indebtedness bear interest at variable rates which approximate current market rates for notes and bonds with similar maturities and credit quality. The University uses an overall interest rate risk-management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in interest expense that are caused by interest rate volatility. Interest rate swaps involve the exchange of fixed- and variable-rate interest payments between two parties, based on a common notional principal amount and maturity date. All derivative instruments are recognized on the combined statements of financial position at their fair values and changes in fair value are recognized in the combined statements of activities.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

3. Investments

The carrying value of the University's investments at June 30, 2012 and 2011, are as follows:

	June 30,	
	2012	2011
Investments in marketable securities		
Corporate stocks and bonds	\$ 16,428,897	\$ 14,756,087
Mutual funds	11,939,125	13,976,042
Money funds	2,965,979	2,387,646
Other investments		
Real estate	37,131,830	36,638,434
Other	977,101	1,886,339
	<u>69,442,932</u>	<u>69,644,548</u>
Certificates of deposit	<u>7,875,272</u>	<u>9,193,275</u>
	<u>\$ 77,318,204</u>	<u>\$ 78,837,823</u>

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

4. Financing Receivables

The University makes uncollateralized loans to students based on financial need. Student loans are funded through federal government loan programs or institutional resources. At June 30, 2012 and 2011, student loans receivable (net of allowance for doubtful accounts) represented 1.9% and 2.3% of total assets, respectively.

	June 30,	
	2012	2011
Federal government programs	\$ 6,713,453	\$ 6,478,189
Institutional and other	337,291	708,448
	7,050,744	7,186,637
Less allowance for doubtful accounts:		
Beginning of year	(410,000)	(410,000)
Increases	-	-
Write-offs	-	-
End of year	(410,000)	(410,000)
Student Loans Receivable, Net	\$ 6,640,744	\$ 6,776,637

In addition to the loans identified above, the University processes and authorizes loans to students through alternative federal loan programs and federal direct loan programs. These loans are not recorded in the University's combined financial statement since the University does not guarantee any federal loan funds related to these programs. The amount of loans issued under these programs was approximately \$120,433,287 and \$114,600,000 for the years ended June 30, 2012 and 2011, respectively.

The University participates in the Perkins federal revolving loan program. The availability of funds for loans under the program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the Federal government of \$4,072,503 at June 30, 2012 and 2011, are ultimately refundable to the government and are classified as liabilities in the combined statements of financial position. Outstanding loans cancelled under the program result in a reduction of the funds available for loan and a decrease in the liability to the government. At June 30, 2012 and 2011, the following amounts were past due under student loan programs:

June 30,	1-60 days past due	60-90 days past due past due	90+ days past due	Total past due
2012	209,009	63,354	649,200	921,563
2011	264,179	54,817	578,012	897,008

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

5. Contributions Receivable

Contributions receivable are expected to be received as follows at June 30, 2012 and 2011:

	June 30,	
	2012	2011
Within one year	\$ 1,014,986	\$ 1,636,306
Within two to five years	-	14,990
	1,014,986	1,651,296
Less discount to reflect contributions receivable	-	(848)
Contributions receivable, net	\$ 1,014,986	\$ 1,650,448

Gross pledges receivable have the following designations:

	June 30,	
	2012	2011
Plant expansion	\$ 1,014,986	\$ 616,306
Scholarships and programs	-	1,034,990
	\$ 1,014,986	\$ 1,651,296

6. Land, Buildings, and Equipment, Net

The University's land, buildings, and equipment consist of the following at June 30, 2012 and 2011:

	June 30,	
	2012	2011
Land	\$ 55,875,289	\$ 55,875,289
Land under capital lease	260,000	260,000
Buildings and improvements	217,172,570	214,194,285
Buildings under capital lease	2,340,000	2,340,000
Equipment and vehicles	36,407,330	32,639,292
Library books	5,505,190	5,497,890
	317,560,379	310,806,756
Less accumulated depreciation	(92,062,391)	(81,142,215)
	225,497,988	229,664,541
Construction in progress	121,425	-
Special collections, works of art, and historical items	2,580,025	2,478,500
Land, buildings, and equipment, net	228,199,438	232,143,041
Less debt secured by land, buildings, and equipment	(134,027,000)	(137,058,000)
Net investment in land, buildings, and equipment	\$ 94,172,438	\$ 95,085,041

