

Consolidated Financial Statements and Report of
Independent Certified Public Accountants

**WESTERN UNIVERSITY OF HEALTH
SCIENCES**

June 30, 2020 (with comparative summarized
financial information for June 30, 2019)

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Western University of Health Sciences

Report on the financial statements

We have audited the accompanying consolidated financial statements of Western University of Health Sciences (a nonprofit organization) and subsidiaries (the "University"), which comprise the consolidated statement of financial position as of June 30, 2020, and the related consolidated statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 University'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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Western University of Health Sciences and subsidiaries as of June 30, 2020, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Report on 2019 summarized comparative information

We have previously audited the University's 2019 consolidated financial statements (not presented herein), and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 18, 2019. In our opinion, the accompanying summarized financial information as of and for the year ended June 30, 2019, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Grant Thornton LLP

Los Angeles, California
October 20, 2020

Western University of Health Sciences

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

June 30, 2020

(with comparative summarized financial information as of June 30, 2019)

	June 30 2020	June 30 2019
ASSETS		
Cash and cash equivalents	\$ 4,840,099	\$ 6,211,070
Accounts receivable, net	3,675,503	3,234,364
Prepaid expenses	2,255,343	2,055,397
Contributions receivable, net	1,293,751	1,685,765
Inventories	670,295	928,386
Other assets	2,577,655	2,410,829
Notes receivable, net	35,448,485	33,550,484
Investments	230,243,952	216,641,880
Property, plant and equipment, net	124,829,530	128,063,487
	<u>\$ 405,834,613</u>	<u>\$ 394,781,662</u>
LIABILITIES AND NET ASSETS		
Accounts payable and accrued liabilities	\$ 33,006,701	\$ 29,607,598
Accrued bond interest payable	164,164	164,164
Deposits for agency funds	588,626	521,094
Deferred revenues	26,108,965	33,016,992
Interest rate swap agreement	30,707,338	22,856,096
Liability on split interest agreements	2,078,520	2,231,217
Government advances for student loans	40,456,234	39,591,022
Bonds payable	80,165,565	82,616,096
	<u>213,276,113</u>	<u>210,604,279</u>
NET ASSETS		
Without Donor Restrictions	171,433,472	163,204,878
With Donor Restrictions	21,125,028	20,972,505
	<u>192,558,500</u>	<u>184,177,383</u>
	<u>\$ 405,834,613</u>	<u>\$ 394,781,662</u>

The accompanying notes are an integral part of this consolidated financial statement.

Western University of Health Sciences

CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

For the Year Ended June 30, 2020

(with comparative summarized financial information for the year ended June 30, 2019)

	Without Donor Restrictions	With Donor Restrictions	2020 Total	2019 Total
Revenues:				
Student tuition	\$ 191,155,463	\$ -	\$ 191,155,463	\$ 189,480,092
Less: scholarships and grants	(5,461,327)	-	(5,461,327)	(4,457,325)
Net tuition	185,694,136	-	185,694,136	185,022,767
Government contracts and grants	6,615,115	-	6,615,115	3,999,114
Private gifts, contracts and grants	1,978,246	2,476,812	4,455,058	4,008,760
Sales and services of auxiliary enterprises	1,188,139	-	1,188,139	1,966,117
Sales and services of educational activities				
Net patient revenue	7,407,322	-	7,407,322	8,044,123
Other sales and services	2,750,283	-	2,750,283	2,840,560
Other operating revenues	3,825,859	-	3,825,859	3,432,943
Net assets released from restrictions	2,429,347	(2,429,347)	-	-
Total revenues	211,888,447	47,465	211,935,912	209,314,384
Expenses:				
Educational and general expenditures:				
Research	19,326,809	-	19,326,809	17,041,630
Instruction	122,880,201	-	122,880,201	121,396,275
Academic support	23,749,415	-	23,749,415	26,563,559
Student services	8,516,821	-	8,516,821	8,890,938
Institutional support	21,737,057	-	21,737,057	18,065,239
Auxiliary enterprises	1,818,859	-	1,818,859	2,285,781
Development and fundraising	3,169,364	-	3,169,364	3,195,823
Total expenses	201,198,526	-	201,198,526	197,439,245
Change in net assets from operating activities	10,689,921	47,465	10,737,386	11,875,139
Other changes in net assets:				
Net investment return	5,251,952	659,859	5,911,811	6,959,901
Change in value of split-interest agreements	287,503	(137,327)	150,176	193,696
Differential in value of swap contract	(7,851,242)	-	(7,851,242)	(5,628,474)
Adjustment to contributions receivable	-	(567,014)	(567,014)	(3,367)
Gain on involuntary conversion	-	-	-	293,161
Redesignation of net assets	(149,540)	149,540	-	-
Change in net assets from non-operating activities	(2,461,327)	105,058	(2,356,269)	1,814,917
Increase in net assets	8,228,594	152,523	8,381,117	13,690,056
Net assets at beginning of year	163,204,878	20,972,505	184,177,383	170,487,327
Net assets at end of year	\$ 171,433,472	\$ 21,125,028	\$ 192,558,500	\$ 184,177,383

The accompanying notes are an integral part of this consolidated financial statement.

Western University of Health Sciences

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Year Ended June 30, 2020

(with comparative summarized financial information for the year ended June 30, 2019)

	<u>2020</u>	<u>2019</u>
Cash flows from operating and non-operating activities:		
Increase in net assets	\$ 8,381,117	\$ 13,690,056
Adjustments to reconcile increase in net assets to net cash provided by operating and non-operating activities:		
Depreciation and amortization	6,835,445	6,846,672
Loss on disposal of property, plant and equipment	3,449	-
Change in fair value of interest rate swap agreement	7,851,242	5,628,474
Bond issuance/modification costs	(293,135)	-
Amortization of bond issuance costs	187,604	173,935
Provision for uncollectible accounts	(75,778)	(45,039)
Net realized/unrealized gains on investments	(910,177)	(1,592,257)
Contributions restricted for endowment	(474,310)	(95,953)
Gain on involuntary conversion	-	(293,161)
(Increase) decrease in assets:		
Accounts receivable	(365,361)	397,548
Contributions receivable	392,014	32,767
Inventories, prepaid expenses and other assets	(108,681)	402,377
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	3,089,213	2,435,923
Accrued bond interest payable	-	(27,718)
Deposits for agency funds	67,532	(20,000)
Deferred revenues	(6,908,027)	278,932
Liability on split-interest agreements	413,168	337,180
Net cash provided by operating and non-operating activities	<u>\$ 18,085,315</u>	<u>\$ 28,149,736</u>

The accompanying notes are an integral part of this consolidated financial statement.

