

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

CONSOLIDATED AUDITED FINANCIAL STATEMENTS
WITH INDEPENDENT AUDITOR'S REPORT

FOR THE YEARS ENDED JUNE 30, 2018 and 2017

UNIVERSITY OF THE NATIONS, KONA, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees and Management of
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 statements of financial position as of June 30, 2018 and 2017, and the related statements of activities and changes in net assets, functional expenses and cash flows for the years 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter Regarding a Prior Period Adjustment

As discussed in Note 14 to the financial statements, the University discovered that it had incorrectly recorded an adjustment to accrue mission income for the year ending June 30, 2015, and beginning net assets as of July 1, 2016 were restated to reflect the correction of this error. Our opinion is not modified with respect to that matter.

Carbonaro CPAs & Management Group

Hilo, Hawaii
December 5, 2018

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statements of Financial Position

As of June 30, 2018 and 2017

ASSETS

	<u>2018</u>	<u>2017</u>
CURRENT ASSETS		
Cash and Cash Equivalents (Notes 2, 8, and 14)	\$ 4,473,236	\$ 2,944,595
Cash Advances (Note 2)	688,313	458,383
Accounts Receivable, Net (Note 2)	92,334	18,710
Inventory (Note 2)	15,359	4,676
Prepaid Expenses	86,251	70,952
Current Portion of Notes Receivable (Note 3)	<u>100,000</u>	<u>-</u>
Total Current Assets	5,455,493	3,497,316
FIXED ASSETS (Note 2)		
Land	9,291,209	6,798,064
Buildings	28,652,492	25,565,979
Assets in Progress	4,043,202	5,710,653
Furniture and Equipment	407,836	332,213
Vehicles	346,013	270,403
Less Accumulated Depreciation	<u>(8,208,608)</u>	<u>(7,379,035)</u>
Net Fixed Assets	34,532,144	31,298,277
NON-CURRENT ASSETS		
Cash Restricted for Endowment	-	220,851
Investments in Hualalai Condominiums (Notes 5 and 10)	2,330,000	2,095,000
Notes Receivable (Note 3)	<u>400,000</u>	<u>3,032,221</u>
Total Non-Current Assets	<u>2,730,000</u>	<u>5,348,072</u>
Total Non-Current Assets and Fixed Assets	<u>37,262,144</u>	<u>36,646,349</u>
TOTAL ASSETS	<u>\$ 42,717,637</u>	<u>\$ 40,143,665</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, 2018 and 2017

LIABILITIES AND NET ASSETS

	<u>2018</u>	<u>2017</u>
CURRENT LIABILITIES		
Accounts Payable and Accrued Expenses	\$ 1,269,807	\$ 1,212,255
Mortgages and Notes Payable - Current (Note 6)	217,294	205,920
Deferred Tuition and Fees Revenue (Note 2)	<u>1,010,963</u>	<u>773,989</u>
Total Current Liabilities	2,498,064	2,192,164
LONG-TERM LIABILITES		
Mortgages and Notes Payable (Note 6)	<u>5,573,786</u>	<u>5,848,727</u>
Total Long-Term Liabilities	5,573,786	5,848,727
Total Liabilities	<u>8,071,850</u>	<u>8,040,891</u>
NET ASSETS (Note 4)		
Unrestricted Net Assets (Note 14)	31,823,994	29,344,411
Unrestricted Board Designated Endowment (Note 7)	150,000	-
Temporarily Restricted Net Assets	901,793	1,002,512
Permanently Restricted Net Assets	<u>1,770,000</u>	<u>1,755,851</u>
Total Net Assets	<u>34,645,787</u>	<u>32,102,774</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 42,717,637</u></u>	<u><u>\$ 40,143,665</u></u>

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

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statements of Activities and Changes in Net Assets
For the Years Ended June 30, 2018 and 2017