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

7. Notes and Bonds Payable

A summary of notes and bonds payable is as follows at June 30, 2012 and 2011:

	June 30,	
	2012	2011
Notes payable		
Uncollateralized loan to an individual, bearing no interest, due June 2015, with quarterly principal payments of \$62,500 beginning June 2013.	\$ 454,395	\$ 500,000
Uncollateralized loan to an individual, bearing no interest due March 2015, quarterly principal payments of \$62,500 beginning March 2013.	458,085	500,000
Total notes payable	912,480	1,000,000
Bonds payable		
Bond payable to the Department of Housing and Urban Development, collateralized by the Turner Campus Center and Adams Hall Dormitory, with interest at 3.0% per annum, due April 2017, interest payable semiannually and principal payable in increasing annual installments.	263,000	308,000
Bond payable to the Department of Housing and Urban Development, collateralized by Smith Hall Dormitory, with interest at 3.75% per annum, April 2015, interest payable semiannually and principal payable in increasing annual installments.	49,000	65,000
Series 2011A variable rate demand refunding revenue bonds payable to Wells Fargo Bank, collateralized by East Campus excluding Football Stadium and University Village to be remarketed April 2016, hedged by interest rate swap agreement with Wells Fargo Bank, interest payable monthly and principal payable quarterly beginning July 1, 2011.	82,950,000	85,000,000
Series 2011B fixed rate refunding revenue bonds payable to California Municipal Financial Authority, collateralized by East Campus excluding Football Stadium and University Village, maturing April 2031 (7.75%) and 2041 (8.00%), respectively. Interest payable monthly and principal payments in increasing annual installments beginning October 1, 2011.	50,765,000	51,685,000
Total bonds payable	134,027,000	137,058,000
Total notes and bonds payable	\$ 134,939,480	\$ 138,058,000

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

7. Notes and Bonds Payable, continued

Annual maturities are as follows:

Years Ending June 30,	
2013	\$ 3,038,451
2014	3,264,032
2015	2,948,997
2016	2,990,000
2017	3,108,000
Thereafter	119,590,000
	\$ 134,939,480

Interest Rate Swap Bonds Payable

	June 30,	
	2012	2011
Fixed rate	4.013%	4.013%
Variable rate	67% 1-month USD-LIBOR- BBA	67% 1-month USD-LIBOR- BBA
Maturity date	April 1, 2039	April 1, 2039
Remaining term of contract in years (years)	26.8	27.8
Original bond payable balance covered by agreement (notional amount)	\$ 70,000,000	\$ 70,000,000
Notional amount outstanding at June 30	\$ 68,765,000	\$ 70,000,000

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

7. Notes and Bonds Payable, continued

The agreement is accounted for as a derivative instrument. The unrealized losses on this agreement are included in other changes in net assets in the combined statements of activities and the corresponding fair value liability is included in interest rate swap liability in the combined statements of financial position.

The effects of derivative instruments on the combined financial statements were as follows as of June 30, 2012 and 2011, and for the years then ended:

Fair Value of Derivative Instruments in the Combined Statements of Financial Position

	<u>Statement Location</u>	<u>Fair Value 2012</u>	<u>Fair Value 2011</u>
Derivative instrument:			
Interest rate swap liability	Liabilities	<u>\$ 25,002,658</u>	<u>\$ 13,611,621</u>

Effects of Derivative Instruments in Combined Statements of Activities

	<u>Statement Location</u>	<u>Loss 2012</u>	<u>Loss 2011</u>
Derivative instrument:			
Unrealized loss on interest rate swap	Other changes in net assets	<u>\$ (11,391,037)</u>	<u>\$ (13,611,621)</u>

Loan Covenants

In conjunction with the bond issuance, the University is required to comply with certain financial ratio and reporting covenants. As of June 30, 2012 and 2011, the University was in compliance with the financial reporting covenants.

Line of Credit

The University has a \$2 million line of credit with a bank. There were no draws on the line of credit at June 30, 2012 and 2011.