Western University of Health Sciences

CONSOLIDATED STATEMENT OF CASH FLOWS - CONTINUED

Year Ended June 30, 2020

(with comparative summarized financial information for the year ended June 30, 2019)

	2020	2019
Cash flows from investing activities:		
Proceeds from sale of investments	\$ 1,176,003,497	\$ 478,951,600
Purchases of investments	(1,188,695,392)	(500,551,904)
Loans issued	(5,495,527)	(4,164,580)
Collections from loans received	3,597,526	4,194,139
Proceeds from involuntary conversion for property, plant and equipment	-	293,161
Purchase of property, plant and equipment	(3,295,047)	(4,695,314)
Net cash used in investing activities	(17,884,943)	(25,972,898)
Cash flows from financing activities:		
Principal payments on bonds payable	(2,345,000)	(2,210,000)
Payments to beneficiaries of split-interest agreements	(565,865)	(600,747)
Contributions restricted for endowment	474,310	95,953
Increase in government advances for student loans	865,212	990,400
Net cash used in financing activities	(1,571,343)	(1,724,394)
Net (decrease) increase in cash and cash equivalents	(1,370,971)	452,444
Cash and cash equivalents at beginning of year	6,211,070	5,758,626
Cash and cash equivalents at end of year	\$ 4,840,099	\$ 6,211,070
Supplemental cash flow information:		
Cash paid for interest	\$ 4,067,617	\$ 4,474,226
Acquisitions of capital assets in accounts payable	\$ 1,007,930	\$ 698,040
Loans cancelled	\$ 434,623	\$ 671,360

The accompanying notes are an integral part of this consolidated financial statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 1 – ORGANIZATION

Western University of Health Sciences (the "University") is a private, nonprofit, accredited institution of higher learning and an academic health center, whose main campus occupies approximately 18 acres in Pomona, California, and includes other locations in California and Oregon. The University is committed to the education of primary care health professionals, with a distinctive philosophy centered in the osteopathic tradition, which embraces the concept that health involves the whole person and the person's relationship to others and the world.

The University was founded in 1977 as the College of Osteopathic Medicine of the Pacific ("COMP"), a four-year medical school educating osteopathic physicians. The institution expanded its mission by adding primary care-focused educational programs in the allied health professions, pharmacy and advanced nursing. In 1996, the institution officially became a university and changed its name to Western University of Health Sciences. The University further expanded its educational programs by adding the College of Veterinary Medicine and in 2009, added four new colleges in dentistry, optometry, podiatry and biomedical sciences.

In 2011, the University expanded its operations to Lebanon, Oregon, with COMP enrolling the first students at the new location. The University also operates patient care centers located in Pomona, Rancho Mirage, Los Angeles California, and Portland Oregon, in addition to Pet Wellness centers located in Pomona and Van Nuys, California that serve as clinical teaching sites for students.

For the fall semester of 2020, approximately 3,800 students were enrolled in the University's nine colleges.

Income Taxes

The University is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (Code), though it is subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the code. The University has been recognized by the California Franchise Tax Board as a University that is exempt from California franchise and income taxes under Section 23701(d) of the California Revenue and Taxation Code and is also exempt from Oregon income taxes under the related state provisions. The University has processes presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; to determine its filing and tax obligations in jurisdictions for which it has nexus; and to identify and evaluate other matters that may be considered tax positions. The University has determined that there are no material uncertain tax positions that require recognition or disclosure in the financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 1 – ORGANIZATION – Continued

The University follows guidance that clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to financial statement recognition and measurement. This guidance provides that the tax effects from an uncertain tax position can only be recognized in the financial statements if the position is “more-likely-than-not” to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position without regard to the likelihood that the tax position may be challenged.

The University is subject to income taxes for unrelated business income realized in connection with its unrelated business activities. Park Hospital Inc., a majority-owned subsidiary; and COMP Enterprises Inc., a wholly owned subsidiary, are included into the University’s consolidated financial statements and are taxed independently. In addition, the University is a single member in WesternU Center for Clinical and Translational Research, a limited liability company and has controlling interest in WesternU Medical Group, a limited liability company.

For the fiscal year ended June 30, 2020 the University had unrelated business activity from leased parking lots. The University estimated the amount of unrelated business tax to be approximately \$4,500.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). All material intercompany accounts and transactions have been eliminated in consolidation.

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, which is intended to improve how a not-for-profit entity classifies its net assets, as well as the information it presents in its financial statements about its liquidity and availability of resources, expenses and investment returns, and cash flows. The guidance replaces the three classes of net assets previously presented on the statement of financial position with two new classes of net assets, which are based on the existence or absence of donor-imposed restrictions. ASU No. 2016-14 includes specific disclosure requirements intended to improve a financial statement user’s ability to assess an entity’s available financial resources, along with its management of liquidity and liquidity risk.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

The University adopted ASU 2016-14 as required for the fiscal year ended June 30, 2019 with significant changes to the financial statements that include:

- Requiring the presentation of two net asset classes classified as “net assets without donor restriction” and “net assets with donor restrictions”:
- Modifying the presentation of underwater endowment funds and related disclosures:
- Requiring the use of the placed in-service approach to recognize the satisfaction of restrictions on gifts used to acquire or construct long-lived assets, absent explicit donor stipulations otherwise:
- Requiring that all not-for -profits present an analysis of expenses by function and nature in a separate statement or in the notes to the financial statements:
- Requiring disclosure of quantitative and qualitative information on liquidity:
- Presenting investment return net of external and direct internal investment expenses; and,
- Modifying other financial statement reporting requirements and disclosures intended to increase the usefulness to the reader.

B. Use of Estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses, including allocations to various program costs, during the reporting period. Actual results could differ from those estimates. Significant estimates in the University’s consolidated financial statements include allowance for uncollectible accounts for accounts and pledges receivable, discount rate for long-term pledges, unobservable investment inputs, non-public investment values, patient service revenue to include contractual discounts and allowances, asset impairments, inventory reserves, expense allocation, student rotations expense, and the present value of future benefits payable on split-interest agreements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

C. Net Assets

Net assets, revenue, and support are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions – Net assets available for use in general operations and not subject to donor restrictions. Board designated funds are also included within net assets without donor restrictions.

Net Assets With Donor Restrictions – Net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that such resources 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.

D. Cash and Cash Equivalents

Cash and cash equivalents consist of cash available for immediate use. Money market accounts, certificates of deposit and other short-term investments with varying maturities are classified as investments.

E. Investments

In accordance with authoritative guidance, investments in equity securities with readily determinable fair market values and all debt securities are reported at fair value with gains and losses included in the consolidated statement of activities and changes in net assets. Non-marketable securities (alternative investments) for which quoted market prices are not available are valued at fair value by the investment managers based on factors deemed relevant by the investment managers including, but not limited to: market transfer conditions, purchase price, estimated liquidation value, restriction on transfer and third-party transactions in the private market. The University's management reviews and evaluates the fair values and methodologies provided by the third-party investment managers and agree with the valuation methods and assumptions used in determining the fair value of the alternative investments. For these investments, the University used the net asset value ("NAV") provided by the investment managers to evaluate the fair value of the investments. The NAV may be adjusted based on factors or other information about the investments that management considers significant to the valuation of the investments.

Other investments, including real estate, are reported at fair value as determined by appraisals performed by independent third-parties on a periodic basis (generally, every few years) unless market conditions would indicate more frequent appraisals are required.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

F. Fair Value of Financial Instruments

The University uses an established framework for measuring fair value that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lower priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the University has the ability to access.

