

UNIVERSITY OF THE NATIONS, KONA, INC.
(A Hawai'i Nonprofit Corporation)

CONSOLIDATED AUDITED FINANCIAL STATEMENTS
(With Independent Auditors' Report)

FOR THE YEAR ENDED JUNE 30, 2017
(With Comparative Totals for the Year Ended June 30, 2016)

UNIVERSITY OF THE NATIONS, KONA, INC.

Contents

Independent Auditor's Report	1
Consolidated Financial Statements:	
Consolidated Statements of Financial Position	3
Consolidated Statement of Activities and Changes in Net Assets	5
Consolidated Statement of Functional Expenses	6
Consolidated Statements of Cash Flows	7
Notes to the Consolidated Financial Statements	8

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
University of the Nations, Kona, Inc.
Kailua-Kona, Hawaii 96740

We have audited the accompanying consolidated financial statements of University of the Nations, Kona, Inc. (a nonprofit corporation), which comprise the consolidated statement of financial position as of June 30, 2017, and the related statements of activities and changes in net assets, functional expenses 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 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 financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 University of the Nations, Kona, Inc. as of June 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Trustees
University of the Nations Kona, Inc.
Independent Auditor's Report (continued)

Report on Summarized Information

We have previously audited University of the Nations Kona, Inc.'s financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated February 28, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Carbonaro CPAs + Management Group

Hilo, Hawaii
April 3, 2018

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statements of Financial Position

As of June 30, 2017 and 2016

ASSETS

	<u>2017</u>	<u>2016</u>
CURRENT ASSETS		
Cash and Cash Equivalents (Note 2)	\$ 3,255,795	\$ 2,193,129
Cash Advances (Note 2)	458,383	613,550
Accounts Receivable, Net (Note 2)	50,619	145,315
Inventory	4,676	2,640
Prepaid Expenses	<u>70,952</u>	<u>77,532</u>
Total Current Assets	3,840,425	3,032,166
FIXED ASSETS (Note 2)		
Land	6,798,064	6,798,064
Buildings	25,428,267	25,428,267
Construction in Progress	5,848,365	5,697,567
Furniture and Equipment	602,616	561,958
Less Accumulated Depreciation	<u>(7,379,035)</u>	<u>(6,792,942)</u>
Net Fixed Assets	31,298,277	31,692,914
NON-CURRENT ASSETS		
Cash Restricted for Endowment	220,851	220,851
Investments in Hualalai Condominiums (Notes 6 and 13)	2,095,000	2,095,000
Notes Receivable (Note 3)	<u>3,000,312</u>	<u>2,700,312</u>
Total Non-Current Assets	<u>5,316,163</u>	<u>5,016,163</u>
Total Non-Current Assets and Fixed Assets	<u>36,614,440</u>	<u>36,709,077</u>
TOTAL ASSETS	<u>\$ 40,454,865</u>	<u>\$ 39,741,243</u>

The accompanying notes are an integral part of these consolidated financial statements.

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statements of Financial Position