8. Retirement Plan

The University participates in an Internal Revenue Service Code 403(b) defined contribution retirement plan that is open to all employees who are at least 21 years of age, work a minimum of 1,000 hours per year, and have completed one year of employment at the University. The plan is funded through the Teacher Insurance and Annuity Association – College Retirement Equities Fund. Full vesting occurs upon the employee’s initial investment. Under this plan, employees must contribute a minimum of 3% of their gross wages to participate. The University then contributes 8% of the employee’s gross wages to the plan. The University’s contributions to the plan for the years ended June 30, 2012 and 2011, totaled approximately \$5,389,335 and \$4,961,979 respectively.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

9. Net Assets

Unrestricted Net Assets

Unrestricted net assets at June 30, 2012 and 2011, are as follows:

	June 30,	
	2012	2011
Undesignated	\$ (9,411,955)	\$ 1,799,840
Designated for endowment funds	24,428,473	25,837,526
Net investment in land, buildings, and equipment	94,172,438	95,085,041
	\$ 109,188,956	\$ 122,722,407

Temporarily Restricted Net Assets

Temporarily restricted net assets were available for the following purposes:

	June 30,	
	2012	2011
Gifts and grants to be used for operating purposes	\$ 3,757,402	\$ 3,869,004
Gifts to be used for capital purposes	13,972,902	14,511,016
Endowment	1,901,276	2,705,619
Beneficial interest in trust held by others	1,200,000	-
Remainder interest trusts	11,795,932	11,482,572
	\$ 32,627,512	\$ 32,568,211

Permanently Restricted Net Assets

Permanently restricted net assets are restricted for investment in perpetuity and consist of the following:

	June 30,	
	2012	2011
Endowments	\$ 24,458,319	\$ 23,600,411
Remainder interest trusts	3,890,838	3,779,854
	\$ 28,349,157	\$ 27,380,265

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

9. Net Assets, continued

Permanently Restricted Net Assets, continued

The University endowment fund consists of individual donor restricted endowment funds and funds designated by the Board to function as endowments. The net assets associated with endowment funds, including those funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The University has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as imposing a duty on the University to use good faith and prudent care in adopting investment and spending policies to preserve endowment assets while providing income and appreciation to meet the donors' intention in perpetuity. As a result of this interpretation, the University classifies the following as permanently restricted net assets:

- (a) The original value of gifts donated to the permanent endowment
- (b) The original value of subsequent gifts to the permanent endowment
- (c) Accumulations to the permanent endowment made in accordance with the direction of the applicable donor gifts instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA.

The University made a decision to allow spending from endowment funds based on the current spending policy. In accordance with UPMIFA, the University considered the following factors in making their determination to appropriate or accumulate 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 expected total return from income and appreciation of investments
- 5. Other resources of the University
- 6. The investment policies of the University

Where the board designates unrestricted funds to function as endowments, they are classified as unrestricted net assets.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

9. Net Assets, continued

Permanently Restricted Net Assets, continued

The following tables present the University's endowment composition, changes, and net asset classifications as of June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	\$ -	\$ 1,901,276	\$ 24,458,319	\$ 26,359,595
Board designated endowment funds	24,428,473	-	-	24,428,473
Total Endowment Funds	<u><u>\$ 24,428,473</u></u>	<u><u>\$ 1,901,276</u></u>	<u><u>\$ 24,458,319</u></u>	<u><u>\$ 50,788,068</u></u>

Changes in endowment net assets for year ended June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2011	\$ 25,837,526	\$ 2,705,619	\$ 23,600,411	\$ 52,143,556
Investment return:				
Investment income	1,611,868	528,458	-	2,140,326
Net appreciation (depreciation)- realized and unrealized	(308,826)	(231,917)	-	(540,743)
Total investment return	1,303,042	296,541	-	1,599,583
Contributions	63,512	-	813,526	877,038
Appropriations of endowment expenses	(1,572,846)	-	-	(1,572,846)
Appropriations of endowment scholarships	(1,284,372)	(941,946)	-	(2,226,318)
Other changes:				
Other net asset releases and transfers between funds	81,611	(158,938)	44,382	(32,945)
Endowment net assets, June 30, 2012	<u><u>\$ 24,428,473</u></u>	<u><u>\$ 1,901,276</u></u>	<u><u>\$ 24,458,319</u></u>	<u><u>\$ 50,788,068</u></u>