Level 2 - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability; and
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. The determination of what constitutes observable requires judgment by the University. The University considers observable data to be that market data that is readily available, regularly distributed or actively involved in the relevant market. The categorization of an investment within the fair value hierarchy is based upon the pricing transparency of the investment and does not necessarily correspond to the University's perceived risk of that investment.

G. Notes and Accounts Receivables Due From Students

Included in accounts receivable is student tuition stated at the amounts billed to students less loan proceeds, grants and scholarships. Military scholarships are separately billed and collected by semester from the corresponding military agencies (e.g., Army, Navy, Air Force, etc.). Approximately 95% of all currently enrolled students rely on some form of financial aid.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

As a policy, students are required to settle their financial obligation and account balance before they are allowed to attend and be promoted to the next academic year. The student accounts receivable balance as of June 30, 2020, is settled by the subsequent receipt of the corresponding financial aid funds for the academic period or by payment received from the students.

Notes receivable consist of amounts due under the federal loan programs and University loan programs and are stated at their outstanding principal amount, net of an allowance for uncollectible accounts. A third-party organization administers the collection process. Loans are made to students based on demonstrated financial need and satisfaction of federal eligibility requirements for the federal loan programs. Principal and interest payments on loans generally do not commence until after the borrower graduates or otherwise ceases enrollment.

H. Revenue Recognition

The University receives grants and contributions from a number of sources including the federal government, private foundations and other donors. Grants and contracts are evaluated as to whether they qualify as exchange transactions or contributions as defined by U.S. GAAP. Grants that are treated as exchange transactions are reported as revenue without donor restrictions when expenses are incurred in accordance with the terms of the agreement.

The excess of amounts received in exchange transactions over the amount of expenditures incurred are classified as deferred revenue on the consolidated statement of financial position.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (ASC 606). The University adopted ASC 606 effective July 1, 2018. The standard outlines a five-step model whereby revenue is recognized as performance obligations within a contract are satisfied. The five-step model is outlined below:

- Step 1: Identify the contract(s) with customers.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the University satisfies a performance obligation.

The University recognizes revenue when control of the promised goods or services are transferred to outside parties in an amount that reflects the consideration the University expects to be entitled to in exchange for those goods or services. ASC 606 also requires new and expanded disclosures regarding revenue recognition to ensure an understanding as to the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

I. Patient Revenues and Patient Receivables

Net patient service revenue is reported at estimated net realizable amounts in the period in which services are provided. The majority of University Patient Care Center (“UPCC”) services are rendered to patients under Medicare, Medical Assistance Programs, Aetna and Anthem Blue Cross Blue Shield. Reimbursement under these programs is based on a combination of prospectively determined rates and historical costs. Amounts received under Medicare and Medical Assistance programs are subject to review and final determination by program intermediaries or their agents. These adjustments are recorded when identified.

The percentage of patient service revenue, net of contractual allowances and discounts, derived from third-party payers and self-pay patients are as follows:

	<u>June 30, 2020</u>	<u>June 30, 2019</u>
Commercial insurance and other	31%	35%
Medicare	27%	23%
Self-pay	6%	6%
Medicaid	36%	36%

The University, in the ordinary course of business, enters into various incentive-sharing agreements with managed care payor’s and other providers. These agreements require retroactive settlement based on data that may not be available or finalized until all claims are processed. Settlement amounts have been estimated for such incentives based on available information.

However, it is reasonably possible that these estimates may change in the near term. Laws and regulations governing the Medicare and Medical Assistance programs are extremely complex and subject to interpretation. Compliance with such laws and regulations are subject to government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medical Assistance programs. As a result, there is at least a reasonable possibility that the recorded estimates may change by a material amount in the near term.

Presentation and disclosure for net patient service revenue requires patient service revenue to be presented net of the provision for uncollectible accounts. Net patient service revenue for the years ended June 30:

	<u>2020</u>	<u>2019</u>
Patient service revenue, gross	\$ 12,243,655	\$ 13,565,853
Contractual discounts and allowances	(4,768,345)	(5,440,796)
Provision for uncollectible accounts	(67,988)	(80,934)
Patient service revenue, net	<u>\$ 7,407,322</u>	<u>\$ 8,044,123</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

The provision for uncollectible accounts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage and other collection indicators. The UPCC records a significant provision for uncollectible accounts in the period services are provided related to self-pay patients, including both uninsured patients and patients with deductible and copayment balances due for which third-party coverage exists for a portion of their balances. Periodically throughout the year, management assesses the adequacy of the provision for uncollectible accounts based upon historical write-off experience. The results of this review are then used to make any modifications to the provision for uncollectible accounts to establish an appropriate provision for uncollectible accounts. Accounts receivable are written off after collection efforts have been followed in accordance with internal policies.

The following is reconciliation of allowance for uncollectible patient care center accounts receivable for the years ended June 30:

	2020	2019
Balance, beginning of the year	\$ 474,836	\$ 429,980
Write offs, net	(53,789)	125,790
Provision for uncollectible accounts	(67,988)	(80,934)
Balance, end of the year	<u>\$ 353,059</u>	<u>\$ 474,836</u>

J. Tuition Revenue

Tuition is generally due at the beginning of the term. Tuition revenue is recognized as it is earned and amounts received in advance are deferred and recognized as instruction takes place.

K. Contributions Receivable

The University records unconditional promises to give (a pledge) as a contribution receivable and revenue in the year the pledge is made (see Note 7). The amount is discounted to present value at a risk-adjusted rate, less a reserve for bad debt.

L. Gift Annuities and Unitrust Agreements (Split-Interest Agreements)

The University has a variety of gift agreements, including charitable gift annuities and charitable remainder trusts for which the University is the trustee. Upon receipt, the present value of each gift annuity or unitrust is recorded as an asset, the present value of the University's obligation to beneficiaries is recorded as a liability, and the remaining amount is included in net assets. Annually, an adjustment is made between the liability and the net assets to record the actuarial gain or loss due to re-computation of the liability based upon the revised life expectancy of the annuitants (also see Note 14). The fair value of these assets at June 30, 2020 and 2019 amounted to \$7,681,794 and \$8,030,393, respectively, and are included in investments in the accompanying consolidated statement of financial position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

M. Perpetual Trusts Held by Others

Perpetual trusts held by others are resources not in the University's possession nor under its control. These funds are held and administered by outside trustees. The University derives income or a residual interest from such funds. Perpetual trusts held by others are reported at the estimated fair value of the assets or at the present value of the future cash flows when the irrevocable trust is established or the University is notified of its existence. At June 30, 2020 and 2019 trust assets amounted to \$117,435 and \$116,742, respectively, and are included in investments in the accompanying consolidated statement of financial position.

N. Inventories

Inventories consist of Bookstore merchandise and resale medical merchandise at the Pet Health Center and Patient Care Centers and are valued at the lower of cost or market on a first-in, first-out basis.

O. Property, Plant and Equipment

Property, plant and equipment are stated at cost or if a gift, at fair value at the date of the gift. Depreciation is calculated on a straight-line basis over the estimated useful lives by major category of assets as follows:

Buildings and improvements (considering the date originally constructed or purchased and remaining useful life)	25 - 45 years
Equipment, furniture and library books	5 - 7 years

The University, using its best estimates based on reasonable and supportable assumptions and projections, reviews long-lived assets to be held and considered for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets might not be recoverable.

