



FC24004

AZUSA PACIFIC UNIVERSITY

Consolidated Financial Statements

June 30, 2002 and 2001

(With Independent Auditors' Report Thereon)





600 Anton Boulevard
Suite 700
Costa Mesa, CA 92626-7651

Independent Auditors' Report

The Board of Trustees
Azusa Pacific University:

We have audited the accompanying consolidated statements of financial position of Azusa Pacific University and wholly owned subsidiary (the University) as of June 30, 2002 and 2001 and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Azusa Pacific University and wholly owned subsidiary as of June 30, 2002 and 2001 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2002 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

September 30, 2002



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AZUSA PACIFIC UNIVERSITY

Consolidated Statement of Financial Position

June 30, 2002

Assets	<u>Operating</u>	<u>Capital</u>	<u>Total</u>
Cash and cash equivalents	\$ 6,231,542	5,950,843	12,182,385
Investments (note 4)	1,958,405	32,814,694	34,773,099
Accounts receivable, less allowance for doubtful accounts of \$1,148,593	6,484,398	—	6,484,398
Contributions receivable, net (note 5)	1,623,785	3,342,843	4,966,628
Loans to students, less allowance for doubtful accounts of \$410,000	4,545,034	—	4,545,034
Inventories	1,309,191	—	1,309,191
Assets whose use is limited – debt service	—	2,374,933	2,374,933
Deposits and other assets	713,571	—	713,571
Land, buildings, and equipment, net (note 6)	—	98,782,259	98,782,259
Total assets	<u>\$ 22,865,926</u>	<u>143,265,572</u>	<u>166,131,498</u>
Liabilities and Net Assets			
Accounts payable and accrued liabilities	\$ 3,839,244	492,339	4,331,583
Notes and bonds payable (note 7)	113,213	24,767,122	24,880,335
Accrued interest payable	—	429,738	429,738
Annuities payable	—	1,971,337	1,971,337
Revocable trust liabilities	—	190,509	190,509
Trust liabilities due to others	—	277,155	277,155
Government grants refundable	3,821,066	—	3,821,066
Other liabilities	3,031,801	49,635	3,081,436
Total liabilities	<u>10,805,324</u>	<u>28,177,835</u>	<u>38,983,159</u>
Net assets:			
Unrestricted	9,461,463	93,102,654	102,564,117
Temporarily restricted (note 9)	2,599,139	9,747,413	12,346,552
Permanently restricted (note 9)	—	12,237,670	12,237,670
Total net assets	<u>12,060,602</u>	<u>115,087,737</u>	<u>127,148,339</u>
Commitments and contingencies (note 10)			
Total liabilities and net assets	<u>\$ 22,865,926</u>	<u>143,265,572</u>	<u>166,131,498</u>

See accompanying notes to consolidated financial statements.

AZUSA PACIFIC UNIVERSITY
Consolidated Statement of Financial Position
June 30, 2001

Assets	<u>Operating</u>	<u>Capital</u>	<u>Total</u>
Cash and cash equivalents	\$ 7,050,904	18,225,176	25,276,080
Investments (note 4)	2,563,217	31,764,552	34,327,769
Accounts receivable, less allowance for doubtful accounts of \$928,658	5,513,400	—	5,513,400
Contributions receivable, net (note 5)	50,000	2,632,327	2,682,327
Loans to students, less allowance for doubtful accounts of \$410,000	4,372,865	—	4,372,865
Inventories	1,172,871	—	1,172,871
Assets whose use is limited – debt service	—	2,629,318	2,629,318
Deposits and other assets	986,048	100,000	1,086,048
Land, buildings, and equipment, net (note 6)	—	86,927,043	86,927,043
Total assets	\$ <u>21,709,305</u>	<u>142,278,416</u>	<u>163,987,721</u>
Liabilities and Net Assets			
Accounts payable and accrued liabilities	\$ 3,820,221	746,753	4,566,974
Notes and bonds payable (note 7)	124,819	27,766,945	27,891,764
Accrued interest payable	—	481,549	481,549
Annuities payable	—	1,895,218	1,895,218
Revocable trust liabilities	—	190,948	190,948
Trust liabilities due to others	—	317,296	317,296
Government grants refundable	3,749,978	—	3,749,978
Other liabilities	3,626,675	34,246	3,660,921
Total liabilities	<u>11,321,693</u>	<u>31,432,955</u>	<u>42,754,648</u>
Net assets:			
Unrestricted	8,900,049	92,775,441	101,675,490
Temporarily restricted (note 9)	1,487,563	8,498,393	9,985,956
Permanently restricted (note 9)	—	9,571,627	9,571,627
Total net assets	<u>10,387,612</u>	<u>110,845,461</u>	<u>121,233,073</u>
Commitments and contingencies (note 10)			
Total liabilities and net assets	\$ <u>21,709,305</u>	<u>142,278,416</u>	<u>163,987,721</u>

