

Consolidated Financial Statements

University Co-operative Society

*As of and for the fiscal years ended June 28, 2020 and June 30, 2019
with Report of Independent Auditors*



AUDIT • TAX • ADVISORY

Report of Independent Auditors

To the Board of Directors of
University Co-operative Society

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of University Co-operative Society and Subsidiary (the “Co-op”), which comprise the consolidated statements of financial position as of June 28, 2020 and June 30, 2019, and the related consolidated statements of activities and cash flows for the fiscal years then ended, and the related notes to the consolidated financial statements.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’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 entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Co-op as of June 28, 2020 and June 30, 2019, and the results of their activities and their cash flows for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.



AUDIT • TAX • ADVISORY

Emphasis of Matter

As discussed in Note 9 to the consolidated financial statements, University Co-operative Society changed its method for accounting for revenue recognition in 2020 due to the adoption of new accounting guidance regarding recognition of revenue with customers. Our opinion is not modified with respect to this matter.

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. The ultimate financial impact and duration of these events cannot be reasonably estimated at this time. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information in the supplemental schedules is presented for purposes of additional analysis is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated 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 consolidated financial statements taken as a whole.

Holtzman Partners, LLP

Austin, Texas
September 30, 2020

University Co-operative Society

Consolidated Statements of Financial Position

	<u>June 28, 2020</u>	<u>June 30, 2019</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,644,307	\$ 141,150
Accounts receivable:		
Trade, net	91,291	221,039
Other	135,536	266,848
Merchandise inventory	2,696,971	2,509,763
Prepaid expenses and other	354,955	506,249
Total current assets	<u>4,923,060</u>	<u>3,645,049</u>
Property and equipment, net	10,900,079	11,765,330
Intangible assets, net	139,163	191,866
Other assets	–	3,750
Total assets	<u><u>\$ 15,962,302</u></u>	<u><u>\$ 15,605,995</u></u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 2,445,597	\$ 2,185,676
Accrued expenses	533,159	700,428
Cash overdraft	–	127,476
Current portion of long-term debt	858,117	369,301
Total current liabilities	<u>3,836,873</u>	<u>3,382,881</u>
Deferred rent	46,749	80,039
Long-term debt, net of current portion	<u>7,286,228</u>	<u>5,866,213</u>
Total liabilities	<u>11,169,850</u>	<u>9,329,133</u>
Net Assets:		
Without donor restrictions	4,372,452	5,856,862
With donor restrictions	<u>420,000</u>	<u>420,000</u>
Total net assets	<u>4,792,452</u>	<u>6,276,862</u>
Total liabilities and net assets	<u><u>\$ 15,962,302</u></u>	<u><u>\$ 15,605,995</u></u>

See accompanying notes to consolidated financial statements.

University Co-operative Society

Consolidated Statements of Activities

	Fiscal year ended June 28, 2020	Fiscal year ended June 30, 2019
Net assets without donor restrictions:		
Revenue:		
Net sales	\$ 20,698,196	\$ 25,034,549
Cost of merchandise sold	(11,826,484)	(14,174,887)
Total gross margin	8,871,712	10,859,662
Operating expenses:		
Personnel costs	5,773,863	6,204,439
Building occupancy costs	808,952	1,331,831
General and administrative	1,893,729	2,096,969
Other selling and promotional costs	418,116	266,662
Total operating expenses	8,894,660	9,899,901
Increase (decrease) in net assets without restrictions from operations	(22,948)	959,761
Other income (expense):		
Non-operating income	450,092	656,746
Depreciation and amortization	(899,755)	(970,200)
Interest expense	(366,927)	(271,659)
Total other expense, net	(816,590)	(585,113)
Income tax benefit (expense)	926	(17,702)
Change in net assets before university gifts and loss on sale of property and equipment	(838,612)	356,946
University gifts	(147,933)	(154,476)
Loss on sale of property and equipment	(281,949)	(17,883)
Change in net assets before membership discounts	(1,268,494)	184,587
Membership discounts	(215,916)	(470,278)
Change in net assets	(1,484,410)	(285,691)
Net assets, beginning of the year	6,276,862	6,562,553
Net assets, end of the year	\$ 4,792,452	\$ 6,276,862

See accompanying notes to consolidated financial statements.

University Co-operative Society

Consolidated Statements of Cash Flows

	Fiscal year ended June 28, 2020	Fiscal year ended June 30, 2019
Cash flows from operating activities:		
Cash received from customers	\$ 20,698,196	\$ 25,034,549
Cash received from rental and other activities	453,213	639,046
Cash paid to suppliers and employees	(20,924,208)	(25,784,083)
Interest paid	(369,125)	(271,659)
Net cash used in operating activities	(141,924)	(382,147)
Cash flows from investing activities		
Purchase of domain name	(3,282)	–
Purchases of property and equipment	(260,468)	(150,592)
Net cash used in investing activities	(263,750)	(150,592)
Cash flows from financing activities:		
Proceeds from line of credit	3,750,000	6,175,000
Payments on line of credit	(3,575,000)	(5,725,000)
Proceeds from notes payable	2,021,300	500,000
Payments on notes payable	(287,469)	(355,801)
Patronage refunds paid	–	(90,695)
Net cash provided by financing activities	1,908,831	503,504
Net change in cash and cash equivalents	1,503,157	(29,235)
Cash and cash equivalents, beginning of year	141,150	170,385
Cash and cash equivalents, end of year	\$ 1,644,307	\$ 141,150
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 369,125	\$ 271,659
Cash paid for taxes	\$ –	\$ 7,000

See accompanying notes to consolidated financial statements.