When assets are retired or sold, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss arising from such disposition is recorded. Expenditures for repairs and maintenance are charged to expenses as incurred and included in the accompanying consolidated statement of activities and changes in net assets.

P. New Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The core principal of this ASU is that a lessee should recognize an asset and a liability for all leases. Lessees should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing their right to use the underlying asset for the lease term. The amendments in this update have been extended to fiscal years beginning after December 15, 2019, with early

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

adoption permitted. Management is in the process of evaluating the impact of this standard on its operations.

Q. Re-Designation of Net Assets

Certain amounts previously received from donors have been transferred among net asset categories due to changes in donor designations or required minimum balances have been obtained.

NOTE 3 – LIQUIDITY AND AVAILABILITY OF FINANCIAL RESOURCES

The University regularly monitors the availability of resources required to meet operating needs and other contractual commitments, while also striving to maximize the investment of its available funds. For purposes of analyzing resources available to meet general expenditures over a 12-month period, the University considers all expenditures related to its ongoing activities of educational programs, clinics, research, as well as the conduct of services to support those activities.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 3 – LIQUIDITY AND AVAILABILITY OF FINANCIAL RESOURCES – Continued

As of June 30, 2020, financial assets and liquidity resources available within one year for general expenditures were as follows:

	<u>2020</u>	<u>2019</u>
Financial assets due within one year or generally available:		
Cash and cash equivalents	\$ 4,840,099	\$ 6,211,070
Accounts receivables, net	3,675,503	3,234,364
Contributions receivable	285,500	123,000
Notes receivable	62,825	85,373
Investments	<u>230,243,952</u>	<u>216,641,880</u>
Total available funds	<u>239,107,879</u>	<u>226,295,687</u>
Less:		
Amounts unavailable for general expenditures within one year due to:		
Donor restricted gifts for educational programs	5,416,838	5,938,281
Donor restricted gifts for research programs	566,276	483,850
Donor restricted gifts for endowed professorships	366,205	339,645
Donor restricted gifts with time restrictions	2,877,236	3,492,771
Restricted by donor in perpetuity	11,898,475	10,717,958
Long-term illiquid investments	<u>4,012,340</u>	<u>1,413,979</u>
Total amounts unavailable due to donor restrictions, time or law	<u>25,137,370</u>	<u>22,386,484</u>
Total financial assets available to management for general expenditures before amounts subject to the Trustee's approval	<u>213,970,509</u>	<u>203,909,203</u>
Less:		
Board designated funds:		
Funds functioning as endowment	35,050,132	33,718,499
Unappropriated accumulated endowment gains	<u>599,548</u>	<u>884,971</u>
Total board designated funds	<u>35,649,680</u>	<u>34,603,470</u>
Total financial assets available for general expenditure before endowment draw	<u>178,320,829</u>	<u>169,305,733</u>
Plus:		
Amount authorized for appropriation within one year	<u>1,700,965</u>	<u>1,567,460</u>
Total financial assets available for general expenditure within one year	<u>\$ 180,021,794</u>	<u>\$ 170,873,193</u>

The University's Trustees have designated a portion of its net assets without donor restrictions for endowment and other purposes. These amounts are identified in the table above as board designated funds. These funds are invested for long-term appreciation and current income but remain available and may be spent at the discretion of the Trustees.

In addition to financial assets available to meet general expenditures over the next 12 months, the University operates with a balanced budget and anticipates collecting sufficient revenue, including federal funds to convert general expenditures not covered by donor-restricted resources. The University typically generates positive cash flows from operations as evidenced by the statement of cash flows for the fiscal year.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 4 – INVESTMENTS

The following table summarizes the University's investments at June 30:

	2020		2019	
	Cost	Fair Value	Cost	Fair Value
Short-term investments	\$ 4,177,365	\$ 4,177,365	\$ 6,905,775	\$ 7,007,533
Certificates of deposits	9,567,691	9,604,031	9,810,237	9,830,124
Mutual funds	79,630,894	81,692,254	74,199,585	76,776,686
Corporate and government bonds	108,642,530	109,524,414	89,351,982	89,406,114
Equities	20,113,820	21,926,690	28,067,261	30,302,224
Cash surrender value of life insurance	313,463	313,464	313,464	313,464
Investments in real estate	1,389,958	3,005,734	1,362,326	3,005,734
Total	<u>\$ 223,835,721</u>	<u>\$ 230,243,952</u>	<u>\$ 210,010,630</u>	<u>\$ 216,641,879</u>

The following is a description of the instruments measured at fair value, and the methods and assumptions used by the University in determining the fair value of the instruments:

Short-term investments, money market accounts and certificates of deposit – These investments are liquid instruments held by external investment managers. The carrying value approximates fair value based on the short maturity of these instruments.

Mutual funds – These consist of pool of funds held by external investment managers. The fair values are based on quoted market prices as determined by investment custodians utilizing prices quoted by securities dealers or brokers and are categorized as Level 1. A trust naming the University as a beneficiary holds Mutual funds as investments and are categorized as Level 3.

Corporate and government bonds – These consist of domestic corporate and government bonds. The fair values are based on market prices as determined by the investment custodians utilizing prices quoted by securities dealers or brokers, investment bankers or statistical services. The University generally categorizes these as Level 2.

Equities – These consist primarily of publicly traded domestic securities held by external investment managers. The fair values are based on quoted market prices as determined by investment custodians utilizing prices quoted by securities dealers or brokers, investment bankers or statistical services and are categorized as Level 1. Other private equity securities are recorded at their appraised value or fair market value based on a net asset value and are categorized as Level 2 or Level 3.

Investments in real estate – These consist of domestic real estate investments. These investments are recorded at their appraised value or fair market value at the date of gift and are categorized as Level 3.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 5 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The following tables summarizes the University’s fair value hierarchy for those assets measured at fair value at June 30:

2020 Investments	Fair Value Measurements Using			
	Quoted Prices in Active Markets	Significant Other Observable Inputs	Significant Unobservable Inputs	Total
	Level 1	Level 2	Level 3	
Short-term investments	\$ 4,177,365	\$ -	\$ -	\$ 4,177,365
Certificates of deposit	-	9,604,031	-	9,604,031
Mutual funds	81,574,818	-	117,435	81,692,253
Corporate and government bonds	-	109,524,415	-	109,524,415
Equities	21,888,090	-	38,600	21,926,690
Cash surrender value of life insurance	-	313,464	-	313,464
Investments in real estate	-	-	3,005,734	3,005,734
Total investments	\$ 107,640,273	\$ 119,441,910	\$ 3,161,769	\$ 230,243,952