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

9. Net Assets, continued

Permanently Restricted Net Assets, continued

The following tables present the University's endowment composition, changes, and net asset classifications as of June 30, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	\$ -	\$ 2,705,619	\$ 23,600,411	\$ 26,306,030
Board designated endowment funds	25,837,526	-	-	25,837,526
Total Endowment Funds	<u><u>\$ 25,837,526</u></u>	<u><u>\$ 2,705,619</u></u>	<u><u>\$ 23,600,411</u></u>	<u><u>\$ 52,143,556</u></u>

Changes in endowment net assets for year ended June 30, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2010	\$ 22,923,132	\$ 831,612	\$ 15,473,806	\$ 39,228,550
Investment return:				
Investment income	1,545,750	1,492,176	-	3,037,926
Net appreciation (depreciation)- realized and unrealized	2,518,442	2,431,154	-	4,949,596
Total investment return	<u>4,064,192</u>	<u>3,923,330</u>	<u>-</u>	<u>7,987,522</u>
Contributions	420,995	-	7,584,048	8,005,043
Appropriations of endowment expenses	(1,127,225)	-	-	(1,127,225)
Appropriations of endowment scholarships	-	(2,049,323)	-	(2,049,323)
Other changes:				
Maturity of annuities	-	-	97,040	97,040
Other net asset releases and transfers between funds	(443,568)	-	445,517	1,949
Endowment net assets, June 30, 2011	<u><u>\$ 25,837,526</u></u>	<u><u>\$ 2,705,619</u></u>	<u><u>\$ 23,600,411</u></u>	<u><u>\$ 52,143,556</u></u>

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

9. Net Assets, continued

Underwater Endowment Funds

From time to time, the fair value of assets associated with individual donor endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. Deficits of this nature reported in unrestricted net assets were \$0 and \$299,497 as of June 30, 2012 and 2011, respectively. Deficits resulted from unfavorable market conditions which resulted in negative investment returns.

Investment Objectives

The University has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, endowment assets are invested in a manner that is intended to yield a long-term rate of return of approximately 7.67% annually, while assuming a moderate level of investment risk. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Investment Objectives

To achieve 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 gains) and current yield (interest and dividends). The University targets a diversified asset allocation to achieve its long-term objectives within prudent risk constraints.

Endowment Spending Allocation

The University's investment committee determines the method to be used to appropriate endowment funds for expenditure. The purpose of the endowment is to provide a perpetual source of operating support to endowed programs. The University's spending policy allocates total earnings from the portfolio between current spending and reinvestment for future earnings and has been designed with four objectives in mind:

1. Provide current programs with a predictable, stable stream of revenues
2. Ensure that the purchasing power or real value of the revenue stream does not decline over time
3. Ensure that the purchasing power or real value of the endowment assets does not decline over time
4. Ensure that the competing needs of current and future generations of students and faculty are in financial equilibrium

To achieve the goals outlined above, the investment committee set a long-term spending rate target (i.e. spending per unit divided by an average of the trailing 12 quarters of net asset values per unit) equal to a maximum of 5.0%.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

10. Allocation of Expenses

The University allocated depreciation, interest expense, and operation and maintenance of plant to the supporting and program services benefited for the years ended June 30, 2012 and 2011 as follows:

	<u>Expenses, as reported</u>	<u>Depreciation, Amortization and Related</u>	<u>Interest Expense</u>	<u>Operation and Maintenance of Plant</u>	<u>Total</u>
2012					
Program services					
Instruction	\$ 85,456,124	\$ 2,605,003	\$ 3,074,236	\$ 1,786,186	\$ 92,921,549
Auxiliary enterprises	17,583,433	1,015,352	4,952,492	635,874	24,187,151
Academic support	17,945,794	1,048,522	-	732,537	19,726,853
Student services	28,958,595	5,597,673	-	3,921,103	38,477,371
Total program services	<u>149,943,946</u>	<u>10,266,550</u>	<u>8,026,728</u>	<u>7,075,700</u>	<u>175,312,924</u>
Supporting services					
Institutional support	41,172,424	836,676	-	566,318	42,575,418
Fund-raising	3,888,205	-	-	-	3,888,205
Total supporting services	<u>45,060,629</u>	<u>836,676</u>	<u>-</u>	<u>566,318</u>	<u>46,463,623</u>
Operation and maintenance of plant	7,642,018	-	-	(7,642,018)	-
Depreciation, accretion, and amortization	11,103,226	(11,103,226)	-	-	-
Interest on indebtedness	8,026,728	-	(8,026,728)	-	-
Total expenses	<u>\$ 221,776,547</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 221,776,547</u>

