



# The State Bar *of California*

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**DATE:** August 3, 2020

**TO:** Members, Eligibility and Budget Review Committee, Legal Services Trust Fund Commission

**FROM:** Doan Nguyen, Acting Program Manager  
Erica Carroll, Senior Program Analyst

**SUBJECT:** IOLTA/EAF Eligibility and Review Issues for Grant Year 2021: Parole Work; Eligibility Review Conferences; and Outstanding Audit Issues

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## EXECUTIVE SUMMARY

Interest on Lawyers' Trust Accounts (IOLTA) and Equal Access Fund (EAF) formula grants (EAF grants) are awarded to approximately 100 qualified legal services projects (QLSP) or support centers (SC) each year to support the provision of free civil legal aid in California to indigent persons, or in the case of SCs, the provision of legal training, technical assistance and advocacy support to QLSPs. These grants must comply with criteria set forth in Business & Professions Code sections 6210-6228 (referred to as the "IOLTA statute"), State Bar Rules, and Eligibility Guidelines for Legal Services Projects and Support Centers.

The purpose of this memo is to describe the issues and provide the relevant governing authorities to aid the Eligibility and Budget Review Committee (Committee) in its deliberations and recommendations. Staff will report on the State Bar's determination that parole work is considered a civil legal matter; and consequently, associated expenses should be considered qualified expenditures in determining an organization's primary purpose and eligibility for IOLTA and EAF funding. This determination will aid the Committee in crafting its recommendation for IOLTA and EAF grant eligibility for 2021 and the calculation of award allocations. This includes 2021 applicant UnCommon Law, which primarily engages in parole work, and whose eligibility largely depended on this determination.

In addition, the Committee will be asked to consider: (1) whether the six new applicants with whom the Committee conducted eligibility review conferences should be recommended as eligible for 2021 IOLTA and EAF funding; (2) whether USC Gould School of Law Immigration Clinic has submitted sufficient documentation to satisfy the audit requirement; (3) additional extension requests for late financial audits or financial reviews; and (4) Legal Aid Society of San Bernardino's (LASSB) eligibility for the pro bono allocation in light of its most recent audit findings.

Recommendations made by the Committee must be approved by the Legal Services Trust Fund Commission.

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## **BACKGROUND**

IOLTA and EAF grants are awarded to approximately 100 QLSPs and SCs each year. QLSPs provide free civil legal aid in California to indigent persons,<sup>1</sup> and SCs provide legal training, legal technical assistance, and advocacy support to the organizations that directly serve indigent persons. Although IOLTA and EAF grants are separate sources of funding, there is one combined application for both IOLTA and EAF grants.

IOLTA funds are mainly generated from interest accrued on lawyers' trust accounts while EAF funds are provided through the State's annual budget act, as part of the judicial branch budget. IOLTA and EAF grants are both governed by the IOLTA statute, State Bar Rules, and Eligibility Guidelines for LSPs and SCs. An organization may apply for IOLTA and EAF funding as either a QLSP or an SC.

The IOLTA statute is the primary governing authority that defines how IOLTA funds are generated and distributed, utilizing a formula to calculate individual award amounts. The vast majority of EAF funds are also distributed using the IOLTA formula.

## **DISCUSSION**

Staff will provide an overview of the State Bar's analysis of parole work, and will ask the Committee to vote on the following: (1) eligibility recommendations for 2021 IOLTA/EAF funding for six new applicants; (2) whether the financial review submitted by USC Gould meets the audit requirement, and consequently, whether it should be recommended as eligible for 2021 IOLTA/EAF funding; (3) whether to grant additional audit/financial review extension requests; and (4) whether to find LASSB eligible for the pro bono allocation. Staff or working group recommendations are provided where appropriate.

### **A. Are Parole Services Criminal Proceedings or Civil Matters?**

IOLTA grants are intended to improve access to civil legal services for indigent people, as stated in the preamble to the IOLTA statute.<sup>2</sup> To be found eligible for IOLTA grants, QLSP applicants must have the primary purpose of providing legal services without charge to indigent persons<sup>3</sup> and SC applicants must have as their primary purpose the provision of support services to the

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<sup>1</sup> Per the IOLTA statute, an "indigent person" is an individual 1) whose income is not higher than 125 percent of the federal poverty threshold, or 2) eligible for Supplemental Security Income or free services under the Older Americans Act (seniors 60+) or Developmentally Disabled Assistance Act. Business & Professions Code §6213(d).

<sup>2</sup> Business & Professions Code §§ 6210-6228, at 6210 (all statutory references hereafter will be to this statute).

<sup>3</sup> Business & Professions Code § 6213(a); see also § 6213(d) (definition of indigent person).

legal aid community. Furthermore, IOLTA grants may not be used to pay for services related to criminal proceedings.<sup>4</sup>

The EAF is authorized annually under the State Budget Act, which has included language since its inception in 1999 requiring that these grants be used for support of legal services in civil matters for indigent persons, and that EAF formula grants be distributed and administered consistently with IOLTA grants.<sup>5</sup>

In reliance on these statutory parameters, the Commission has not typically counted services provided in criminal proceedings when determining whether an applicant has satisfied the primary purpose requirement, or when calculating the amounts to be allocated to eligible organizations. However, the Commission has historically considered parole work to be more akin to administrative hearings and civil litigation, as the work does not challenge an underlying criminal offense.

A new applicant for 2021 funding, UnCommon Law, has as its primary purpose the representation of clients at parole hearings. As a result, staff sought guidance from the State Bar's Office of General Counsel (OGC) regarding the qualifying nature of parole services in order to determine eligibility. OGC's privileged legal analysis has been provided to you separately. After reviewing the legal opinion, the State Bar has determined that parole work should be treated as civil and should be counted as qualifying for purposes of determining eligibility and calculating award allocations.

## **B. Recommendations from Working Group Regarding Eligibility Review Conferences**

At the Committee's July 28 meeting, oral presentations were provided regarding UnCommon Law and East Bay Family Defenders' eligibility review conferences (ERCs). Since the memoranda regarding these applicants were not finalized by the date of the meeting, the Committee did not vote on the working groups' recommendations for these applicants. The Committee will vote on the working groups' recommendations at its August 6 meeting.

In addition, ERCs have been completed or scheduled for the remaining four new applicants: (1) Housing Rights Center (completed) and (2) Social Justice Collaborative (completed), and (3) Community Lawyers, Inc. (scheduled) and (4) Kids in Need of Defense (KIND) (scheduled).

UnCommon Law is recommended to be found eligible for IOLTA/EAF funding. East Bay Family Defenders and Housing Rights Center are recommended to be found ineligible this year. Memoranda regarding the ERCs and the working groups' recommendations for UnCommon Law, East Bay Family Defenders and Housing Rights Center are attached for the Committee's consideration. (Attachment A.) Staff will provide an oral update on Social Justice Collaborative, Community Lawyers, Inc. and Kids in Need of Defense at the meeting. Materials for these three organizations will be posted and sent to the Committee once they are finalized.

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<sup>4</sup> Business & Professions Code § 6223(b).

<sup>5</sup> State Budget Act, as authorized annually, at § 0250-101-0001, schedule 5 and associated provisions.

### **C. USC Gould School of Law Immigration Clinic**

USC Gould School of Law Immigration Clinic (USCGould) is a law school clinical program that had received IOLTA and EAF grants from 1992 until 2013. Its application for 2021 grants was accompanied by an independent audit of the entire law school; that audit did not specifically identify the expenditures of the clinical program, which are necessary to compare to the expenditures reported in its application. Instead, the clinical program's expenses were confirmed by separate, internally-produced documentation prepared by the School of Law's Finance Department. (Attachment B.)

The independent audit requirements of Business & Professions Code section 6222 and State Bar Rule 3680(E)(1) enable verification of the expenditures cited in the application. An independent audit can disclose non-qualified expenditures, determine organizational eligibility for grants, and is used in calculating grant allocations. However, law school clinical programs are typically unable to submit audits specific to their own activities, because they are not separately incorporated. As a result, the Commission has allowed these organizations to submit an independent audit of its host institution that includes a separate schedule from the auditor identifying and isolating the clinical program's expenditures. Such an independently audited (or reviewed) statement provides confirmation of the figures in the application, and also helps establish the program as an "identifiable law school unit" as required by Business & Professions Code section 6213(a)(2)(A).

### **Staff Recommendation Regarding USC Gould School of Law Immigration Clinic**

The Committee previously extended USCGould's deadline until August 1 to submit an independently-audited schedule of expenses specific to the clinical program. As of July 31, USCGould has not provided any new documentation and has communicated to staff that it will not be able to do so by the deadline. Therefore, staff recommends that USCGould be found ineligible for IOLTA grants in 2021.<sup>6</sup>

### **D. Late Financial Audits or Financial Reviews**

At its June 26 and July 10 meetings, the Committee approved extension requests from 17 IOLTA/EAF applicants. Extensions were granted through August 1. At the Committee's meeting on July 28, staff informed the Committee that at least three applicants had expressed concern about meeting the August 1 deadline, mostly due to delays from their auditors or other operational interferences related to COVID-19.

Since this memorandum was finalized before the August 1 deadline, staff will provide an oral update at the August 6 meeting. If any organizations fail to meet the deadline, staff will provide a recommendation regarding whether to allow any further extension.

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<sup>6</sup> This memorandum was finalized prior to the August 1 deadline; should any changes occur, staff will update the Committee accordingly.

## **E. Legal Aid Society of San Bernardino's Pending Pro Bono Allocation**

At its July 10 meeting, the Committee considered requests from applicants seeking an additional pro bono allocation. To obtain the designation as a pro bono program, these applicants must demonstrate that the recruitment and coordination of substantial numbers of private attorneys is their principal means of delivering civil legal services to indigent persons. There are three tests by which applicants can meet this requirement, two of which are quantitative (Tests A and B), and one of which (Test C) allows applicants to provide a narrative response explaining how they nonetheless are entitled to the allocation in the event they fail to pass Tests A or B.

LASSB applied for a pro bono allocation under Test C. LASSB had requested and received an audit extension, so staff did not receive the final audit prior to the July 28 Committee meeting. Staff tentatively recommended finding LASSB eligible for the pro bono allocation, pending receipt of the audit and confirmation of its volunteer hours. The Committee adopted this recommendation.

LASSB submitted its audit on July 29. LASSB received a qualified audit opinion of its 2019 financial statements. (Attachment C.) The basis for the qualified opinion is insufficient audit evidence to verify the recorded revenue and expense related to volunteer attorney hours. LASSB tracks volunteer attorney hours to report the value of donated services and for funding purposes.<sup>7</sup> LASSB recorded \$320,700 of revenue and expenses for approximately 1,069 donated attorney hours at an hourly rate of \$300. The auditors were unable to determine if adjustments were necessary to the reported amount because, "the underlying documentation and record of the hours was not properly maintained by management."

The auditors further identified the tracking of contributed hours as a material weakness in the Schedule of Finding and Questioned Costs of the audit report. "A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis."<sup>8</sup>

As noted in its Test C narrative, LASSB "experienced repeated failings with the database" it used to record volunteer time. The auditors noted in their finding the effect of the unreliability of LASSB's database was the "potential material misstatement of contributed hours revenue and expense." Their recommendation to LASSB is to "implement a reconciliation process for contributed hours, and regularly verify the database record." LASSB concurred with the recommendation and has updated internal control policies and procedures for 2020.

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<sup>7</sup> LAASB received federal grant funding for Pro Bono Private Attorney Involvement (PAI) Civil Legal Services, in addition to IOLTA and EAF pro bono allocations.

<sup>8</sup> Eadie + Payne, LLP, Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.

Additionally, LASSB engaged an accounting firm to review the updated procedures and provide further recommendations.<sup>9</sup>

### **Staff Recommendation Regarding Legal Aid Society of San Bernardino**

In light of the findings in the audit, staff recommends finding LASSB ineligible for the pro bono allocation, because the auditors were unable to verify LASSB's volunteer hours for 2019.

### **F. Eligibility of Remaining Applicants for 2021 IOLTA/EAF Funding**

The Office of Access and Inclusion received 106 applications for IOLTA/EAF funding in 2021, including seven programs that are new or not currently funded. Staff is completing its review of all applications.

The list of remaining applicants recommended as eligible will be presented to the Committee at its August 14 meeting. The Committee will then make a recommendation to the LSTFC for approval at its meeting later that day. Upon the LSTFC's determination of those programs eligible for funding, staff will run the formula for tentative grant awards.

### **ATTACHMENTS**

- A.** Memoranda and Working Group Recommendations after Eligibility Review Conferences
- B.** USC Gould Audit and Internally Produced Documentation
- C.** Excerpts from LASSB's Auditor Opinion Letter and Findings

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<sup>9</sup> LASSB must submit reports on its progress to improve policies and procedures as stipulated in its conditional grant agreements for 2020 IOLTA and EAF funding. LASSB submitted a progress report on May 27, 2020. A working group, consisting of Commission members and State Bar staff, reviewed the report and requested LASSB engage its auditors to confirm that the protocols referenced in LASSB's response letter dated April 16 and progress report dated May 27 are in place.



## The State Bar of California

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**DATE:** August 6, 2020

**TO:** Legal Services Trust Fund Commission - Eligibility and Budget Review Committee

**FROM:** Rebecca Delfino, Member, LSTFC Eligibility and Budget Review Committee  
Debra Meyers, Member, LSTFC Eligibility and Budget Review Committee  
Kim Savage, Member, LSTFC Eligibility and Budget Review Committee

**SUBJECT:** UnCommon Law: Eligibility Review Conference for 2021 IOLTA and EAF Funding

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### EXECUTIVE SUMMARY

UnCommon Law is a new applicant for funding as a Qualified Legal Services Project (QLSP) that provides assistance to incarcerated individuals with regard to parole hearings. The Eligibility and Budget Review Committee (Committee) called UnCommon Law for an Eligibility Review Conference to consider the following questions raised by its 2021 IOLTA and EAF application:

- Whether parole hearings are civil matters or criminal proceedings, for purposes of determining an applicant organization's primary purpose and function, or when calculating grants; and
- Whether any of UnCommon Law's services should be considered non-legal and should be excluded when determining their eligibility or grant allocations.

The Eligibility Review Conference (ERC) was held on July 24, 2020 with the Committee represented by a Working Group. This memo presents the Working Group's recommendation to the Committee regarding UnCommon Law's eligibility for 2021 IOLTA and EAF funding. The full Commission will consider the Committee's recommendation at its August 14 meeting.

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### BACKGROUND

#### Organizational Description

UnCommon Law is a new applicant for eligibility as a QLSP, providing service since 2006 and incorporated as a non-profit corporation in 2012. Their application identifies a staff of three

attorneys, two paralegals and a part-time “Parole Success Advocate,” plus three administrative and development staff, and a full-time volunteer deputy director – as well as over 2,000 hours of services volunteered by attorneys and law students. They are headquartered in Oakland and seek allocations in twenty counties based on the physical location of their clients. The organization’s services are exclusively dedicated to helping incarcerated people prepare for their parole hearings. They have reported total expenditures of \$660,925 and qualified expenditures of \$580,594, yielding an 87.8 percent qualified expenditures ratio.

In its application, UnCommon Law describes its work as:

...trauma-informed, comprehensive legal advocacy for people experiencing long-term incarceration. We represent people in their parole hearings, provide parole consultations, provide a wide variety of parole resources, engage in litigation and public policy advocacy, and engage in public education to address systemic discrimination in the criminal justice system. We provide education and training to law students, attorneys and system-impacted community members to improve the quality of preparation for, and representation in, parole hearings. We also run in-prison workshops to provide information and parole-readiness training and resources to currently-incarcerated people.

The UnCommon Law website states that the organization:

....fights to ensure that all people incarcerated for violent crime have access to healing, justice, and effective legal representation. [...]In developing new self-narratives, the people we serve are able to more effectively disrupt violence inside and outside prison, and become leaders who change negative societal narratives about those incarcerated for violent crime.

### Eligibility Review Conference

UnCommon Law’s ERC was held on July 24, 2020. The applicant was represented by Keith Wattley (Founder and Director), Annie Roge (Development Associate), and Sara Norman (Board Chair); the Committee was represented by Kim Savage, Rebecca Delfino, and Debra Meyers. State Bar staff included Doan Nguyen, Elizabeth Hom, Erica Carroll, Brady Dewar, Dan Passamaneck, and Greg Shin.

### Governing Authorities

- **Business & Professions Code**, sections 6210 (Preamble to Interest on Lawyer Trust Accounts IOLTA Statute), 6213(a) (primary purpose), 6214(b) (eligibility criteria for legal services projects), 6216(b)(1)(A) (allocation calculation methodology)
- **State Bar Rules**, Rule 3.671(A) (primary purpose), 3.672(A) (legal services)



- **Legal Services Trust Fund Program Eligibility Guidelines for Qualified Legal Services Projects, Guideline 2.3.1 (civil legal services)**

## DISCUSSION

To be found eligible for IOLTA grants as a QLSP, an organization must have the primary purpose and function of providing civil legal services without charge to indigent people in California.<sup>1</sup> Eligibility for grants, and grant allocations, are determined in part based on how much of an organization's expenditures are spent for this purpose.<sup>2</sup> Services with respect to criminal proceedings, and non-legal services, are not considered when determining primary purpose or grant allocations.<sup>3</sup>

### A. Civil Legal Services

The IOLTA program is authorized under Business & Professions Code sections 6210 through 6228. The statute's preamble cites the IOLTA program's overarching goal "to expand the availability and improve the quality of existing free legal services in civil matters to indigent persons."<sup>4</sup> QLSPs must have the primary purpose and function of providing legal services without charge to indigent persons; their grant allocations are calculated based upon each organization's total expenditures for such services in the prior year.<sup>5</sup> IOLTA grants may not be used to pay for services related to criminal proceedings.<sup>6</sup>

In reliance on these statutory parameters, the Commission typically has not counted services provided in criminal proceedings when determining the primary purpose of grant-seeking organizations, or when calculating the amounts to be allocated to eligible organizations. If parole hearings are not considered, and their related expenses are disallowed when determining primary purpose or calculating grants, UnCommon Law would not be eligible for funding.

At the Eligibility Review Conference, Mr. Wattley asserted that parole hearings are administrative, not criminal, in nature, and that hearings are non-adversarial and are governed by the California Code of Regulations. UnCommon Law also stated that the parole board's officers are not judges and that appeals are taken directly to the Superior Court, typically as a writ of habeas corpus. Most of UnCommon Law's litigation consists of habeas petitions; they have also brought impact litigation challenging the use of risk assessments to evaluate suitability for parole. Mr. Wattley noted a statutory right to appointed counsel for parole hearings in California, but distinguished the legal assistance provided by UnCommon Law as more in-depth and effective.