	2018			2017				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2018	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2017
REVENUES AND OTHER SUPPORT								
Student and Staff Fees, Net	\$ 13,787,410	\$ 6,607	\$ -	\$ 13,794,017	\$ 11,570,204	\$ 131,942	\$ -	\$ 11,702,146
Contributions and Support	1,178,547	9,954,832	-	11,133,379	1,788,295	9,311,250	-	11,099,545
Sales and Other Revenue	603,006	336,632	-	939,638	495,144	109,980	-	605,124
Rental Income on Investments in Hualalai Condominiums, Net (Notes 5 and 7)	2,043	47,424	14,149	63,616	29,500	68,420	-	97,920
Donations In-Kind (Note 11)	610,444	-	-	610,444				
Net Assets Released from Restrictions	10,446,214	(10,446,214)	-	-	9,382,467	(9,382,467)	-	-
Total Public Support and Revenue	26,627,664	(100,719)	14,149	26,541,094	23,265,610	239,125	-	23,504,735
EXPENSES								
Program Expense	21,875,375	-	-	21,875,375	19,262,696	-	-	19,262,696
Management and General Expenses	1,884,925	-	-	1,884,925	1,527,905	-	-	1,527,905
Fundraising Expense	237,781	-	-	237,781	196,953	-	-	196,953
	23,998,081	-	-	23,998,081	20,987,554	-	-	20,987,554
Fraud Loss (Note 9)	-	-	-	-	1,153,115	-	-	1,153,115
Total Expenses	23,998,081	-	-	23,998,081	22,140,669	-	-	22,140,669
CHANGE IN NET ASSETS	2,629,583	(100,719)	14,149	2,543,013	1,124,941	239,125	-	1,364,066
NET ASSETS, BEGINNING OF YEAR	29,344,411	1,002,512	1,755,851	32,102,774	28,530,670	763,387	1,755,851	31,049,908
Prior Period Adjustment (Note 14)	-	-	-	-	(311,200)	-	-	(311,200)
NET ASSETS, END OF YEAR	<u>\$ 31,973,994</u>	<u>\$ 901,793</u>	<u>\$1,770,000</u>	<u>\$ 34,645,787</u>	<u>\$ 29,344,411</u>	<u>\$ 1,002,512</u>	<u>\$ 1,755,851</u>	<u>\$ 32,102,774</u>

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

UNIVERSITY OF THE NATIONS, KONA, INC.

Consolidated Statements of Functional Expenses
For the Years Ended June 30, 2018 and 2017

	2018				2017			
	Program Services	Management and General	Fundraising	Total 2018	Program Services	Management and General	Fundraising	Total 2017
Missionary Payments	\$ 9,189,899	\$ -	\$ -	\$ 9,189,899	\$ 8,639,654	\$ -	\$ -	\$ 8,639,654
Outreach Services	5,295,464	-	-	5,295,464	4,719,521	-	-	4,719,521
Household	1,729,189	432,298	-	2,161,487	1,587,643	396,911	-	1,984,554
Occupancy	1,354,879	241,703	16,113	1,612,695	1,215,275	216,799	14,453	1,446,527
Contracted Services	506,909	405,837	101,460	1,014,206	448,906	359,398	89,850	898,154
Depreciation Expense	700,920	175,231	-	876,151	468,874	117,219	-	586,093
Schools and Programs	709,336	53,418	-	762,754	649,890	48,941	-	698,831
Supplies	463,831	123,577	30,894	618,302	167,400	44,600	11,150	223,150
Travel	425,147	106,287	-	531,434	248,039	62,010	-	310,049
Donations	497,739	-	-	497,739	209,901	-	-	209,901
Information Technology	291,533	89,902	67,426	448,861	293,105	90,387	67,790	451,282
Interest (Note 6)	204,933	51,233	-	256,166	213,916	53,479	-	267,395
Cost of Sales and Services	198,050	10,468	-	208,518	136,753	7,228	-	143,981
Merchant Fees	120,382	51,593	-	171,975	103,051	44,165	-	147,216
Equipment Rental and Maintenance	99,761	25,357	1,267	126,385	57,225	14,545	727	72,497
Accounting	-	91,479	-	91,479	-	56,840	-	56,840
Telephone	36,692	9,288	465	46,445	21,458	5,432	272	27,162
Postage and Shipping	10,899	6,226	14,010	31,135	5,998	3,427	7,711	17,136
Printing and Publications	23,515	3,054	3,971	30,540	19,739	2,563	3,333	25,635
Promotional	15,358	-	1,706	17,064	12,912	-	1,434	14,346
Legal and Professional	939	7,974	469	9,382	466	3,961	233	4,660
Bad Debt Expense	-	-	-	-	42,970	-	-	42,970
Total Operating Expenses	\$ 21,875,375	\$ 1,884,925	\$ 237,781	\$23,998,081	\$ 19,262,696	\$ 1,527,905	\$ 196,953	\$ 20,987,554