As of June 30, 2017 and 2016

LIABILITIES AND NET ASSETS

	<u>2017</u>	<u>2016</u>
CURRENT LIABILITIES		
Accounts Payable and Accrued Expenses	\$ 1,212,255	\$ 1,610,528
Mortgages and Notes Payable - Current (Note 9)	205,920	197,684
Deferred Tuition and Fees Revenue (Note 2)	<u>773,989</u>	<u>829,168</u>
Total Current Liabilities	2,192,164	2,637,380
LONG-TERM LIABILITES		
Mortgages and Notes Payable (Note 9)	<u>5,848,727</u>	<u>6,053,955</u>
Total Long-Term Liabilities	5,848,727	6,053,955
Total Liabilities	<u>8,040,891</u>	<u>8,691,335</u>
NET ASSETS (Note 5)		
Unrestricted Net Assets	29,655,611	28,530,670
Temporarily Restricted Net Assets	1,002,512	763,387
Permanently Restricted Net Assets	<u>1,755,851</u>	<u>1,755,851</u>
Total Net Assets	<u>32,413,974</u>	<u>31,049,908</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 40,454,865</u></u>	<u><u>\$ 39,741,243</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statement of Activities and Changes in Net Assets
 For the Year Ended June 30, 2017
 (With Comparative Totals for the Year Ended June 30, 2016)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2017	Total 2016
REVENUES AND OTHER SUPPORT					
Student and Staff Fees, Net	\$ 11,570,204	\$ 131,942	\$ -	\$ 11,702,146	\$ 10,942,559
Contributions and Support	1,788,295	9,311,250	-	11,099,545	9,339,822
Sales, Rental and Other Revenue	495,144	109,980	-	605,124	421,129
Rental Income on Investments in Hualalai Condominiums, Net (Notes 6 and 10)	29,500	68,420	-	97,920	69,460
Donations In-Kind	-	-	-	-	214,949
Net Assets Released from Restrictions	9,382,467	(9,382,467)	-	-	-
Total Public Support and Revenue	23,265,610	239,125	-	23,504,735	20,987,919
EXPENSES					
Program Expense	19,262,696	-	-	19,262,696	18,140,071
Management and General Expenses	1,527,905	-	-	1,527,905	1,245,270
Fundraising Expense	196,953	-	-	196,953	125,049
	20,987,554	-	-	20,987,554	19,510,390
Fraud Loss (Note 12)	1,153,115	-	-	1,153,115	1,675,079
Total Expenses	22,140,669	-	-	22,140,669	21,185,469
CHANGE IN NET ASSETS	1,124,941	239,125	-	1,364,066	(197,550)
Prior Period Change in Accounting Principal	-	-	-	-	177,791
NET ASSETS, BEGINNING OF YEAR	28,530,670	763,387	1,755,851	31,049,908	31,069,667
NET ASSETS, END OF YEAR	\$ 29,655,611	\$ 1,002,512	\$ 1,755,851	\$ 32,413,974	\$ 31,049,908

The accompanying notes are an integral part of these consolidated financial statements.

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statement of Functional Expenses
 For the Year Ended June 30, 2017
 (With Comparative Totals for the Year Ended June 30, 2016)

	Program Services	Management and General	Fundraising	Total 2017	Total 2016
Missionary Payments	\$ 8,639,654	\$ -	\$ -	\$ 8,639,654	\$ 8,490,440
Outreach Services	4,719,521	-	-	4,719,521	4,042,687
Household	1,587,643	396,911	-	1,984,554	1,744,493
Occupancy	1,215,275	216,799	14,453	1,446,527	1,563,780
Contracted Services	448,906	359,398	89,850	898,154	314,360
Schools and Programs	649,890	48,941	-	698,831	873,866
Depreciation Expense	468,874	117,219	-	586,093	557,234
Information Technology	293,105	90,387	67,790	451,282	302,130
Travel	248,039	62,010	-	310,049	261,893
Interest	213,916	53,479	-	267,395	280,130
Supplies	167,400	44,600	11,150	223,150	289,246
Donations	209,901	-	-	209,901	296,851
Merchant Fees	103,051	44,165	-	147,216	129,122
Cost of Sales and Services	136,753	7,228	-	143,981	103,846
Bad Debt Expense	42,970	-	-	42,970	-
Equipment Rental and Maintenance	57,225	14,545	727	72,497	114,670
Accounting	-	56,840	-	56,840	42,457
Telephone	21,458	5,432	272	27,162	27,533
Printing and Publications	19,739	2,563	3,333	25,635	21,921
Postage and Shipping	5,998	3,427	7,711	17,136	25,198
Promotional	12,912	-	1,434	14,346	16,278
Legal and Professional	466	3,961	233	4,660	12,255
Total Operating Expenses	\$ 19,262,696	\$ 1,527,905	\$ 196,953	\$20,987,554	\$ 19,510,390

The accompanying notes are an integral part of these consolidated financial statements.

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statements of Cash Flows
For the Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Contributions and Support	\$ 11,099,545	\$ 9,339,822
Cash Received from Student and Staff Fees	11,698,693	11,418,292
Cash Received from Sales, Rental and Other Income	703,044	490,589
Cash Paid for Interest	(267,395)	(280,130)
Cash Paid to Volunteer Staff, Employees and Vendors	<u>(21,788,773)</u>	<u>(19,506,327)</u>
Net Cash Provided by Operating Activities (Note 4)	1,445,114	1,462,246
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	(185,456)	(1,132,688)
Loans to Related Parties	<u>-</u>	<u>(87,081)</u>
Net Cash Used by Investing Activities	(185,456)	(1,219,769)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of Long-Term Mortgage	<u>(196,992)</u>	<u>(189,383)</u>
Net Cash Used by Financing Activities	(196,992)	(189,383)
Net Increase in Cash for the Year	<u>1,062,666</u>	<u>53,094</u>
CASH BALANCE, BEGINNING OF YEAR	<u>2,413,980</u>	<u>2,360,886</u>
CASH BALANCE, END OF YEAR	<u><u>\$ 3,476,646</u></u>	<u><u>\$ 2,413,980</u></u>

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2017

Note 1. ORGANIZATION

The University of the Nations, Kona, Inc. (the University) is a private Christian educational institution located in Kailua-Kona, Hawai'i. The University was founded in 1978 and, prior to October 25, 2013, the University's formal name was University of the Nations, Inc.