<sup>1</sup> Business & Professions Code, § 6213 at (a)(1), (a)(2)(a).

<sup>2</sup> Business & Professions Code, § 6216(b)(1)(A).

<sup>3</sup> Eligibility Guidelines for Qualified Legal Services Projects, Guideline 2.3.1.

<sup>4</sup> Business & Professions Code, § 6210.

<sup>5</sup> Business and Professions Code, §§ 6213(a), 6216(b)(1)(A).

<sup>6</sup> Business & Professions Code, § 6223(b).

To aid the Commission in its determination, the State Bar's Office of General Counsel (OGC) opined on the question of whether parole matters were criminal or civil in nature.<sup>7</sup> OGC concluded that, consistent with Mr. Wattley's statement, both case law and statute support characterizing legal services related to parole proceedings as civil, and thus they can be treated as civil legal services for purposes of IOLTA funding.

UnCommon Law's legal services related to parole matters are therefore qualified expenditures and may be considered when determining the organization's primary purpose and function as described at Business & Professions Code section 6213(a).

## **B. Non-Legal Services**

IOLTA and EAF grants must be used to provide legal services for indigent people.<sup>8</sup> "Legal services" are defined by State Bar Rules as including all professional services of an attorney, and similar or complementary services of a law student or paralegal under the supervision and control of an attorney.<sup>9</sup> Current office practice acknowledges that the successful provision of legal services can sometimes involve the assistance of other professionals or lay advocates. Such ancillary services have been considered to be a component of the delivery of legal services, when an attorney provides overall supervision and control for the case, and the resolution of a legal issue is the underlying reason for any other services.

UnCommon Law's services combine "trauma-informed, healing-centered mental health and legal counseling," with teams that include an attorney, social worker, therapist, law student, intern, or other counselors. Additional services include leadership training, providing parole resources to families of parole-seeking individuals, public education, and in-prison workshops to provide information and parole-readiness training and resources. While all of UnCommon Law's services seem to be provided in the context of support for the parole hearing, it was not clear from the application whether they are all legal services as defined by the State Bar Rules.

At the conference, Mr. Wattley explained that UnCommon Law's "wrap-around" services are provided by therapists and therapy students to help clients prepare for parole hearings and reach the legally required "insight" into their past behavior. These services are provided under the direction of attorneys, and only to individuals already receiving legal support for their parole hearings. Other ancillary services provided by UnCommon Law include post-hearing assistance with transitional housing and continuing therapeutic supports.

Services to families of parole seeking individuals include education prior to the hearing about rules, policies, and procedures; and post-release plans and support for the client's success. Their leadership training project (currently delayed due to COVID-19) will teach formerly-incarcerated people to be in-prison parole coaches with UnCommon Law; some of that training includes non-legal skills like public speaking or how to build a curriculum.

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<sup>7</sup> This memo is subject to attorney-client privilege.

<sup>8</sup> Business & Professions Code, § 6218.

<sup>9</sup> State Bar Rules, rule 3.672(A).

The Working Group concluded that UnCommon Law’s “wrap-around” social and ancillary services are an integral component of their legal services, tied to achieving and maintaining desired legal outcomes.

### **Working Group Recommendations**

In light of the legal analysis that legal services related to parole constitute civil legal services, the Working Group recommends that UnCommon Law be found eligible for IOLTA/EAF grant funding for 2021.

The Working Group recommends that UnCommon Law’s “wrap-around” social and ancillary services be considered qualified so long as they are provided in conjunction with, and as a complement to, qualified legal services.

### **ATTACHMENT**

- A.** Excerpts from Governing Authorities: Business & Professions Code; State Bar Rules; Qualified Legal Services Project Eligibility Guidelines

**UNCOMMON LAW – 2021 ELIGIBILITY REVIEW CONFERENCE  
JULY 24, 2020**

**ATTACHMENTS**

**RELEVANT AUTHORITIES**

**Business and Professions Code**

**Section 6210**

The Legislature finds that, due to insufficient funding, existing programs providing free legal services in civil matters to indigent persons, especially underserved client groups, such as the elderly, the disabled, juveniles, and non-English-speaking persons, do not adequately meet the needs of these persons. It is the purpose of this article to expand the availability and improve the quality of existing free legal services in civil matters to indigent persons, and to initiate new programs that will provide services to them. The Legislature finds that the use of funds collected by the State Bar pursuant to this article for these purposes is in the public interest, is a proper use of the funds, and is consistent with essential public and governmental purposes in the judicial branch of government. The Legislature further finds that the expansion, improvement, and initiation of legal services to indigent persons will aid in the advancement of the science of jurisprudence and the improvement of the administration of justice.

**Section 6213(a)**

(a) "Qualified legal services project" means either of the following:

- (1) A nonprofit project incorporated and operated exclusively in California that provides as its primary purpose and function legal services without charge to indigent persons and that has quality control procedures approved by the State Bar of California.
- (2) A program operated exclusively in California by a nonprofit law school accredited by the State Bar of California that meets the requirements of subparagraphs (A) and (B).
  - (A) The program shall have operated for at least two years at a cost of at least twenty thousand dollars (\$20,000) per year as an identifiable law school unit with a primary purpose and function of providing legal services without charge to indigent persons.
  - (B) The program shall have quality control procedures approved by the State Bar of California.

**Section 6214(b)**

Projects meeting the requirements of subdivision (a) of Section 6213 but not qualifying under the presumption specified in subdivision (a) [pertaining to projects receiving funds from certain federal sources] shall qualify for funds under this article if they meet all of the following additional criteria:

- (1) They receive cash funds from other sources in the amount of at least twenty thousand dollars (\$20,000) per year to support free legal representation to indigent persons.
- (2) They have demonstrated community support for the operation of a viable ongoing program.

(3) They provide one or both of the following special services:

(A) The coordination of the recruitment of substantial numbers of attorneys in private practice to provide free legal representation to indigent persons or to qualified legal services projects in California.

(B) The provision of legal representation, training, or technical assistance on matters concerning special client groups, including the elderly, the disabled, juveniles, and non-English-speaking groups, or on matters of specialized substantive law important to the special client groups.

**Section 6216(b)(1)(A)**

In any county which is served by more than one qualified legal services project, the State Bar shall distribute funds for the county to those projects which apply on a pro rata basis, based upon the amount of their total budget expended in the prior year for legal services in that county as compared to the total expended in the prior year for legal services by all qualified legal services projects applying therefor in the county. In determining the amount of funds to be allocated to a qualified legal services project specified in paragraph (2) of subdivision (a) of Section 6213, the State Bar shall recognize only expenditures attributable to the representation of indigent persons as constituting the budget of the program.

**Section 6218(a)**

Qualified legal services programs shall ensure that funds appropriated pursuant to this article shall be used solely to defray the costs of providing legal services to indigent persons or for such other purposes as set forth in this article.

**Section 6223**

No funds allocated by the State Bar pursuant to this article shall be used for any of the following purposes:

(a) The provision of legal assistance with respect to any fee generating case, except in accordance with guidelines which shall be promulgated by the State Bar.

(b) The provision of legal assistance with respect to any criminal proceeding.

(c) The provision of legal assistance, except to indigent persons or except to provide support services to qualified legal services projects as defined by this article.

**State Bar Rules**

**Rule 3.671(A)**

A qualified legal services project is required by statute to have as its primary purpose and function providing legal services without charge to indigent persons. A qualified legal services project applying for Trust Fund Program funds is presumed to have such a purpose and function if 75% or more of the budget for the fiscal year for which it is seeking funds is designated to provide free legal services to indigents, and 75% or more of its expenditures for the most recent reporting year were incurred for such services. The calculation of 75% of expenditures may include a reasonable share of administrative and overhead expenses.

**Rule 3.672(A)**

“Legal services” include all professional services provided by a licensee of the State Bar and similar or complementary services of a law student or paralegal under the supervision and control of a licensee of the State Bar in accordance with law.

**Qualified Legal Services Project Eligibility Guidelines****Guideline 2.3.1: provides civil legal services**

**Commentary:** You must provide legal services within the definition of Rule 3.672(A). That rule provides that “legal services include all professional services provided by a member of the State Bar, and similar or complementary services of a law student or a paralegal under the supervision and control of a member of the State Bar in accordance with law.” If your organization provides services in 6 addition to legal services, your application must describe those other activities, identify the percentage of the overall services provided that are not legal services, and state the basis by which you computed that percentage. [Rule 3.671(A)]

**2019 State Budget Act****Section 0250-101-0001, Schedule 5, Provision 1**

In order to improve equal access and the fair administration of justice, the funds appropriated in Schedule (5), after distribution of the \$20,000,000 in Provision 6, are to be distributed by the Judicial Council through the Legal Services Trust Fund Commission to qualified legal services projects and support centers as defined in Sections 6213 to 6215, inclusive, of the Business and Professions Code, to be used for legal services in civil matters for indigent persons. The Judicial Council shall approve awards made by the commission if the council determines that the awards comply with statutory and other relevant guidelines. Ten percent of the funds in Schedule (5) shall be for joint projects of courts and legal services programs to make legal assistance available to pro per litigants and 90 percent of the funds in Schedule (5) shall be distributed consistent with Sections 6216 to 6223, inclusive, of the Business and Professions Code. The Judicial Council may establish additional reporting or quality control requirements consistent with Sections 6213 to 6223, inclusive, of the Business and Professions Code.



## The State Bar of California

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**DATE:** July 28, 2020

**TO:** Legal Services Trust Fund Commission - Eligibility and Budget Review Committee

**FROM:** Banafsheh Akhlaghi, Member, LSTFC Eligibility and Budget Review Committee  
Pamela Bennett, Member, LSTFC Eligibility and Budget Review Committee  
Corey Friedman, Member, LSTFC Eligibility and Budget Review Committee

**SUBJECT:** East Bay Family Defenders: Eligibility Review Conference for 2021 IOLTA and EAF Funding

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### EXECUTIVE SUMMARY

East Bay Family Defenders (EBFD) is a new applicant for funding as a Qualified Legal Services Project (QLSP) providing services in Alameda County. EBFD was incorporated in California in December 2017 and launched in September 2018.

EBFD's mission is to keep families together and minimize the time children spend in foster care. The organization was founded on the premise that strong, interdisciplinary family defense is the most potent means of interrupting intergenerational cycles of foster care that harm children, their families, and their communities.

The Eligibility and Budget Review Committee requested an Eligibility Review Conference to consider the following two issues raised by the IOLTA/EAF application:

1. Until the recent change implemented on July 1, 2020 to begin collecting client income information, EBFD was not conducting income screening during its client intake process.
2. While EBFD employs a full-time licensed clinical social worker and two senior parent advocates to assist approximately 10% of its clients in support of its legal representation, it is unclear how much of EBFD's social work is tied to actual legal outcomes which impacts their qualified expenditures percentage and their potential funding allocation.

The Eligibility Review Conference was held on July 27, 2020, and Co-Executive Directors, Eliza Patten and Zabrina Aleguire and EBFD's CPA, Ragini Singh attended on behalf of the organization. The Eligibility and Budget Review Committee's working group members Banafsheh Akhlaghi, Pamela Bennett, and Corey Friedman, as well as staff members Erica Carroll, Brady Dewar, Doan Nguyen, and Greg Shin attended on behalf of the State Bar.

## BACKGROUND

### Organizational Description

According to its application, “EBFD was co-founded by Eliza Patten and Zabrina Aleguire, experienced juvenile dependency attorneys, to prioritize the reunification of families separated by child protective authorities in Alameda County..EBFD was founded on a commitment to nationally-recognized, fundamental attributes of quality legal representation for children and parents in the child welfare system and is participating as a demonstration site with the American Bar Association's Family Justice Initiative for implementation and measurement of improved outcomes resulting from strengthened legal representation.” EBFD was incorporated as a 501(c)(3) nonprofit organization in California on December 29, 2017.

Since September 1, 2018, EBFD has been providing court-appointed dependency counsel services to the Superior Court of California, County of Alameda. EBFD attorneys staff each of the Alameda County Superior Court’s three Family Treatment Courts and represent parent clients and conflict child clients in all stages of dependency proceedings. In its first year, EBFD served 2,000 clients and closed 800 cases. EBFD attorneys work collaboratively with their clients and, in some cases, with the support of an in-house social worker or peer parent advocate, to holistically understand client needs and develop a case strategy.

### Governing Authorities

#### **Business and Professions Code section 6213(d) (definition of indigent person):**

“Indigent person” means a person whose income is (1) 125 percent or less of the current poverty threshold established by the United States Office of Management and Budget, or (2) who is eligible for Supplemental Security Income or free services under the Older Americans Act or Developmentally Disabled Assistance Act. For the purpose of this subdivision, the income of a person who is disabled shall be determined after deducting the costs of medical and other disability related special expenses.

#### **State Bar Rule 3.671(A) (“primary purpose”):**

A qualified legal services project is required by statute to have as its primary purpose and function providing legal services without charge to indigent persons. A qualified legal services project applying for Trust Fund Program funds is presumed to have such a purpose and function if 75 percent or more of the budget for the fiscal year for which it is seeking funds is designated to provide free legal services to indigent clients, and 75 percent or more of its expenditures for the most recent reporting year were incurred for such services. The calculation of 75 percent of expenditures may include a reasonable share of administrative and overhead expenses.

#### **State Bar Rule 3.672(A) (“legal services”):**

“Legal services” include all professional services provided by a licensee of the State Bar and similar or complementary services of a law student or paralegal under the supervision and control of a licensee of the State Bar in accordance with law.



## DISCUSSION

To be found to meet the definition of a QLSP, an organization must have a primary purpose to provide free civil legal aid in California to indigent individuals. In addition, pursuant to current office practice interpreting the definition of “legal services,” an organization providing social work must demonstrate that work is tied to legal services/outcomes and can therefore be considered as qualifying in determining if they meet the primary purpose test.

### A. Income Eligibility for Services/Primary Purpose Calculation

As noted above, QLSPs are defined as organizations having the primary purpose and function of providing legal services without charge to indigent persons, as defined. State Bar Rules reiterate this standard, and further provide that this primary purpose may be presumed if 75 percent or more of the organization’s expenditures were incurred providing legal services without charge to indigent people.<sup>1</sup> Grant allocations for both IOLTA and EAF grants are calculated based upon each organization’s total expenditures for legal services in the prior year.<sup>2</sup>

Prior to July 1, 2020, when a new intake process was implemented to begin collecting client income information, EBFD was NOT conducting income screening, thus preventing calculation of their qualifying expenditures percentage. EBFD indicated that unlike other courts that require indigence screening of clients per the Judicial Council of California’s program for determining eligibility for court-appointed counsel, the Alameda Superior Court did not require, nor was it interested in requiring, any form of income screening.

EBFD’s pre-July 1, 2020 intake process only approximated indigence level based on income source and housing status as captured in their intake form. Income options included: Unemployed/No Income, Public Benefits (including unemployment and retirement), Paid Part-Time Work, and Paid Full-time Work. Housing status options included several options for insecure housing (car, park, street, motel, transitional housing, incarceration, and living with others without paying rent), as well as renting a home or owning a home. At the Eligibility Review Conference, EBFD was asked about its ability to further break down its client data to demonstrate indigency based on screening factors like homeless clients or clients receiving CalWorks benefits. They acknowledged that they could segregate their data based on the various questions on their intake form but that their overall data collection in this area was limited.

Acknowledging that its own data on income eligibility was insufficient to measure indigence, EBFD looked to Dependency Advocacy Center<sup>3</sup> (DAC) in Santa Clara County, a similar size dependency jurisdiction as a proxy for income screening. EBFD expressed its belief that because Santa Clara County is a similarly sized county with similar population statistics as Alameda

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<sup>1</sup> State Bar Rule 3.671(A).

<sup>2</sup> Business & Professions Code § 6216(b)(1)(A).

<sup>3</sup> DAC provided fiscal sponsorship to EBFD when it got started.

County, it would serve as a reliable proxy for income screening purposes<sup>4</sup>. Therefore, EBFD utilized DAC's income eligibility statistics and estimated that approximately 15% of the clients served would not qualify as indigent as defined by the IOLTA statute. They then took 15% of their attorney salaries expense and deducted that amount as non-qualifying yielding their 97.79% qualified expenditures percentage. Even assuming that their estimation of 15% non-indigent clients was acceptable, it was pointed out that EBFD should have not only applied the 15% against attorney salaries but against other personnel and administrative/overhead expenses under the premise that if 15% of their clients are not indigent, then approximately 85% of EBFD's expenditures should be considered qualifying (following further communication with DAC, EBFD subsequently revised its application to reflect a 20% non-indigency estimate which yielded a revised 80% qualifying expenditures percentage).

EBFD was also asked about its intended use of IOLTA funds if approved for funding and it cited a number of projects that it would like to pursue, separate and apart from its current work funded by the Judicial Council including:

- Representing clients who are placed in California's Child Abuse Central Index (CACI) registry in administrative hearings. They believe this could have significant impact on clients' ability to find employment in certain industries like child care and healthcare, improving their economic situations.
- Working on special education advocacy efforts for its clients' children who have individualized education programs (IEPs).
- Working on introducing legal standardization and reform in the practices of the Juvenile Dependency Court in terms of regulating potential over-medication of children in foster care.

## **B. Deducting Potentially Non-Qualified Legal Services**

"Legal services" are defined by State Bar Rules as including all professional services of an attorney, and similar or complementary services of a law student or paralegal under the supervision and control of an attorney.<sup>5</sup>

EBFD employs an interdisciplinary family defense team model in which social work and peer parent advocate support is used to assess and respond to client needs, strengthen attorney-client communication and client engagement, and advance clients' legal goals and objectives. The attorney oversees the case and provides direction to the social worker and peer parent advocate who operate as agents of the attorney in advancing the legal representation.

While EBFD was compelling in its description of the work conducted by its social worker and peer parent advocates as critical in the context of advancing clients' legal goals and objectives, it is not clear whether all of the services like assisting clients with mental health issues or assisting with intake into substance abuse treatment are legal services as defined by the State

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<sup>4</sup> According to EBFD, Alameda County has a higher poverty rate than Santa Clara County which was confirmed by staff's review of the 2018 United States Census Bureau data.

<sup>5</sup> State Bar Rule 3.672(A).

Bar Rules. EBFD further emphasized that the work performed by its social worker and peer parent advocates in helping clients navigate their mental health or cognitive issues and complying with substance abuse treatment participation can and oftentimes do impact legal case outcomes.

Current office practice acknowledges that the successful provision of legal services can involve the assistance of social workers or other advocates. Social services work must, however, tie directly to the legal services work in order for it to be considered a component of legal services. This issue will be reviewed further during the rules codification process.