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, 2018 and 2017

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in Net Assets	\$ 2,543,013	\$ 1,364,066
Expense Items Not Requiring Current Cash:		
Depreciation	876,151	586,093
Bad Debts Expense	-	42,970
Loss on Sale of Assets	1,313	-
Increase in Accounts Payable and Accrued Expenses	57,552	-
Cash Received Not Related to Income or Expense:		
Decrease in Accounts Receivable	-	51,726
Decrease in Cash Advances	-	155,167
Decrease in Prepaid Expenses	-	6,580
Decrease in Notes Receivable	2,532,221	-
Increase in Deferred Revenue	236,974	-
Income Items Not Creating Current Cash:		
Gain on Sale of Assets	-	(6,000)
Receivable Recorded for Fraud Restitution	-	(300,000)
Decrease in Deferred Income	-	(55,179)
Donations in Kind (Non-cash Investing Activity)	(610,444)	-
Increase in Accounts Receivable	(73,624)	-
Cash Paid Not Related to Current Income or Expense:		
Decrease in Accounts Payable	-	(398,273)
Increase in Inventory	(10,683)	(2,036)
Increase in Prepaid Expenses	(15,299)	-
Increase in Cash Advances	(229,930)	-
Net Cash Provided by Operations	<u><u>5,307,244</u></u>	<u><u>1,445,114</u></u>

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, 2018 and 2017

CASH FLOWS FROM INVESTING ACTIVITIES	2018	2017
Gross Proceeds from Sale of Assets	4,500	-
Purchases of Property and Equipment, Net of \$610,444 in Donated Construction Labor	(3,505,387)	(185,456)
Investment in Condos	(235,000)	-
Net Cash Used by Investing Activities	<u>(3,735,887)</u>	<u>(185,456)</u>
 CASH FLOWS FROM FINANCING ACTIVITIES		
Net Reduction in Long-Term Debt	<u>(263,567)</u>	<u>(196,992)</u>
Net Cash Used by Financing Activities	<u>(263,567)</u>	<u>(196,992)</u>
 NET INCREASE IN CASH FOR THE YEAR	1,307,790	1,062,666
 BEGINNING CASH BALANCE	<u>3,165,446</u>	<u>2,102,780</u>
 ENDING CASH BALANCE	<u><u>\$ 4,473,236</u></u>	<u><u>\$ 3,165,446</u></u>

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

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2018 and 2017

Note 1. UNIVERSITY

The University of the Nations, Kona, Inc. (the University) is a private Christian educational institution located in Kailua-Kona, Hawaii. 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 utilizes a modular class approach where 12 week lecture phases are typically followed by a 12 week practicum, often in a foreign country. The University offers its classes 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 certain 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 components make up the bulk of the University's revenue: (a) Contributions and Support, which are donations from the general public; and (b) Program-related Tuition and Fees charged to students and staff. Contributions and Support are comprised of donations made to the University's general fund and programs, as well as donations to support the independent missionaries (volunteers) working throughout the world. The University has discretion over the donations received to support its volunteers, thus these transactions are not agency transactions.

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 within 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, 2018 and 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 reports are provided upon return that support how the funds were used along with any balance of cash which is redeposited.

Accounts Receivable: Accounts receivable primarily represents student and staff fees owed to the University. The accounts receivable gross balance from students and staff was \$282,929 and \$253,167 as of June 30, 2018 and 2017, respectively. Management has recorded an allowance for doubtful accounts equal to 82.5% and 92.6% of those receivables as of June 30, 2018 and 2017, respectively. Management considers these percentages to be reasonable based on the University's recent historic rates of collection of accounts receivable. Accounts receivable as of June 30, 2018, also includes a double payment made to a vendor in the amount of \$43,863. This payment was refunded to the University in July 2018.

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 supplies and merchandise and is valued at the lower of cost or market on a first-in, first-out basis.

Fixed Assets: Land, buildings, equipment, and vehicles 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 with 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 amounts collected from students and staff for tuition, housing fees, and outreach fees in advance of the 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, 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.

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.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2018 and 2017

Note 3. NOTES RECEIVABLE

Notes receivable consist of various non-interest bearing demand notes. The notes are:

- *Ka Ohana Waiaha (KOW)* - \$2,476,285 as of June 30, 2017. This note was offset against the acquisition of property from KOW in 2018. See Note 5 for further information.
- *Restitution Receivable* - \$300,000. The University has recorded for accounting purposes an expected fraud settlement receivable of \$300,000 which approximates 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 9 for further information.
- *Kama'aina Hale Apartments* - \$200,000 and \$210,936 as of June 30, 2018 and 2017 respectively. Full repayment is expected based on appropriate timing agreed to by both parties. See Note 5 for further information.
- *Kings/Ahualani* \$45,000 as of June 30, 2017. Payment was received in settlement of this note in 2018.