See accompanying notes to consolidated financial statements.

AZUSA PACIFIC UNIVERSITY
Consolidated Statement of Activities
Year ended June 30, 2002

	Unrestricted					
	Funds functioning as endowment	Annuities and loans	Facilities and debt service	Total unrestricted	Temporarily restricted	Permanently restricted
	General					Total
Revenue and support:						
Tuition and fees, net of discounts of \$11,900,757	\$ 74,364,356	—	—	74,364,356	—	74,364,356
Auxiliary enterprises	14,242,872	—	—	14,242,872	—	14,242,872
Government grants and contracts	950,937	—	—	950,937	—	950,937
Private gifts, grants, and contracts	1,600,500	83,756	—	1,688,466	1,739,487	6,034,548
Pledge income	—	—	515,661	515,661	2,931,121	3,446,782
Investment income (loss)	1,918,546	199,449	—	2,100,107	—	2,118,774
Net unrealized losses on investments	(1214,302)	(123,935)	—	(1,765,959)	—	(1,765,959)
Net realized gains (losses) on sale of investments	115,124	(245,446)	(1,536)	113,588	6,500	120,088
Change in value of split-interest agreements	—	—	—	(245,446)	(32,547)	(266,787)
Other income	3,776,150	—	—	3,798,157	1,580	3,799,737
Total revenue and support	95,754,183	(86,176)	514,125	95,762,739	4,644,561	103,045,348
Net assets released from restrictions	2,839,043	—	—	2,255,970	(2,283,965)	—
Total revenue, support, and net assets released from restrictions	98,593,226	(86,176)	514,125	98,018,709	2,360,596	103,045,348
Expenses (note 12):						
Instruction	36,729,272	—	—	36,729,272	—	36,729,272
Auxiliary enterprises	10,039,039	—	—	10,039,039	—	10,039,039
Academic support	6,274,302	—	—	6,274,302	—	6,274,302
Student services	14,228,354	—	—	14,228,354	—	14,228,354
Institutional support	16,004,909	—	—	16,652,647	—	16,652,647
Fund-raising	2,641,989	—	—	2,641,989	—	2,641,989
Operation and maintenance of plant	4,813,574	—	347,785	5,161,359	—	5,161,359
Depreciation	—	—	3,557,381	3,557,381	—	3,557,381
Interest on indebtedness	12,348	—	1,833,391	1,845,739	—	1,845,739
Total expenses	90,743,787	—	5,738,557	97,130,082	—	97,130,082
Transfers within unrestricted net assets:						
Loan fund matching grant	(22,811)	22,811	—	—	—	—
Principal and interest for debt service	(4,488,855)	—	4,488,855	—	—	—
Funds functioning as endowment	243,751	—	1,459,851	—	—	—
Facilities and equipment acquisitions	(1,459,851)	—	1,000,000	—	—	—
Renewals and replacements	(1,000,000)	—	—	—	—	—
Total transfers	(6,727,766)	22,811	6,948,706	—	—	—
Change in net assets	1,121,673	(63,365)	1,724,274	888,627	2,360,596	5,915,266
Net assets at beginning of year	7,886,725	3,819,690	77,196,712	101,675,490	9,985,956	121,233,073
Net assets at end of year	\$ 9,008,398	3,756,325	78,920,986	102,564,117	12,346,552	127,148,339
Nature of specific net assets:						
Available for operations	\$ 8,800,622	—	—	8,800,622	—	8,800,622
Board-designated	207,776	1,036,135	—	1,243,911	—	1,243,911
Donor-restricted	—	—	—	—	6,980,485	10,283,662
Donor-restricted for facility construction	—	2,720,190	—	2,720,190	5,366,067	5,366,067
Annuities	—	—	—	—	—	—
Endowments	—	—	—	—	—	—
Funds functioning as endowment	—	—	—	—	—	—
Facilities renewals and replacements	—	—	2,960,654	2,960,654	—	2,960,654
Net investment in land, buildings, and equipment	—	—	75,960,332	75,960,332	—	75,960,332
	\$ 9,008,398	3,756,325	78,920,986	102,564,117	12,346,552	127,148,339