University Co-operative Society

Notes to the Consolidated Financial Statements

As of and for the fiscal years ended June 28, 2020 and June 30, 2019

1. Organization

The University Co-operative Society (the “Co-op” or “Company”) is a 501(c)(3) nonprofit organization that was organized on June 20, 1925, under the laws of the State of Texas. The Co-op sells goods and services on-line and through its retail stores to the faculty, staff, Board of Regents, and students of The University of Texas at Austin (“UT”), other members of the Co-op, and the general public. The management of the Co-op’s affairs is vested in the Board who are trustees of the Co-op. In the event of the dissolution of the Co-op, the Board of Directors shall consider placing the net assets in an endowment fund so that the interest and proceeds are awarded to scholarships for students at The University of Texas at Austin.

In July 2009, the Co-op formed its wholly-owned subsidiary University Stores, Inc. (“USI”), a Texas for-profit corporation. USI closed the San Antonio store as of December 2018, and closed the Plano store as of March 2020.

During the year ended June 28, 2020, the Company reported a reduction in net assets of approximately \$1,484,000 and had an operating cash flow deficit of approximately \$142,000. Failure to generate adequate revenues could result in the Company having to significantly adjust or potentially cease operations. As of June 28, 2020, the Company had cash totaling approximately \$1,644,000. Management is devoting efforts to fund anticipated operating shortfalls and believes that a combination of cash on hand, available debt financing, and adjusting the current level of operations and cash expenditures to an internally sustainable level will be sufficient to finance the operations of the Company through at least the twelve months from the report issuance date.

2. Summary of Significant Accounting Policies

Definition of Fiscal Year

The Co-op reports its results of operations on a 52- or 53-week fiscal year ending on the last Sunday closest to June 30. Fiscal year 2020 was a 52-week year.

Basis of Accounting and Consolidation

The consolidated financial statements include the accounts of the Co-op and its wholly-owned subsidiary. The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) as defined by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). All significant intercompany transactions have been eliminated in consolidation.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of the consolidated 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 amounts reported in the consolidated financial statements and accompanying notes and supplemental schedules. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Co-op considers all highly liquid investments acquired with an original maturity of three months or less at the date of purchase to be cash equivalents. Cash equivalents are stated at cost, which approximates market value, because of the short maturity of these instruments.

Accounts Receivable

Trade accounts receivable are recorded at net realizable value and represent amounts due from customers. Other accounts receivable predominantly represent credit amounts due from vendors for returned items. The Co-op continually assesses the collectability of outstanding trade accounts receivable and vendor credits and if deemed necessary, maintains an allowance for estimated losses resulting from the non-collection of trade accounts receivable and vendor credits. The amount of the allowance for doubtful accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, and other collection indicators. Actual customer collections could differ from the Company's estimates. The allowance for doubtful accounts was \$4,000 at June 28, 2020 and June 30, 2019.

Concentration of Credit Risk

Financial instruments that potentially subject the Co-op to concentrations of credit risk consist of cash and cash equivalents and accounts receivable. The Co-op maintains its cash and cash equivalent balances in highly rated financial institutions, which at times may exceed federally insured limits. The Co-op has not experienced any loss relating to cash and cash equivalents in these accounts. As of June 28, 2020, 39% of the gross accounts receivable balance comprised amounts due to the Co-op primarily from its vendors for returned items. These receivables arise from a broad national vendor base and the Co-op routinely assesses the financial strength of its textbook vendors. The Co-op does not maintain collateral for its receivables and does not believe significant risk exists with respect to receivables. No customer represented more than 10% of total revenues in fiscal year 2020 and one vendor represented more than 17% of accounts receivable as of June 28, 2020.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments

The Company's financial instruments consist principally of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses. The carrying amounts of these financial instruments are considered to approximate their respective fair values due to the short-term nature of such financial instruments. The Company's debt is not measured at fair value on a recurring or nonrecurring basis and is carried at initial proceeds less payments made.

Merchandise Inventory

Merchandise inventories, which consists of goods for resale, are stated at the lower of cost or net realizable value. Cost includes the acquisition cost of purchased goods determined by the weighted-average cost method. Net realizable value is the estimated selling price less reasonably predictable costs to sell. Management estimates a reserve for obsolete inventory based on a review of specific inventory items at risk for obsolescence. No obsolescence reserve was considered necessary as of June 28, 2020 or June 30, 2019.

Property and Equipment, net

Property and equipment are carried at cost or, if donated, at the estimated fair market value at the date of the donation less accumulated depreciation. Major additions and betterments are capitalized. Repairs, maintenance, and minor replacements that do not materially improve or extend the lives of the respective assets are charged to operating expense as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the shorter of the remaining terms of the respective leases or the remaining useful lives of the improvements.