### **C. Working Group Recommendation**

The working group recommends that EBFD be found not eligible for IOLTA/EAF grants in 2021 since it has only begun conducting income screening as of July 1, 2020 and is therefore unable to generate its qualifying expenditures calculation to determine whether it meets the primary purpose requirement of providing legal services without charge to indigent persons. In addition, the working group does not accept EBFD's use of DAC's income screening statistics for Santa Clara as a stand-in for its own income screening in Alameda County. The two counties are not identical and while the use of another county's income statistics may provide a basis for an indigency estimate, it is not a reliable methodology to determine if EBFD meets the primary purpose test.

The working group acknowledges that following the Eligibility Review Conference, EBFD quickly provided preliminary income data gathered from its new intake process which showed that 100% of its new clients met the indigency standard. While this is encouraging news, the amount of time that the new intake process has been in place (less than 30 days) is insufficient to reliably establish EBFD's primary purpose calculation.

## **ATTACHMENTS LIST**

### **A. Excerpts from Governing Authorities: Business & Professions Code; State Bar Rules**

**EAST BAY FAMILY DEFENDERS  
2021 ELIGIBILITY REVIEW CONFERENCE  
JULY 27, 2020**

**ATTACHMENTS**

**RELEVANT AUTHORITIES**

**Business and Professions Code**

**Section 6213(a)**

(a) "Qualified legal services project" means either of the following:

(1) A nonprofit project incorporated and operated exclusively in California that provides as its primary purpose and function legal services without charge to indigent persons and that has quality control procedures approved by the State Bar of California.

(2) A program operated exclusively in California by a nonprofit law school accredited by the State Bar of California that meets the requirements of subparagraphs (A) and (B).

(A) The program shall have operated for at least two years at a cost of at least twenty thousand dollars (\$20,000) per year as an identifiable law school unit with a primary purpose and function of providing legal services without charge to indigent persons.

(B) The program shall have quality control procedures approved by the State Bar of California.

**Section 6213(d)**

"Indigent person" means a person whose income is (1) 125 percent or less of the current poverty threshold established by the United States Office of Management and Budget, or (2) who is eligible for Supplemental Security Income or free services under the Older Americans Act or Developmentally Disabled Assistance Act. With regard to a project that provides free services of attorneys in private practice without compensation, "indigent person" also means a person whose income is 75 percent or less of the maximum levels of income for lower income households as defined in Section 50079.5 of the Health and Safety Code. For the purpose of this subdivision, the income of a person who is disabled shall be determined after deducting the costs of medical and other disability related special expenses.

**Section 6216(b)(1)(A)**

In any county which is served by more than one qualified legal services project, the State Bar shall distribute funds for the county to those projects which apply on a pro rata basis, based upon the amount of their total budget expended in the prior year for legal services in that county as compared to the total expended in the prior year for legal services by all qualified legal services projects applying therefor in the county. In determining the amount of funds to be allocated to a qualified legal services project specified in paragraph (2) of subdivision (a) of Section 6213, the State

Bar shall recognize only expenditures attributable to the representation of indigent persons as constituting the budget of the program.

**State Bar Rules**

**Rule 3.671(A)**

A qualified legal services project is required by statute to have as its primary purpose and function providing legal services without charge to indigent persons. A qualified legal services project applying for Trust Fund Program funds is presumed to have such a purpose and function if 75% or more of the budget for the fiscal year for which it is seeking funds is designated to provide free legal services to indigents, and 75% or more of its expenditures for the most recent reporting year were incurred for such services. The calculation of 75% of expenditures may include a reasonable share of administrative and overhead expenses.

**Rule 3.672(A)**

“Legal services” include all professional services provided by a licensee of the State Bar and similar or complementary services of a law student or paralegal under the supervision and control of a licensee of the State Bar in accordance with law.



## The State Bar of California

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**DATE:** August 3, 2020

**TO:** Members, LSTFC Eligibility and Budget Review Committee

**FROM:** Banafsheh Akhlaghi, Erica Connolly, and Herman DeBose, Eligibility Review Conference Working Group

**SUBJECT:** Eligibility Review Conference for 2021 IOLTA and EAF Funding for Housing Rights Center

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### EXECUTIVE SUMMARY

Housing Rights Center (HRC) is a first-time IOLTA/EAF applicant, applying as a legal services project. The organization was first recognized by the Internal Revenue Service as a 501(c)(3) nonprofit in 1969. It operates in Los Angeles and Ventura counties with a mission of providing “active support and promotion of freedom of residence through education, advocacy, and litigation.” Most of its services center on education and lower-level interventions to enable tenants to assist themselves prior to pursuing litigation, and its primary source of funding is through Community Development Block Grants (CDBG).

This working group held an Eligibility Review Conference (ERC) with HRC on July 29. In attendance from HRC were Executive Director Chancela Al-Mansour, Director of Litigation Scott Chang, and Director of Finance Danny Batalla.

The issues addressed at the ERC included:

- Whether HRC’s primary purpose and function is the provision of legal services to indigent persons without charge, including questions regarding:
  - Whether services offered by HRC satisfy the definition of “legal services” as defined by the IOLTA statute and the Rules of the State Bar; and
  - If HRC has an appropriate methodology for calculating its qualified expenditures and whether that methodology has been correctly applied in this application.
- HRC’s division of expenses among Los Angeles and Ventura counties and whether it has an accurate way to track and report expenditures by county; and
- Information missing from the application that would be necessary to determine HRC’s qualification as a legal services project.

The working group requested additional information from HRC regarding their expenditures in order to have a complete application. HRC was requested to submit this information no later than noon on July 30. HRC was unable to comply with the request, leaving its application

incomplete. Consequently, this working group recommends that HRC be found ineligible for IOLTA/EAF funding in 2021.

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## BACKGROUND

### Organizational Description

HRC describes itself as “California’s largest non-profit civil rights organization dedicated to securing the right to equal access in housing.” It operates in Los Angeles and Ventura counties and seeks allocations for both counties. HRC has a staff of approximately 30 people and provides services in the following four areas:

- (1) Housing Discrimination Complaint Investigation (staff: 10)
- (2) Fair Housing Landlord/Tenant Counseling (staff: 9)
- (3) Education and Outreach (staff: 3), and
- (4) Fair Housing Legal Services (staff: 4)

The remaining employees are administrative/executive staff. The organization reported \$1,947,183 in total corporate expenditures in fiscal year 2019. The audit states that the “majority of its funding is received from federal financial assistance pass-through awards originating with the United States Department of Housing and Urban Development.” HRC applies income eligibility guidelines as prescribed by HUD’s Community Development Block Grants (CDBG).

### Governing Authorities

- Business & Professions Code sections 6210 (Preamble to IOLTA Statutes), 6213(a) (“primary purpose”), 6213(d) (“indigent person”), 6214(a) and (b) (eligibility criteria for legal services projects), 6216(b) (allocation calculation methodology)
- State Bar Rules 3.671(A) and (C) (“primary purpose”); 3.672(A) (“legal services”); 3.680 (application requirements)
- Legal Services Trust Fund Program Guidelines – Legal Services Projects, Guideline 1.4. (application requirements), 2.3.2. (“without charge”), 2.3.4. (“indigent”)

## DISCUSSION

IOLTA grants are intended to improve access to civil legal services for indigent people, as stated in the preamble to the IOLTA statute.<sup>1</sup> Interest on Lawyers’ Trust Accounts (IOLTA) grants and Equal Access Fund (EAF) formula grants must be used to provide legal services. To be found eligible for these grants, HRC must have as its primary purpose and function providing legal

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<sup>1</sup> Business & Professions Code § 6210; “IOLTA statute” refers to Business and Professions Code sections 6210 through 6228, which govern the administration of the IOLTA grants.

services without charge to indigent persons.<sup>2</sup> It must also have a complete and accurate application that will allow staff, among other things, to determine whether they meet threshold requirements as a legal services project.

### A. Primary Purpose

To be considered a qualified legal services project, HRC must provide “as its primary purpose and function legal services without charge to indigent persons.”<sup>3</sup> To determine the organization’s primary purpose, the IOLTA/EAF application instructs the applicant to separate out its expenditures devoted to providing such free legal services to indigent persons in the prior fiscal year (referred to as “qualified expenditures”) and calculates those as a percentage of the organization’s total corporate expenditures.<sup>4</sup>

If the applicant organization’s qualified expenditures constitute 75 percent or more of its corporate expenditures, the organization is presumed to meet the primary purpose requirement.<sup>5</sup> If qualified expenditures are less than 75 percent of corporate expenditures, an applicant must provide a narrative response to be reviewed by the Eligibility and Budget Review Committee.<sup>6</sup> Historically, the Committee has recommended organizations with qualified expenditures between 50 and 75 percent as eligible for funding.

A number of factors impact what an organization can and cannot count as a qualified expenditure for purposes of eligibility for IOLTA/EAF funding. This includes services to non-indigent persons and services that do not qualify as “civil legal services.” Applicants are not prohibited from serving non-indigent persons or providing services other than legal services, but they must make appropriate deductions to ensure that only qualified expenditures count toward their grant allocations.

#### 1. Deducting Services Provided to Non-Indigent Persons

HRC reports that they use CDBG guidelines from HUD to track client income. Based on the information in the application regarding income eligibility, it appears the CDBG income threshold is up to 80 percent of the area median income (AMI). This threshold is higher than the threshold for indigence under the IOLTA statute. Further, the application states elsewhere that “HRC provides services to **all residents over 18 years of age** in the areas of Los Angeles and Ventura counties that we serve. A large majority of individuals requesting services are in the **low to moderate income classifications** as provided annually by HUD” (emphasis added).

The example given in the application reflects the income ranges applied in Los Angeles. The chart shows that 80 percent AMI (moderate income classification) for a family of four would be up to \$90,100 per year, and 50 percent AMI (low income classification) for the same household

<sup>2</sup> Business & Professions Code § 6213(a).

<sup>3</sup> Business & Professions Code § 6213(a)(1).

<sup>4</sup> The organization’s grant award is also calculated based on the amount of qualified expenditures, not the total corporate expenditures.

<sup>5</sup> State Bar Rule 3.671(A).

<sup>6</sup> State Bar Rule 3.671(C).



would be \$56,300 per year. In contrast, an “indigent person” under the IOLTA statute is a person whose income is 125 percent or less of the federal poverty level;<sup>7</sup> in 2020 for a family of four, that would be \$32,750 per year.

The IOLTA/EAF application asks several questions to prompt applicants to make appropriate deductions from their qualified expenditures. This includes whether civil legal services were provided to non-indigent persons and charging for services. HRC did not make any deductions and reported 100 percent qualified expenditures. Given the information provided elsewhere in the application, it seems apparent that deductions should have been made.

It is unclear what percentage of HRC’s services are provided to non-indigent individuals; even if the majority of HRC’s clients are in the low to moderate income ranges mentioned above, the deductions are likely to be significant, because the HUD income ranges are not equivalent to those used for IOLTA and EAF grants. Staff notified HRC more than once that it appears that deductions should have been made on its qualified expenditures form, and staff has asked HRC to revisit this form and make any appropriate deductions, but none have been made to date.

Another open question is the nature of the organization’s impact work. HRC reported participation in several impact litigation cases, but the corresponding impact litigation and advocacy work forms were not completed. Consequently, staff has not been able to determine if these cases were undertaken primarily for the benefit of indigent persons.<sup>8</sup> If not, work related to those cases would need to be deducted as well from HRC’s qualified expenditures.

During the ERC, HRC stated that it captures client income but does not deny services or charge based on that information. The organization reported that the majority of its clients are below 80 percent AMI but acknowledged that this is not the same as the IOLTA standard. HRC hoped to be able to implement a mechanism in its case management system to measure this but had not yet been able to separate out the amount of expenditures for services provided to indigent persons under the IOLTA definition. HRC also provided examples of two of their impact litigation cases, which involve low-income renters. HRC mentioned that it often represents itself in housing litigation because of the difficulty finding tenants who are willing to be named plaintiffs. However, the organization has not completed the Impact Litigation and Advocacy Work report forms for those or any other impact cases in order for staff to assess whether they meet the requirements to be considered qualified expenditures.

## **2. Deducting Non-Qualified Legal Services**

HRC has four main service areas: Housing Discrimination Complaint Investigation; Fair Housing Landlord/Tenant Counseling; Education and Outreach; and Fair Housing Legal Services.

Of a staff of approximately 30, HRC’s legal department is comprised of four people: Director of Litigation, staff attorney, paralegal, and legal secretary. (This does not include the Executive Director, who is also an attorney.) In addition to their own caseload, HRC reports that the legal

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<sup>7</sup> Business & Professions Code § 6213(d).

<sup>8</sup> Eligibility Guidelines for Legal Services Projects, Guideline 2.3.4.

department reviews correspondence from HRC's housing investigators to ensure the applicable housing law was correctly cited.

The application does not provide an answer to the question about incorporating non-legal staff in HRC's service delivery model. Without knowing more, some services present questions about whether they constitute "legal services" as contemplated by the statute.<sup>9</sup> For example, housing discrimination investigations are likely integral components of gathering evidence to pursue a viable housing discrimination legal claim. However, HRC's investigations department is not under the supervision of an attorney (though there is some input from the legal department), and, if no or insufficient evidence exists to support a legal claim, the matter ends without referral to the legal department.

Further, HRC's education and outreach entails workshops and programs, as well as written materials, that target a diverse audience of landlords, realtors, tenants, potential homebuyers, government officials and local nonprofits. Its Fair Housing Certification Training seminar for landlords and property managers charges \$100-150 per person, and HRC updates affordable housing resources and rental listings on its website monthly.<sup>10</sup>

During the ERC, HRC discussed its landlord/tenant counseling services and housing discrimination investigations. HRC said that the counseling services include a disclaimer that they are not legal services and typically involve referral to relevant service providers based on the issue presented, or providing the caller with the applicable law related to their concerns. The counselors are not under the supervision of an attorney, but the legal department does work on developing the information offered to callers and reviews the information that was shared after the fact for accuracy. There is not currently a mechanism for separating out calls that might constitute advice and counsel versus simply informational or referral calls.

The housing investigators typically receive discrimination complaints and/or reasonable accommodation requests. HRC confirmed that investigations do not always reach the legal department, but attorneys will review the correspondence sent by investigators to landlords to ensure they are correctly citing the law. Investigators also meet with the legal department before filing any sort of administrative action or to discuss potential legal issues in their cases.

There was brief discussion about HRC's outreach and education. HRC stated that it is contractually obligated to offer presentations and trainings to landlords and property managers, but that no one ever signs up for those trainings, and that the bulk of this work is targeted to low-income renters as well.

## **B. Determining Expenditures by County**

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<sup>9</sup> "'Legal services' include all professional services provided by a licensee of the State Bar and similar or complementary services ... under the supervision and control of a licensee of the State Bar ..." State Bar Rule 3.672(A).

<sup>10</sup> Information taken from HRC's website, not the application.

The application provided a narrative response explaining that most of HRC's expenditures are in Los Angeles County. It provided general information about funding received in Ventura County, but Business and Professions Code section 6216(b) states that funds will be disbursed on a county-by-county pro rata basis. The application requires specific information regarding qualified expenditures in each county in order to ensure proper allocations are made when staff applies the formula in the statute. There is insufficient information to determine qualified expenditures in Los Angeles versus Ventura counties, and consequently, appropriate allocations for each if HRC.

### **C. Working Group Recommendation**

The working group asked HRC to provide the missing information in its application by noon on July 30. Specifically, HRC was asked to provide an accounting of its expenditures devoted to non-indigent persons and to services that would not be considered "legal services" under the statute and rules in order to determine its qualified expenditures in each county. The working group also requested a copy of HRC's income eligibility guidelines.

Staff followed up with an email to HRC summarizing the requested information shortly after the meeting ended, explaining that a funding allocation could not be determined without it. Staff further informed HRC that if the requested information was not provided, the recommendation to the Committee would be to find HRC ineligible for 2021 funding because the application would be incomplete.

Staff received a response from HRC on July 30 that indicated it was not able provide the requested information but would return to seek funding in the future. Consequently, this working group recommends that HRC be found ineligible for 2021 IOLTA/EAF funding under State Bar Rule 3.680 and Eligibility Guideline 1.4 of the Eligibility Guidelines for Legal Services Projects, for failing to submit a timely and complete application. The working group advised HRC to work with staff before and during the application process in the future in order to ensure compliance with the application requirements.

### **D. Next Steps**

The Eligibility and Budget Review Committee will review this recommendation at its August 6 meeting and, in turn, make a recommendation to the LSTFC regarding HRC's eligibility for 2021 funding. The LSTFC will then make a final determination of HRC's eligibility at its August 14 meeting.

## **ATTACHMENTS LIST**

- A.** Excerpts from Governing Authorities: Business and Professions Code; Rules of the State Bar of California; Legal Services Trust Fund Program Eligibility Guidelines for Legal Services Projects

## **Attachment A: Excerpts from Governing Authorities: Business and Professions Code; Rules of the State Bar of California; Eligibility Guidelines for Legal Services Projects**

### **California Business and Professions Code section 6210**

The Legislature finds that, due to insufficient funding, existing programs providing free legal services in civil matters to indigent persons, especially underserved client groups, such as the elderly, the disabled, juveniles, and non-English-speaking persons, do not adequately meet the needs of these persons. It is the purpose of this article to expand the availability and improve the quality of existing free legal services in civil matters to indigent persons, and to initiate new programs that will provide services to them. The Legislature finds that the use of funds collected by the State Bar pursuant to this article for these purposes is in the public interest, is a proper use of the funds, and is consistent with essential public and governmental purposes in the judicial branch of government. The Legislature further finds that the expansion, improvement, and initiation of legal services to indigent persons will aid in the advancement of the science of jurisprudence and the improvement of the administration of justice.

### **California Business and Professions Code section 6213**

As used in this article:

(a) "Qualified legal services project" means either of the following:

(1) A nonprofit project incorporated and operated exclusively in California that provides as its primary purpose and function legal services without charge to indigent persons and that has quality control procedures approved by the State Bar of California.

(2) A program operated exclusively in California by a nonprofit law school accredited by the State Bar of California that meets the requirements of subparagraphs (A) and (B).

(A) The program shall have operated for at least two years at a cost of at least twenty thousand dollars (\$20,000) per year as an identifiable law school unit with a primary purpose and function of providing legal services without charge to indigent persons.

(B) The program shall have quality control procedures approved by the State Bar of California.

[subsections (b) and (c) omitted]

(d) "Indigent person" means a person whose income is (1) 125 percent or less of the current poverty threshold established by the United States Office of Management and Budget, or (2) who is eligible for Supplemental Security Income or free services under the Older Americans Act

or Developmentally Disabled Assistance Act. With regard to a project that provides free services of attorneys in private practice without compensation, "indigent person" also means a person whose income is 75 percent or less of the maximum levels of income for lower income households as defined in Section 50079.5 of the Health and Safety Code. For the purpose of this subdivision, the income of a person who is disabled shall be determined after deducting the costs of medical and other disability-related special expenses.