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

10. Allocation of Expenses, continued

	<u>Expenses, as reported</u>	<u>Depreciation, Amortization and Related</u>	<u>Interest Expense</u>	<u>Operation and Maintenance of Plant</u>	<u>Total</u>
2011					
Program services					
Instruction	\$ 80,172,385	\$ 2,475,567	\$ 3,342,804	\$ 1,666,442	\$ 87,657,198
Auxiliary enterprises	17,366,810	881,291	5,398,777	593,246	24,240,124
Academic support	17,933,522	1,015,261	-	683,428	19,632,211
Student services	25,255,061	5,434,462	-	3,658,237	34,347,760
Total program services	<u>140,727,778</u>	<u>9,806,581</u>	<u>8,741,581</u>	<u>6,601,353</u>	<u>165,877,293</u>
Supporting services					
Institutional support	40,097,783	784,890	-	528,353	41,411,026
Fund-raising	3,419,870	-	-	-	3,419,870
Total supporting services	<u>43,517,653</u>	<u>784,890</u>	<u>-</u>	<u>528,353</u>	<u>44,830,896</u>
Operation and maintenance of plant	7,129,706	-	-	(7,129,706)	-
Depreciation, accretion, and amortization	10,591,471	(10,591,471)	-	-	-
Interest on indebtedness	8,741,581	-	(8,741,581)	-	-
Total expenses	<u>\$ 210,708,189</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 210,708,189</u>

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

11. Fair Value of Financial Instrument Measurements

Fair Value Measurements topic of the FASB ASC establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels:

1. Level 1 – Quoted market prices in active markets for identical assets and liabilities
2. Level 2 – Observable market based inputs or unobservable inputs that are corroborated by market data
3. Level 3 – Pricing inputs are unobservable and include situations where there is little, if any market activity for the investment

The University uses appropriate valuation techniques based on the available inputs to measure the fair value of its investments. When available, the University measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value. Level 3 inputs are only used when Level 1 or Level 2 inputs are not available.

The tables that follow present the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2012 and 2011:

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

11. Fair Value of Financial Instrument Measurements. continued

	June 30, 2012	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investments:				
Money market funds	\$ 2,965,979	\$ 2,965,979	\$ -	\$ -
Common stocks and bonds:				
Small Cap	554,738	554,738	-	-
Commodity Related	1,468,003	1,468,003	-	-
Emerging Markets	1,876,213	1,876,213	-	-
Institutional International	5,864,253	5,864,253	-	-
Growth	3,514,438	3,514,438	-	-
Value	3,151,252	3,151,252	-	-
	<u>16,428,897</u>	<u>16,428,897</u>	<u>-</u>	<u>-</u>
Mutual funds:				
Multi-Strategy	1,744,948	1,400	1,724,847	18,701
High Yield	2,813,989	2,813,989	-	-
US Corporate	1,100,060	1,100,060	-	-
US Government	1,442,857	1,442,857	-	-
US Mortgage/Asset Backed	1,364,534	1,364,534	-	-
Total Return	3,419,264	3,419,264	-	-
Growth	53,473	53,473	-	-
	<u>11,939,125</u>	<u>10,195,577</u>	<u>1,724,847</u>	<u>18,701</u>
Real estate	37,131,830	-	37,131,830	-
Other investments:				
Notes receivable	875,633	-	-	875,633
Limited Partnerships	101,468	-	-	101,468
	<u>977,101</u>	<u>-</u>	<u>-</u>	<u>977,101</u>
Total	<u>\$ 69,442,932</u>	<u>\$ 29,590,453</u>	<u>\$ 38,856,677</u>	<u>\$ 995,802</u>
Liabilities				
Derivative contracts/swaps	<u>\$ (25,002,658)</u>	<u>\$ -</u>	<u>\$ (25,002,658)</u>	<u>\$ -</u>