Long-Lived Assets

Long-lived assets, which consist primarily of property and equipment and intangible assets, are reviewed for impairment whenever events or circumstances indicate their carrying value may not be recoverable. When such events or circumstances arise, an estimate of future undiscounted cash flows produced by the asset, or the appropriate grouping of assets, is compared to the asset's carrying value to determine if impairment exists. If the asset is determined to be impaired, the impairment loss is measured based on the excess of its carrying value over its fair value. No indicators of impairment were identified during the fiscal years ended June 28, 2020, or June 30, 2019.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Intangible Assets Subject to Amortization

Intangible assets include lease premiums, copyrights, and a domain name. Amounts are subject to amortization on a straight-line basis over the estimated period of benefit and are subject to annual impairment consideration. Costs incurred to renew or extend the term of a recognized intangible asset are capitalized as part of the intangible asset and amortized over its revised estimated useful life. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of the intangible assets may not be recoverable. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets may not be recoverable. The Company evaluates the recoverability of intangible assets by comparing their carrying amounts to future net undiscounted cash flows expected to be generated by the intangible assets. If such intangible assets are considered to be impaired, the impairment recognized is measured as the amount by which the carrying amount of the intangible assets exceeds the fair value of the assets. The Company determines fair value based on discounted cash flows using a discount rate commensurate with the risk inherent in the Company's current business model for the specific intangible asset being valued. No impairment charges were recorded in the fiscal years ended June 28, 2020, or June 30, 2019.

Unredeemed Gift Certificates

Upon issuance of a gift certificate, a liability is established for its cash value. The liability is relieved and revenue is recorded upon redemption by the customer. The total liability related to unredeemed gift certificates was approximately \$125,000 and \$82,000 as of June 28, 2020, and June 30, 2019, and is included in accrued expenses in the accompanying consolidated balance sheets.

Revenue Recognition

On July 1, 2019, the Company adopted Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* ("ASC 606"). Refer to Note 9, Revenue Recognition, for a detailed discussion of accounting policies related to revenue recognition, including deferred revenue and deferred commissions.

Cost of Merchandise Sold

Cost of merchandise sold includes cost of inventory sold during each fiscal year (net of discounts) and freight-in costs.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Advertising

The Co-op expenses advertising costs as incurred. Advertising expenses were approximately \$418,000 and \$267,000 for the fiscal years ended June 28, 2020, and June 30, 2019, and are included in other selling and promotional costs in the consolidated statements of activities.

Sales Taxes

The Co-op records sales and other taxes collected from customers and subsequently remitted to government authorities as sales tax payable. The Co-op relieves the sales tax payable balances from the balance sheet as cash is remitted to the tax authority. Revenue is recorded net of sales tax.

University Gifts

University gifts are declared periodically at the discretion of the Board. All university gifts are recorded at the time of declaration.

Net Asset Classification

Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Co-op and changes therein are classified as follows:

- Without donor restrictions – Net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited by Board designation.
- With donor restrictions –
 - Net assets subject to donor-imposed stipulations that are met by actions of the Co-op or the passage of time. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are released to net assets without restrictions and reported in the consolidated statements of activities as net assets released from restrictions.
 - Net assets subject to donor-imposed stipulations that they be maintained permanently. The Co-op has not received any permanently restricted contributions to date as of June 28, 2020.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Income Taxes

The Co-op is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code, except to the extent of unrelated business income, if any. The Co-op did not incur significant tax liabilities due to unrelated business income in fiscal year 2020 or 2019. The Co-op files Form 990 tax returns in the U.S. federal jurisdiction and is subject to routine examinations of its returns; however, there are no examinations currently in progress.

USI is subject to federal income taxation as a C corporation and files income tax returns in the U.S. federal jurisdiction and the state of Texas. USI uses the asset and liability method of accounting for income taxes as set forth in the applicable guidance. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities will be recognized in the period that includes the enactment date. A valuation allowance is established against the deferred tax assets to reduce their carrying value to an amount that is more likely than not to be realized.

The Co-op and USI account for uncertain tax positions based on a “more-likely-than-not” threshold for the recognition and de-recognition of tax positions, which includes the accounting for interest and penalties relating to tax positions. At June 28, 2020, and June 30, 2019, the Co-op and USI do not have any unrecognized tax benefits resulting from their tax positions.

The Co-op and USI recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense. No such interest or penalties were recognized during the periods presented. The Co-op and USI had no accruals for interest and penalties at June 28, 2020 or June 30, 2019.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Functional Allocation of Expenses

The Co-op has allocated expenses, comprised of cost of merchandise sold, operating expenses, depreciation and amortization, and interest expense, as follows on a functional basis:

	Fiscal year ended June 28, 2020	Fiscal year ended June 30, 2019
Program		
Cost of merchandise sold	\$ 11,826,484	\$ 14,174,887
Personnel costs	3,436,274	3,668,950
Building occupancy costs	686,625	1,212,405
Depreciation and amortization	740,736	953,923
Other expenses	1,885,027	1,789,506
Total program expenses	\$ 18,575,146	\$ 21,799,671
Management and general		
Personnel costs	\$ 2,337,589	\$ 2,535,489
Building occupancy costs	122,327	119,426
Depreciation and amortization	159,019	16,277
Other expenses	793,740	845,784
Total management and general expenses	\$ 3,412,675	\$ 3,516,976
Total expenses	\$ 21,987,821	\$ 25,316,647