See accompanying notes to consolidated financial statements.

AZUSA PACIFIC UNIVERSITY
Consolidated Statement of Activities
Year ended June 30, 2001

	Unrestricted					Temporarily restricted	Permanently restricted	Total
	General	Funds functioning as endowment	Amnities and loans	Facilities and debt service	Total unrestricted			
Revenue and support:								
Tuition and fees, net of discounts of \$10,127,386	\$ 67,041,494	—	—	—	67,041,494	—	—	67,041,494
Auxiliary enterprises	13,293,816	—	—	—	13,293,816	—	—	13,293,816
Government grants and contracts	1,053,689	—	—	—	1,053,689	—	—	1,053,689
Private gifts, grants, and contracts	1,501,497	12,500	106,301	819,420	2,439,718	977,056	—	5,525,231
Pledge income	—	—	—	—	—	2,108,457	—	2,108,457
Investment income	1,987,965	30,927	247,140	1,423,355	3,689,387	2,669,161	19,133	3,708,520
Net unrealized losses on investments	(781,138)	(135,728)	(69,859)	(312,756)	(1,299,481)	—	—	(1,299,481)
Net realized gains (losses) on sale of investments	237,316	(2,563)	5,402	—	240,155	—	—	240,155
Change in value of split-interest agreements	—	—	(162,623)	—	(162,623)	(24,535)	(310,407)	(497,565)
Other income	3,629,448	324,038	—	—	3,953,486	1,018	151,580	4,106,084
Total revenue and support	87,964,087	229,174	126,361	1,930,019	90,249,641	4,754,101	837,362	95,841,104
Net assets released from restrictions	5,417,001	101,942	—	—	5,518,943	(5,518,943)	—	—
Total revenue, support, and net assets released from restrictions	93,381,088	331,116	126,361	1,930,019	95,768,584	(764,842)	837,362	95,841,104
Expenses (note 12):								
Instruction	31,528,732	—	—	—	31,528,732	—	—	31,528,732
Auxiliary enterprises	9,081,728	—	—	—	9,081,728	—	—	9,081,728
Academic support	5,573,275	—	—	—	5,573,275	—	—	5,573,275
Student services	12,624,521	—	—	—	12,624,521	—	—	12,624,521
Institutional support	14,003,431	17,730	—	—	14,021,161	—	—	14,021,161
Fund-raising	1,543,284	—	—	—	1,543,284	—	—	1,543,284
Operation and maintenance of plant	5,237,141	—	—	354,623	5,591,764	—	—	5,591,764
Depreciation	2,389	—	—	3,200,837	3,203,226	—	—	3,203,226
Interest on indebtedness	13,222	—	—	2,054,607	2,067,829	—	—	2,067,829
Total expenses	79,607,723	17,730	—	5,610,067	85,235,520	—	—	85,235,520
Transfers within unrestricted net assets:								
Loan fund matching grant	(24,721)	—	24,721	—	—	—	—	—
Principal and interest for debt service	(4,471,600)	—	—	4,471,600	—	—	—	—
Facilities and equipment acquisitions	(5,420,976)	(250,000)	—	5,670,976	—	—	—	—
Renewals and replacements	(3,150,000)	—	—	3,150,000	—	—	—	—
Total transfers	(13,067,297)	(250,000)	24,721	13,292,576	—	—	—	—
Change in net assets	706,068	63,386	151,082	9,612,528	10,533,064	(764,842)	837,362	10,605,584
Net assets at beginning of year, as restated	7,180,657	12,708,977	3,668,608	67,584,184	91,142,426	10,750,798	8,734,265	110,627,489
Net assets at end of year	\$ 7,886,725	\$ 12,772,363	\$ 3,819,690	\$ 77,196,712	\$ 101,675,490	\$ 9,985,956	\$ 9,571,627	\$ 121,233,073
Nature of specific net assets:								
Available for operations	\$ 7,678,949	—	—	—	7,678,949	—	—	7,678,949
Board-designated	207,776	—	1,013,324	—	1,221,100	—	—	1,221,100
Donor-restricted for facility construction	—	—	—	—	—	5,922,149	846,618	6,768,767
Endowments	—	—	2,806,366	—	2,806,366	4,063,807	—	4,063,807
Funds functioning as endowment	—	—	—	—	—	8,725,009	—	8,725,009
Designated for facilities additions	—	12,772,363	—	—	12,772,363	—	—	12,772,363
Facilities renewals and replacements	—	—	—	6,425,247	6,425,247	—	—	6,425,247
Net investment in land, buildings, and equipment	—	—	—	9,463,598	9,463,598	—	—	9,463,598
	—	—	—	61,307,867	61,307,867	—	—	61,307,867
	\$ 7,886,725	\$ 12,772,363	\$ 3,819,690	\$ 77,196,712	\$ 101,675,490	\$ 9,985,956	\$ 9,571,627	\$ 121,233,073