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

11. Fair Value of Financial Instrument Measurements, continued

	June 30, 2011	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investments:				
Money market funds	\$ 2,387,646	\$ 2,387,646	\$ -	\$ -
Common stocks and bonds:				
Small Cap	549,996	549,996	-	-
Commodity Related	1,074,999	1,074,999	-	-
Emerging Markets	1,366,199	1,366,199	-	-
Institutional International	5,407,955	5,407,955	-	-
Growth	3,522,836	3,522,836	-	-
Value	2,834,102	2,834,102	-	-
	<u>14,756,087</u>	<u>14,756,087</u>	<u>-</u>	<u>-</u>
Mutual funds:				
Multi-Strategy	1,681,617	8,913	1,653,702	19,002
High Yield	2,440,253	2,440,253	-	-
US Corporate	1,972,574	1,972,574	-	-
US Government	2,389,330	2,389,330	-	-
US Mortgage/Asset Backed	2,312,045	2,312,045	-	-
Total Return	3,122,651	3,122,651	-	-
Growth	57,572	57,572	-	-
	<u>13,976,042</u>	<u>12,303,338</u>	<u>1,653,702</u>	<u>19,002</u>
Real estate	36,638,434	-	36,638,434	-
Other investments:				
Notes receivable	1,784,871	-	-	1,784,871
Limited Partnerships	101,468	-	-	101,468
	<u>1,886,339</u>	<u>-</u>	<u>-</u>	<u>1,886,339</u>
Total	<u>\$ 69,644,548</u>	<u>\$ 29,447,071</u>	<u>\$ 38,292,136</u>	<u>\$ 1,905,341</u>
Liabilities				
Derivative contracts/swaps	<u>\$ (13,611,621)</u>	<u>\$ -</u>	<u>\$ (13,611,621)</u>	<u>\$ -</u>

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

11. Fair Value of Financial Instrument Measurements, continued

Level 1 Fair Value Measurements

Generally includes the fair values of corporate bonds, U.S. Government bonds, common stock, and mutual funds based on quoted market prices, when available.

Level 2 Fair Value Measurements

Generally includes the fair values of derivative contract/swaps, real estate, certain U.S. Government bonds, and mutual funds for which quoted market prices are not available or valued based on yields currently available on comparable securities of issuers with similar credit ratings.

Level 3 Fair Value Measurements

Generally includes the University's alternative investments, which consist of limited partnerships, notes receivable, and certain mutual funds. These investments do not typically transact on a regular basis, nor do they have readily determinable fair values. Therefore the University relies heavily on investment manager-reported valuations for mutual funds and K-1 Government filings for limited partnerships.

The University performed due diligence around all reported net asset values to ensure that the values are accurate and appropriate. For each investment, due diligence efforts included analysis of funds' audited financial statements, review of valuation policies and procedures, and review of other investment attributes including redemption terms and restrictions.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

11. Fair Value of Financial Instrument Measurements, continued

As a result of these efforts, the University concluded that no further adjustments to reported net asset values were necessary.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. In addition, while the University believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table sets forth a reconciliation of beginning and ending balances, separately for each major category of assets for financial instruments designated as Level 3:

	Notes Receivable	Limited Partnerships	Mutual Funds	Total
<u>June 30, 2012</u>				
Balance, June 30, 2011	\$ 1,784,871	\$ 101,468	\$ 19,002	\$ 1,905,341
Net collections	(909,238)	-	-	(909,238)
Realized losses	-	-	(301)	(301)
Unrealized gains	-	-	-	-
Balance, June 30, 2012	<u>\$ 875,633</u>	<u>\$ 101,468</u>	<u>\$ 18,701</u>	<u>\$ 995,802</u>
<u>June 30, 2011</u>				
Balance, June 30, 2010	\$ 1,816,304	\$ 116,900	\$ 18,512	\$ 1,951,716
Net collections	(31,433)	-	-	(31,433)
Realized losses	-	(15,432)	-	(15,432)
Unrealized gains	-	-	490	490
Balance, June 30, 2011	<u>\$ 1,784,871</u>	<u>\$ 101,468</u>	<u>\$ 19,002</u>	<u>\$ 1,905,341</u>

Realized losses and unrealized gains in the table above are reflected in the accompanying combined statements of activities.