The University trains individuals to become Christian missionaries who fulfill the University's motto: "To Know God and to Make Him Known". The University grants post-secondary degrees through its seven colleges at its main campus in Kona. The University operates multiple Discipleship Training Schools (DTS) and related Bible study courses on the Kona campus. The DTS comprise a twelve week lecture phase followed by a twelve week outreach (practical training in the mission field) generally in a foreign location. The University offers its classes and begins the DTS on a calendar quarterly basis. The University also operates a school for the children of students and staff.

The University contracts with outside employment agencies for its key functions, but is otherwise staffed by volunteers (missionaries). Volunteer staff are responsible for raising their own support and are considered independent contractors and not employees. The University acts as a qualified missions agency and collects and disburses donations to the missionaries. The volunteer staff are individually responsible for any required filings with government agencies.

Two component make up the bulk of the University's revenue: contributions and support, which are donation from the general public, and program-related tuition and fees charged to students and staff. Contributions and Support comprise donations make to the University's general fund or specific programs, and donation to the University to support the independent missionaries (volunteers) working throughout the world. The University has discretion over the donations received to support its volunteer, thus these transactions are not agency transaction.

There are many *Youth with a Mission* non-profit corporations around the world with which the University is associated. Each corporation is autonomous in control and structure. These financial statements include only the operation controlled by University of the Nations, Kona, Inc., Kailua-Kona, Hawai'i USA campus.

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting: The University uses the accrual method of accounting for financial statement reporting according to generally accepted accounting principles. Under this method of accounting, revenue is recognized when earned rather than when received and expenses are recognized when incurred rather than when paid.

Basis of Consolidation: These financial statements include the accounts for all academic and administrative departments of the University. Additionally, the financial statements include the net assets and activities of the University of the Nations Kona Foundation (UNKF), a separate nonprofit corporation that exists to solicit gifts for the University, and which is controlled by the University. All Significant inter-company accounts have been eliminated in consolidation.

Revenue Recognition: Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. Unconditional promises to give due in the next year are reflected as current promises to give and are recorded at their net realizable value. Grants and other contributions of cash are reported as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2017

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net assets released from restriction: When a donor restriction expires, the related temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Cash and Cash Equivalents: For the purpose of the statement of cash flows, cash is defined as demand deposits and savings accounts with maturities of three months or less.

Cash Advances: The University uses this account to track cash provided in advance to missionaries and students for travel and outreach purposes. The cash advance is maintained in full on the balance sheet until receipts are provided that support how the funds were used along with any balance of cash which is redeposited.

Accounts Receivable: Accounts receivable represent student and staff fees owed to the University. The accounts receivable gross balance from students and staff was \$285,076 and \$336,802 as of June 30, 2017 and 2016, respectively. Management has recorded an allowance for doubtful accounts equal to 82% and 57% of gross accounts receivable as of June 30, 2017 and 2016, respectively. Management has increased the allowance for doubtful accounts to match the probability of collection. Management considers this percentage to be reasonable per the University's recent historic rates of collection of accounts receivable.

Income Taxes: The University is exempt from Federal income taxes pursuant to Internal Revenue Code section 501 (c) (3), and exempt from State income taxes under Section 237-23 (b) of the Hawaii Revised Statutes. Therefore, no provision for Federal or State income taxes is required for the financial statements.

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 certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Inventory: Inventory consists of food service supplies and is valued at the lower of cost or market on a first-in, first-out basis.

Fixed Assets: Land, buildings and equipment are stated at cost or at fair value at date of donation. Major renewals and improvements are capitalized, while maintenance and repairs that do not extend the lives of the assets are charged to operations. Management capitalizes items over \$5,000 and a useful life greater than 1 year. Depreciation is provided over the estimated useful lives of the assets using the straight-line method.

Deferred Tuition and Fees Revenue: Deferred tuition and fees revenue represent deposits collected from students and staff for tuition, housing fees, and outreach fees in advance of time of invoice.