See accompanying notes to consolidated financial statements.

AZUSA PACIFIC UNIVERSITY
Consolidated Statements of Cash Flows
Years ended June 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Tuition, fees, sales, and services of auxiliary enterprises	\$ 91,435,965	82,451,505
Gifts	3,306,661	3,912,256
Grants, contracts, and government appropriations	950,937	1,053,689
Investment income	2,634,434	3,708,521
Payments to employees and suppliers	(92,812,993)	(79,225,473)
Interest paid	(1,897,551)	(2,067,829)
Deposits paid (collected)	372,477	(690,558)
Distribution of matured trusts and annuities	(230,808)	(581,530)
Net cash provided by operating activities	<u>3,759,122</u>	<u>8,560,581</u>
Cash flows from investing activities:		
Purchases of investments	(2,738,947)	(3,271,313)
Proceeds from sales of investments	3,682,427	4,007,424
Student loans:		
New loans made	(857,564)	(881,343)
Principal collected	685,395	623,704
Expenditures for facilities	(15,313,447)	(17,546,153)
Net cash used in investing activities	<u>(14,542,136)</u>	<u>(17,067,681)</u>
Cash flows from financing activities:		
Federal student loan funds received	68,434	74,164
Interest on student loans	44,054	335,751
Retirement of indebtedness	(3,011,429)	(2,827,245)
Decrease of debt reserve funds	254,385	249,819
Gifts restricted for long-term investment	333,875	2,023,177
Net cash used in financing activities	<u>(2,310,681)</u>	<u>(144,334)</u>
Decrease in cash and cash equivalents	<u>(13,093,695)</u>	<u>(8,651,434)</u>
Cash and cash equivalents, beginning of year	<u>25,276,080</u>	<u>33,927,514</u>
Cash and cash equivalents, end of year	<u>\$ 12,182,385</u>	<u>25,276,080</u>

(Continued)

AZUSA PACIFIC UNIVERSITY
Consolidated Statements of Cash Flows, Continued
Years ended June 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	\$ 5,915,266	10,605,584
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Contributed assets	(3,133,831)	(2,038,343)
Depreciation	3,557,381	3,203,226
Net depreciation in fair value of investments	1,765,959	1,299,481
Net gain on sales of investments	(120,088)	(240,155)
Change in value of split-interest agreements	266,787	497,565
Gifts restricted for long-term investment	(333,875)	(2,023,177)
Changes in operating assets and liabilities:		
Accounts receivable	(1,083,486)	(2,275,669)
Contributions receivable	(2,284,301)	(1,208,067)
Inventories	(136,320)	(261,005)
Deposits and other assets	372,477	(694,618)
Accounts payable and accrued liabilities	(235,391)	1,006,173
Interest payable	(51,811)	12,485
Annuities payable	(190,668)	244,945
Revocable trust liabilities	(439)	120
Trust liabilities due to others	(40,141)	160,981
Government grants refundable	71,088	116,302
Other liabilities	(579,485)	154,753
Net cash provided by operating activities	\$ <u>3,759,122</u>	<u>8,560,581</u>

See accompanying notes to consolidated financial statements.