Recent Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*. This standard requires lessees to recognize a lease liability and a lease asset for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The standard also expands the required quantitative and qualitative disclosures surrounding leases. In July 2018 this standard was updated and improved through ASU 2018-10 and ASU 2018-11. In June 2020, the FASB issued ASU 2020-05, which changed the effective date for entities other than public business entities to annual periods beginning after December 15, 2021. Early adoption is permitted. This standard will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. However, per ASU 2018-11, the Company can elect to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than in the earliest period presented. Management is currently evaluating the effect of these provisions on the Company's financial position and results of operations.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This standard is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments. For trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward-looking “expected loss” model that generally will result in the earlier recognition of allowances for losses. In November 2019, the FASB issued ASU 2019-10, which changed the effective date for entities other than public business entities to annual periods beginning after December 15, 2022. Early adoption is permitted. This standard will be applied as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. Management is currently evaluating the effect of these provisions on the Company’s financial position and results of operations.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments — a consensus of the Emerging Issues Task Force*. This standard promotes consistency in the presentation of certain items on the Statement of Cash Flows. In November 2016 the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*. This standard clarifies restricted cash and restricted cash equivalents should be presented in the statement of cash flows. These new standards are effective for annual periods beginning after December 15, 2018. Early adoption is permitted. These standards have been adopted retrospectively beginning with the reporting period ended June 28, 2020.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, which clarifies how entities will determine whether to account for a transfer of assets as an exchange transaction or a contribution and how they will determine whether a contribution is conditional. While accounting for contributions primarily affects not-for-profit entities, the clarified guidance applies to all entities (including business entities) that receive or make contributions, except for certain transactions such as transfers of assets that business entities receive from government entities. For private entities in which the entity serves as the resource recipient, this standard is effective for annual reporting periods beginning after December 15, 2018. For private entities in which the entity serves as the resource provider, this standard is effective for annual reporting periods beginning after December 15, 2019.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Early adoption is permitted. Management is currently evaluating the effect of these provisions on the Company's financial position and results of operations.

In March 2019, the FASB issued ASU No. 2019-03, *Not-for-Profit Entities (Topic 958): Updating the Definition of Collections*. The amendments in this Update modify the definition of the term collections and require that a collection-holding entity disclose its policy for the use of proceeds when collection items are removed from a collection. The amendments in this update are effective for fiscal years beginning after December 15, 2019. Early application of the amendments is permitted. Entities are required to apply the amendments in this update on a prospective basis. Management does not expect this standard to have a material effect on its financial position and results of operations.

Subsequent Events

Subsequent events have been evaluated through September 30, 2020, which represents the date the financial statements were available to be issued.

3. Liquidity and Availability of Resources

The following table represents the Co-op's financial assets available to meet cash needs for general expenditures within one year of June 28, 2020.

	<u>June 28, 2020</u>
Current financial assets, at year end	
Cash and cash equivalents	\$ 1,644,307
Accounts receivable, net	<u>226,827</u>
	1,871,134
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 1,871,134</u>

The Organization maintains a policy of structuring its financial assets to be available as its general expenditures, liabilities, and other obligations come due.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

4. Property and Equipment

Property and equipment consist of the following:

	June 28, 2020	June 30, 2019
Land	\$ 1,155,694	\$ 1,155,694
Buildings	14,885,917	14,806,752
Furniture & office equipment	2,996,172	6,007,933
Leasehold improvements	2,110,706	2,597,702
Construction in progress	26,300	1,912
Total cost	21,174,789	24,569,993
Less accumulated depreciation	(10,274,710)	(12,804,663)
Property and equipment, net	\$ 10,900,079	\$ 11,765,330

Estimated useful lives are from 5 to 50 years for buildings and improvements and 5 to 7 years for furniture and office equipment.

For the fiscal years ended June 28, 2020 and June 30, 2019 respectively, depreciation and amortization expense for the above assets was \$843,770 and \$914,272, and is included in depreciation and amortization expense in the accompanying consolidated statement of activities.

5. Intangible Assets

Intangible assets consist of the following:

	Useful Life	June 28, 2020	June 30, 2019
Lease premiums	18-22 years	\$ 1,710,429	\$ 1,710,429
Copyright	10 years	9,870	9,870
Domain name	15 years	3,282	—
		1,723,581	1,720,299
Accumulated amortization		(1,584,418)	(1,528,433)
Intangible assets, net		\$ 139,163	\$ 191,866

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

5. Intangible Assets (continued)

The Co-op periodically reviews the estimated useful lives of its identifiable intangible assets, taking into consideration any events or circumstances that might result in either a diminished fair value or revised useful life. Management has determined there have been no indicators of impairment or change in useful life during the fiscal year ended June 28, 2020. Amortization expense relating to the Co-op's intangible assets was \$55,985 and \$55,928 for the fiscal years ended June 28, 2020 and June 30, 2019 respectively, and is included in depreciation and amortization expense in the accompanying consolidated statement of activities.