Note 4. 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:

- 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 University's operations and services. Unrestricted net assets may be designated by the board of trustees 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, 2018 and 2017 were as follows:

	<u>2018</u>	<u>2017</u>
Endowment Balance (Note 7)	\$ 94,719	\$ 89,795
Financial Aid and Other Scholarships	97,565	59,535
Building Funds	232,381	177,358
International Funds	55,701	191,127
Ministry Funds	421,427	484,697
Total	<u>\$ 901,793</u>	<u>\$ 1,002,512</u>

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2018 and 2017

Note 4. NET ASSETS (continued)

- (c) 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 scholarships. Permanently restricted funds were \$1,770,000 and \$1,755,851 as of June 30, 2018 and 2017 respectively.

Note 5. 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 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 leased a parcel of land owned by KOW for \$1 per year. This land comprised 57 undeveloped acres adjacent to the University property. On June 30, 2017, the University also held a note receivable from KOW in the amount of \$2,476,285.

On June 14, 2018, KOW sold the 57 acres to the University along with an additional 5 acres of adjoining land in settlement of the note. The University also paid all fees associated with the transaction, bringing the total cost of the acquisition to \$2,493,145.

KOW also owns Hualalai Village, a condominium development located adjacent to University Property. The University owns eight individual condominium units in Hualalai Village, of which six were purchased as investments of its permanent endowment funds. The eighth unit was purchased during the fiscal year ended June 30, 2018, for \$235,000. All of the units are debt-free.

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

The investments in the condominiums are stated at current realizable value which is the contractual price for which each unit can be sold per deed restrictions. As of both June 30, 2018 and June 30, 2017, this current realizable value was below fair market value. See notes 7 and 10.

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.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2018 and 2017

Note 6. LONG TERM DEBT

As of June 30, 2018 and 2017, long term debt consisted of the following:

	<u>2018</u>	<u>2017</u>
Central Pacific Bank Loan payable-1 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%. (Management estimates a new rate of 6.0%). Monthly payments of principal 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.	\$ 4,933,323	\$ 5,116,040
Central Pacific Bank Loan payable-2 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%. (Management estimates a new rate of 6.0%). Monthly payments of principal 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.	857,757	938,607
Total Long-Term Debt	<u>5,791,080</u>	<u>6,054,647</u>
Less Current Installments of Long-Term Debt	<u>(217,294)</u>	<u>(205,920)</u>
Net Long-Term Debt	<u>\$ 5,573,786</u>	<u>\$ 5,848,727</u>

Total interest paid on long-term debt was \$256,166 and \$267,395 for the years ended June 30, 2018 and 2017, respectively.

As of June 30, 2018, estimated maturities of long-term debt were as follows:

<u>Fiscal Year</u>	
2019	\$ 217,294
2020	147,729
2021	129,273
2022	137,247
2023	145,712
Thereafter	<u>5,013,825</u>
Total	<u>\$ 5,791,080</u>

Note 7. ENDOWMENTS

The University has invested its permanently restricted endowment fund in debt-free condominiums in the Hualalai Village project (See Note 5) and cash restricted for endowment. As of June 30, 2018 and 2017, the permanently restricted endowment net assets amounted to \$1,770,000 and \$1,755,851 respectively.

UNIVERSITY OF THE NATIONS, KONA, INC.

Notes to the Consolidated Financial Statements

June 30, 2018 and 2017

Note 7. ENDOWMENTS (continued)

Changes are shown in the following chart:

	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	(22,000)	-	(22,000)
Endowment net assets June 30, 2017	\$ 89,795	\$ 1,755,851	\$ 1,845,646
Investment Return:			
Net Rental Income	47,424	14,149	61,573
Endowment Increase (Decrease)	-	-	-
Appropriation of endowment assets for expenditure	(42,500)	-	(42,500)
Endowment net assets June 30, 2018	\$ 94,719	\$ 1,770,000	\$ 1,864,719

In addition, an unrestricted endowment of \$150,000 was authorized by the Board in 2018. These funds will be invested in a condominium to provide earnings to fund scholarships for residents of Hawaii Island.

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.

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 University and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the University
7. The investment policies of the University

UNIVERSITY OF THE NATIONS, KONA, INC.

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Note 7. ENDOWMENTS (continued)

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 unit is to be used for the benefit of the endowment fund.

Spending Policy

It is the policy of the University that it may distribute all the net rental income derived from the endowment assets. In accordance with the purpose restrictions established by the endowment donors, all distributions 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.