AZUSA PACIFIC UNIVERSITY

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(1) Nature of Organization

Celebrating over 100 years of *God First* and excellence in higher education, Azusa Pacific University (the University) is a comprehensive Christian, evangelical university, located 26 miles northeast of Los Angeles. With an enrollment of more than 6,000 students, the University offers more than 40 areas of undergraduate study, 18 master's degree programs, and 3 doctorates.

The University 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. The University admits students from around the world, with the largest concentration coming from California. Revenues are derived primarily from tuition and other student charges.

On December 4, 1998, Azusa Pacific Foundation, Inc. (the Foundation) was formed as an auxiliary organization to the University for the purpose of supporting the University's fund-raising activities and managing funds raised. During the years ended June 30, 2002 and 2001, the University transferred cash totaling \$2,080,000 and \$1,750,000, respectively, to the Foundation. The Foundation assumed ownership and investment management of these assets. Foundation assets are included in investments in the accompanying consolidated statement of financial position as of June 30, 2002.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The consolidated financial statements of the University have been prepared on the accrual basis of accounting.

The consolidated statement of financial position is presented in order of liquidity. Assets are sequenced according to their nearness of conversion to cash, and liabilities according to the nearness of their maturity and resulting use of cash. The statement is presented using operating and capital designations. The operating designation represents those assets and liabilities that are isolated to fund the operations of the University. Capital assets, though they may benefit operations, include student loans, endowments, fixed assets, or board-designated funds and are in effect intended for long-term use or investment.

In accordance with the provisions of Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made* (SFAS No. 116), contributions, including unconditional promises to give, are recognized as revenue in the period received.

Under the provisions of Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations* (SFAS No. 117), revenues, gains, expenses, and losses 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.

AZUSA PACIFIC UNIVERSITY
Notes to Consolidated Financial Statements
June 30, 2002 and 2001

- 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 consolidated financial statements as net assets released from restrictions.
- Permanently restricted net assets – Net assets for which the donor has stipulated that the principal be maintained into 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.

(b) Cash and Cash Equivalents

All highly liquid investments, with a maturity of three months or less when purchased, are considered to be cash equivalents. The carrying amount of cash and cash equivalents approximates fair value due to the short-term nature of these financial instruments.

(c) Investments

Marketable Securities

Investments in marketable securities, comprised of equity securities, corporate debt, and U.S. government obligations, 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.

Investments also include mortgages and notes receivable from faculty and staff, secured by deeds of trust and other collateral. Such investments are recorded at cost and carry interest rates ranging from 6% to 12%. Additionally, the University maintains investments in limited partnerships, which are accounted for under the cost method of accounting.

(d) Contributions Receivable

Unconditional promises to give that are expected to be collected in future periods are recorded at net present value. The discount rate used during the years ended June 30, 2002 and 2001 was 7%.

(e) Assets Whose Use is Limited

Assets whose use is limited are comprised of bond reserve funds amounting to \$2,374,933 and \$2,629,318 as of June 30, 2002 and 2001, respectively. Such funds are invested in U.S. Treasury securities as of June 30, 2002 and 2001.

AZUSA PACIFIC UNIVERSITY
Notes to Consolidated Financial Statements
June 30, 2002 and 2001

(f) Split-Interest Agreements

The University is the charitable remainder beneficiary of 41 trusts with combined assets valued at \$7,568,577 and \$5,694,512 as of June 30, 2002 and 2001, respectively, for which it also serves as trustee. 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 has been included in investments in the University's consolidated statements of financial position and a corresponding liability has been recorded and is classified as follows:

- "Revocable trust liabilities" represent revocable living trust balances that are due to the trustor because of their revocable nature.
- "Trust liabilities due to others" represent the remainderman share of trust balances, if matured, due to third parties.