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Notes to Combined Financial Statements

June 30, 2012 and 2011

12. Commitments and Contingencies

In the normal course of operations, the University is named as a defendant in suits and is subject to periodic examinations by regulatory agencies. After consultation with legal counsel, management of the University is of the opinion that no other liabilities, if any, arising from such litigation and examinations would have a material effect on the University's financial position.

The University has operating lease commitments covering facilities and equipment. The remaining balances of these lease commitments at June 30, 2012 are summarized as follows:

Years Ending June 30	
2013	\$ 4,533,604
2014	4,159,440
2015	3,998,077
2016	3,274,403
2017	2,888,304
Thereafter	<u>25,646,541</u>
Total	<u>\$ 44,500,369</u>

The maturity dates of the lease agreements range from January, 2013 to December, 2036, with monthly lease payments ranging from \$99 to \$74,160.

Rent expense for the years ended June 30, 2012 and 2011 totaled approximately \$4,922,664 and \$3,859,886, respectively.

The University is committed to noncancelable service contracts at June 30, 2012. Future payments on these contracts are \$105,586 and \$42,105 for the years ending June 30, 2013 and 2014, respectively.

Certain federal grants, including financial aid which the University administers and for which it receives reimbursements, are subject to audit and final acceptance by federal granting agencies. Current and prior year costs of such grants are subject to adjustment upon audit. The amount of expenditures that may be disallowed by the grantor, if any, cannot be determined at this time, although the University expects such amounts, if any, would not have a significant impact on the financial position of the University.

13. Related Party Transactions

Azusa Pacific International Education Foundation (API) is incorporated in the Republic of South Africa and its purpose is to facilitate a university study abroad program in South Africa. Two of the board members are senior management at the University. The University paid approximately \$1,033,000 and \$827,000 to API in the years end June 30, 2012 and 2011, respectively.

14. Subsequent Events

Subsequent events have been evaluated through the report date, which represents the date the financial statements were available to be issued. Subsequent events after that date have not been evaluated.

SUPPLEMENTAL INFORMATION

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Supplemental Combining Statement of Financial Position

June 30, 2012

	APU	APOU	Subtotal	Eliminating Entries	Total
ASSETS					
Cash and cash equivalents	\$ 20,508,339	\$ 385,971	\$ 20,894,310	\$ -	\$ 20,894,310
Investments	77,318,204	-	77,318,204	-	77,318,204
Student accounts receivable, less allowance \$1,794,435	9,971,004	441,138	10,412,142	-	10,412,142
Accounts receivable	949,604	74,875	1,024,479	(75,088)	949,391
Beneficial interest in trusts held by others	1,200,000	-	1,200,000	-	1,200,000
Contributions receivable	1,014,986	-	1,014,986	-	1,014,986
Loans to students, less allowance \$410,000	6,640,744	-	6,640,744	-	6,640,744
Inventories	2,381,110	-	2,381,110	-	2,381,110
Notes receivable	620,000	-	620,000	-	620,000
Assets whose use is limited-debt service	5,631,344	-	5,631,344	-	5,631,344
Deposits and other assets	3,776,786	-	3,776,786	-	3,776,786
Land, buildings, and equipment, net	227,750,087	449,351	228,199,438	-	228,199,438
Total Assets	\$ 357,762,208	\$ 1,351,335	\$ 359,113,543	\$ (75,088)	\$ 359,038,455
LIABILITIES AND NET ASSETS					
Accounts payable and accrued liabilities	\$ 13,374,878	\$ 260,530	\$ 13,635,408	\$ (75,088)	\$ 13,560,320
Deferred revenue	3,912,612	-	3,912,612	-	3,912,612
Annuities payable	1,322,012	-	1,322,012	-	1,322,012
Trust liabilities due to others	336,590	-	336,590	-	336,590
Government grants refundable	4,072,503	-	4,072,503	-	4,072,503
Notes and bonds payable	134,027,000	912,480	134,939,480	-	134,939,480
Interest rate swap liability	25,002,658	-	25,002,658	-	25,002,658
Asset retirement obligation	1,032,634	-	1,032,634	-	1,032,634
Capital lease obligation	2,529,468	-	2,529,468	-	2,529,468
Other liabilities	2,164,553	-	2,164,553	-	2,164,553
Total liabilities	187,774,908	1,173,010	188,947,918	(75,088)	188,872,830
Net Assets					
Unrestricted	109,098,152	90,804	109,188,956	-	109,188,956
Temporarily restricted	32,539,991	87,521	32,627,512	-	32,627,512
Permanently restricted	28,349,157	-	28,349,157	-	28,349,157
Total net assets	169,987,300	178,325	170,165,625	-	170,165,625
Total Liabilities and Net Assets	\$ 357,762,208	\$ 1,351,335	\$ 359,113,543	\$ (75,088)	\$ 359,038,455