2019 Investments	Fair Value Measurements Using			
	Quoted Prices in Active Markets	Significant Other Observable Inputs	Significant Unobservable Inputs	Total
	Level 1	Level 2	Level 3	
Short-term investments	\$ 7,007,533	\$ -	\$ -	\$ 7,007,533
Certificates of deposit	-	9,830,124	-	9,830,124
Mutual funds	76,659,945	-	116,742	76,776,687
Corporate and government bonds	-	89,406,114	-	89,406,114
Equities	30,264,204	-	38,020	30,302,224
Cash surrender value of life insurance	-	313,464	-	313,464
Investments in real estate	-	-	3,005,734	3,005,734
Total investments	\$ 113,931,682	\$ 99,549,702	\$ 3,160,496	\$ 216,641,880

Other financial instruments recorded at fair value as of June 30, 2020:

	Level 1	Level 2	Level 3	Total
Interest rate swap agreement	\$ -	\$ 30,707,338	\$ -	\$ 30,707,338

Other financial instruments recorded at fair value as of June 30, 2019:

	Level 1	Level 2	Level 3	Total
Interest rate swap agreement	\$ -	\$ 22,856,096	\$ -	\$ 22,856,096

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 5 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES - Continued

The following is a roll forward of Level 3 investments for the years ended June 30:

		Total gain/(loss) included in changes in net assets	Purchases	Sales	Transfers	Ending Balance
2020	Beginning Balance					
Mutual funds	\$ 116,742	\$ 693	\$ -	\$ -	\$ -	\$ 117,435
Equities	38,020	580	-	-	-	38,600
Investments in real estate	3,005,734	-	-	-	-	3,005,734
Total	<u>\$ 3,160,496</u>	<u>\$ 1,273</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,161,769</u>
		Total gain/(loss) included in changes in net assets	Purchases	Sales	Transfers	Ending Balance
2019	Beginning Balance					
Mutual funds	\$ 112,891	\$ 3,851	\$ -	\$ -	\$ -	\$ 116,742
Equities	56,820	1,430	-	-	(20,230)	38,020
Investments in real estate	3,005,734	-	-	-	-	3,005,734
Total	<u>\$ 3,175,445</u>	<u>\$ 5,281</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (20,230)</u>	<u>\$ 3,160,496</u>

The following table shows quantitative information about unobservable inputs related to the Level 3 fair value measurements as of June 30, 2020:

Type	Fair value	Valuation technique	Significant unobservable inputs	Availability
Real estate	\$ 3,005,734	Third party appraisal	Reliance on appraisers valuations	No restrictions
Equities	\$ 38,600	Market fair value	Original cost, financial statement, materiality	N/A
Mutual funds	\$ 117,435	Discounted cash flow	Market	No restrictions

Pledges and contributions receivable – Granting date fair values are estimated as the present value of the promises to give, using a risk adjustment and discount rates applicable to the donor and federal interest rates.

Interest rate swap – The carrying value of the University’s interest rate swap agreement is recorded at fair value based on the spread between the effective interest rate on the bonds payable on June 30, 2020, and the fixed rate per the interest rate swap agreement. The University categorizes this swap as Level 2.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 5 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES - Continued

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the University believes 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 fair value measurement at the reporting date.

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such transfers, the transfer is reported at the beginning of the reporting period. For the year ended June 30, 2020, there were no significant transfers between levels or changes in the methodologies.

NOTE 6 – ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, consisted of the following at June 30:

	2020	2019
Student accounts receivable	\$ 1,121,662	\$ 1,173,470
Patient care center accounts receivable	978,708	1,251,195
Grants and contracts receivable	1,116,703	959,244
Other receivables	1,071,704	585,506
Less: allowance for uncollectible accounts	(613,274)	(735,051)
Total accounts receivable, net	<u>\$ 3,675,503</u>	<u>\$ 3,234,364</u>

NOTE 7 – CONTRIBUTIONS RECEIVABLE, NET

The following unconditional promises to give are included in the consolidated financial statements as contributions receivable, net, at June 30:

	2020	2019
Contributions receivable	\$ 5,403,000	\$ 5,228,000
Less: Unamortized discount	(1,083,183)	(1,214,023)
Less: Allowance for doubtful accounts	(3,026,066)	(2,328,212)
Total contributions receivable, net	<u>\$ 1,293,751</u>	<u>\$ 1,685,765</u>

The University used rates between 1.0% and 4.0% to discount gross unconditional promises to give in consideration of the present value of the future cash flows.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 7 – CONTRIBUTIONS RECEIVABLE, NET - Continued

Unconditional promises to give are expected to be collected in the following periods ending June 30:

	2020	2019
In one year or less	\$ 285,500	\$ 123,000
Between one year and five years	117,500	85,000
More than five years	5,000,000	5,020,000
Total gross pledges	<u>\$ 5,403,000</u>	<u>\$ 5,228,000</u>

NOTE 8 – NOTES RECEIVABLE AND STUDENT LOAN RECEIVABLES, NET

Student loans receivable are primarily federally sponsored student loans with United States government-mandated interest rates and repayment terms subject to significant restrictions as to their transfer and disposition. 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, student loan receivables, which are included in notes receivable, net, in the accompanying consolidated statement of financial position, and consisted of the following:

	2020	2019
Federal Government programs	\$ 35,462,545	\$ 33,528,553
Institutional programs	62,825	85,373
	35,525,370	33,613,926
Less: allowance for doubtful accounts	(76,885)	(63,442)
Notes student loans receivable, net	<u>\$ 35,448,485</u>	<u>\$ 33,550,484</u>

The University participates in federal revolving loan programs. The availability of funds for loans under this program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the Federal government in the amount of \$40.5 and \$39.6 million as of June 30, 2020 and 2019, respectively, are ultimately refundable to the government and are classified as Government advances for student loans in the accompanying consolidated statement 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.

Federal Perkins Loans - Perkins loans were made to students who demonstrated financial need. Historically, participating schools received a certain amount of funds each year from the federal government for distribution under this program, which supplement funds in a

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 8 – NOTES RECEIVABLE AND STUDENT LOAN RECEIVABLES, NET - Continued

school's revolving fund, from which new disbursements were made. Once the full amount of the school's funds had been awarded to students, no more loans could be made under this program for the year. This loan program officially expired on September 30, 2017.

Allowances for uncollectible accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts per the loan terms. Institutional loan balances are written off only when they are deemed to be permanently uncollectible. Amounts due under the Perkins loan program are guaranteed by the government and therefore, no reserves are placed on any past-due balances under the program.

Past due amounts under the Perkins loan programs were \$165,370 and \$174,984 for the years ending June 30, 2020 and 2019, respectively.

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consisted of the following at June 30:

	<u>2020</u>	<u>2019</u>
Buildings	\$ 124,342,446	\$ 124,342,446
Building improvements	42,666,898	41,781,980
Equipment and furniture	51,687,283	49,168,603
Library books	2,024,578	1,967,466
	<u>220,721,205</u>	<u>217,260,495</u>
Less: accumulated depreciation	(102,147,743)	(95,453,076)
	118,573,462	121,807,419
Land	6,256,068	6,256,068
Total property, plant and equipment, net	<u>\$ 124,829,530</u>	<u>\$ 128,063,487</u>

Depreciation and amortization expense amounted to \$6,835,445 and \$6,846,672 during the years ended June 30, 2020 and 2019, respectively.