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, which is included in investments, totaled \$1,971,337 and \$1,895,218 as of June 30, 2002 and 2001, respectively.

(g) Inventories

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

(h) 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, equal to or in excess of \$2,500, when such assets benefit multiple years. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	10 to 40 years
Equipment and vehicles	3 to 20 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 by the amount by which the carrying amount of the asset exceeds the fair value of the asset. During 2002 and 2001, there were no events or changes in circumstances indicating that the carrying amount of the fixed assets may not be recoverable.

AZUSA PACIFIC UNIVERSITY
Notes to Consolidated Financial Statements
June 30, 2002 and 2001

(i) 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.

(j) 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.

(k) Functional Expenses

Expenses that can be specifically identified with a specific program or supporting service are charged directly to the related program or supporting service. Expenses that are associated with more than one program or supporting service are allocated based on an evaluation by management.

(l) Fair Value of Financial Instruments

The carrying value of the University's financial instruments, not otherwise disclosed herein and excluding notes and bonds payable, is comparable to the fair value due to the short-term nature of these financial instruments. The carrying value of the University's notes payable with variable rates approximates fair value as these instruments of financial indebtedness bear interest at variable rates which approximate current market rates for notes with similar maturities and credit quality. It is not practicable to estimate the fair value of the University's remaining notes and bonds payable as information regarding currently available borrowing rates to the University for loans with similar terms is not available.

(m) 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 and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of changes in net assets during the reporting period. Actual results could differ from those estimates.

(n) Reclassifications

Certain reclassifications have been made to the 2001 amounts to conform to the 2002 presentation.

(3) Concentration of Credit Risk

The University maintains checking and interest-bearing savings accounts in several financial institutions insured by the Federal Deposit Insurance Corporation (FDIC). As of June 30, 2002 and 2001, the funds maintained at Bank of America totaled \$2,986,635 and \$3,450,507, respectively, and funds maintained at City National Bank totaled \$212,168 and \$306,357, respectively. Such amounts exceed the \$100,000 level insured by the FDIC.

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(4) Investments

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

	<u>2002</u>	<u>2001</u>
Investments in marketable securities:		
Corporate stocks and bonds	\$ 839,622	850,214
Mutual funds	17,090,486	18,339,274
Other investments:		
Real estate	12,888,299	9,461,291
Mortgages, notes, and other	3,954,692	5,676,990
	<u>\$ 34,773,099</u>	<u>34,327,769</u>

(5) Contributions Receivable

Contributions receivable are expected to be received as follows at June 30:

	<u>2002</u>	<u>2001</u>
Within one year	\$ 925,000	700,000
Within two to five years	4,543,371	2,450,000
	5,468,371	3,150,000
Less discount to reflect contributions receivable at present value	(451,743)	(370,944)
Less allowance for uncollectible contributions receivable	(50,000)	(96,729)
Contributions receivable, net	<u>\$ 4,966,628</u>	<u>2,682,327</u>

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(6) Land, Buildings, and Equipment, Net

The University's land, buildings, and equipment consists of the following:

	2002		
	Balance, June 30, 2001	Additions/ deletions	Balance, June 30, 2002
Land and improvements	\$ 18,743,380	6,100,000	24,843,380
Buildings and improvements	70,221,982	8,132,374	78,354,356
Equipment and vehicles	14,781,971	506,518	15,288,489
Construction in progress	4,515,545	362,782	4,878,327
Library books	3,143,654	310,923	3,454,577
Subtotal	111,406,532	15,412,597	126,819,129
Less accumulated depreciation	(24,479,489)	(3,557,381)	(28,036,870)
Land, buildings, and equipment, net	\$ 86,927,043	11,855,216	98,782,259

	2001		
	Balance, June 30, 2000	Additions/ deletions	Balance, June 30, 2001
Land and improvements	\$ 18,268,380	475,000	18,743,380
Buildings and improvements	53,976,647	16,245,335	70,221,982
Equipment and vehicles	13,427,167	1,354,804	14,781,971
Construction in progress	5,298,657	(783,112)	4,515,545
Library books	2,889,528	254,126	3,143,654
Subtotal	93,860,379	17,546,153	111,406,532
Less accumulated depreciation	(21,276,263)	(3,203,226)	(24,479,489)
Land, buildings, and equipment, net	\$ 72,584,116	14,342,927	86,927,043