The following table represents the total estimated amortization of intangible assets for the five succeeding fiscal years:

Fiscal years ending	Total estimated amortization
2021	\$ 55,559
2022	55,162
2023	25,872
2024	219
2025	219
Thereafter	2,132
Total amortization expense	<u>\$ 139,163</u>

6. Accrued Expenses and Other

Accrued expenses consist of the following at:

	June 28, 2020	June 30, 2019
Accrued payroll and benefits	\$ 181,789	\$ 202,126
Accrued property, sales, and Texas margin taxes	156,190	257,963
Other accrued expenses	195,180	240,339
Accrued expenses and other	<u>\$ 533,159</u>	<u>\$ 700,428</u>

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt

Long-term debt consists of the following:

	June 28, 2020	June 30, 2019
Revolving line of credit	\$ 3,500,000	\$ 3,325,000
Notes payable	4,644,345	2,910,514
Long-term debt	8,144,345	6,235,514
Less: current maturities	(858,117)	(369,301)
	<u>\$ 7,286,228</u>	<u>\$ 5,866,213</u>

In January 2014, the Co-op entered into a loan and security agreement (“LSA”) with a financial institution offering a revolving line of credit up to a maximum principle amount of \$3.5 million. Borrowings under the revolving line of credit bear interest at the prime rate plus 0.5% per annum (5.00% at June 28, 2020), with a floor of 4.00%. Interest is payable monthly and any outstanding principal balance is due at maturity. In January 2017, the LSA was modified to extend the maturity date of the revolving line of credit to January 2019. In September 2018, the LSA was amended to extend the maturity date of the revolving line of credit to January 2020. In December 2019, the LSA was amended to extend the maturity date of the revolving line of credit to July 2021. The balance of the revolving line of credit was \$3,500,000 and \$3,325,000 as of June 28, 2020 and June 30, 2019, respectively.

Under the LSA, the Co-op also entered into a term loan in the amount of \$6,551,152. Amounts due under the term loan bear interest at the prime rate plus 0.5% per annum (5.25% at June 28, 2020), with a floor of 4.00%. Interest is payable monthly beginning February 2014 until maturity in January 2020. The balance of the term loan was \$1,956,013 and \$2,076,268 as of June 28, 2020 and June 30, 2019, respectively. In May 2019, the Co-op entered into a second term loan under the LSA in the amount of \$1,500,000, of which only \$500,000 had been advanced as of June 30, 2019. The remaining \$1,000,000 was advanced in July 2019. Amounts due under the term loan bear interest at an effective interest rate of 6.375% and are payable in monthly installments beginning September 2019 until maturity in August 2029. The balance of the second term loan was \$1,443,822 and \$500,000 as of June 28, 2020 and June 30, 2019, respectively. Substantially all of the Co-op’s assets are pledged as collateral under the LSA.

The Co-op is required to meet certain financial and nonfinancial covenants as detailed in the LSA.

In August 2017, the Co-op entered into a term loan in the amount of \$459,404. Amounts due under the term loan bear interest at an effective interest rate of 6.07% and are payable in monthly installments beginning September 2017 until maturity in August 2022. The balance of the term loan was \$212,638 and \$304,995 as of June 28, 2020 and June 30, 2019, respectively. In February 2018, the Co-op entered into an additional term loan in the amount of \$55,035.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

7. Long-Term Debt (continued)

Amounts due under the term loan bear interest at an effective rate of 4.50% and are payable in monthly installments beginning February 2018 until maturity in January 2021. The balance of the additional term loan was \$10,572 and \$29,251 as of June 28, 2020 and June 30, 2019, respectively.

As part of the federal government's response to the economic impacts of COVID-19, in March 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted which, among other measures, provided for the Paycheck Protection Program (PPP) administered by the U.S. Small Business Administration. In April 2020, the Company applied and was approved for a PPP loan in the amount of 1,021,3000. All or a portion of the PPP loan may qualify for forgiveness under the terms of the PPP. Amounts not qualifying for forgiveness bear interest at a rate of 1% per annum and will be repaid in monthly installments of principal and accrued interest through April 2022, at which time the loan matures and all outstanding principal and accrued interest is due. The balance of the PPP loan was \$1,021,300 as of June 28, 2020.

The aggregate maturities of the Co-op's debt are as follows at June 28, 2020:

Fiscal years ending	Principal Payments
2021	\$ 858,117
2022	4,479,290
2023	335,555
2024	346,051
2025	368,145
Thereafter	1,757,187
Total principal payments on debt	<u>\$ 8,144,345</u>

For the fiscal years ended June 28, 2020 and June 30, 2019, interest expense on the Co-op's long-term debt was \$366,927 and \$271,659, respectively.

8. Commitments and Contingencies

Operating Leases

The Co-op accounts for rent expense for its operating leases on a straight-line basis in accordance with authoritative guidance on accounting for leases. The Co-op leases facilities that have terms expiring between 2020 and 2026. The terms of the store leases are considered their initial obligation periods, which do not include option periods. The store leases generally have renewal clauses of five years exercisable at the option of the Co-op. Most lease agreements contain rent holidays and/or rent escalation clauses. The Co-op includes scheduled rent holidays and rent escalation clauses for the purposes of recognizing straight-line rent over the lease term.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

8. Commitments and Contingencies (continued)

Commitments

The Co-op leases building facilities and equipment under non-cancellable operating leases. The Co-op recognizes expense on a straight-line basis and records the difference between the recognized rental expense and amounts payable under the facilities lease as deferred rent. Rental expense totaled \$317,258 and \$645,636 during the fiscal years ended June 28, 2020 and June 30, 2019 respectively, and is included in building occupancy costs per the accompanying consolidated statement of activities.