[subsections (e) through (k) omitted]

**California Business and Professions Code section 6214**

(a) Projects meeting the requirements of subdivision (a) of Section 6213 which are funded either in whole or part by the Legal Services Corporation or with Older American Act funds shall be presumed qualified legal services projects for the purpose of this article.

(b) Projects meeting the requirements of subdivision (a) of Section 6213 but not qualifying under the presumption specified in subdivision (a) shall qualify for funds under this article if they meet all of the following additional criteria:

(1) They receive cash funds from other sources in the amount of at least twenty thousand dollars (\$20,000) per year to support free legal representation to indigent persons.

(2) They have demonstrated community support for the operation of a viable ongoing program.

(3) They provide one or both of the following special services:

(A) The coordination of the recruitment of substantial numbers of attorneys in private practice to provide free legal representation to indigent persons or to qualified legal services projects in California.

(B) The provision of legal representation, training, or technical assistance on matters concerning special client groups, including the elderly, the disabled, juveniles, and non-English-speaking groups, or on matters of specialized substantive law important to the special client groups.

**California Business and Professions Code section 6216**

The State Bar shall distribute all moneys received under the program established by this article for the provision of civil legal services to indigent persons. The funds first shall be distributed 18 months from the effective date of this article, or upon such a date, as shall be determined by the State Bar, that adequate funds are available to initiate the program. Thereafter, the funds

shall be distributed on an annual basis. All distributions of funds shall be made in the following order and in the following manner:

(a) To pay the actual administrative costs of the program, including any costs incurred after the adoption of this article and a reasonable reserve therefor.

(b) Eighty-five percent of the funds remaining after payment of administrative costs allocated pursuant to this article shall be distributed to qualified legal services projects. Distribution shall be by a pro rata county-by-county formula based upon the number of persons whose income is 125 percent or less of the current poverty threshold per county. For the purposes of this section, the source of data identifying the number of persons per county shall be the latest available figures from the United States Department of Commerce, Bureau of the Census. Projects from more than one county may pool their funds to operate a joint, multicounty legal services project serving each of their respective counties.

(1) (A) In any county which is served by more than one qualified legal services project, the State Bar shall distribute funds for the county to those projects which apply on a pro rata basis, based upon the amount of their total budget expended in the prior year for legal services in that county as compared to the total expended in the prior year for legal services by all qualified legal services projects applying therefor in the county. In determining the amount of funds to be allocated to a qualified legal services project specified in paragraph (2) of subdivision (a) of Section 6213, the State Bar shall recognize only expenditures attributable to the representation of indigent persons as constituting the budget of the program.

(B) The State Bar shall reserve 10 percent of the funds allocated to the county for distribution to programs meeting the standards of subparagraph (A) of paragraph (3) and paragraphs (1) and (2) of subdivision (b) of Section 6214 and which perform the services described in subparagraph (A) of paragraph (3) of Section 6214 as their principal means of delivering legal services. The State Bar shall distribute the funds for that county to those programs which apply on a pro rata basis, based upon the amount of their total budget expended for free legal services in that county as compared to the total expended for free legal services by all programs meeting the standards of subparagraph (A) of paragraph (3) and paragraphs (1) and (2) of subdivision (b) of Section 6214 in that county. The State Bar shall distribute any funds for which no program has qualified pursuant hereto, in accordance with the provisions of subparagraph (A) of paragraph (1) of this subdivision.

(2) In any county in which there is no qualified legal services projects providing services, the State Bar shall reserve for the remainder of the fiscal year for distribution the pro rata share of funds as provided for by this article. Upon application of a qualified legal services project proposing to provide legal services to the indigent of the county, the State Bar shall distribute the funds to the project. Any funds not so distributed shall be added to the funds to be distributed the following year.

[subsection (c) omitted]

**State Bar Rule 3.671: Primary purpose and function**

- (A) A qualified legal services project is required by statute to have as its primary purpose and function providing legal services without charge to indigent persons. A qualified legal services project applying for Trust Fund Program funds is presumed to have such a purpose and function if 75% or more of the budget for the fiscal year for which it is seeking funds is designated to provide free legal services to indigents, and 75% or more of its expenditures for the most recent reporting year were incurred for such services. The calculation of 75% of expenditures may include a reasonable share of administrative and overhead expenses.

[subsection (B) omitted]

- (C) A qualified legal services project or qualified support center that does not meet the 75% test may nevertheless apply, provided that the applicant can satisfactorily demonstrate that it meets the primary purpose and function requirement by other means.

**State Bar Rule 3.672: Delivery of Legal Services**

- (A) “Legal services” include all professional services provided by a licensee of the State Bar and similar or complementary services of a law student or paralegal under the supervision and control of a licensee of the State Bar in accordance with law.

[subsection (B) omitted]

**State Bar Rule 3.680: Application for Trust Fund Program grants**

To be considered for a Trust Fund Program grant, a qualified legal services project or qualified support center seeking a Trust Fund Program grant must submit a timely and complete application for funding in the manner prescribed by the Commission. The applicant must agree to use any grant in accordance with grant terms and legal requirements.

- (A) A qualified legal services project must meet statutory criteria.

[subsections (B) through (D) omitted]

- (E) An application must include
- (1) an audited financial statement by an independent certified public accountant for the fiscal year that concluded during the prior calendar year. A financial review in lieu of an audited financial statement may be submitted by an applicant

whose gross corporate expenditures were less than the amount specified in the Schedule of Charges and Deadlines; 10 Business & Professions Code § 6223. 5

- (2) information about the maintenance of quality service and professional standards and how the applicant maintains standards, such as internal quality control and review procedures; experience and educational requirements of attorneys and paralegals; supervisory structure, procedures, and responsibilities; job descriptions and current salaries for all filled and unfilled professional and management positions; and fiscal controls and procedures.
- (3) a budget and budget narrative, which must be submitted within thirty days of receipt of a notice of tentative allocation, explaining how funds will be used to provide civil legal services to indigent persons, especially underserved client groups such as, the elderly, the disabled, juveniles, and non-English-speaking persons within the applicant's service area; and
- (4) information about program activities, such as substantive practice areas, extent and complexity of services, a summary of litigation, and populations served.

**Eligibility Guidelines for Legal Services Projects, Guideline 1.4.**

**If the Commission or staff requests any further information relating to an applicant's eligibility, or related to the amount of the allocation under the Legal Services Trust Fund Program, the applicant must supply that information. However, the Commission is not required to notify applicants if their initial application fails to include information sufficient to demonstrate eligibility. Failure to provide information necessary to the Commission's decisions on eligibility or eligible expenditures (or failure to supply requested information relevant to those decisions) will be grounds for denial of eligibility, or for refusal to recognize part of the applicant's expenditures within the allocation formula. [Rules 3.680(E) and 3.691(A)]**

**Eligibility Guidelines for Legal Services Projects, Guideline 2.3.2.**

**2.3.2. without charge**

***Commentary:***

Payments by clients for costs and expenses or a processing fee of \$20 or less shall not be considered a "charge" for legal services, so long as the processing fee is administered so that it does not prevent indigent persons from receiving services. If you charge a processing fee, you must establish procedures for waiving the fee for all clients who cannot afford it. You must



inform prospective clients of the availability of a waiver at the same time and in the same manner that they are informed of the fee, and in a language the client can understand.

If you charge a processing fee, your application must include information about established procedures for waiving the fee for clients who cannot afford it. The maximum of \$10 per processing fee will be regarded as a qualified expenditure.

If you charge some clients amounts in excess of costs, your application must state the percentage of your work in which such charges are made, and the basis for computing that percentage.

If attorneys' fees are generated through court awards, such fees must be used to provide further civil legal services without charge to indigent persons. [Rule 3.673(B)]

"Costs and expenses" include any out-of-pocket expenses incurred by the organization (or by pro bono attorneys recruited by the organization), including recoverable costs of litigation, copying charges, telephone charges, postage charges, and other out-of-pocket expenses normally charged to clients by attorneys in private practice. An applicant may be considered as providing legal services without charge within the meaning of Guideline 2.3.2 in spite of charges to clients for such items. [Rule 3.673(B)]

#### **Eligibility Guidelines for Legal Services Projects, Guideline 2.3.4.**

##### **2.3.4. who are indigent**

###### ***Commentary:***

An indigent person is defined by the Business and Professions Code §§6213(d), 6213(g), 6213(h), and 6213(i) as follows: "Indigent person means a person whose income is (1) 125 percent or less of the current poverty threshold established by the United States Office of Management and Budget, or (2) who is eligible for Supplemental Security Income or free services under the Older Americans Act or Developmentally Disabled Assistance Act. With regard to a project which provides free services of attorneys in private practice without compensation, indigent person also means a person whose income is 75 percent or less of the maximum levels of income for lower income households as defined in §50079.5 of the Health and Safety Code. For the purpose of this subdivision, the income of a person who is disabled shall be determined after deducting the costs of medical and other disability-related special expenses."

Your application must state the percentage of your organization's services that were provided during the previous calendar year to clients who did not fall within this definition. You must adopt written financial eligibility guidelines. If your eligibility criteria includes persons who are

not indigent within the definition of §6213(d) above, explain how you determined the percentage of clients served that falls outside the definition. If you did not have written financial eligibility guidelines in the prior year, your application must explain the basis of your computation of percentage and supply objective support for the computation. [B&P Code §§6213(d) and 6218]

If you provide legal services for the benefit of a group or class of persons beyond the specific individuals or organizations who are your clients, you may consider the services as “legal services provided to indigent persons” only if the legal matter is primarily for the benefit of indigent persons.

In determining whether a legal matter is primarily for the benefit of indigent persons, the Commission may consider the following factors and any others that aid in making that determination: (1) the forum in which the matter is being pursued, e.g., courts, administrative agency, legislature, etc.; (2) whether named clients are indigent persons or qualifying organizations (under Commentary 2.3.3 above); (3) in the case of a class action, the definition of the class contained in the complaint and proposed or actual class certification orders; (4) a description of the group of individuals that would benefit from a favorable resolution of the legal matter; (5) whether a majority of those who would benefit are indigent persons; (6) the relation of the legal issues raised by the matter to the needs of indigent persons; and (7) whether indigent persons are disproportionately impacted by the legal issues raised by the matter.

If legal services for the benefit of a group or class of persons beyond the specific individuals or organizations who are your clients constitute more than ten percent of your legal services, your application must identify the ten such legal matters on which you expended the largest amount of funds in the prior calendar year. For each of the matters so identified in your application, describe who would benefit from the services, state whether the matter is primarily for the benefit of indigent persons and, if so, explain the reasons you reached that conclusion. For any such matter that is primarily for the benefit of indigent persons, your description should include the information listed as items (1) through (7) in the preceding paragraph; you must quantify the percentage of your clients who are indigent persons (or organizations qualifying under Commentary 2.3.3 above) and the percentage of the persons who would benefit from the services who are indigent persons. Explain the basis of this information. You need not disclose information protected by the attorney-client privilege.

If some portion of your legal services are for the benefit of a group or class of persons beyond your specific clients and are not primarily for the benefit of indigent persons, identify the percentage of overall services provided in such matters and explain the basis of your computation.



Consolidated Financial Statements  
For the Years Ended  
June 30, 2019 and 2018



## Report of Independent Auditors

To the Board of Trustees of the University of Southern California

We have audited the accompanying consolidated financial statements of the University of Southern California and its subsidiaries (collectively the “University”), which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of activities and of cash flows for the years then ended.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the 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 our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the University's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University of Southern California and its subsidiaries as of June 30, 2019 and 2018, and their changes in net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

December 16, 2019

# Consolidated Balance Sheets

in thousands

	June 30, 2019	June 30, 2018
<b>Assets</b>		
1 Cash and cash equivalents	\$1,042,239	\$818,978
2 Accounts receivable, net	471,711	461,051
3 Notes receivable, net	61,066	68,585
4 Pledges receivable, net	462,329	570,186
5 Investments	6,351,236	6,231,311
6 Inventories, prepaid expenses and other assets	386,941	278,831
7 Property, plant and equipment, net	4,363,842	4,174,090
8 <b>Total Assets</b>	<b>\$13,139,364</b>	<b>\$12,603,032</b>
<b>Liabilities</b>		
9 Accounts payable	\$285,359	\$273,631
10 Accrued liabilities	1,373,097	750,430
11 Refundable advances	21,477	15,974
12 Deposits and deferred revenue	257,066	261,894
13 Actuarial liability for annuities payable	104,442	108,842
14 Federal student loan funds	67,936	64,319
15 Asset retirement obligations	132,918	126,865
16 Capital lease obligations	75,869	74,222
17 Bonds and notes payable	1,626,346	1,652,388
18 Other liabilities	6,692	4,936
19 <b>Total Liabilities</b>	<b>3,951,202</b>	<b>3,333,501</b>
<b>Net Assets</b>		
20 Without donor restrictions	4,279,003	4,331,141
21 With donor restrictions	4,909,159	4,938,390
22 <b>Total Net Assets</b>	<b>9,188,162</b>	<b>9,269,531</b>
23 <b>Total Liabilities and Net Assets</b>	<b>\$13,139,364</b>	<b>\$12,603,032</b>

The accompanying notes are an integral part of these statements.

# Consolidated Statements of Activities

in thousands

			Year Ended June 30, 2019
	Without Donor Restrictions	With Donor Restrictions	Total Net Assets
<b>Operating</b>			
<b>Revenues:</b>			
1 Net student tuition and fees	\$1,575,446		\$1,575,446
2 Health care services	1,890,318		1,890,318
3 Contracts and grants	571,059		571,059
4 Auxiliary enterprises	372,584		372,584
5 Sales and services	157,850		157,850
6 Contributions	273,875		273,875
7 Other	139,619		139,619
8 Allocation of endowment spending	245,579		245,579
9 Total Revenues	5,226,330		5,226,330
10 Net assets released from restrictions	228,859	(\$228,859)	
11 <b>Total Revenues and Reclassifications</b>	<b>5,455,189</b>	<b>(228,859)</b>	<b>5,226,330</b>
<b>Expenses:</b>			
12 Salaries and benefits	3,114,194		3,114,194
13 Operating expenses	2,162,650		2,162,650
14 Depreciation	281,159		281,159
15 Interest on indebtedness	64,324		64,324
16 <b>Total Expenses</b>	<b>5,622,327</b>		<b>5,622,327</b>
17 <b>Decrease in Net Assets from Operating Activities</b>	<b>(167,138)</b>	<b>(228,859)</b>	<b>(395,997)</b>
<b>Non-operating</b>			
18 Allocation of endowment spending to operations	(112,895)	(132,684)	(245,579)
19 Changes in funding status of defined benefit plan	13,165		13,165
20 Investment and endowment income	88,343	549	88,892
21 Net appreciation in fair value of investments	59,833	155,668	215,501
22 Contributions	5,973	166,914	172,887
23 Present value adjustment to annuities payable		9,181	9,181
24 <b>Increase in Net Assets from Non-operating Activities</b>	<b>54,419</b>	<b>199,628</b>	<b>254,047</b>
25 <b>Total decrease in Net Assets</b>	<b>(112,719)</b>	<b>(29,231)</b>	<b>(141,950)</b>
26 Beginning Net Assets	4,331,141	4,938,390	9,269,531
27 Cumulative effect of accounting change	60,581		60,581
28 Beginning Net Assets, as restated	4,391,722	4,938,390	9,330,112
29 <b>Ending Net Assets</b>	<b>\$4,279,003</b>	<b>\$4,909,159</b>	<b>\$9,188,162</b>

The accompanying notes are an integral part of these statements.

# Consolidated Statements of Activities

in thousands

			Year Ended June 30, 2018
	Without Donor Restrictions	With Donor Restrictions	Total Net Assets
<b>Operating</b>			
<b>Revenues:</b>			
1 Student tuition and fees	\$2,043,455		\$2,043,455
2 Less financial aid	(556,121)		(556,121)
3 Net student tuition and fees	1,487,334		1,487,334
4 Health care services	1,726,724		1,726,724
5 Contracts and grants	515,956		515,956
6 Auxiliary enterprises	375,898		375,898
7 Sales and services	163,052		163,052
8 Contributions	292,758		292,758
9 Other	138,208		138,208
10 Allocation of endowment spending	236,896		236,896
11 Total Revenues	4,936,826		4,936,826
12 Net assets released from restrictions	155,927	(\$155,927)	
13 <b>Total Revenues and Reclassifications</b>	<b>5,092,753</b>	<b>(155,927)</b>	<b>4,936,826</b>
<b>Expenses:</b>			
14 Salaries and benefits	2,808,353		2,808,353
15 Operating expenses	1,693,235		1,693,235
16 Depreciation	261,462		261,462
17 Interest on indebtedness	65,725		65,725
18 <b>Expenses before Settlement</b>	<b>4,828,775</b>		<b>4,828,775</b>
19 <b>Increase (decrease) in Net Assets from Operating Activities before Settlement</b>	<b>263,978</b>	<b>(155,927)</b>	<b>108,051</b>
20 Settlement (refer to Note 14)	215,000		215,000
21 <b>Increase (decrease) in Net Assets from Operating Activities</b>	<b>48,978</b>	<b>(155,927)</b>	<b>(106,949)</b>
<b>Non-operating</b>			
22 Allocation of endowment spending to operations	(97,462)	(139,434)	(236,896)
23 Changes in funding status of defined benefit plan	23,433		23,433
24 Investment and endowment income	67,665	737	68,402
25 Net appreciation in fair value of investments	124,229	336,557	460,786
26 Contributions	13,083	265,664	278,747
27 Present value adjustment to annuities payable		1,790	1,790
28 <b>Increase in Net Assets from Non-operating Activities</b>	<b>130,948</b>	<b>465,314</b>	<b>596,262</b>
29 <b>Total increase in Net Assets</b>	<b>179,926</b>	<b>309,387</b>	<b>489,313</b>
30 Beginning Net Assets	4,151,215	4,629,003	8,780,218
31 <b>Ending Net Assets</b>	<b>\$4,331,141</b>	<b>\$4,938,390</b>	<b>\$9,269,531</b>

The accompanying notes are an integral part of these statements.