NOTE 10 – OTHER ASSETS

Other assets consisted of the following at June 30:

	<u>2020</u>	<u>2019</u>
Computer network and installation	\$ 86,500	\$ 86,500
Less: accumulated amortization	(19,565)	(7,208)
Goodwill Medical Practice	178,661	-
Less: accumulated amortization	(2,978)	-
Cash surrender value of life insurance contract	2,063,301	2,063,301
Miscellaneous holdings	20,236	20,236
Deposits	251,500	248,000
Total	<u>\$ 2,577,655</u>	<u>\$ 2,410,829</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 11 – BONDS PAYABLE

In October 2007, the University entered into a Loan Agreement with California Statewide Communities Development Authority pursuant to which the Revenue Bonds, Series 2007 (the “Bonds”) were issued. The University used the proceeds to finance the acquisition, construction, improvement, expansion and equipping of various educational facilities, defeasance of certain outstanding tax-exempt bonds and paying costs in connection with the issuance of the Bonds. The Loan Agreement requires the University to comply with various covenants, conditions and restrictions. The University was in compliance with these covenants at June 30, 2020.

Currently, the Bonds bear interest at a Weekly Interest Rate, under which Wells Fargo Bank, N.A., as remarketing agent, determines the interest rate of the Bonds on a weekly basis. Wells Fargo Bank, N.A. also issued a direct pay letter of credit pursuant to which Wells Fargo Bank, N.A. agrees to pay holders of the Bonds principal and interest on the Bonds as it comes due. In addition, holders of the Bonds have the right to tender their Bonds on seven days’ notice and, under the terms of the letter of credit, Wells Fargo Bank, N.A. has agreed to pay the purchase price of any tender by a holder if Wells Fargo Bank, N.A., as remarketing agent, is unable to remarket the tendered Bonds to new holders.

Interest expense includes costs and discounts related to the issuance of bonds and are being amortized over the life of the bonds utilizing the straight-line method, which approximates the effective interest method.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 11 – BONDS PAYABLE – Continued

The Reimbursement Agreement requires Bonds to be redeemed annually each June 1st on the following redemption schedule:

Redemption of Bonds	
Year	Total Bonds to be Redeemed
2021	\$ 2,480,000
2022	2,630,000
2023	2,785,000
2024	2,950,000
2025	3,125,000
2026	3,310,000
2027	3,505,000
2028	3,715,000
2029	3,935,000
2030	4,165,000
2031	4,415,000
2032	4,675,000
2033	4,960,000
2034	5,285,000
2035	5,600,000
2036	5,930,000
2037	6,280,000
2038	6,655,000
2039	7,055,000
Subtotal	83,455,000
Less unamortized bond issuance costs	(3,289,435)
Total bonds payable, net	\$ 80,165,565

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 11 – BONDS PAYABLE – Continued

Reimbursement Agreement

In connection with the issuance of the direct pay letter of credit, Wells Fargo Bank, N.A. and the University entered into a reimbursement agreement pursuant to which the University has agreed to reimburse Wells Fargo Bank, N.A. for any draws on the direct pay letter of credit. In addition, the University made representations and warranties and agreed to financial, affirmative and negative covenants. The reimbursement agreement sets forth specified events of default. Upon the occurrence of an event of default, Wells Fargo Bank, N.A. has the right to accelerate all of the principal and interest on the Bonds. The direct pay letter of credit is scheduled to terminate on September 23, 2022 at which time the Bonds will be subject to mandatory tender unless Wells Fargo Bank, N.A. extends the letter of credit or the University secures a replacement letter of credit or converts the interest rate mode of the Bonds.

Security Agreement

In connection with the Bonds, the University entered into a Security Agreement pursuant to which it created a security interest in all of the personal property of the University to secure the University's obligations under the Bonds, the reimbursement agreement, the interest rate swap agreement between the University and Wells Fargo Bank, N.A. among other obligations. The property constituting collateral under the Security Agreement includes the gross revenues and investment property of the University as well as its equipment. While the University agrees in the reimbursement agreement not to encumber its real property, the University has not created any deed of trust or other encumbrance in its real property to secure the Bonds, the reimbursement agreement or the interest rate swap agreement.

Interest Rate Swap Agreement

In connection with the original issuance of the Bonds, the University entered into an Interest Rate Swap Agreement (the "Swap Agreement"), which currently is with Wells Fargo Bank, N.A. The Swap Agreement reduces the risk of interest rate changes with respect to the Bonds during the term of the agreement. The scheduled termination of the Swap Agreement is the same date as the final maturity of the Bonds, June 1, 2039.

Under the Interest Rate Swap Agreement, the University pays Wells Fargo Bank, N.A., a fixed interest rate of 4.004% per annum, and Wells Fargo Bank, N.A. pays the University a variable interest rate equal to 70% of one-month LIBOR. The notional amount will be adjusted as the principal is reduced to equal the outstanding principal amount of the Bonds. The University does not enter into derivative instruments for any purpose other than cash flow hedging purposes and does not speculate for investment purposes using derivative instruments. Changes in the fair value of the swap agreement are reported as unrealized gains (assets) or losses (liabilities) on the interest rate swap related to bonds in the accompanying consolidated statement of activities and changes in net assets. At June 30, 2020, a liability of \$30,707,338 is included in liabilities with respect to the Swap Agreement. The change in the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 11 – BONDS PAYABLE – Continued

fair value of the Swap Agreement from July 1, 2019 through June 30, 2020, was \$7,851,242 and is included as the differential in fair value of swap agreement in the accompanying consolidated statement of activities and changes in net assets.

NOTE 12 – ENDOWMENTS

The University's endowments consist of several individual donor- restricted funds established to support scholarship and loan funds for students as well as funds designated by the Board of Trustees to function as endowments. Net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The University has interpreted the California Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment fund absent explicit donor stipulations to the contrary. As a result of this interpretation, the University classifies as endowment funds within net assets with donor restrictions: (a) the original value of the gifts donated to the endowment, (b) the original value of subsequent gifts to the endowment, and (c) accumulations to the endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment funds are held until those amounts are appropriated for expenditure by the University in a manner consistent with the standard prudence prescribed by UPMIFA. In accordance with UPMIFA, 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 organization 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 organization
- (7) The investment policies of the organization

Unless otherwise acknowledged by the donor, the spending policy for the consolidated investment endowment pool follows the objective of the investment policy and establishes the amount made available for spending from the endowment pool. The current Board of Trustees' approved spending policy is 5% of the market value of the endowment pool on the weighted average over the trailing three years. In the event the current market value of the endowment is less than the historical gift value, spending will continue at 5% for the remaining of the University's fiscal year.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 12 – ENDOWMENTS - Continued

Income derived from the investment of the endowment funds has been accounted for by utilizing the market value unit method for maintaining pooled endowment funds. The following schedule summarizes data pertaining to this method of accounting for the year ended June 30:

	<u>2020</u>	<u>2019</u>
Unit market value	\$ 9.14	\$ 9.31
Units outstanding	5,284,486	4,936,013

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or law requires the University to maintain as a fund of perpetual duration. In such circumstances, the University maintains the donor-required fund level with donor restrictions and includes any deficiency within net assets with donor restrictions.