Future minimum payments required under operating leases, by fiscal year and in aggregate, that have initial or remaining non-cancellable lease terms in excess of one year as of June 28, 2020, are as follows:

Fiscal years ending	Operating Leases
2021	\$ 638,743
2022	617,868
2023	621,896
2024	557,056
2025	302,500
Thereafter	110,330
Total minimum lease payments	<u>\$ 2,848,393</u>

Defined Contribution Plans

The Co-op has defined contribution 401(k) and 403(b) retirement plans (the “Plans”) and a custodial account covering individuals who have been employed by the Co-op at least one year, who work a minimum of 1,000 hours per year, and who have attained the age of 21. Participants in the 403(b) Plan are permitted to make elective deferrals of their pre-tax compensation to the 403(b) Plan, not to exceed limits set by Internal Revenue Code Section 402(g). The 403(b) Plan is administered by a custodial trustee under the guidance of the Board.

During 2018, the Board approved a match program beginning subsequent to the current fiscal year for eligible employees, which would deposit an amount to each eligible employee’s 401(k) and 403(b) accounts, not to exceed 5% of the eligible employee’s annual compensation. The Co-op’s contributions under the Plans totaled \$113,144 during the fiscal year ended June 28, 2020.

The Board has agreed to fund the post-retirement medical benefits for the former President/CEO and spouse not to exceed amounts paid to his successor. A reasonable estimate for the cost cannot be determined; therefore, no liability is recorded in the consolidated financial statements at this time.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

8. Commitments and Contingencies (continued)

Litigation

In the normal course of business, the Co-op may become involved in various lawsuits and legal proceedings. While the ultimate results of these matters cannot be predicted with certainty, management does not expect them to have a material adverse effect on the consolidated financial position or results of operations of the Co-op.

9. Revenue Recognition

For revenue recorded in fiscal year 2019, revenue is recognized when persuasive evidence of agreement exists, delivery of the product has occurred, the fee is fixed and determinable, and collection is probable.

After adoption of ASC 606 on July 1, 2019, revenues are recognized when control of the promised goods or services is transferred to a customer in an amount that reflects the consideration the Co-op is expected to be entitled to in exchange for those goods. Revenues are recognized net of sales credits and allowances. Revenue is recognized net of any taxes collected from customers, which are subsequently remitted to governmental authorities.

Revenue is recognized based on the following five-step model in accordance with ASC 606, *Revenue from Contracts with Customers*:

1. Identification of the contract with a customer
2. Identification of the performance obligations in the contract
3. Determination of the transaction price
4. Allocation of the transaction price to the performance obligations in the contract
5. Recognition of revenue when, or as, the Company satisfies a performance obligation

Revenue-generating activities consist of retail sales, textbook rentals, and custom publishing activities for various departments of the University of Texas.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

9. Revenue Recognition (continued)

Retail Sales

The Co-op recognizes revenue from retail sales when goods are provided to the customer, either in-person at a retail location, or when products are shipped from the warehouse.

Textbook Rental

Textbook rental revenue is recognized when the rental occurs. Rentals are short-term in nature and are only made for a single semester at a time.

Custom Publishing

The Co-op recognizes revenue from custom publishing services when orders are completed.

Disaggregation of Revenue from Contracts with Customers

The following table disaggregates the Co-op's revenue based on the timing of satisfaction of performance obligations for the fiscal year ended June 28, 2020:

<u>Major Contracts</u>	
Retail sales	\$ 19,646,237
Textbook rental	435,777
Custom publishing	415,920
Other sales	200,262
Total	<u>\$ 20,698,196</u>
<u>Timing of Revenue Recognition</u>	
Performance obligations satisfied at a point in time	\$ 20,698,196
Total	<u>\$ 20,698,196</u>

Significant Judgments

Performance Obligations

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. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. The Co-op's contracts with customers do not typically include multiple performance obligations.

Standalone Selling Price

Because the Co-op's contracts with customers do not typically include multiple performance obligations, it is not necessary to allocate the total transaction price based on standalone selling price.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

9. Revenue Recognition (continued)

Variable Consideration

Contracts with customers do not include variable consideration.

Principal and Agent Considerations – Digital Textbooks

The Co-op evaluated principal vs. agent considerations to determine whether it is appropriate to record digital textbook purchase costs paid to the originating vendor as an expense or as a reduction of revenue. Digital textbook purchase costs are recorded as a reduction of revenue and not cost of revenue because the Co-op does not control the goods before they are transferred to the customer. While the Co-op transfers the product to the final customer, the Co-op is not responsible for establishing prices, does not hold inventory, and does not have any additional responsibilities to the customer once the digital textbook has been purchased.

Shipping and Handling

The Co-op has elected to account for shipping and handling as fulfillment activities, even if those activities occur after control of the goods has been transferred to the customer. As such, the Co-op expenses shipping and handling costs associated with the contract when the associated revenue is recognized. Shipping and handling costs are included in general and administrative expenses in the consolidated statements of activities.