# Consolidated Statements of Cash Flows

in thousands

	Year Ended June 30, 2019	Year Ended June 30, 2018
<b>Cash Flows from Operating Activities</b>		
1 <b>Change in Net Assets</b>	<b>(\$81,369)</b>	<b>\$489,313</b>
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
2 Depreciation and amortization	281,159	261,462
3 Loss on the disposal/sale of plant assets	248	1,160
4 In-kind receipt of property, plant and equipment	(4,797)	(1,624)
5 Present value adjustment to annuities payable	(9,003)	(1,663)
6 Increase in accounts receivable	(10,660)	(54,421)
7 Decrease (increase) in pledges receivable	9,528	(64,109)
8 Increase in inventories, prepaid expenses and other assets	(22,472)	(46,188)
9 Decrease in accounts payable	(410)	(34,017)
10 Increase in accrued liabilities	505,825	263,974
11 Increase (decrease) in refundable advances	5,503	(2,216)
12 (Decrease) increase in deposits and deferred revenue	(4,827)	15,253
13 Increase in other liabilities	1,756	1,493
14 Contributions restricted for property, plant and equipment and permanent investment	(163,965)	(242,161)
15 Net realized gain on sale of investments	(185,014)	(228,398)
16 Net unrealized appreciation in investments	(28,396)	(232,402)
17 <b>Net Cash provided by Operating Activities</b>	<b>293,106</b>	<b>125,456</b>
<b>Cash Flows from Investing Activities</b>		
18 Proceeds from note collections	12,972	16,372
19 Notes issued	(4,612)	(10,251)
20 Proceeds from sale and maturity of investments	4,775,556	4,471,561
21 Purchase of investments	(4,652,547)	(4,495,337)
22 Purchase of property, plant and equipment	(448,171)	(420,545)
23 <b>Net Cash used in Investing Activities</b>	<b>(316,802)</b>	<b>(438,200)</b>
<b>Cash Flows from Financing Activities</b>		
Contributions restricted for permanent investment:		
24 Endowment	190,368	223,520
25 Plant	70,632	139,252
26 Trusts and other	1,292	1,947
27 Repayment of long-term debt	(23,555)	(1,400)
28 Increase (decrease) in federal student loan funds	3,617	(1,330)
29 Investment gain (loss) on annuities payable	8,500	(6,667)
30 Payment on annuities payable	(11,007)	(11,315)
31 Increase to annuities payable resulting from new contributions	7,110	4,210
32 <b>Net Cash provided by Financing Activities</b>	<b>246,957</b>	<b>348,217</b>
33 <b>Net increase in Cash and Cash equivalents</b>	<b>223,261</b>	<b>35,473</b>
34 Cash and Cash equivalents at beginning of year	818,978	783,505
35 <b>Cash and Cash equivalents at end of year</b>	<b>\$1,042,239</b>	<b>\$818,978</b>

The accompanying notes are an integral part of these statements.



## Notes to Consolidated Financial Statements

### Note 1.

#### Significant Accounting Policies Followed by the University of Southern California are Set Forth Below:

##### General:

The University of Southern California (“university”) is a not-for-profit (“NFP”), major private research university. The university is generally exempt from federal income taxes under the provisions of Internal Revenue Code Section 501(c)(3). The university is also generally exempt from payment of California state income, gift, estate and inheritance taxes.

##### Basis of Presentation:

The consolidated financial statements have been prepared on the accrual basis of accounting, in accordance with accounting principles generally accepted in the United States of America and with the provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*, which requires the university to classify its net assets into two categories according to donor-imposed restrictions: net assets without donor-imposed restrictions and net assets with donor-imposed restrictions. All material transactions between the university and its subsidiaries have been eliminated.

##### Net Assets Without and With Donor Restrictions:

Net assets without donor restrictions are the part of net assets of a not-for-profit entity that are not subject to donor-imposed restrictions. A donor-imposed restriction is a donor stipulation that specifies a use for a contributed asset that is more specific than broad limits resulting from the following: a) the nature of the not-for-profit entity, b) the environment in which it operates and c) the purposes specified in its articles of incorporation or bylaws or comparable documents.

This classification includes all revenues, gains and expenses not restricted by donors. The university reports all expenses, with the exception of investment expenses, which are required to be netted against investment return, in this class of net assets, since the use of restricted contributions in accordance with donors’ stipulations results in the release of the restriction.

The part of net assets of a not-for-profit entity that is subject to donor-imposed restrictions includes contributions for which donor-imposed restrictions have not been met (primarily future capital projects), endowment appreciation, charitable remainder unitrusts, pooled income funds, gift annuities and pledges receivable.

##### Measure of Operations:

The university’s measure of operations as presented in the consolidated statements of activities includes revenue from tuition (net of certain scholarships and fellowships) and fees, grants and contracts, health care services, contributions for operating programs, the allocation of endowment spending for operations and other revenues. Operating expenses are reported on the consolidated statements of activities by natural classification.

The university’s non-operating activity within the consolidated statements of activities includes investment returns and other activities related to endowment, long-term benefit plan obligation funding changes, student loan net assets and contributions related to land, buildings and equipment that are not part of the university’s operating activities.

##### Other Accounting Policies:

Cash and cash equivalents consist of U.S. Treasury bills, certificates of deposit, money market funds and all other short-term investments available for current operations with original maturities of 90 days or less at the time of purchase.

## Notes to Consolidated Financial Statements

### Note 1. (continued)

Investments are stated at fair value. Net appreciation (depreciation) in the fair value of investments, which consists of the realized gains or losses and the unrealized appreciation (depreciation) on those investments, is shown in the consolidated statements of activities. Realized gains and losses upon the sale of investments are calculated using the specific identification method and trade date.

Alternative investment holdings and certain other limited partnership interests are invested in both publicly traded and privately owned securities. The fair values of private investments are based on estimates and assumptions of the general partners or partnership valuation committees in the absence of readily determinable market values. Such valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments and other pertinent information.

The university applies the provision of FASB ASC 820, *Fair Value Measurements*, which defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the university for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

- Level I - Quoted prices in active markets for identical assets or liabilities.
- Level II - Inputs other than Level I that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities.
- Level III - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level III investments are valued by the university based upon valuation information received from the relevant entity, which may include last trade information, third-party appraisals of real estate or valuations prepared by custodians for assets held in trusts by other trustees where the university is named as a beneficiary. The university may also utilize industry standard valuation techniques, including discounted cash flow models. Significant increases or decreases in these inputs in isolation may result in a significantly lower or higher fair value measurement, respectively.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The university applies the authoritative guidance contained in FASB ASC 820-10, *Fair Value Measurements and Disclosures*, for estimating the fair value of investments in investment funds that have calculated Net Asset Value (NAV) per share in accordance with FASB ASC 946-10, Financial Services-Investment Companies (formerly the American Institute of Certified Public Accountants Audit and Accounting Guide, Investment Companies). According to this guidance, in circumstances in which NAV per share of an investment is not determinative of fair value, a reporting entity is permitted to estimate the fair value of an investment in an investment fund using the NAV per share of the investment (or its equivalent) without further adjustment, if the NAV per share of the investment is determined in accordance with FASB ASC 946-10 as of the reporting entity's measurement date. Accordingly, the university uses the NAV as reported by the money managers as a practical expedient to determine the fair value of investments in investment funds which (a) do not have a readily determinable fair value and (b) either have the attributes of an investment fund or prepare their financial statements consistent with the measurement principles of an investment fund. At June 30, 2019 and 2018, the fair value of all such investments in investment funds has been determined by using NAV as a practical expedient, adjusted for capital calls, distributions and significant known valuation changes, if any, of its related portfolio.

Inventories are valued at the lower of cost (first-in, first-out) or market.

## Notes to Consolidated Financial Statements

### Note 1. (continued)

Property, plant and equipment, including collections of works of art and historical treasures, are stated at cost or fair value at the date of contribution, plus the estimated value of any associated legal retirement obligations, less accumulated depreciation, computed on a straight-line basis over the estimated useful or component lives of the assets (equipment and library books useful lives ranging from 4 to 10 years and buildings component lives ranging from 5 to 50 years). Equipment is removed from the records at the time of disposal. The university follows the policy of recording contributions of long-lived assets directly in without donor restrictions, when the asset is placed in service.

The university's split interest agreements with donors consist primarily of gift annuities, unitrusts, pooled income funds and life estates. For irrevocable agreements, assets contributed are included in the university's investments and stated at fair value. Contribution revenue is recognized at the date each trust is established after recording liabilities for the actuarially determined present value of the estimated future payments to be made to the beneficiaries. The actuarial liability is discounted at an appropriate risk-adjusted rate at the inception of each agreement and the applicable actuarial mortality tables. Discount rates on split interest agreements range from 2.2% to 7.5%. The liabilities are adjusted during the terms of the trusts for changes in the fair value of the assets, accretion of discounts and other changes in the estimates of future benefits. The valuation follows generally accepted actuarial methods and is based on the requirements of FASB ASC 958.

The 2012 Individual Annuity Mortality Basic Table (without margin) for Males and Females with Projection Scale G2 for Males and Females were used in the valuations. For split interest agreements related to the state of Washington, the university holds a Certificate of Exemption issued by the state of Washington's Office of Insurance Commissioner to issue charitable gift annuities. The university has been in compliance with Revised Code of Washington 48.38.010(6) throughout the time period covered by the financial statements.

The university has recorded conditional asset retirement obligations associated with the legally required removal and disposal of certain hazardous materials, primarily asbestos, present in its facilities. When an asset retirement obligation is identified, the university records the fair value of the obligation as a liability. The fair value of the obligation is also capitalized as property, plant and equipment and then amortized over the estimated remaining useful life of the associated asset. The fair value of the conditional asset retirement obligations is estimated using a probability weighted, discounted cash flow model. The present value of future estimated cash flows is calculated using the credit adjusted interest rate applicable to the university in order to determine the fair value of the conditional asset retirement obligations. For the years ended June 30, 2019 and 2018, the university recognized accretion expense related to conditional asset retirement obligations of approximately \$6,526,000 and \$6,237,000, respectively. For the years ended June 30, 2019 and 2018, the university settled asset retirement obligations of approximately \$944,000 and \$1,000,000, respectively. As of June 30, 2019 and 2018, included in the consolidated balance sheets are asset retirement obligations of \$132,918,000 and \$126,865,000, respectively.

The university recognizes tuition and fees revenue on a straight-line basis over each academic session based on gross price, net of explicit price concessions such as scholarships, discounts and waivers ("Financial aid"), and is displayed in the consolidated statements of activities in "Tuition and fees". Given the timing of each year's academic sessions, nearly all performance obligations are satisfied by the university within the fiscal year. Tuition and fees revenue is derived from degree programs and executive and continuing education programs. Financial aid is awarded to students based on need and merit. Financial aid does not include payments made to students for services rendered to the university.

Financial aid for the year ended June 30, 2019, consists of the following (in thousands):

	Undergraduate	Graduate	Total
Institutional scholarships	\$330,683	\$170,758	\$501,441
Endowed scholarships	36,488	18,842	55,330
External financial aid	30,182	15,585	45,767
<b>Total</b>	<b>\$397,353</b>	<b>\$205,185</b>	<b>\$602,538</b>

## Notes to Consolidated Financial Statements

### Note 1. (continued)

Financial aid for the year ended June 30, 2018, consists of the following (in thousands):

	Undergraduate	Graduate	Total
Institutional scholarships	\$302,203	\$166,884	\$469,087
Endowed scholarships	28,938	15,980	44,918
External financial aid	27,132	14,984	42,116
<b>Total</b>	<b>\$358,273</b>	<b>\$197,848</b>	<b>\$556,121</b>

Room and board revenues are included as part of auxiliary enterprises, however the revenue recognition process mirrors that for tuition and fees. Each of these items is supported by separate contracts entered into between the university and the individual student. Tuition and fees and room and board revenues are recognized as operating revenue in the period in which the university satisfies its performance obligations to its students. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of accounting in ASC 606. The university's performance obligations are to provide education to the student and, in certain instances, other performance obligations such as room and board. The value that is recognized for each performance obligation is set forth in publicly available university price lists, which the university believes approximates the stand alone selling price, and is codified in the individual contracts with each student. Individual contracts for tuition and fees and room and board display the transaction price on a standalone basis for each service to be provided to each specific student. Additionally, the contract will contain the price adjustment in the form of financial aid grants that are being awarded to the student.

The timing(s) of billings, cash collections and revenue recognition results in accounts receivable and deferred revenue and student deposits on the consolidated statements of financial position. Receivables are recognized only to the extent that the university has an unconditional right to consideration to which it is entitled in exchange for goods and services transferred to the student. Receipts received in advance of goods and services performed are recorded as deferred revenue and student deposits.

Sponsored research agreements are primarily considered non-exchange transactions which are recognized in contracts and grants revenue on the consolidated statements of activities as the associated barriers are overcome, which generally is as allowable expenditures under such agreements are incurred. Non-exchange agreements are considered conditional if the terms of the agreement include both a right of return/release of assets received/promised and a barrier. Any funding received in advance of expenditure is recorded as a refundable advance. For sponsored research agreements considered to be exchange transactions, revenues are recognized as performance obligations are satisfied which in most cases mirrors the timing of when related costs are incurred. Net assets include contributions to the university and its various schools and departments. The university has determined that any donor-imposed restrictions of contributions for current or developing programs and activities are generally met within the operating cycle of the university and therefore, the university's policy is to record these net assets as without donor restrictions. Internally designated net assets are those which have been appropriated by the Board of Trustees or designated by management, and reflected in net assets without donor restrictions.

The university receives federal reimbursement for a portion of the costs of its facilities and equipment used in organized sponsored research. The federal Office of Management and Budget establishes principles for determining such reimbursable costs and requires conformity of the lives and methods used for federal cost reimbursement accounting and financial reporting purposes. The university's policies and procedures are in conformity with these principles.

Contributions from donors, including contributions receivable (unconditional promises to give), are recorded as revenues in the year received. Noncash contributions are recorded at fair value using quoted market prices, market prices for similar assets, independent appraisals or appraisals performed by university management. Contributions receivable are reported at their discounted value using credit-adjusted borrowing rates and an allowance for amounts estimated to be uncollectible is provided. Donor-restricted contributions, which are received and either spent or deemed spent within the same year, are reported as revenue without donor restrictions.

## Notes to Consolidated Financial Statements

### Note 1. (continued)

Contributions of long-lived assets with no donor-imposed time restrictions are reported as revenue without donor restrictions in the year received. Contributions restricted to the acquisition or construction of long-lived assets or subject to other time or purpose restrictions are reported as revenue with donor restrictions. The donor-restricted net assets resulting from these contributions are released to net assets without donor-restricted when the donor-imposed restrictions are fulfilled or the assets are placed in service. Contributions received for endowment investment are held in perpetuity and recorded as revenue with donor restrictions. Included in contributions on the consolidated statements of activities is a reclassification of private contracts and grants revenue. For the years ended June 30, 2019 and 2018, the university recognized approximately \$145,000,000 and \$164,000,000 of private contracts and grants revenue in contributions on the consolidated statements of activities.

Health care services revenues include the net patient service revenues associated with Keck Hospital of USC, USC Norris Cancer Hospital, USC Verdugo Hills Hospital and USC Care Medical Group, Inc. Healthcare services revenue is reported at the amount that reflects the consideration to which the organization expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors, government programs and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, the university bills patients and third-party payors several days after the services are performed or the patient is discharged. Revenue is recognized as performance obligations are satisfied. Health care services revenues also include the revenues associated with the professional services agreement with the County of Los Angeles.

The majority of the Hospitals' services are rendered to patients with commercial or managed care insurance, or under the federal Medicare and California State Medi-Cal programs. Reimbursement from these various payors is based on a combination of prospectively determined rates per discharge, per diem payments, discounted charges and reimbursed costs. Amounts received under the Medicare program are subject to retroactive settlements based on review and final determination by program intermediaries or their agents. The gross charges may be reduced by explicit price concessions, which include contractual adjustments based on agreements with third party payors or implicit price concessions provided to uninsured patients. Provisions for contractual adjustments and retroactive settlements related to these payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as additional information becomes known or as final settlements are determined.

Net patient service revenue is recorded over time during the period these performance obligations are satisfied and at the determined transaction price, which represents the estimated net realizable amounts due from patients, third-party payers and others for health care services rendered. Estimated net realizable amounts represent amounts due, net of implicit and explicit price concessions. Implicit price concessions are based on management's assessment of expected net collections considering economic conditions, historical experience, trends in health care coverage and other collection indicators. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. The university believes this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in our hospitals receiving inpatient acute care or patients receiving care in our outpatient centers. The university measures the performance obligation from admission into the hospital or commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services.

Sales and Services revenue include revenues from university pharmacies and student clinics. The university recognizes revenue as it provides pharmaceutical products and consultative services to the community (students, faculty, staff, retired employees, alumni, broader Los Angeles market). The transaction price is the amount the university expects to be entitled to in exchange for the products provided (either published rates available on the university pharmacy websites or agreed upon rates from third party payers). Retail pharmacy sales revenue is recognized at a point in time when the pharmaceutical is provided to the patient, and consultative services, although the performance obligation meets over time revenue recognition as the patient benefits over time from the university, revenue is recognized at a point in time. This is due to consultative services being outpatient in nature, and thus, all services are provided on the same day.



## Notes to Consolidated Financial Statements

### Note 1. (continued)

Auxiliary enterprise revenue includes multiple revenue streams which are included in the consolidated statements of activities, and reported as net assets without donor restrictions. These multiple revenue streams include point of sale transactions from hospitality, food, beverage, bookstore transactions, transportation and revenue generated from athletics. Revenue generated from hospitality, food, beverage, and bookstore goods is recognized at a point in time, and the value that is recognized for each performance obligation is explicitly listed at each location, which the university believes approximates the stand alone transaction price. The transaction price for revenue related to athletics is publicly available on the university Ticket Office website. The performance obligation related to football season tickets is completely satisfied within the fiscal year, and any season ticket sales that occur in advance of the next fiscal year are recognized as deferred revenue.

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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Certain reclassifications have been made to prior years' financial statements for comparative purposes.

### Recent Accounting Pronouncements:

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 outlines a single comprehensive standard for revenue recognition across all industries and supersedes most existing revenue recognition guidance. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of the financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Under ASC 606, amounts recognized as bad debt expense related to healthcare services under the previous revenue recognition guidance are considered implicit price concessions which reduce the revenue that is recorded and no longer requires the presentation of allowance for doubtful accounts. Prior to the adoption of ASC 606, the university presented healthcare services revenue net of bad debt expense and accounts receivable related to patient care, net of allowance for doubtful accounts. Therefore, there was no impact to the presentation of revenue on the consolidated statements of activities as a result of adopting the standard, and the presentation of patient care receivables on the consolidated balance sheets. Furthermore, as a result of this adoption, tuition and fees revenue are recorded net of explicit price concessions such as scholarships, discounts and waivers ("Financial aid"), and displayed in the consolidated statements of activities in "Tuition and fees". Prior to the adoption of ASC 606, the university presented tuition and fees revenue less financial aid on the consolidated statements of activities. The university adopted this standard for fiscal year 2019 using the modified retrospective method for all contracts that are not completed at the adoption date. The adoption of this standard did not materially impact the university's financial position.