Note 8. CONCENTRATION OF RISK

The University maintains its cash accounts at Central Pacific Bank. These balances exceed the Federal Deposit Insurance Corporation (FDIC) insured limit per corporate depositor. Management acknowledges the possibility of risk in this arrangement; however, the size and the longevity of the depository institution minimizes such risk. The following represents a summary of deposits as of June 30:

	2018	2017
Fully Insured Deposits	\$ 250,000	\$ 250,000
Uninsured and Uncollateralized	4,223,236	2,915,446
	<u>\$4,473,236</u>	<u>\$ 3,165,446</u>

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 University does not believe that these concentrations represent a material risk of loss with respect to its financial position.

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Note 9. FRAUD LOSS

Management discovered fraud in January 2017, with the former acting CFO inflating construction invoices and misappropriating the 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 fraud losses of \$1,153,115 and \$1,675,079 in the years ending June 30, 2017, and June 30, 2016, respectively. In addition, the University has recorded \$300,000 as a non-current receivable to approximate assets in the court's possession that have been ordered liquidated and presented to the University pending the conclusion of appeals. However, the total court ordered restitution of \$3,128,194 is collectable by the University at some future date.

Note 10. INVESTMENTS

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

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.
- 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 a 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, 2018 and 2017 are summarized in the following chart:

	<u>Total</u>	<u>Quoted Prices: Level 1</u>	<u>Significant Other Inputs: Level 2</u>	<u>Significant Non- Observable Inputs: Level 3</u>
June 30, 2017	\$ 2,095,000	\$ -	\$ -	\$ 2,095,000
June 30, 2018	\$ 2,330,000	\$ -	\$ -	\$ 2,330,000

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Note 10. INVESTMENTS (continued)

* The Hualalai Condominiums measured at level 3 are based on the real estate value capped at the allowable sales price. The increase in value occurring during the year ending June 30, 2018 was the result of purchasing an additional condominium unit for \$235,000.

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

Note 11. DONATED SERVICES, MATERIALS, AND FACILITIES

During the year the University placed the Building J dormitory into service and accordingly capitalized donated labor in addition to purchased costs of its construction. An in-kind donation of \$610,444 was recorded on the books to reflect the estimated value of this donation as required by FASB ASC 958-605-25-16. (See Note 2, *Contributions and Donations*.)

Note 12. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, Presentation of Financial Statements for Not-For-Profit Entities. The standard makes improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB's improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance, and cash flows. ASU 2016-14 is effective for annual reporting periods beginning after December 31, 2017, but early adoption is permitted. The provisions are effective for the University's fiscal year ending June 30, 2019. Management is currently evaluating the impact that the adoption of these provisions will have on the financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, which supersedes FASB Accounting Standards Codification (ASC) Topic 840, Leases, and makes other conforming amendments to U.S. GAAP. ASU 2016-02 requires lessees, among other changes to the lease accounting guidance, to recognize most leases on the balance sheet via a right-of-use asset and lease liability as well as provide additional qualitative and quantitative disclosures. ASU 2016-02 is effective for entity fiscal years beginning December 15, 2019, but permits early adoption, and mandates a modified retrospective transition method. The provisions are effective for the University's fiscal year ending June 30, 2021. Management is currently evaluating the impact that the adoption of these provisions will have on the financial statements, but expects ASU 2016-02 to add significant right-of-use assets and lease liabilities to the statement of financial position.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The new standard is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. The provisions are effective for the University's fiscal year ending June 30, 2020.

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Note 12. RECENT ACCOUNTING PRONOUNCEMENTS (continued)

The amendments should be applied using a retrospective transition method to each period presented. Management is currently evaluating the impact that the adoption of these provisions will have on the financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity also should disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard is effective for the entity for annual periods in fiscal years beginning after December 15, 2018 (as amended in August 2015 by ASU 2015-14, Deferral of the Effective Date). The provisions are effective for the University's fiscal year ending June 30, 2020. Management does not expect the adoption of these provisions to have a significant impact on the financial statements.

Note 13. RECLASSIFICATIONS

Certain account balances in the 2017 financial statements have been reclassified for comparative purposes to conform to the 2018 financial statement presentation. These had no effect on the Total Assets or Change in Net Asset figures reported for 2017.

Note 14. PRIOR PERIOD ADJUSTMENT

During the year, the University discovered that it had incorrectly recorded an adjustment to accrue mission income for the year ending June 30, 2015. Based on this, the University recorded a prior-period adjustment. This adjustment had the following effects on the June 30, 2017 financial statements:

Decrease in Unrestricted Net Assets	\$ 311,200
Decrease in Cash and Cash Equivalents	\$ 311,200

Note 15. SUBSEQUENT EVENTS

In preparing these financial statements, the University has evaluated events and transactions for potential recognition or disclosure through December 5, 2018, and there were no significant events to be reported.