Payment Terms

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days and include no general rights of return. Payment for retail sales is due at the time of purchase. In instances where the timing of revenue recognition differs from the timing of invoicing, the Co-op has determined that contracts do not include a significant financing component.

Contract Balances

The timing of revenue recognition, billings and cash collections can result in billed accounts receivable. At June 28, 2020 and June 30, 2019, accounts receivable totaled \$226,827 and \$487,887, respectively.

Deferred Contract Costs

The Company has determined it does not have significant incremental costs of obtaining or fulfilling contracts with customers. Any costs are recorded within operating expenses as incurred.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

9. Revenue Recognition (continued)

Financial Statement Impact of Adoption of ASC 606

The adoption of ASC 606 did not have a significant impact on the Company's financial statements and there was no cumulative impact as a result of adoption of ASC 606 on July 1, 2019.

10. Rental Income

The Co-op leases portions of its buildings to unrelated third-parties under lease agreements. As of June 28, 2020, the property held for leasing, which was included in property and equipment on the consolidated statement of financial position, had a cost basis and accumulated depreciation of \$263,982 and \$146,388 respectively.

On June 29, 2020, the Co-op executed a lease termination agreement for a tenant. On July 16, 2020, a temporary lease agreement with a new tenant for the same space was executed. On August 20, 2020, the Co-op executed a 5-year lease renewal agreement for the lease of an ATM space at the same street address as noted above.

After the lease termination, new lease agreement, and lease renewal, the Co-op has the following future minimum rental payments to be received in future years:

2020	\$ 1,733,823
2021	487,098
2022	416,256
2023	382,218
2024	320,900
Thereafter	29,495
Total minimum lease payments	<u>\$ 3,369,790</u>

11. Net Assets with Donor Restrictions

On September 1, 2005, University Presbyterian Church (the "Church") contributed to the Co-op a tract of land adjacent to two parking lots owned by the Co-op. The land was valued at \$420,000 on the date of contribution and was recorded at its fair value. The Co-op constructed a parking garage on the three lots, which was completed in August 2006. In exchange for the contributed land, the Co-op granted the Church an easement to certain parking spaces upon completion of the parking garage for a term of 99 years. In accordance with the reversion clause of the deed, the contributed land must be operated as a parking garage for the term of 99 years or ownership of the land will revert back to the Church. Due to the donor-imposed use and time restrictions, the contribution was recorded as non-operating income classified as a net asset with donor restrictions.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

12. Non-operating Income (Expense)

Non-operating income (expenses) consisted of the following for the fiscal years ended June 28, 2020 and June 30, 2019:

	2020	2019
Rental income	\$ 944,591	\$ 1,002,755
Gain on parking lot, net	360,733	412,680
Unredeemed patronage refunds	–	47,480
Sales tax discount	9,074	10,375
Other expense	(864,306)	(816,544)
Total non-operating income	<u>\$ 450,092</u>	<u>\$ 656,746</u>

13. Income Taxes

The components of the consolidated provision for income taxes are as follows for the fiscal years ended June 28, 2020, and June 30, 2019:

	2020	2019
Current:		
Federal	\$ –	\$ 15,407
State	(926)	2,294
Total current	(926)	17,702
Total income tax expense (benefit)	<u>\$ (926)</u>	<u>\$ 17,702</u>

The Co-op's consolidated provision for income taxes attributable to continuing operations differs from the expected tax expense amount computed by applying the statutory federal income tax rate of 21% to income before income taxes, primarily as a result of the application of the valuation allowance, losses generated that are exempt from income taxation, and permanent differences.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

13. Income Taxes (continued)

Significant components of USI's deferred tax assets and liabilities at June 28, 2020 and June 30, 2019 are as follows:

	2020	2019
Deferred tax assets		
Net operating loss carryforward	\$ 212,055	\$ 2,160,088
Depreciable assets	—	71,311
Inventory reserve	—	276
Charitable contribution carryforward	5,572	14,269
Total deferred tax assets	<u>217,627</u>	<u>2,293,067</u>
Net deferred tax asset before valuation allowance	217,627	2,293,067
Less: valuation allowance	<u>(217,627)</u>	<u>(2,293,067)</u>
Net deferred tax asset	<u>\$ —</u>	<u>\$ —</u>

USI has established a valuation allowance equal to the net deferred tax asset due to uncertainties regarding the realization of the deferred tax asset based on USI's lack of earnings history. The valuation allowance decreased by approximately \$2,075,000 during the fiscal year ended June 28, 2020, primarily due to reduction of net deferred tax assets, which is a result of utilization of net operating loss by the forgiveness of debt.

At June 28, 2020, USI has U.S. net operating loss carryforwards of approximately \$1,009,000, of which \$662,000 will begin to expire in 2037 if not utilized, and \$347,000 will carry forward indefinitely.

Utilization of the net operating loss and tax credit carryforwards is likely subject to annual limitations due to the "change in ownership" provisions (Section 382) of the Internal Revenue Code. The annual limitations may result in the expiration of net operating losses before their utilization. The net operating loss carryforwards are subject to Internal Revenue Service adjustments until the statute closes on the year the net operating loss is utilized.

The Co-op recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities. As of June 28, 2020, the Co-op has recorded no unrecognized tax benefits. Additionally, the Company does not expect any unrecognized tax benefits to change significantly over the next twelve months.