In January 2016, the FASB issued Accounting Standards Update (ASU) 2016-01, *Financial Instruments—Overall Recognition and Measurement of Financial Assets and Financial Liabilities*. This update impacts all organizations that hold financial assets and liabilities and changes how these organizations will recognize, measure, present, and disclose information about certain financial instruments. ASU 2016-01 is effective for annual reporting periods beginning after December 15, 2018. The university is currently evaluating the effect of adoption to the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. ASU 2016-02 requires recognition of rights and obligations arising from lease contracts, including existing and new arrangements, as assets and liabilities on the consolidated balance sheets. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018. The university is currently evaluating the effect of adoption to the financial statements.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. The standard addresses the classification of certain transactions within the statement of cash flows, including cash payments for debt repayment or debt extinguishment costs, contingent considerations payments made after a business combination, and distribution received from equity method investments. The ASU is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The university is currently evaluating the effect of adoption to the financial statements.

## Notes to Consolidated Financial Statements

### Note 1. (continued)

In November 2016, the FASB issued ASU 2016-18, a standard on Restricted Cash. This standard requires that the Consolidated Statement of Cash Flows explain the change during the period in the total of cash, cash equivalents, restricted cash and restricted cash equivalents (“Total Cash”). Additionally, a disclosure describing the nature of the restrictions and a reconciliation of Total Cash to the amounts of Cash and cash equivalents presented on the consolidated balance sheet is required. The ASU is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The university is currently evaluating the effect of adoption to the financial statements.

In March 2017, the FASB issued ASU 2017-17, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which requires that an employer report the service cost component of pension costs in the same line item as employee compensation costs within operating income. The other components of net benefit cost are required to be presented in the consolidated statements of activities separately from the service cost component and outside a subtotal of income from operations, and will not be eligible for capitalization. The ASU is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The university is currently evaluating the effect of adoption to the financial statements.

In June 2018, the FASB issued ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The standard is intended to clarify and improve the scope and the accounting guidance for contributions received and made. The ASU is effective for fiscal years beginning after June 15, 2018, including interim periods within that annual period. Early adoption is permitted. The university adopted this standard, on a modified prospective basis for fiscal year 2019, and the adoption of this standard did not materially impact the university’s financial position.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820) Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. This standard removes certain disclosures, modifies certain disclosures and adds additional disclosures related to fair value measurement. The ASU is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The university is currently evaluating the effect of adoption to the financial statements.

### Note 2.

#### Liquidity and Availability:

USC’s financial assets available within one year of the consolidated balance sheet date for general expenditure are as follows as of June 30 (in thousands):

	Year Ended June 30, 2019	Year Ended June 30, 2018
<b>Total assets at year end</b>	\$13,139,364	\$12,603,032
<i>Less:</i>		
Notes receivable due in more than one year	(9,337)	(11,562)
Pledges receivable due in more than one year	(381,413)	(454,270)
Donor-restricted endowment funds	(4,222,348)	(4,060,117)
Board-designated endowment funds	(1,517,217)	(1,484,150)
Annuities and living trusts	(169,328)	(168,332)
Inventories, prepaid expenses and other assets	(127,154)	(124,080)
Property, plant and equipment	(4,363,842)	(4,174,090)
<b>Financial assets available at year end for current use</b>	<b>\$2,348,725</b>	<b>\$2,126,431</b>

## Notes to Consolidated Financial Statements

### Note 2. (continued)

The university's endowment funds consist of donor-restricted and board-designated endowment funds. Income from donor-restricted endowments is restricted for specific purposes and therefore, is not available for general expenditure. As described in Note 7, for fiscal year 2019 and 2018, the Board of Trustees approved current distribution of 100% of the prior year's payout, within a minimum of 4% and a maximum of 6% of the average market value for the previous 12 calendar quarters. Under the provision of the spending rule, for fiscal year 2019 and 2018, the Board of Trustees approved an endowment pool payout of \$29.45 a share, for a total spending rule allocation of \$246,551,000 and \$233,765,000. As described in Note 6, the university also has unfunded commitments on alternative investments totaling \$749,821,000 and \$656,181,000 for fiscal year 2019 and 2018.

As part of the university's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. In addition, the university invests cash in excess of daily requirements in short-term investments. To help manage unanticipated liquidity needs, the university has committed lines of credit in the amount of \$500,000,000, which it could draw upon. Additionally, the university has a board-designated endowment of \$1,517,217,000 as of June 30, 2019. Although the university does not intend to spend from its board-designated endowment funds other than amounts appropriated for general expenditures as part of its annual budget approval and appropriation process, amounts from its board-designated endowment could be made available if necessary. However, both the board-designated endowment fund and donor-restricted endowments contain investments with lock-up provisions that reduce the total investments that could be made available (see Note 6 for disclosures about investments).

### Note 3.

#### Accounts Receivable:

Accounts receivable are summarized as follows at June 30 (in thousands):

	2019	2018
U.S. Government	\$40,010	\$37,938
Student and other, net of allowance for doubtful accounts of \$12,505 (2019), \$12,505 (2018)	157,919	187,992
Patient care, net of allowance for doubtful accounts of \$0 (2019), \$13,999 (2018)	273,782	235,121
<b>Total</b>	<b>\$471,711</b>	<b>\$461,051</b>

### Note 4.

#### Notes and Loans Receivable:

The university is required to disclose the nature of credit risk inherent in the portfolio of financing receivables, its analysis and assessment in arriving at the allowance for credit losses (doubtful accounts) and the changes and reasons for those changes in the allowance for credit losses.



## Notes to Consolidated Financial Statements

### Note 4. (continued)

Long-term financing receivables as of June 30, 2019, consist of the following (in thousands):

	June 30, 2019	
	Financing Receivables, Gross	Allowance for Doubtful Accounts
		Net
Perkins loans	\$38,255	\$38,255
University student loans	8,552	(\$2,106)
Other student loans	16,365	16,365
<b>Total student loans</b>	63,172	(2,106)
Faculty and other loans	31,052	31,052
<b>Total</b>	<b>\$94,224</b>	<b>(\$2,106)</b>

Long-term financing receivables as of June 30, 2018, consist of the following (in thousands):

	June 30, 2018	
	Financing Receivables, Gross	Allowance for Doubtful Accounts
		Net
Perkins loans	\$45,734	\$45,734
University student loans	11,547	(\$2,968)
Other student loans	14,272	14,272
<b>Total student loans</b>	71,553	(2,968)
Faculty and other loans	33,532	33,532
<b>Total</b>	<b>\$105,085</b>	<b>(\$2,968)</b>

Management regularly assesses the adequacy of the allowance for credit losses by performing ongoing evaluations of the student loan portfolio, including such factors as the differing economic risks associated with each loan category, the financial condition of specific borrowers, the economic environment in which the borrowers operate, the level of delinquent loans, the value of any collateral and where applicable, the existence of any guarantees or indemnifications. The university's Perkins loans represent the amounts due from current and former students under the Federal Perkins Loan Program. Loans disbursed under the Federal Perkins Loan Program are able to be assigned to the federal government in certain non-repayment situations. In these situations, the federal portion of the loan balance is guaranteed. Included in other student loans are loans related to the Federal Health Professional Student Loan Program and Loans for Disadvantaged Students.

Factors also considered by management when performing its assessment of the adequacy of the allowance, in addition to general economic conditions and the other factors described above include, but are not limited to a detailed review of the aging of the student loan receivable detail and a review of the default rate by loan category in comparison to prior years. The level of the allowance is adjusted based on the results of management's analysis. It is the university's policy to write off a loan only when it is deemed to be uncollectible.

## Notes to Consolidated Financial Statements

### Note 4. (continued)

The following table illustrates the aging analysis of receivables as of June 30, 2019 (in thousands):

	1-60 Days Past Due	61-90 Days Past Due	> 91 Days Past Due	Current	Total Financing Receivables
Perkins loans	\$1,188	\$273	\$6,281	\$30,513	\$38,255
University student loans	135	14	4,221	4,182	8,552
Other student loans	172	-	224	15,969	16,365
<b>Total student loans</b>	<b>1,495</b>	<b>287</b>	<b>10,726</b>	<b>50,664</b>	<b>63,172</b>
Faculty and other loans				31,052	31,052
<b>Total</b>	<b>\$1,495</b>	<b>\$287</b>	<b>\$10,726</b>	<b>\$81,716</b>	<b>\$94,224</b>

The following table illustrates the aging analysis of receivables as of June 30, 2018 (in thousands):

	1-60 Days Past Due	61-90 Days Past Due	> 91 Days Past Due	Current	Total Financing Receivables
Perkins loans	\$1,164	\$210	\$6,865	\$37,495	\$45,734
University student loans	277	14	5,940	5,316	11,547
Other student loans	417	8	308	13,539	14,272
<b>Total student loans</b>	<b>1,858</b>	<b>232</b>	<b>13,113</b>	<b>56,350</b>	<b>71,553</b>
Faculty and other loans				33,532	33,532
<b>Total</b>	<b>\$1,858</b>	<b>\$232</b>	<b>\$13,113</b>	<b>\$89,882</b>	<b>\$105,085</b>

Considering the other factors already discussed herein, management considers the allowance for credit losses to be prudent and reasonable. Furthermore, the university's allowance is general in nature and is available to absorb losses from any loan category. Management believes that the allowance for credit losses at June 30, 2019 and 2018, is adequate to absorb credit losses inherent in the portfolio as of these dates.

As part of the program to attract and retain exemplary faculty and senior staff, the university provides home mortgage financing assistance. Notes receivable amounting to \$31,052,000 and \$33,532,000 were outstanding as of June 30, 2019 and 2018, respectively, and are collateralized by deeds of trust. No allowance for doubtful accounts has been recorded against these loans based on their collateralization and prior collection history. At June 30, 2019, there were no amounts past due under the faculty and staff loan program.

Determination of the fair value of notes receivable, which are primarily federally sponsored student loans with U.S. government-mandated interest rates and repayment terms, and subject to significant restrictions as to their transfer or disposition, could not be made without incurring excessive costs.

### Note 5.

#### Pledges Receivable:

Unconditional promises are included in the consolidated financial statements as pledges receivable and revenue in the appropriate net asset category. Pledges are recorded after discounting using rates ranging from 1% to 6% in order to derive the present value of the future cash flows.

## Notes to Consolidated Financial Statements

### Note 5. (continued)

Unconditional promises are expected to be realized in the following periods as of June 30 (in thousands):

	2019	2018
Less than one year	\$80,916	\$115,916
One to five years	313,667	362,714
More than five years	194,727	242,007
Less: discount	(75,398)	(94,478)
Less: allowance	(51,583)	(55,973)
<b>Total</b>	<b>\$462,329</b>	<b>\$570,186</b>

Pledges receivable at June 30 have the following restrictions (in thousands):

	2019	2018
Endowment for departmental programs and activities	\$203,837	\$254,888
Endowment for scholarship	28,133	28,492
Building construction	97,515	144,507
Departmental programs and activities	132,844	142,299
<b>Total</b>	<b>\$462,329</b>	<b>\$570,186</b>

Conditional pledges for the university, which depend on the occurrence of specified future and uncertain events, at June 30, 2019 and 2018, was \$316,536,000 and \$345,517,000, respectively. The majority of these conditional pledges are related to construction of the Ellison Institute for Transformative Medicine, as well as the renovation of the Los Angeles Memorial Coliseum.

### Note 6.

#### Investments:

Investments consist of the following at June 30 (in thousands):

	2019	2018
Equities	\$2,344,188	\$2,291,991
Fixed income securities	1,024,505	1,114,134
Alternative investments:		
Hedge funds	1,217,195	1,107,682
Private capital	1,340,500	1,360,698
Real estate and other	276,671	207,078
Assets held by other trustees	148,177	149,728
<b>Total</b>	<b>\$6,351,236</b>	<b>\$6,231,311</b>

## Notes to Consolidated Financial Statements

### Note 6. (continued)

The following table summarized the levels of financial instruments carried at fair value as defined by ASC 820 valuation hierarchy defined previously, for the year ended June 30, 2019 (in thousands):

	Level I	Level II	Level III	NAV	Total
Investments:					
Equities	\$2,133,797	\$984	\$94,425	\$114,982	\$2,344,188
Fixed income securities	263,994	736,046	24,464		1,024,504
Hedge funds				1,217,196	1,217,196
Private capital				1,340,500	1,340,500
Real estate and other			30,566	246,105	276,671
Assets held by other trustees			148,177		148,177
<b>Total</b>	<b>\$2,397,791</b>	<b>\$737,030</b>	<b>\$297,632</b>	<b>\$2,918,783</b>	<b>\$6,351,236</b>

The following table summarized the levels of financial instruments carried at fair value as defined by ASC 820 valuation hierarchy defined previously, for the year ended June 30, 2018 (in thousands):

	Level I	Level II	Level III	NAV	Total
Investments:					
Equities	\$2,081,176	\$738	\$94,416	\$115,661	\$2,291,991
Fixed income securities	324,488	757,909	31,737		1,114,134
Hedge funds				1,107,682	1,107,682
Private capital				1,360,698	1,360,698
Real estate and other			36,245	170,833	207,078
Assets held by other trustees			149,728		149,728
<b>Total</b>	<b>\$2,405,664</b>	<b>\$758,647</b>	<b>\$312,126</b>	<b>\$2,754,874</b>	<b>\$6,231,311</b>

The following table summarized the university's Level III reconciliation of investments for the year ended June 30, 2019 (in thousands):

	Beginning Balance	Purchases	Sales and Maturities	Realized Gain/(Loss)	Unrealized Gain/(Loss)	Transfers In	Transfers Out	Ending Balance
Investments:								
Equities	\$94,416					\$9		\$94,425
Fixed income securities	31,737	\$34,523	(\$41,437)	\$160	(\$70)		(\$449)	24,464
Real estate and other	36,245		(4,480)	(1,350)	237		(86)	30,566
Assets held by other trustees	149,728	4,979	(8,298)	1,787	(19)			148,177
<b>Total</b>	<b>\$312,126</b>	<b>\$39,502</b>	<b>(\$54,215)</b>	<b>\$597</b>	<b>\$148</b>	<b>\$9</b>	<b>(\$535)</b>	<b>\$297,632</b>

## Notes to Consolidated Financial Statements

### Note 6. (continued)

The following table summarized the university's Level III reconciliation of investments for the year ended June 30, 2018 (in thousands):

	Beginning Balance	Purchases	Sales and Maturities	Realized Gain/(Loss)	Unrealized Gain/(Loss)	Transfers In	Transfers Out	Ending Balance
Investments:								
Equities	\$83,402				\$11,014			\$94,416
Fixed income securities	29,289	\$41,104	(\$38,324)	\$276	(608)			31,737
Real estate and other	43,600	34	(6,674)	(820)	200		(\$95)	36,245
Assets held by other trustees	146,120				3,608			149,728
<b>Total</b>	<b>\$302,411</b>	<b>\$41,138</b>	<b>(\$44,998)</b>	<b>(\$544)</b>	<b>\$14,214</b>	<b>\$0</b>	<b>(\$95)</b>	<b>\$312,126</b>

The university uses the NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company.

Investment income and gains presented on the consolidated statements of activities contains endowment appreciation utilized to fund the spending rule, and investment income net of expenses. Current year investment return reported in non-operating activities is net of external and direct internal investment costs, reduced by endowment appreciation utilized to fund the spending rule. The university's total investment return for the years ended June 30, 2019 and 2018, was \$304,393,000 and \$529,188,000, respectively.

## Notes to Consolidated Financial Statements

### Note 6. (continued)

The following table lists investments by major category for the year ending June 30, 2019 (in thousands):

At June 30, 2019

Category of Investment	Investment Strategy	Fair Value Determined Using NAV	Unfunded Commitments	Remaining Life	Redemption Terms	Redemption Restrictions and Terms
<b>Distressed Obligation Partnerships</b>	U.S. and Non-U.S. Distressed Debt Securities	\$9,867	\$15,255	Approximately 2 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Hedge Funds</b>	U.S. and Non-U.S. Investments in Relative Value, Event Driven, Long/Short and Directional Strategies	1,217,196	98,576	99.9% of NAV has an open-ended life and 0.1% of NAV will be liquidated on an undetermined basis.	Ranges between bimonthly redemption with 75 days notice, quarterly redemption with up to 185 days notice, semiannual redemption with up to 120 days notice, annual redemption with up to 120 days notice, biannual redemption with 90 days notice and 5-year lockup with 90 days notice.	2% of NAV is locked-up for 1 month, 11% of NAV is locked-up for 3 months, 45% of NAV is locked-up for 1 year, 42% of NAV is locked-up for more than 1 year.
<b>Natural Resources Partnerships</b>	U.S. and Non-U.S. Investments in Upstream, Midstream and Downstream Natural Resources Investments	417,816	151,782	Approximately 4 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Private Capital Partnerships</b>	U.S. and Non-U.S. Private Equity and Venture Capital Investments	912,817	273,424	Approximately 3 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Private Real Estate Partnerships</b>	U.S. and Non-U.S. Real Estate	239,056	210,784	Approximately 5 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Equity Funds</b>	U.S. and Non-U.S. Equity Securities	114,982	Not Applicable	Open Ended	Minimum monthly	None
<b>Other Funds</b>	U.S. and Non-U.S. Investments in Securities Other than Equity and Fixed Income	7,049	Not Applicable	Open Ended	Monthly	None
<b>Total</b>		<b>\$2,918,783</b>	<b>\$749,821</b>			

## Notes to Consolidated Financial Statements

### Note 6. (continued)

The following table lists investments by major category for the year ending June 30, 2018 (in thousands):

At June 30, 2018						
Category of Investment	Investment Strategy	Fair Value Determined Using NAV	Unfunded Commitments	Remaining Life	Redemption Terms	Redemption Restrictions and Terms
<b>Distressed Obligation Partnerships</b>	U.S. and Non-U.S. Distressed Debt Securities	\$15,736	\$17,042	Approximately 2 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Hedge Funds</b>	U.S. and Non-U.S. Investments in Relative Value, Event Driven, Long/Short and Directional Strategies	1,107,683	58,868	99.9% of NAV has an open-ended life and 0.1% of NAV will be liquidated on an undetermined basis.	Ranges between bimonthly redemption with 75 days notice, monthly redemption with 90 days notice, quarterly redemption with up to 120 days notice, semiannual redemption with 60 to 90 days notice, annual redemption with up to 120 days notice, biannual redemption with 90 days notice and 5-year lockup with 90 days notice.	1% of NAV is locked-up for 1 month, 17% of NAV is locked-up for 3 months, 52% of NAV is locked-up for 1 year 30% of NAV is locked-up for more than 1 year.
<b>Natural Resources Partnerships</b>	U.S. and Non-U.S. Investments in Upstream, Midstream and Downstream Natural Resources Investments	501,549	191,668	Approximately 4 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Private Capital Partnerships</b>	U.S. and Non-U.S. Private Equity and Venture Capital Investments	843,413	216,373	Approximately 3 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Private Real Estate Partnerships</b>	U.S. and Non-U.S. Real Estate	170,718	172,230	Approximately 4 Years	Redemptions are not permitted during the life of the fund.	Not Applicable
<b>Equity Funds</b>	U.S. and Non-U.S. Equity Securities	115,661	Not Applicable	Open Ended	Minimum monthly	None
<b>Other Funds</b>	U.S. and Non-U.S. Investments in Securities Other than Equity and Fixed Income	114	Not Applicable	Open Ended	Monthly	None
<b>Total</b>		<b>\$2,754,874</b>	<b>\$656,181</b>			

## Notes to Consolidated Financial Statements

### Note 7.

#### Endowment:

Endowment net assets are subject to the restrictions of gift instruments requiring that the principal be invested in perpetuity and only the income and realized gains be utilized for current and future needs. Long-term investment net assets (board-designated endowment funds) have been established from restricted contributions whose restrictions have been met and unrestricted contributions which have been designated by the Board of Trustees or management for the same purpose as endowment. The university also has a beneficial interest in the net income earned from assets which are held and managed by other trustees.