Contributions and Donations: Under FASB ASC 958-605-25-16, contributions of donated goods and services that create or enhance non-financial assets or that require specialized skills, and are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation, are recorded at their fair values in the period received.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2017

Note 3. NOTES RECEIVABLE

Notes receivable consist of various non interest bearing, demand notes. Most are considered programmatic investments. These notes contain contributive elements; however, the amount is not significant. Thus, no contribution expense has been recorded. The notes are described thus:

- Ka Ohana Waiaha note - \$2,476,285. Management intends to receive property or the use of property, not cash, for settlement of the note. See Note 6 for further information.
- Restitution Receivable - \$300,000. The University has recorded for accounting purposes an expected settlement receivable of \$300,000 which approximates the assets in the court's possession which have been ordered to be liquidated and presented to the University. However, the total court ordered restitution is \$3,128,194 and is collectable by the University at some future date. See Note 12 for further information.
- Kama'aina Hale Apartments - \$179,027. Full repayment is expected based on appropriate timing agreed to by both parties. See Note 6 for further information.
- Kings / Ahualani - \$45,000.

Note 4. RECONCILIATION OF CHANGE IN NET ASSETS WITH NET CASH PROVIDED BY OPERATING ACTIVITIES

	2017	2016
Change in Net Assets	\$ 1,364,066	\$ (197,550)
Adjustment to Reconcile:		
Add Depreciation	586,093	557,234
Add Loss on Disposal of Fixed Assets due to Fraud		910,369
Add Bad Debt Expenses	42,970	-
Less Gain on Sale of Fixed Assets	(6,000)	-
Increase in Notes Receivable for Restitution (Note 12)	(300,000)	
Less Donation In-Kind	-	(214,949)
Change in Accounts Receivable	51,726	52,557
Change in Cash Advance	155,167	(223,593)
Change in Inventory	(2,036)	772
Change in Prepaids	6,580	10,173
Change in Accounts Payable	(398,273)	167,889
Change in Deferred Revenue	(55,179)	423,176
Change in Capital Lease Liability	-	(23,832)
Net Cash Provided by Operating Activities	<u>\$ 1,445,114</u>	<u>\$ 1,462,246</u>

Note 5. NET ASSETS

The University has conformed to *FASB ASC 958-210-45-9* "Not-for-Profit Entities, Classifications of Net Assets". Accordingly, The University is required to report information regarding its financial position and activities according to three classes of net assets:

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2017

Note 5. NET ASSETS (continued)

Unrestricted net assets are not subject to donor-imposed restrictions, or are received with restrictions that are satisfied in the same reporting period. They are available for support of all organizational operations and services. Unrestricted net assets may be designated by the board of directors for specific purpose at any time.

Temporarily restricted net assets represent restricted donations and funds received from foundations and donors for which the restriction had not yet been fulfilled. Restricted contributions are reported as increases in restricted net assets. When the restriction is met the amount is reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restrictions. Temporarily restricted net assets as of June 30, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Endowment Balance (Note 10)	\$ 89,795	\$ 43,375
Financial Aid and Other Scholarships	59,535	66,345
Building Funds	177,358	173,996
International Funds	191,127	164,468
Ministry Funds	484,696	315,203
Total	<u>\$ 1,002,512</u>	<u>\$ 763,387</u>

Permanently restricted net assets are subject to donor-imposed stipulations that they be maintained permanently by The University. These net assets constitute the university's endowment fund. Income realized by the endowment, as well as unrealized capital appreciation on the endowment, is recorded as an increase in temporarily restricted net assets until the income is appropriated for expenditure for us in the scholarship programs. Permanently restricted funds as of June 30, 2017 and 2016 were \$1,755,851 for both years.

Note 6. RELATED PARTY TRANSACTIONS

Economic Interest in KOW: Ka Ohana Waiaha (KOW) is a community land trust corporation that was created to fund the purchases of housing for long-term members of the University staff. KOW was formed in 2008 and is a tax-exempt for federal and state income tax purposes under Internal Revenue Code 501(c)(3). KOW is a separate entity and is not controlled by the University.

Beginning July 1, 2013, the University leases a parcel of land that is owned by KOW, for \$1 per year. This land comprises 57 undeveloped acres and is adjacent to the University property.

As of June 30, 2017 and 2016, the University has a note receivable of \$2,476,285 due from KOW. This is an unsecured, interest-free, demand note. Management intends to receive payment in the form of property or use of property, not cash.