(7) Notes and Bonds Payable

A summary of notes and bonds payable is as follows at June 30, 2002 and 2001:

	2002	2001
Notes payable:		
Unsecured notes payable to individuals, due on demand, with interest rates ranging from 6% to 8% per annum	\$ 97,234	108,840
Unsecured notes payable, due to individuals, with interest rates ranging from 6% to 10% per annum, due at various dates through fiscal 2003	15,979	15,979

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	<u>2002</u>	<u>2001</u>
Notes payable to the Department of Housing and Urban Development, secured by Modular Student Housing, due October 2002, bearing interest at 3% per annum, interest payable semiannually and principal payable	\$ 30,545	90,288
Note payable to an individual, due 2003, non-interest bearing note, principal payable in equal annual installments of \$50,000	50,000	100,000
Note payable to The Redevelopment Agency of the City of Azusa, secured by a trust deed on a parcel of land, due 2010, bearing interest at 5% per annum, principal and interest payable in semiannual installments	<u>2,062,077</u>	<u>2,267,157</u>
Total notes payable	<u>2,255,835</u>	<u>2,582,264</u>
Bonds payable:		
3% bond payable to the Department of Education, secured by the Wynn Science Building, due 2004, interest payable semiannually and principal payable in increasing annual installments	105,500	140,000
3% bond payable to the Department of Housing and Urban Development, secured by the Turner Campus Center and Adams Hall Dormitory, due 2017, interest payable semiannually and principal payable in increasing annual installments	673,000	708,000
3.75% bond payable to the Department of Housing and Urban Development, secured by Smith Hall Dormitory, due 2015, interest payable semiannually and principal payable in increasing annual installments	181,000	191,500
7% Series 1999 Bonds, interest payable semiannually and principal payable in annual installments including \$2,605,000 due in fiscal 2003	5,665,000	8,270,000
7.25% Series 1999 Bonds, due 2009, interest payable semiannually and principal payable in increasing annual installments commencing in fiscal 2005	<u>16,000,000</u>	<u>16,000,000</u>
Total bonds payable	<u>22,624,500</u>	<u>25,309,500</u>
Total notes and bonds payable	<u>\$ 24,880,335</u>	<u>27,891,764</u>

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Future principal payments on notes and bonds payable at June 30, 2002 are as follows:

Year ending June 30:	
2003	\$ 3,113,007
2004	3,239,870
2005	3,531,830
2006	3,026,870
2007	3,235,520
Thereafter	<u>8,733,238</u>
Total	\$ <u>24,880,335</u>

The University also maintains a line of credit with Bank of America in the amount of \$10,000,000, which expires in December 2002. As of June 30, 2002 and 2001, no amounts were drawn against the line of credit.

(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 30 hours a week, 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 fiscal 2002 and 2001 totaled \$2,254,925 and \$1,987,329, respectively.

(9) Net Assets

(a) Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30, 2002 and 2001 are available for the following purposes:

	<u>2002</u>	<u>2001</u>
Gifts available for construction of facilities	\$ 5,366,067	4,063,807
Gifts and grants available for instruction, academic support, and other operating and capital purposes	<u>6,980,485</u>	<u>5,922,149</u>
	\$ <u>12,346,552</u>	<u>9,985,956</u>

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(b) Permanently Restricted Net Assets

Permanently restricted net assets are restricted for investment in perpetuity and consist of the following at June 30, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
Endowments	\$ 8,934,493	8,725,009
Remainder interest trusts	3,303,177	846,618
	<u>\$ 12,237,670</u>	<u>9,571,627</u>

(10) Commitments and Contingencies

In October 2001, Mt. San Jacinto Community College District ("MSJCCD") filed an eminent domain action against the University in the Superior Court for Riverside County seeking to acquire title to a 30-acre parcel of land located near the MSJCCD campus in Menifee, California. The subject parcel of real property and improvements added to the parcel by the University are recorded on the financial statements with a land value of \$4,170,000 and a building value of \$3,213,492. On May 2, 2002, the Superior Court ruled that the Community College District had the right to take the subject property and set a separate jury trial to determine the compensation that the University would receive for the property. On June 27, 2002, the Court ruled that the University would not be permitted to present evidence of improvements added to the property at the jury trial. On September 27, 2002, the University filed a complaint in inverse condemnation against the Community College District seeking compensation for its improvements to the property. The Community College District has filed a demurrer seeking to have the inverse condemnation action dismissed and that matter is expected to be heard by the court in December 2002. A trial in this matter is not expected before the summer of 2003, and as such no accrual for potential loss has been recorded in the accompanying financial statements.