Donor-restricted and board-designated endowment funds are summarized as follows for the year ended June 30, 2019 (in thousands):

	Board-Designated Endowment Funds	Donor-Restricted Endowment	Total
Pooled	\$1,421,852	\$4,093,419	\$5,515,271
Non-pooled	95,365	128,929	224,294
<b>Total</b>	<b>\$1,517,217</b>	<b>\$4,222,348</b>	<b>\$5,739,565</b>

Donor-restricted and board-designated endowment funds are summarized as follows for the year ended June 30, 2018 (in thousands):

	Board-Designated Endowment Funds	Donor-Restricted Endowment	Total
Pooled	\$1,409,305	\$3,933,331	\$5,342,636
Non-pooled	74,845	126,786	201,631
<b>Total</b>	<b>\$1,484,150</b>	<b>\$4,060,117</b>	<b>\$5,544,267</b>

Pooled investments represent donor-restricted and board-designated endowment funds which have been commingled in a unitized pool (unit value basis) for purposes of investment. At June 30, 2019 and 2018, the pool is comprised of cash and cash equivalents (0.65%) and (0.63%), equities (56.70%) and (54.29%), fixed income securities (11.86%) and (12.06%), alternative investments (26.61%) and (29.94%) and real estate and other investments (4.18%) and (3.08%), respectively. Access to or liquidation from the pool is on the basis of the market value per unit on the preceding monthly valuation date. The unit value at June 30, 2019 and 2018, was \$676.76 and \$676.51, respectively.

The Board of Trustees has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the original contribution as of the contribution date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the university classifies as donor-restricted funds (a) the original value of contributions donated to the endowment, (b) the original value of subsequent contributions to the endowment and (c) accumulations to the endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. In accordance with UPMIFA, the university considers various factors in making a determination to appropriate or accumulate endowment funds including: duration and preservation of the fund, economic conditions, effects of inflation or deflation, expected return on the funds and other economic resources of the university.



## Notes to Consolidated Financial Statements

### Note 7. (continued)

Endowment net asset composition by type of funds as of June 30, 2019 (in thousands):

	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted endowment funds		\$4,222,348	\$4,222,348
Board-designated endowment funds	\$1,517,217		1,517,217
<b>Total</b>	<b>\$1,517,217</b>	<b>\$4,222,348</b>	<b>\$5,739,565</b>

Endowment net asset composition by type of funds as of June 30, 2018 (in thousands):

	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted endowment funds		\$4,060,117	\$4,060,117
Board-designated endowment funds	\$1,484,150		1,484,150
<b>Total</b>	<b>\$1,484,150</b>	<b>\$4,060,117</b>	<b>\$5,544,267</b>

Changes in endowment net assets for the year ended June 30, 2019 (in thousands):

	Without Donor Restrictions	With Donor Restrictions	Total
<b>Endowment net assets at July 1, 2018</b>	\$1,484,150	\$4,060,117	\$5,544,267
Total investment return, net	114,815	138,274	253,089
Contributions and transfers	31,147	156,641	187,788
Appropriation of endowment assets for expenditure	(112,895)	(132,684)	(245,579)
<b>Endowment net assets at June 30, 2019</b>	<b>\$1,517,217</b>	<b>\$4,222,348</b>	<b>\$5,739,565</b>

Changes in endowment net assets for the year ended June 30, 2018 (in thousands):

	Without Donor Restrictions	With Donor Restrictions	Total
<b>Endowment net assets at July 1, 2017,</b>	\$1,404,699	\$3,725,821	\$5,130,520
Total investment return, net	156,808	314,605	471,413
Contributions and transfers	20,105	159,125	179,230
Appropriation of endowment assets for expenditure	(97,462)	(139,434)	(236,896)
<b>Endowment net assets at June 30, 2018</b>	<b>\$1,484,150</b>	<b>\$4,060,117</b>	<b>\$5,544,267</b>

## Notes to Consolidated Financial Statements

### Note 7. (continued)

Endowments classified with donor restrictions are to be utilized for the following purposes:

The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA as of June 30 (in thousands):

	2019	2018
Restricted for scholarship support	\$982,166	\$945,638
Restricted for faculty support	975,872	955,824
Restricted for program support	2,264,310	2,158,655
<b>Total endowment assets with donor restrictions</b>	<b>\$4,222,348</b>	<b>\$4,060,117</b>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor contribution amounts (deficit). When donor-restricted endowment fund deficits exist, they are classified as a reduction of net assets with donor restrictions. Deficits of this nature exist in various donor-restricted endowment funds, which together have an original value of \$36,070,000 and a current value of \$35,756,000 with a deficiency of \$314,000 and an original value of \$26,978,000 and a current fair value of \$26,743,000 and a deficiency of \$235,000 as of June 30, 2019 and 2018, respectively. These deficits resulted from unfavorable market fluctuations that occurred shortly after the investment of newly established endowments and authorized appropriation that was deemed prudent. The university has interpreted UPMIFA to permit spending from underwater funds in accordance with the prudent measures required under the law.

The university has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under these policies, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return against a blended index, based on the endowment's target allocation applied to the appropriate individual benchmarks. The university expects its endowment funds over time to provide an average rate of return of approximately 8% annually. Actual returns in any given year may vary from this amount.

To achieve its long-term rate of return objectives, the university relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The university targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

The university utilizes a spending rule for its pooled endowment. The spending rule determines the endowment income and realized gains to be distributed currently for spending with the provision that any amounts remaining after the distribution be transferred and reinvested in the endowment pool as board-designated as endowment.

For the 2019 fiscal year, the Board of Trustees approved current distribution of 100% of the prior year's payout, within a minimum of 4% and a maximum of 6% of the average market value for the previous 12 calendar quarters. Under the provisions of the spending rule, \$29.45 was distributed to each time-weighted unit for a total spending rule allocation of \$246,551,000. Investment income amounting to \$7.14 per time-weighted unit was earned, totaling \$59,756,000, and \$186,795,000 was appropriated for current operations from cumulative gains of pooled investments. Endowment pool earnings allocated for spending in fiscal year 2019 represent 4.47% of the market value of the endowment pool at June 30, 2019.

## Notes to Consolidated Financial Statements

### Note 7. (continued)

For the 2018 fiscal year, the Board of Trustees approved current distribution of 100% of the prior year's payout, within a minimum of 4% and a maximum of 6% of the average market value for the previous 12 calendar quarters. Under the provisions of the spending rule, \$28.87 was distributed to each time-weighted unit for a total spending rule allocation of \$233,765,000. Investment income amounting to \$4.51 per time-weighted unit was earned, totaling \$36,517,000, and \$197,249,000 was appropriated for current operations from cumulative gains of pooled investments. Endowment pool earnings allocated for spending in fiscal year 2018 represent 4.38% of the market value of the endowment pool at June 30, 2018.

### Note 8.

#### Property, Plant and Equipment:

Property, plant and equipment consisted of the following at June 30 (in thousands):

	2019	2018
Land and improvements	\$201,409	\$196,738
Buildings and improvements	5,538,709	5,170,770
Buildings under capital leases	65,822	65,822
Equipment	740,141	679,578
Library books and collections	421,392	399,399
Construction-in-progress	253,250	250,575
	<b>7,220,723</b>	<b>6,762,882</b>
Less: Accumulated depreciation	2,856,881	2,588,792
<b>Total</b>	<b>\$4,363,842</b>	<b>\$4,174,090</b>

## Notes to Consolidated Financial Statements

### Note 9.

#### Leases:

The university is the lessee of various equipment and space under non-cancelable operating and capital leases. Operating lease rental expense for the years ended June 30, 2019 and 2018, was approximately \$42,122,00 and \$37,539,000, respectively. Space leases contain customary escalation clauses, which are included in annual aggregate minimum rentals.

Future aggregate minimum rental payments as of June 30, under operating and capital leases are as follows (in thousands):

<b>Future minimum rental payments:</b>	<b>Operating</b>	<b>Capital</b>
2020	\$54,350	\$1,642
2021	50,084	1,685
2022	48,554	1,730
2023	41,305	1,775
2024	35,987	1,823
Thereafter	246,267	664,470
	<b>476,547</b>	<b>673,125</b>
Less: Interest on capital leases		(597,256)
<b>Total</b>	<b>\$476,547</b>	<b>\$75,869</b>

The university entered into a lease agreement with the Los Angeles Memorial Coliseum Commission (LAMCC) to assume the operations of the Los Angeles Memorial Coliseum and Los Angeles Memorial Sports Arena.

The lease agreement with the LAMCC expires in 2033, or in 2054, if all options are exercised, at which time a second lease agreement with the California Science Center (CSC), an institution of the state of California, commences. The lease with the CSC expires in 2111, assuming all options are exercised. Under the terms of both lease agreements, the university is required to make certain capital improvements. The present value of the future minimum lease payments as of June 30, 2019 and 2018, is \$75,869,000 and \$74,222,000, respectively.

## Notes to Consolidated Financial Statements

### Note 10.

#### Bonds and Notes Payable

Bond and notes payable outstanding as of June 30 (*in thousands*):

	Interest %	Maturity	2019	2018
<i>California Educational Facilities Authority Revenue Bonds and Notes:</i>				
Series 2009C	5.25	2025	\$82,305	\$82,305
Premium			3,051	3,661
Series 2012A	5.00	2024	41,595	41,595
Premium			4,389	5,401
Series 2015A	5.00	2026	42,960	42,960
Premium			6,248	7,232
<i>University of Southern California Bonds:</i>				
Series 1998 Taxable	6.26	2019		4,585
Discount				(5)
Series 2011 Taxable	5.25	2112	300,000	300,000
Discount			(2,478)	(2,505)
Series 2016 Taxable	3.03	2040	722,580	722,580
Discount			(3,236)	(3,395)
Series 2017 Taxable	3.84	2048	402,320	402,320
Discount			(1,682)	(1,740)
<i>California Infrastructure Revenue Bonds (USC- Soto Street Health Sciences):</i>				
Series 2010 (Soto)	3.25-5.00	2018-2032	26,750	28,220
Premium			1,544	1,674
Notes Payable	5.00	2018-2020		17,500
			1,626,346	1,652,388
Less: current portion of long-term debt			1,540	6,055
<b>Total</b>			<b>\$1,624,806</b>	<b>\$1,646,333</b>

Principal payment requirements relating to bonds and notes payable, after giving effect to refunding, for the next five fiscal years are approximately: 2020 \$1,540,000; 2021 \$1,620,000; 2022 \$1,700,000; 2023 \$1,755,000; 2024 \$43,435,000, thereafter \$1,568,460,000.

Interest payments for fiscal year 2019 and 2018 were \$63,428,000 and \$63,405,000, respectively.

The university has a revolving line of credit with a bank with a maturity date of November 30, 2020. The credit agreement was amended on April 12, 2017, to increase the revolving line of credit to \$500,000,000, with all other terms and conditions, including the applicable rate and maturity, remaining substantially the same. The line of credit accrues interest based on LIBOR and contains a fee on the unused portion of the line of credit. During fiscal years ending June 30, 2019 and 2018, the university did not draw down on the line of credit. The line of credit contains certain restrictive covenants which include a minimum credit rating of "A" and "A2" from Standard and Poor's and Moody's, respectively, as well as a minimum total net assets of \$5,500,000,000. USC was in compliance with these covenants during fiscal years ending June 30, 2019 and 2018.

## Notes to Consolidated Financial Statements

### Note 11.

#### Retirement Benefits:

Retirement benefits for eligible university employees are provided through the Teachers Insurance and Annuity Association, The Vanguard Group, AIG Sun America, Fidelity Investments and Prudential Financial. Under these defined contribution plans, the university and plan participants make contributions to purchase individual, fixed or variable annuities equivalent to retirement benefits earned or to participate in a variety of mutual funds. Under the USC Retirement Savings Program, the university makes a 5% non-elective contribution to all eligible employees and also matches dollar for dollar the first 5% of the employees' contributions. Newly hired employees on or after January 1, 2012, will have the university non-elective contribution subject to a four year vesting schedule. Benefits commence upon termination or retirement and pre-retirement survivor death benefits are also provided. Charges to operating expenses for the university's share of costs were approximately \$181,478,000 and \$169,505,000 during the years ended June 30, 2019 and 2018, respectively.

Retirement benefits for employees of USC Verdugo Hills Hospital and University Physician Associates are provided by a defined contribution 401(k) plan through Fidelity Investments. Until August 2011, the Keck and Norris hospital employees covered under a collective bargaining agreement with California Nurses Association were also covered under this 401(k) plan. Until January 2017, the National Union of Healthcare Workers ("NUHW") employees at Keck and Norris hospitals were also covered under this 401(k) plan. Under the 401(k) defined contribution plan, participants make contributions to purchase a variety of mutual funds.

Effective January 2018, the university contribution to the 401(k) plan is made on a paycheck-by-paycheck basis. Prior to this, the university made its contribution in a lump sum following the end of the calendar year and matched 100% of the participants' contributions up to 4% of eligible earnings, providing the participant was employed on the last day of the calendar year. In addition, the university made a 1% retiree medical benefit contribution to all NUHW participants who were both employed on the last day of the calendar year and worked 1,500 hours in that calendar year. The university contribution is subject to a five year vesting schedule, although previously credited years prior to the Tenet and Verdugo acquisitions have been carried over. Benefits commence at age 59 1/2, termination of employment or retirement. Pre-retirement survivor death benefits are also provided. Charges to operating activities expenses for the university's share of costs were approximately \$0 and \$33,000 during the years ended June 30, 2019 and 2018, respectively.

Retirement benefits for non-exempt university employees are provided through a noncontributory defined benefit pension plan, the USC Support Staff Retirement Plan ("Plan"). The following table sets forth the Plan's funded status at June 30 (in thousands):

<b>Changes in Projected Benefit Obligation</b>	<b>2019</b>	<b>2018</b>
Benefit obligation at end of prior year	\$229,537	\$251,857
Interest cost	8,779	9,862
Actuarial gain	30,498	(12,939)
Annuity purchase for plan participants	(108,958)	
Benefits paid	(11,691)	(19,243)
	<b>\$148,165</b>	<b>\$229,537</b>
<b>Change in Plan Assets</b>		
Fair value of plan assets at the end of prior year	\$208,841	\$190,974
Actual return on plan assets	16,481	16,110
Employer contribution	22,000	21,000
Annuity purchase for plan participants	(108,958)	
Benefits paid	(11,691)	(19,243)
	<b>\$126,673</b>	<b>\$208,841</b>

## Notes to Consolidated Financial Statements

## Note 11. (continued)

<b>Reconciliation of Funded Status</b>	<b>2019</b>	<b>2018</b>
Accumulated benefit obligation at end of year	(\$148,165)	(\$229,537)
Projected benefit obligation at end of year	(148,165)	(229,537)
Fair value of plan assets at end of year	126,672	208,840
<b>Funded status</b>	<b>(\$21,493)</b>	<b>(\$20,697)</b>
<hr/>		
<b>Components of Net Periodic Benefit Cost</b>	<b>2019</b>	<b>2018</b>
Interest cost	\$8,779	\$9,862
Expected return on plan assets	(10,300)	(11,513)
Amortization of net loss	3,702	5,898
Settlement	33,781	
<b>Total benefit cost</b>	<b>\$35,962</b>	<b>\$4,247</b>
<hr/>		
<b>Amounts recognized in the Statement of Financial Position</b>	<b>2019</b>	<b>2018</b>
Accrued liabilities	(\$21,493)	(\$20,697)
<hr/>		
<b>Amounts not yet recognized as components of Net Periodic Benefit Cost</b>	<b>2019</b>	<b>2018</b>
Net loss	\$48,219	\$61,384
<hr/>		
<b>Changes in the net reduction to Without Donor Restrictions</b>	<b>2019</b>	<b>2018</b>
Net gain (loss)	\$24,318	(\$17,535)
Amortization of net loss	(3,702)	(5,898)
Recognition of net (gain) due to settlement	(33,781)	
<b>Total benefit cost</b>	<b>(\$13,165)</b>	<b>(\$23,433)</b>

The estimated net loss/(gain) and prior service cost for the Plan that will be recognized as components of net periodic benefit cost over the next fiscal year are \$3,512,000 and \$0, respectively.

The Plan was amended to freeze benefit accruals for all remaining active union participants effective December 23, 2009, and to provide full vesting for those participants. On April 5, 2019, a payment of \$108,957,844 was made to purchase annuities for 1,720 retirees and beneficiaries who were receiving monthly benefit payments from the Plan. As a result of this transaction, the responsibility for payment of the pension benefits was transferred to the insurance company, and ASC 715 settlement accounting was required. The effect of the settlement was determined based on a measurement date of March 31, 2019, in accordance with ASC 715-30-35-66A. As a result of the annuity purchase, 44.15% of the benefit obligation for the Plan was settled, and a prorata portion of the net actuarial loss was recognized in expense, resulting in additional pension expense during fiscal 2019 of \$33,781,181.