Hualalai Condominiums: The Hualalai Condominiums consist of seven condominiums located in Hualalai Village, a development located adjacent to University Property. The development is owned by KOW. The University invested its permanent endowment funds with the debt-free purchase of five of the seven condominiums, see note 10.

Net income earned from the endowment condominiums is used for scholarships, in accordance with purpose restrictions established by endowment donors. The University rents the units to staff and students and pays related expenses and association fees to KOW.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2017

Note 6. RELATED PARTY TRANSACTIONS (continued)

The investments in the condominiums are stated at current realizable value which is the contractual price each unit can be sold per deed restrictions. As of June 30, 2017 this current realizable value is below fair market value.

Indemnity Agreement with KHA: In August of 2013, a separate nonprofit corporation, Kama‘aina Hale Apartments (KHA), was formed. The purpose of KHA is to acquire a 128 unit low cost housing development adjacent to the University’s campus. The University has signed an indemnity agreement on behalf of KHA, guaranteeing annual sub-lease payments of \$400,000 to the land owner, Kamehameha Schools Bishop Estate (KSBE). The University does not expect to be required to make payments to KSBE on behalf of KHA.

NOTE 7. FUNCTIONAL ALLOCATION OF EXPENSES

The costs of providing the various programs and activities have been summarized on a functional basis in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Note 8. SUBSEQUENT EVENTS

In preparing these financial statements, the University has evaluated events and transactions for potential recognition or disclosure through April 3, 2018, and there were none to be reported.

Note 9. LONG TERM DEBT

The University has two loans outstanding with Central Pacific Bank. At June 30, 2017 and 2016, long-term debt consisted of the following:

	<u>2017</u>	<u>2016</u>
Central Pacific Bank 1 –Loan payable, carries interest rate of 4.0%, fixed until September 2019 at which time the rate will adjust to CPB’s prevailing fixed interest rate or CPB’s base rate plus a margin of 1.5%. Monthly payments of principle and interest are \$31,909 per month. The loan term is ten years and matures in 2024. The loan is secured by a first mortgage on the campus property.	\$ 5,116,040	\$ 5,289,738
Central Pacific Bank 2 –Loan payable, carries interest rate of 4.75%, fixed until September 2019 at which time the rate will adjust to CPB’s prevailing fixed interest rate or CPB’s base rate plus a margin of 1.5%. Monthly payments of principle and interest are \$5,701 per month. The loan term is ten years and matures in 2024. The loan is secured by a second mortgage on the campus property.	938,607	961,901
Total Long-Term Debt	<u>6,054,647</u>	<u>6,251,639</u>
Less Current Installments of Long-Term Debt	<u>(205,920)</u>	<u>(197,684)</u>
Net Long-Term Debt	<u>\$ 5,848,727</u>	<u>\$ 6,053,955</u>

Total interest paid on long-term debt was \$267,395 and \$280,130 for the years ended June 30, 2017 and 2016, respectively.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2017

Note 9. LONG TERM DEBT (continued)

Estimated maturities on long-term debt as of June 30, 2017:

2018	\$	205,920
2019		214,499
2020		223,437
2021		232,750
2022		242,450
Thereafter		<u>4,935,591</u>
	\$	<u><u>6,054,647</u></u>

Note 10. ENDOWMENTS

The endowments are donor-restricted endowments. The University has invested its permanently restricted endowment fund in debt-free condominiums in the Hualalai Village project (See Note 6). At June 30, 2017 and 2016, the permanently restricted endowment net assets amounted to \$1,755,851 for both years, which consists of \$1,535,000 condominium value and \$220,851 cash.

Changes in endowment net assets as follows:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets June 30, 2016	\$ 43,375	\$ 1,755,851	\$ 1,799,226
Investment Return:			
Net Rental Income	68,420	-	68,420
Endowment Increase (Decrease)	-	-	-
Appropriation of endowment assets for expenditure	<u>(22,000)</u>	<u>-</u>	<u>(22,000)</u>
Endowment net assets June 30, 2017	<u><u>\$ 89,795</u></u>	<u><u>\$ 1,755,851</u></u>	<u><u>\$ 1,845,646</u></u>

Interpretation of the law

The Board of Trustees of the University has interpreted the 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 funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, and (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift at the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, management considers in its determination to appropriate or accumulate donor restricted endowment funds the following factors:

1. The duration and preservation of the fund
2. The purposes of the organization and the donor-restricted endowment fund
3. General economic conditions

Notes to the Consolidated Financial Statements

June 30, 2017

Note 10. ENDOWMENTS (continued)

4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the University
7. The investment policies of the University

Return Objectives and Risk Parameters

The University has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding while still maintaining purchasing power of the endowed assets. The University's endowment assets are invested in such a way that will generate long-term, predictable rate of return from rental income (net of expenses) and will preserve the value of the endowment assets.