University Co-operative Society

Notes to Consolidated Financial Statements (continued)

14. COVID-19

On March 11, 2020, the World Health Organization declared a novel strain of coronavirus ("COVID-19") a "Public Health Emergency of International Concern" and characterized COVID-19 as a pandemic. On March 13, 2020, the President of the United States declared the COVID-19 pandemic a national emergency, invoking powers under the Stafford Act, the legislation that directs federal emergency disaster response. The extent of the impact of COVID-19 on the Co-op's operational and financial performance will depend on future developments, including the duration and spread of the outbreak, additional government restrictions, and the impact of COVID-19 on the Company's operations, all of which are highly uncertain and cannot be predicted.

15. Subsequent Events

See Note 10 for discussion of subsequent events related to rental income agreements.

Supplemental Schedules

University Co-operative Society and Subsidiary

Consolidating Schedule of Financial Position

As of June 28, 2020

	Co-op	USI	Total	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	\$ 1,640,050	\$ 4,257	\$ 1,644,307	—	\$ 1,644,307
Accounts receivable:					
Trade, net	91,291	—	91,291	—	91,291
Other	135,536	—	135,536	—	135,536
Merchandise inventory	2,696,971	—	2,696,971	—	2,696,971
Prepaid expenses and other	354,955	—	354,955	—	354,955
Total current assets	4,918,803	4,257	4,923,060	—	4,923,060
Property and equipment, net	10,900,079	—	10,900,079	—	10,900,079
Intangible assets, net	139,163	—	139,163	—	139,163
Investment in subsidiary	(264,808)	—	(264,808)	264,808	—
Total assets	\$15,693,237	\$ 4,257	\$ 15,697,494	264,808	\$ 15,962,302
Liabilities and Net Assets					
Current liabilities:					
Accounts payable	\$ 2,184,692	\$ 260,905	\$ 2,445,597	—	\$ 2,445,597
Accrued expenses	524,999	8,160	533,159	—	533,159
Current portion of long-term debt	858,117	—	858,117	—	858,117
Total current liabilities	3,567,808	269,065	3,836,873	—	3,836,873
Deferred rent	46,749	—	46,749	—	46,749
Long-term debt, net of current portion	7,286,228	—	7,286,228	—	7,286,228
Total liabilities	10,900,785	269,065	11,169,850	—	11,169,850
Net Assets:					
Without restrictions	4,372,452	(264,808)	4,107,644	264,808	4,372,452
With donor restrictions	420,000	—	420,000	—	420,000
Total net assets	4,792,452	(264,808)	4,527,644	264,808	4,792,452
Total liabilities and net assets	\$15,693,237	\$ 4,257	\$ 15,697,494	\$ 264,808	\$ 15,962,302

University Co-operative Society and Subsidiary

Consolidating Schedule of Activities

For the fiscal year ended June 28, 2020

	Co-op	USI	Total	Eliminations	Consolidated
Net assets without restrictions					
Revenue:					
Net sales	\$ 20,373,040	\$ 325,156	\$ 20,698,196	–	\$ 20,698,196
Cost of merchandise sold	(11,643,865)	(182,619)	(11,826,484)	–	(11,826,484)
Total gross margin	8,729,175	142,537	8,871,712		8,871,712
Operating expenses:					
Personnel costs	5,454,213	319,650	5,773,863	–	5,773,863
Building occupancy costs	600,533	208,419	808,952	–	808,952
General and administrative	12,469,200	(10,575,471)	1,893,729	–	1,893,729
Other selling and promotional costs	418,078	38	418,116	–	418,116
Total operating expenses	18,942,024	(10,047,364)	8,894,660	–	8,894,660
Increase (decrease) in net assets without restrictions from operations	(10,212,849)	10,189,901	(22,948)	–	(22,948)
Other income (expense):					
Non-operating income (expense)	657,495	(207,403)	450,092	–	450,092
Depreciation and amortization	(826,761)	(72,994)	(899,755)	–	(899,755)
Interest expense	(366,927)	–	(366,927)	–	(366,927)
Equity in income of subsidiary	9,795,835	–	9,795,835	(9,795,835)	–
Total other income (expense), net	9,259,642	(280,397)	8,979,245	(9,795,835)	(816,590)
Income tax benefit (expense)	–	926	926	–	926
Change in net assets without restrictions before university gifts and loss on sale of property and equipment	(953,207)	9,910,430	8,957,223	(9,795,835)	(838,612)
University gifts	(147,933)	–	(147,933)	–	(147,933)
Loss on sale of property and equipment	(168,837)	(113,112)	(281,949)	–	(281,949)
Change in net assets without restrictions before patronage refunds and membership discounts	(1,269,977)	9,797,318	8,527,341	(9,795,835)	(1,268,494)
Membership discounts	(214,433)	(1,483)	(215,916)	–	(215,916)
Change in net assets without restrictions	(1,484,410)	9,795,835	8,311,425	(9,795,835)	(1,484,410)
Net assets, beginning of the year	6,276,862	(10,060,643)	(3,783,781)	10,060,643	6,276,862
Net assets, end of the year	\$ 4,792,452	\$ (264,808)	\$ 4,527,644	\$ 264,808	\$ 4,792,452