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.

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The University has operating lease commitments covering facilities and equipment. The remaining balances of these lease commitments at June 30, 2002 are summarized as follows:

Year ending June 30:	
2003	\$ 1,946,581
2004	1,548,995
2005	740,662
2006	463,825
2007	353,524
Thereafter	<u>73,084</u>
	<u>\$ 5,126,671</u>

Rental expense for the years ended June 30, 2002 and 2001 totaled \$1,908,620 and \$2,012,256, respectively.

(11) Related Party Interest

On November 9, 1998, Azusa Pacific International (API) was formed as a civil association in Mexico to expand the University's ministries in Mexico. During the year ended June 30, 1999, the University purchased El Refugio, a 17-acre ranch property in Ensenada, Mexico, for \$150,000 on behalf of API. Additionally, the University provided funding of \$164,246 during the year ended June 30, 2001 to API to pay for certain operating expenses and improvements to the ranch property. Amounts provided by the University are included in student services expenses in the accompanying consolidated statement of activities for the year ended June 30, 2001.

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(12) 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, 2002 and 2001 as follows:

	2002				
	Expenses, as reported	Depreciation	Interest expense	Operation and maintenance of plant	Total
Program services:					
Instruction	\$ 36,729,272	585,967	173,664	1,348,247	38,837,150
Academic support	6,274,302	720,639	169,116	1,011,372	8,175,429
Student services	14,228,354	329,412	615,183	293,334	15,466,283
Total program services	57,231,928	1,636,018	957,963	2,652,953	62,478,862
Supporting services:					
Institutional support	16,652,647	639,969	12,348	1,769,902	19,074,866
Fund-raising	2,641,989	—	—	—	2,641,989
Total supporting services	19,294,636	639,969	12,348	1,769,902	21,716,855
Auxiliary enterprises	10,039,039	1,281,394	875,428	738,504	12,934,365
Operation and maintenance of plant	5,161,359	—	—	(5,161,359)	—
Depreciation	3,557,381	(3,557,381)	—	—	—
Interest on indebtedness	1,845,739	—	(1,845,739)	—	—
Total expenses	\$ 97,130,082	—	—	—	97,130,082

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2001					
	<u>Expenses, as reported</u>	<u>Depreciation</u>	<u>Interest expense</u>	<u>Operation and maintenance of plant</u>	<u>Total</u>
Program services:					
Instruction	\$ 31,528,732	833,608	192,340	1,480,395	34,035,075
Academic support	5,573,275	636,182	190,791	997,166	7,397,414
Student services	<u>12,624,521</u>	<u>151,063</u>	<u>693,079</u>	<u>301,719</u>	<u>13,770,382</u>
Total program services	<u>49,726,528</u>	<u>1,620,853</u>	<u>1,076,210</u>	<u>2,779,280</u>	<u>55,202,871</u>
Supporting services:					
Institutional support	14,021,161	1,125,881	13,222	1,745,040	16,905,304
Fund-raising	<u>1,543,284</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,543,284</u>
Total supporting services	<u>15,564,445</u>	<u>1,125,881</u>	<u>13,222</u>	<u>1,745,040</u>	<u>18,448,588</u>
Auxiliary enterprises	9,081,728	456,492	978,397	1,067,444	11,584,061
Operation and maintenance of plant	5,591,764	—	—	(5,591,764)	—
Depreciation	3,203,226	(3,203,226)	—	—	—
Interest on indebtedness	<u>2,067,829</u>	<u>—</u>	<u>(2,067,829)</u>	<u>—</u>	<u>—</u>
Total expenses	<u>\$ 85,235,520</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>85,235,520</u>