The following table presents endowment net asset composition by type of fund as of June 30:

	<u>With Donor Restrictions</u>					Total Endowment Funds
	<u>Without Donor Restrictions</u>	<u>Original Gift</u>	<u>Accumulated Gains (Losses)</u>	<u>Available for Distribution</u>	<u>Total</u>	
<u>2020</u>						
Donor-restricted:						
Underwater	\$ -	\$ 4,229,957	\$ (300,734)	\$ -	\$ 3,929,223	\$ 3,929,223
Other	-	8,996,935	708,161	1,752,771	11,457,867	11,457,867
Board-designated	<u>35,050,132</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>35,050,132</u>
Total endowment funds	<u>\$ 35,050,132</u>	<u>\$ 13,226,892</u>	<u>\$ 407,427</u>	<u>\$ 1,752,771</u>	<u>\$ 15,387,090</u>	<u>\$ 50,437,222</u>

	<u>With Donor Restrictions</u>					Total Endowment Funds
	<u>Without Donor Restrictions</u>	<u>Original Gift</u>	<u>Accumulated Gains (Losses)</u>	<u>Available for Distribution</u>	<u>Total</u>	
<u>2019</u>						
Donor-restricted:						
Underwater	\$ -	\$ 2,838,563	\$ (212,292)	\$ -	\$ 2,626,271	\$ 2,626,271
Other	-	9,186,952	884,971	1,930,816	12,002,739	12,002,739
Board-designated	<u>33,718,499</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>33,718,499</u>
Total endowment funds	<u>\$ 33,718,499</u>	<u>\$ 12,025,515</u>	<u>\$ 672,679</u>	<u>\$ 1,930,816</u>	<u>\$ 14,629,010</u>	<u>\$ 48,347,509</u>

The investment objectives for the management of endowment assets are to manage contributions in a manner that will maximize the benefit intended by the donor, to produce current income to support the programs of the University and donor objectives and to

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 12 – ENDOWMENTS - Continued

achieve growth of both principal value and income over time sufficient to preserve or increase the purchasing power of the assets, thus protecting the assets against inflation. The University's distributable spending policy is calculated at 5% of the three-year trailing average endowment pool market value. Under the current spending policy, if the ordinary income of pooled investments is insufficient to provide the full amount of the spending rate, the balance to be expended may be appropriated from the accumulated realized and unrealized gains of the pooled endowment or if accumulations are not sufficient, appropriation will be from operating investment revenues.

The following represents a description of the changes in the net endowment assets for the years ended June 30:

<u>2020</u>	Without Donor Restrictions	With Donor Restrictions	Total
Net endowment assets, beginning of year	\$ 33,718,499	\$14,629,010	\$ 48,347,509
Investment income, net	1,604,284	672,207	2,276,492
New gifts	-	458,711	458,711
Appropriation for expenditures	(2,339,307)	(619,175)	(2,958,482)
Other changes, including redesignations	2,066,655	246,337	2,312,992
Net endowment assets, end of year	<u>\$ 35,050,132</u>	<u>\$15,387,091</u>	<u>\$ 50,437,222</u>

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 12 – ENDOWMENTS - Continued

<u>2019</u>	Without Donor Restrictions	With Donor Restrictions	Total
Net endowment assets, beginning of year	\$ 30,207,375	\$12,997,880	\$ 43,205,255
Investment income, net	2,046,574	584,318	2,630,892
New gifts	6,145	95,953	102,098
Appropriation for expenditures	(2,092,596)	(421,743)	(2,514,339)
Other changes, including redesignations	4,773,710	149,893	4,923,603
Reclassification to implement ASU 2016-14	(1,222,709)	1,222,709	-
Net endowment assets, end of year	<u>\$ 33,718,499</u>	<u>\$14,629,010</u>	<u>\$ 48,347,509</u>

Included in the amounts above are pledges receivable of \$146,316 and \$133,963 for the years ending June 30, 2020 and 2019, respectively.

Reclassification to implement ASU 2016-14 for the period ending June 30, 2019 consists of the following:

Accumulated endowment earnings	\$ 672,679
Beginning emergency loan funds	416,067
Pledges receivable	<u>133,963</u>
	<u>\$ 1,222,709</u>

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 13 – NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions at June 30, are available for the following purposes or time periods as follows:

	<u>2020</u>	<u>2019</u>
Net assets subject to expenditure for specified purposes or time periods:		
Educational support	\$ 2,755,849	\$ 2,419,402
Research programs	566,276	483,850
Endowed professorships	366,205	339,645
Student scholarships	2,660,988	3,518,879
Time restricted	<u>2,877,236</u>	<u>3,492,771</u>
Total subject to expenditure for specified purposes or time periods	<u>9,226,554</u>	<u>10,254,547</u>
Endowments to be maintained in perpetuity:		
Educational loan programs	889,332	873,483
Endowed professorships	707,036	816,239
Student scholarships	<u>10,302,107</u>	<u>9,028,236</u>
Total donor contributions to be maintained in perpetuity	<u>11,898,475</u>	<u>10,717,958</u>
Total net assets with donor restrictions	<u>\$ 21,125,030</u>	<u>\$ 20,972,505</u>

NOTE 14 – DEFERRED GIFT AGREEMENTS

The University has arrangements with donors classified as charitable remainder trusts and charitable gift annuities. In general, under these arrangements the University receives a gift from a donor and agrees to pay the donor stipulated amounts over the remaining life of the donor or income beneficiary or for a specific term of years. The arrangements may cover one or more lives. The University is obligated under the California Department of Insurance to comply with regulations for annuities under code sections 11520 through 11524 that determine the type of investments and amount to be held in reserves based on mortality life expectancy tables. Under unitrusts, when the agreement reaches the end of its term, remaining assets are retained by the University, or in some instances, distributed to third-party beneficiaries.

When a deferred gift is received, it is split into the amount representing the actuarial present value of the future distributions to the donor and the remaining gift value to be retained for the benefit of the University or third-party beneficiaries. The actuarial liability is adjusted annually using actuarial tables appropriate for the type of arrangement, number of lives covered and age of the income beneficiaries. The University uses a 5.6% interest rate assumption for annuities prior to December 31, 1999, in making the calculation.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 15 – FUNCTIONAL EXPENSES

The following tables represents functional expenses by natural category for the year ended June 30:

	<u>2020</u>	Compensation and Benefits	Supplies and Services	Operation and	Depreciation	Interest Expense	Total					
				Maintenance of Plant								
Research	\$	13,162,476	\$	4,212,661	\$	884,389	\$	654,880	\$	412,403	\$	19,326,809
Instruction		91,625,744		18,838,827		5,626,070		4,166,045		2,623,515		122,880,201
Academic Support		14,969,645		6,381,491		1,086,766		804,739		506,774		23,749,415
Student Services		6,256,364		1,400,406		389,727		288,589		181,735		8,516,821
Institutional Support		7,873,922		11,671,232		993,248		735,490		463,165		21,737,057
Auxiliary Enterprises		379,305		1,291,534		85,045		62,975		-		1,818,859
Development and Fundraising		2,552,450		296,863		145,029		107,393		67,629		3,169,364
Operation and Maintenance of Plant		2,701,522		6,508,752		(9,210,274)		-		-		-
Total Expenses	\$	139,521,428	\$	50,601,766	\$	-	\$	6,820,111	\$	4,255,221	\$	201,198,526