AZUSA PACIFIC UNIVERSITY AND AFFILIATE

Supplemental Combining Statement of Activities

Year Ended June 30, 2012

	APU	APOU	Subtotal	Eliminating Entries	Total
SUPPORT, REVENUE, AND RECLASSIFICATIONS:					
Tuition and fees	\$ 220,044,121	\$ 1,772,523	\$ 221,816,644	\$ -	\$ 221,816,644
Less Tuition assistance	(52,013,160)	(91,030)	(52,104,190)	-	(52,104,190)
Net tuition and fees	168,030,961	1,681,493	169,712,454	-	169,712,454
Auxiliary enterprises	32,988,334	-	32,988,334	-	32,988,334
Government grants and contracts	917,422	-	917,422	-	917,422
Private gifts, grants, and contracts	8,335,512	2,367,707	10,703,219	(2,280,186)	8,423,033
Pledge income	1,000,848	-	1,000,848	-	1,000,848
Investment income	2,491,886	120	2,492,006	-	2,492,006
Net loss on investments	(494,933)	-	(494,933)	-	(494,933)
Outreach ministries	845,896	-	845,896	-	845,896
Other income	4,707,898	13,489	4,721,387	-	4,721,387
	218,823,824	4,062,809	222,886,633	(2,280,186)	220,606,447
Net assets released from restrictions and redesignation	-	-	-	-	-
Total Support, Revenue, and Reclassifications	218,823,824	4,062,809	222,886,633	(2,280,186)	220,606,447
Operating Expenses:					
Instruction	85,072,620	383,504	85,456,124	-	85,456,124
Auxiliary enterprises	17,583,433	-	17,583,433	-	17,583,433
Academic support	17,372,322	573,472	17,945,794	-	17,945,794
Student services	28,204,619	753,976	28,958,595	-	28,958,595
Institutional support	39,010,151	2,162,273	41,172,424	-	41,172,424
Fund-raising	3,888,205	-	3,888,205	-	3,888,205
Operation and maintenance of plant	7,642,018	-	7,642,018	-	7,642,018
Depreciation	10,845,291	74,885	10,920,176	-	10,920,176
Amortization	183,050	-	183,050	-	183,050
Interest on indebtedness	8,026,728	-	8,026,728	-	8,026,728
Total Operating Expenses	217,828,437	3,948,110	221,776,547	-	221,776,547
Change in Net Assets From Operations	995,387	114,699	1,110,086	(2,280,186)	(1,170,100)
Other Change in Net Assets:					
Accretion for asset retirement obligation	(36,503)	-	(36,503)	-	(36,503)
Change in value of split-interest agreements	92,382	-	92,382	-	92,382
Unrealized loss on interest rate swap	(11,391,037)	-	(11,391,037)	-	(11,391,037)
Grant to APOU	(2,280,186)	-	(2,280,186)	2,280,186	-
Change in Net Assets	(12,619,957)	114,699	(12,505,258)	-	(12,505,258)
Net Assets, Beginning of Year	182,607,257	63,626	182,670,883	-	182,670,883
Net Assets, End of Year	\$ 169,987,300	\$ 178,325	\$ 170,165,625	\$ -	\$ 170,165,625