Strategies Employed for Achieving Objectives

In order to meet the endowment's return objectives, the Board of Trustees has stipulated that the fixed monthly rental amount received by the University for each condominium is to be used to enrich the endowment fund.

Spending Policy

It is the policy of the University that it may distribute the Board of Trustees has stipulated the net rental income derived from the endowment assets are to be used exclusively to fund student scholarships.

Funds with Deficiencies

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 UPMIFA requires the University to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets. These deficiencies result from overspending of endowment funds by the Board and continued appropriation for scholarship funding.

Note 11. CONCENTRATION OF RISK

The University maintained its cash accounts at several financial institutions. These balances at times may exceed the Federal Deposit Insurance Corporation (FDIC) insured limit per financial institution. Management acknowledges the possibility of risk in this arrangement; however, the size and the longevity of the depository institution minimize such risk. As required by *GASB Statement NO. 40*, Deposits and Investment Risk Disclosures, the following represents a summary of deposits as of June 30, 2017:

Fully insured Deposits	\$ 250,000
Uninsured and Uncollateralized	<u>3,226,646</u>
	<u>\$ 3,476,646</u>

The University has an unsecured note receivable for KOW. The University's investments are concentrated in the Hualalai Village condominium development. A large portion of the fundraising for the University is conducted by Loren Cunningham, co-founder of the University and President of the Board of Trustees (the Board). The University does not believe that these concentrations represent a material risk of loss with respect to its financial position.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2017

Note 12. FRAUD LOSS

Management discovered fraud in January 2017, with the former acting CFO inflating construction invoices and misappropriating the over inflated amounts. Management and the FBI investigated the situation, performed extensive internal auditing and litigated accordingly. During litigation, it was determined that the acting CFO embezzled a total of \$3,128,194. Final judgment was delivered January 22, 2018, and the acting CFO was ordered to repay the amount during and after a lengthy prison term.

The University recognized in the Statement of Activities and Changes in Net assets, a fraud loss of \$1,153,115 in the year ending June 30, 2017, and \$1,675,079 in the year ending June 30, 2016. In addition, the University has recorded for accounting purposes an expected settlement receivable of \$300,000 as a non-current receivable, which approximates the assets in the court's possession which have been ordered to be liquidated and presented to the University. However, the total court ordered restitution is \$3,128,194 is collectable by the University at some future date.

Note 13. INVESTMENTS

The Organization follows *FASB ASC 820-10-50-1* which establishes a fair value hierarchy for inputs to be used in measuring fair market value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are those that market participants would use in pricing the asset or liability based on the best information available in the circumstances.

This fair value hierarchy consists of three broad levels:

- Level 1 inputs consist of unadjusted quoted prices in active markets such as stock exchanges for identical assets and have the highest priority.
- Level 2 inputs consist of significant other observable inputs such as quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset and liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs consist of significant unobservable inputs and include situations where there is little, if any, market activity for the investment. The inputs require significant judgment or estimates, such as those associated with discounted cash flow methodologies and appraisals.

Fair values of the Hualalai Condominiums measured on a recurring basis at June 30, 2017 and 2016 are summarized below:

Assets	Total as of June 30, 2017	Quoted Prices: Level 1	Significant Other Inputs: Level 2	Significant Non- Observable Inputs: Level 3
Hualalai Condominiums *	\$ 2,095,000	\$ -	\$ -	\$ 2,095,000
Total	\$ 2,095,000	\$ -	\$ -	\$ 2,095,000

Assets	Total as of June 30, 2016	Quoted Prices: Level 1	Significant Other Inputs: Level 2	Significant Non- Observable Inputs: Level 3
Hualalai Condominiums *	\$ 2,095,000	\$ -	\$ -	\$ 2,095,000
Total	\$ 2,095,000	\$ -	\$ -	\$ 2,095,000

* The Hualalai Condominiums measured at level 3 are based on the real estate value capped at the allowable sales price and there was no change in the valuation from the year ending June 30, 2016 to June 30, 2017.

There are no other assets or liabilities measured at fair value on a recurring or non-recurring basis.