	<u>2019</u>	Compensation and Benefits	Supplies and Services	Operation and	Depreciation	Interest Expense	Total					
				Maintenance of Plant								
Research	\$	11,017,671	\$	4,286,063	\$	742,593	\$	591,404	\$	403,899	\$	17,041,630
Instruction		87,416,632		21,611,678		5,284,761		4,208,803		2,874,401		121,396,275
Academic Support		17,150,121		6,705,280		1,157,180		921,583		629,395		26,563,559
Student Services		6,029,160		1,955,084		387,425		308,547		210,722		8,890,938
Institutional Support		4,799,091		11,431,939		783,747		624,179		426,283		18,065,239
Auxiliary Enterprises		379,603		1,722,907		102,021		81,250		-		2,285,781
Development and Fundraising		2,518,442		351,473		139,259		110,906		75,743		3,195,823
Operation and Maintenance of Plant		2,602,049		5,994,937		(8,596,986)		-		-		-
Total Expenses	\$	131,912,769	\$	54,059,361	\$	-	\$	6,846,672	\$	4,620,443	\$	197,439,245

Expenses not directly attributable to one program such as depreciation, interest and plant operations are allocated to specific programs and support services using proportional direct costs incurred by each department.

NOTE 16 – LIFE INSURANCE POLICIES

The University maintains a program whereby donors can make a contribution to the University, which is used to purchase whole life and term insurance policies with the University as owner and beneficiary. The cash surrender value is included in investments. The face amount of these policies was \$1,251,319 of June 30, 2020 and 2019, this activity is not recorded in the University's financial statements.

NOTE 17 – CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the University to concentrations of credit risk consist principally of cash, short-term investments, marketable securities and other investments and accounts and notes receivable. The University places substantially all of its cash and liquid investments with established commercial financial institutions and limits the amount of credit exposure to any one financial institution; however, cash balances periodically

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 17 – CONCENTRATIONS OF CREDIT RISK - Continued

exceed federally insured limits. Cash balances in excess of federally insured and Securities Investor Protection Corporation limits at June 30, 2020 and 2019, amounted to \$8,827,643 and \$8,490,172, respectively. Marketable securities, consisting of both debt and equity instruments, are generally placed in a variety of managed funds administered by different investment managers in order to limit credit risk.

NOTE 18 – OPERATING LEASES

The University's ongoing significant lease obligations are from the building and space usage due to expansion and academic growth. Additionally, there are operational equipment, primarily copiers, which continue to be leased and renewed periodically. Rent and lease expense amounted to \$8,069,146 and \$8,028,878 for the years ending June 30, 2020 and 2019, respectively.

The following minimum lease payments will continue after June 30, 2020:

<u>Years Ending June 30,</u>	<u>Operating</u>
2021	\$ 7,350,762
2022	6,544,436
2023	6,133,084
2024	6,068,917
2025	6,172,188
Thereafter	30,370,492
Total	<u>\$ 62,639,879</u>

NOTE 19 – EMPLOYEE RETIREMENT PLANS

The University has a contributory retirement plan (a "403(b) plan") covering non-student employees who work at least 20 hours per week. Participation in the plan is mandatory for an employee who becomes eligible on the first day of the month subsequent to their hire date. The minimum employee contribution is 1% with optional additional voluntary amounts in 0.5% increments.

The University contributes 1-1/2 times the employee contribution to the 403(b) plan up to a maximum of 5% of employee contributions for each participating employee. The University had 1,272 and 1,207 active participants in the plan as of December 31, 2019 and 2018. The University's contribution to the plan was \$7,219,567 and \$7,070,802 for the year ended June 30, 2020 and 2019, respectively.

The University provides a non-funded, post-retirement medical benefit to an employee and has recorded an estimated liability of \$293,600 and \$234,880 at June 30, 2020 and 2019, respectively.

Western University of Health Sciences

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

June 30, 2020

(with comparative financial summarized information at June 30, 2019)

NOTE 20 – NET ASSETS RELEASED FROM RESTRICTIONS

Net assets released from time or purpose restrictions are from the following categories for the year ended June 30:

	<u>2020</u>	<u>2019</u>
Research	\$ 306,821	\$ 80,474
Instruction	1,074,166	614,599
Student services	-	3,952
Institutional support	66,710	76,316
Scholarships and fellowships	981,650	666,928
Total	<u>\$ 2,429,347</u>	<u>\$ 1,442,269</u>

NOTE 21 – FEDERAL AND STATE GRANTS

Certain federal and state grants, including financial aid which the University administers and for which it receives reimbursements, are subject to audit and final acceptance by federal and state granting agencies. Current and prior-year expenditures of those 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 that those amounts, if any, would not have a significant impact on the University's financial position. Currently, there are no audits being conducted related to federal and state grants performed by granting agencies.

NOTE 22 – AFFILIATION WITH SAN BERNARDINO COUNTY

The University has an affiliation with San Bernardino County, specifically, Arrowhead Regional Medical Center ("ARMC") in Colton, California. The Osteopathic Post Graduate Training Institute OPTI-West Education Consortium ("Consortium"), a separate tax-exempt IRC Section 501(c)(3) corporation, is comprised of the University, ARMC, and five other health care organizations. This membership Consortium serves to promote clinical teaching and training of health profession students, maintain advanced education and certification in primary and specialty medicine and access to health care services. Consortium financial activities are not included in these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

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(with comparative financial summarized information at June 30, 2019)

NOTE 23 – CONTINGENCIES

The University is subject to claims and lawsuits that arise in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position of the University. The University purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. US GAAP requires a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the University's claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Upon reviewing the University's employee retirement plan documents, it was discovered that the definition of what constitutes wages subject to retirement plan contributions did not conform to what subject wages were used to calculate employee's retirement plan contributions. Management is currently waiting for a final determination letter from the Internal Revenue Service but does not anticipate any additional money due.

NOTE 24 – SUBSEQUENT EVENTS

In preparing these consolidated financial statements, the University has evaluated events and transactions for potential recognition or disclosure through October 20, 2020, the date the consolidated financial statements were available to be issued.

The COVID-19 pandemic has had an effect on many industries but especially difficult for the educational industry. Western University of Health Sciences campuses in California and Oregon were closed March 13, 2020 with students moving immediately to virtual programming where possible. In person events and programs were canceled or reschedule to a future date. Campuses and associated facilities began a gradual re-opening where allowed based on State, County, and City guidelines. The financial statements ending June 30, 2020 accurately reflect the financial impact of the pandemic.

The duration and impact of the COVID-19 pandemic remains unclear at this time. It is not possible to reliably estimate the duration and severity of these consequences, as well as their impact on the financial position and results of students for future periods. At this time management believes the University has adequate reserves to operate for the foreseeable future.