## Notes to Consolidated Financial Statements

### Note 11. (continued)

Weighted-average assumptions used to determine net periodic benefit cost for year ended June 30:

	2019	2018
Discount rate	4.40%	4.00%
Expected return on plan assets	5.70%	6.20%
Rate of compensation increase	N/A	N/A

Weighted-average assumptions used to determine net year-end benefit obligations at June 30:

	2019	2018
Discount rate	3.65%	4.40%
Rate of compensation increase	N/A	N/A

### Plan Assets

In managing the Plan assets, the university's objective is to be a responsible fiduciary while minimizing financial risk. Plan assets include a diversified mix of fixed income securities and equity securities across a range of sectors and levels of capitalization to maximize the long-term return for a prudent level of risk. In addition to producing a reasonable return, the investment strategy seeks to minimize the volatility in the university's expense and cash flow. The target allocation for pension benefit plan assets is 40% equity securities and 60% fixed income securities.

As described in Note 1, the university uses a hierarchy to report invested assets, including the invested assets of the Plan. Following is a description of the valuation methodologies used for assets measured at fair value.

### Fair Value

The Plan's interest in collective trusts is valued based on the net asset value information reported by the investment advisor. The fund is valued at the normal close of trading on the New York Stock Exchange every day the exchange is open (a "Business Day"). Equity securities are valued at the official closing price of, or the last reported sales price on, the exchange or market on which such securities are traded, as of the close of business on the day the securities are being valued or at the last available bid price. In cases where equity securities are traded on more than one exchange, the securities are valued on the exchange or market determined to be the most representative market, which may be either a securities exchange or the over-the-counter market. Short-term investments are carried at fair value.

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

At June 30, 2019, a summary of fair value measurements by level for Plan investments measured at fair value on a recurring basis is as follows (in thousands):

	Level I	Level II	Level III	NAV	Total
Collective Trust Funds:					
Short-term investment fund		\$3,637			\$3,637
Equity securities		46,715			46,715
Fixed income securities		76,320			76,320
<b>Total</b>		<b>\$126,672</b>			<b>\$126,672</b>



## Notes to Consolidated Financial Statements

### Note 11. (continued)

At June 30, 2018, a summary of fair value measurements by level for investments measured at fair value on a recurring basis is as follows (in thousands):

	Level I	Level II	Level III	NAV	Total
Collective Trust Funds:					
Short-term investment fund		\$3,647			\$3,647
Equity securities		99,114			99,114
Fixed income securities		106,079			106,079
<b>Total</b>		<b>\$208,840</b>			<b>\$208,840</b>

### Allocation of Assets

The year-end asset allocation, which approximates the weighted-average allocation for the Plan assets as of June 30 and in comparison to target percentages for each asset category, is as follows:

Asset Category	Actual at June 30, 2019	Target at June 30, 2019	Actual at June 30, 2018	Target at June 30, 2018
Short-term investment fund	2.9%	0.0%	1.7%	0.0%
Equity securities	36.9%	40.0%	47.5%	50.0%
Fixed income securities	60.2%	60.0%	50.8%	50.0%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

The portfolio is evaluated annually or when the actual allocation percentages are plus or minus 2% of the stated target allocation percentages. Changes in policy may be indicated as a result of changing market conditions or anticipated changes in the pension plan's needs. Prohibited transactions include investment transactions prohibited by the Employee Retirement Income Security Act of 1974 and speculative investments including commodities or unregistered stock without specific prior approval by the university's Investment Committee.

### Contributions

No contribution to the plan is required to be made during the fiscal year ending June 30, 2019. At this time, it is anticipated that the university will make discretionary contributions to the pension plan during the next fiscal year, although the total amount of such contributions has not yet been determined.

### Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

	Fiscal Year Ending June 30
2020	\$1,987
2021	2,892
2022	3,742
2023	4,509
2024	5,198
2025-2029	34,521

# Notes to Consolidated Financial Statements

## Note 12.

### Net Assets:

The university's net assets as of June 30, 2019, includes the following (in thousands):

Nature of Specific Net Assets	Without Donor Restrictions	With Donor Restrictions	Year Ended June 30, 2019
			Total Net Assets
Internally reserved	\$1,030,039		\$1,030,039
Donor-restricted		\$55,154	55,154
Pledges		462,329	462,329
Unexpended endowment income	302,203		302,203
Annuity and living trusts		169,328	169,328
Donor-restricted endowment funds		4,222,348	4,222,348
Board-designated endowment funds	1,517,217		1,517,217
Debt service funds	120,696		120,696
Invested in plant	1,308,848		1,308,848
<b>Total</b>	<b>\$4,279,003</b>	<b>\$4,909,159</b>	<b>\$9,188,162</b>

The university's net assets as of June 30, 2018, includes the following (in thousands):

Nature of Specific Net Assets	Without Donor Restrictions	With Donor Restrictions	Year Ended June 30, 2018
			Total Net Assets
Internally reserved	\$1,252,267		\$1,252,267
Donor-restricted		\$139,755	139,755
Pledges		570,186	570,186
Unexpended endowment income	295,792		295,792
Annuity and living trusts		168,332	168,332
Donor-restricted endowment funds		4,060,117	4,060,117
Board-designated endowment funds	1,484,150		1,484,150
Debt service funds	121,413		121,413
Invested in plant	1,177,519		1,177,519
<b>Total</b>	<b>\$4,331,141</b>	<b>\$4,938,390</b>	<b>\$9,269,531</b>

## Notes to Consolidated Financial Statements

### Note 13.

#### Functional Expenses:

Expenses are presented below by functional classification in accordance with the overall service mission of the university. Each functional classification displays all expenses related to the underlying operations by natural classification. Depreciation expense is allocated based on square footage occupancy. Interest expense on external debt is allocated to the functional categories which have benefited from the proceeds of the external debt. Plant operations and maintenance represents space related costs which are allocated to the functional categories directly and/or based on the square footage occupancy.

For the year ended June 30, 2019, functional expense consists of the following (in thousands):

	Academic, Health Care and Student Services	Support Services	Fundraising Activities	Year Ended June 30, 2019
Compensation	\$2,040,161	\$340,824	\$32,563	\$2,413,548
Fringe benefits	578,002	111,633	11,011	700,646
Operating expenses	1,100,015	858,153	14,865	1,973,033
Cost of goods sold	85,483	43,982		129,465
Travel	48,734	10,640	778	60,152
Settlement				
Allocations:				
Depreciation	188,348	91,127	1,684	281,159
Interest	21,239	43,085		64,324
Plant operations and maintenance	162,475	(165,364)	2,890	
<b>Total</b>	<b>\$4,224,457</b>	<b>\$1,334,080</b>	<b>\$63,791</b>	<b>\$5,622,327</b>

For the year ended June 30, 2018, functional expense consists of the following (in thousands):

	Academic, Health Care and Student Services	Support Services	Fundraising Activities	Year Ended June 30, 2018
Compensation	\$1,850,553	\$321,320	\$35,970	\$2,207,843
Fringe benefits	480,922	107,207	12,381	600,510
Operating expenses	1,086,780	390,897	14,336	1,492,013
Cost of goods sold	87,895	49,188		137,083
Travel	51,256	12,041	842	64,139
Settlement		215,000		215,000
Allocations:				
Depreciation	180,797	78,514	2,151	261,462
Interest	22,332	43,393		65,725
Plant operations and maintenance	170,212	(173,139)	2,927	
<b>Total</b>	<b>\$3,930,747</b>	<b>\$1,044,421</b>	<b>\$68,607</b>	<b>\$5,043,775</b>

## Notes to Consolidated Financial Statements

### Note 14.

#### Commitments and Contingencies

Contractual commitments for educational plant amounted to approximately \$104,934,000 and \$132,631,000 at June 30, 2019 and 2018, respectively. It is expected that the resources to satisfy these commitments will be provided from certain unexpended plant net assets, anticipated contributions and/or debt proceeds.

During the year ended June 30, 2007, the university entered into an agreement with the County of Los Angeles to provide professional services at Los Angeles County+USC Medical Center. Under the terms of the agreement, the contract automatically renews on an annual basis unless either party gives four years' notice of the termination. To date, no such notice has been provided by either party.

The university is contingently liable as guarantor on certain obligations relating to equipment loans, student and parent loans, and various campus organizations.

The university has a broad portfolio of civil litigation, which reflects the complexity of the higher education environment and the diversity of issues facing universities today. Among other matters, these include lawsuits regarding the retirement plan, research and faculty recruitment, student disciplinary matters, athletic injuries, medical malpractice, and employment litigation. In preparing these financial statements, management reviewed the entire litigation portfolio with the assistance of legal counsel and in accordance with ASC 450, Contingencies, and recorded a contingent liability on the consolidated balance sheets to properly account for the entire litigation portfolio.

Of note, during fiscal years ended June 30, 2018 and 2019 the university was named in civil lawsuits in state and federal court in connection with alleged misconduct by a physician who was previously employed by the university and practiced at the university student health center; this individual was alleged to have engaged in inappropriate conduct and made inappropriate statements to patients. On October 9, 2018, the university and the federal plaintiffs reached an agreement in principle for a federal class action settlement of \$215 million, plus attorneys' fees not to exceed \$25 million. As of June 30, 2019 there have been no payments made in connection with the federal class action settlement. The federal class action settlement is currently being processed in accordance with the terms of the settlement and is expected to receive final approval by the court and related payments made during calendar 2020. For the years ended June 30, 2018 and 2019, the university has recorded a liability for the federal class action settlement of \$215 million. The state court civil lawsuits have continued to proceed through the court process. There have been significant developments in related matters that could impact the civil litigation, including currently, approximately 800 cases have opted out of the federal class action settlement, criminal charges being filed against the physician who was previously employed by the student health center and the change in California state law that eliminated the statute of limitations for certain individuals potentially impacted.

Management has assessed the risk of loss related to the alleged misconduct above together with other litigation and for those matters deemed estimable and probable has accrued expenses included in operating expenses in the consolidated statement of activities. While the university expects that a significant portion of the settlement accrual and the liability will be covered by insurance, no insurance reimbursements for settlements have been received as of June 30, 2019, and there can be no guarantee of the ultimate amount of coverage. Subsequent to year end certain amounts have been received from insurance which have been considered in the recording of the contingent liability estimate at June 30, 2019. Amounts of future insurance reimbursements are unknown as of June 30, 2019, and as a result no insurance recovery accruals have been recorded in the 2018 and 2019 consolidated financial statements. The university recognizes that the ultimate outcome of these matters may be different than the estimates made in the consolidated financial statements as of and for the years ended June 30, 2019 and 2018, and those differences may be material to the university's financial position.

## Notes to Consolidated Financial Statements

### Note 15.

#### Grants and Contracts:

Executed contracts, grants, subcontracts and cooperative agreements for future sponsored research activity which are not reflected in the consolidated financial statements at June 30 are summarized as follows (in thousands):

	2019	2018
Current sponsored awards	\$780,063	\$764,272
Executed grants and contracts for future periods	1,414,199	1,192,476
<b>Total</b>	<b>\$2,194,262</b>	<b>\$1,956,748</b>

### Note 16.

#### Related Parties

Members of the Board of Trustees and senior management may, from time to time, be associated, either directly or indirectly, with companies doing business with the university. For senior management, the university requires annual disclosure of significant financial interest in entities doing business with the university. These annual disclosures cover both senior management and their immediate family members. When such relationships exist, measures are taken to appropriately manage the actual or perceived conflict in the best interests of the university. The university has a written conflict of interest policy that requires, among other things, that no member of the Board of Trustees can participate in any decision in which he or she or an immediate family member has a material financial interest. Each trustee is required to certify compliance with the conflict of interest policy on an annual basis and indicate whether the university does business with an entity in which a trustee has a material financial interest. When such relationships exist, measures are taken to mitigate any actual or perceived conflict, including requiring the recusal of the conflicted trustee and that such transactions be conducted at arm's length, for good and sufficient consideration, based on terms that are fair and reasonable to and for the benefit of the university, and in accordance with applicable conflict of interest laws.

### Note 17.

#### Subsequent Events

The university has performed an evaluation of subsequent events through December 16, 2019, which is the date the financial statements were issued.

In November 2019, the Lord Foundation of California, a non-profit foundation that supports the University, has received approximately \$262 million to fund research and teaching as a beneficiary of the recent sale of the North Carolina-based LORD Corporation.

Immigration Clinic Revenue Sources for Calendar Year 2019

Individual Contributions		6,845
	<i>Attorneys</i>	<i>5,693</i>
	<i>Other</i>	<i>1,152</i>
Organization Contributions		16,518
	<i>Law Firms</i>	<i>15,018</i>
	<i>Bar Associations</i>	
	<i>Other</i>	<i>1,500</i>
Foundations		120,155
	Calif. Community Foundation	120,155
Government Funding		37,640
	<i>CDSS</i>	<i>37,640</i>
Cy Pres Awards <sup>1</sup>		200,006
Attorneys Fees		
Other Cash Support		
Law School		284,706
University/Provost & Law School		160,000
<b>REVENUE GRAND TOTAL</b>		<b>825,871</b>

Immigration Clinic Expenditures for Calendar Year 2019

Non-Cash Expenditures		-
	<i>Unrealized Gains/Losses</i>	
Personnel		639,463
	<i>Lawyers (Frenzen, Reisz, Macias, Alemi)</i>	<i>431,296</i>
	<i>Other Personnel (Sirimane, Chan (0.10))</i>	<i>57,720</i>
	<i>Benefits</i>	<i>150,447</i>
Non-Personnel		248,356
	<i>Overhead - Space - Office Equipment - Utilities - Services</i>	<i>207,498</i>
	<i>Equipment rental and maintenance</i>	
	<i>Office supplies</i>	<i>1,432</i>
	<i>Printing and Postage</i>	<i>4,617</i>
	<i>Telecommunications</i>	<i>308</i>
	<i>Technology</i>	<i>318</i>
	<i>Travel</i>	<i>25,080</i>
	<i>Training</i>	<i>180</i>
	<i>Witness Court Fees</i>	<i>4,500</i>
	<i>Legal Research</i>	<i>1,492</i>
	<i>Client Parking</i>	<i>2,116</i>
	<i>Memberships</i>	<i>815</i>
	<i>Library</i>	
	<i>Insurance</i>	
	<i>Audit</i>	
	<i>Depreciation</i>	
<b>EXPENSE GRAND TOTAL</b>		<b>887,819</b>

<sup>1</sup>CyPres Funding is a one time funding with no expiration date

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Legal Aid Society of San Bernardino, Inc.  
San Bernardino, CA

### Report on the Financial Statements

We have audited the accompanying financial statements of Legal Aid Society of San Bernardino, Inc. (a nonprofit organization), which consist of the statement of financial position as of December 31, 2019, and the related statements of activities, cash flows, and functional expenses for the year then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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.



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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 financial statements.

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

**Basis for Qualified Opinion**

As described in Note 7 to the financial statements, Legal Aid Society of San Bernardino, Inc. records non-cash contributions of volunteer attorney hours as contributed legal service revenue and legal consultant expense in the statement of activities. Legal Aid Society of San Bernardino, Inc. has recorded \$320,700 of revenue and expense related to these contributions. We were unable to obtain sufficient audit evidence for the year ended December 31, 2019 because the underlying documentation and records of the hours was not properly maintained by management. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

**Qualified Opinion**

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Legal Aid Society of San Bernardino, Inc. as of December 31, 2019, 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.

**Emphasis of Matter**

As discussed in Note 2B to the financial statements, in 2019, Legal Aid Society of San Bernardino, Inc. adopted new accounting guidance for contributions received. Our opinion is not modified with respect to this matter.

**Prior Period Financial Statements**

The financial statements of Legal Aid Society of San Bernardino, Inc. for the year ended December 31, 2018, were audited by another auditor who expressed an unmodified opinion on those financial statements dated March 13, 2019.

**Other Matter**

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Private Attorney Involvement Revenue and Expense Statement on Page 17 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated July 17, 2020 on our consideration of Legal Aid Society of San Bernardino, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Legal Aid Society of San Bernardino, Inc.'s internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Legal Aid Society of San Bernardino, Inc.'s internal control over financial reporting and compliance.

*Eddie and Payne HP*

Riverside, California  
July 17, 2020

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors  
Legal Aid Society of San Bernardino, Inc.  
San Bernardino, CA

We have audited, in accordance with auditing standards generally accepted in the United States of America, with standards applicable to financial audits contained in *Government Auditing Standards* issued by the U.S. Comptroller General of the United States, the financial statements of Legal Aid Society of San Bernardino, Inc. (Society), which are comprised of the statement of financial position as of December 31, 2019, and the related statements of activities, cash flows, and functional expenses for the year then ended, and the related notes to financial statements, and we have issued our report thereon dated July 17, 2020.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Society's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Society's internal control. Accordingly, we do not express an opinion on the effectiveness of the Society's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we did identify certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and significant deficiencies.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2019-001 and 2019-006 to 2019-008 to be material weaknesses.



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A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2019-005 and 2019-009 to 2019-010 to be significant deficiencies.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Society's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2019-001 to 2019-002 and 2019-011 to 2019-012.

### **Legal Aid Society of San Bernardino Inc.'s Response to Findings**

The Society's response to the findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The Society's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **Purpose of This Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Society's internal control or on compliance. The report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Society's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Riverside, California  
July 17, 2020

LEGAL AID SOCIETY OF SAN BERNARDINO COUNTY, INC.  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**  
FOR THE YEAR ENDED DECEMBER 31, 2019

**Planned Implementation Date:** December 31, 2020

**Responsible Person:** Deborah Davis, Interim Executive Director

**2019-008 - Tracking of Contributed Hours (MW)**

**Criteria:** The Society tracks contributed hours from private attorneys to meet compliance requirements and to report the value of donated services.

**Condition:** Contributed hours were not accurately tracked during the year.

**Cause:** The database used to record contributed hours was not reliable and did not provide an accurate reporting of hours.

**Effect or Potential Effect:** Potential material misstatement of contributed hours revenue and expense. This resulted in the Society losing funding from ICLS and put the funding from the State Bar Association at risk.

**Repeat of a Prior-Year Finding:** No

**Recommendation:** We recommend the Society implement a reconciliation process for contributed hours, and regularly verify the database record.

*Management Response and Corrective Action Plan*

**Society's Response:** The Society concurs with the recommendation.

**Corrective Action Plan:** The Society has updated its internal control policies and procedures for the 2020 year. Additionally, they have engaged an accounting firm to review the updated procedures and give further recommendations.

**Planned Implementation Date:** December 31, 2020

**Responsible Person:** Deborah Davis, Interim Executive Director

**2019-009 - Tracking of Cash Donations (SD)**

**Criteria:** Accurate tracking of cash donations at the Society's clinic locations is essential in safeguarding the Society's assets.

**Condition:** The Society did not accurately track cash donations during the year.

**Cause:** Lack of adequate policies and procedures to ensure effective tracking of cash donations.

**Effect or Potential Effect:** Potential misstatement of cash and revenue.

**Repeat of a Prior-Year Finding:** No

**Recommendation:** We recommend the Society evaluate the controls in place over cash receipts, and develop new procedures to verify accurate tracking of cash donations.