

Settlement Music School of Philadelphia

Consolidated Financial Statements
Years Ended June 30, 2017 and 2016



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SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

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INDEPENDENT AUDITOR'S REPORT

Central Board Settlement Music School of Philadelphia

We have audited the accompanying consolidated financial statements of Settlement Music School of Philadelphia (a nonprofit organization), which comprise the consolidated statements of financial position as of June 30, 2017 and 2016, and the related consolidated statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; 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 U.S. generally accepted auditing standards. 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 financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 Settlement Music School of Philadelphia as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

BBD, LLP.

**Philadelphia, Pennsylvania
January 15, 2018**

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
CURRENT ASSETS		
Cash	\$ 2,779,093	\$ 1,470,759
Accounts receivable	57,861	34,712
Contributions receivable		
Grants receivable	1,626,000	410,000
Pledges and bequests receivable, net of allowance for doubtful accounts of \$25,000 in 2017 and \$50,000 in 2016	207,320	1,016,507
Prepaid expenses	<u>122,723</u>	<u>78,430</u>
Total current assets	<u>4,792,997</u>	<u>3,010,408</u>
PROPERTY AND EQUIPMENT, NET	<u>17,654,865</u>	<u>18,011,647</u>
INVESTMENTS	<u>7,572,383</u>	<u>6,854,875</u>
NONCURRENT ASSETS		
Life insurance policies	300,000	300,000
Beneficial interest in charitable remainder unitrust	629,640	611,046
Pledges and bequests receivable, due beyond one year	<u>1,238,207</u>	<u>948,269</u>
Total noncurrent assets	<u>2,167,847</u>	<u>1,859,315</u>
	<u>\$ 32,188,092</u>	<u>\$ 29,736,245</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Line of credit	\$ -	\$ 125,000
Accounts payable and accrued expenses	172,795	608,151
Agency obligations	448,613	-
Deposits and advance payments	387,210	408,106
Current portion of term loans	<u>136,233</u>	<u>132,856</u>
Total current liabilities	<u>1,144,851</u>	<u>1,274,113</u>
NONCURRENT LIABILITIES		
Agency obligations, net of current portion	1,113,750	-
Term loans, net of current portion	<u>5,317,036</u>	<u>5,611,684</u>
Total noncurrent liabilities	<u>6,430,786</u>	<u>5,611,684</u>
Total liabilities	<u>7,575,637</u>	<u>6,885,797</u>
NET ASSETS		
Unrestricted	14,068,478	13,669,027
Temporarily restricted	4,072,512	3,202,947
Permanently restricted	<u>6,471,465</u>	<u>5,978,474</u>
Total net assets	<u>24,612,455</u>	<u>22,850,448</u>
Total liabilities and net assets	<u>\$ 32,188,092</u>	<u>\$ 29,736,245</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended June 30, 2017 with comparative totals for 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Totals</u>	
				<u>2017</u>	<u>2016</u>
OPERATING					
Public support, revenues and gains					
Public support					
Contributions, bequests and grants	\$ 1,453,893	2,846,791	\$ -	\$ 4,300,684	\$ 5,011,071
Special event	384,936	-	-	384,936	363,204
Net assets released from restrictions	<u>1,986,329</u>	<u>(1,986,329)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total public support	<u>3,825,158</u>	<u>860,462</u>	<u>-</u>	<u>4,685,620</u>	<u>5,374,275</u>
Revenues and gains					
Tuition and registration fees	4,516,394	-	-	4,516,394	4,580,110
Endowment spending policy distribution	325,000	-	-	325,000	335,000
Rental and miscellaneous income	<u>212,662</u>	<u>-</u>	<u>-</u>	<u>212,662</u>	<u>205,818</u>
Total revenues and gains	<u>5,054,056</u>	<u>-</u>	<u>-</u>	<u>5,054,056</u>	<u>5,120,928</u>
Total public support, revenues and gains	<u>8,879,214</u>	<u>860,462</u>	<u>-</u>	<u>9,739,676</u>	<u>10,495,203</u>
Expenses					
Program services					
Instruction and student activities	5,194,907	-	-	5,194,907	5,290,638
Non-Core programs	<u>1,678,588</u>	<u>-</u>	<u>-</u>	<u>1,678,588</u>	<u>1,669,395</u>
Total program services	<u>6,873,495</u>	<u>-</u>	<u>-</u>	<u>6,873,495</u>	<u>6,960,033</u>
Supporting services					
Management and general	1,177,392	-	-	1,177,392	1,250,372
Fundraising	<u>551,413</u>	<u>-</u>	<u>-</u>	<u>551,413</u>	<u>557,268</u>
Total supporting services	<u>1,728,805</u>	<u>-</u>	<u>-</u>	<u>1,728,805</u>	<u>1,807,640</u>
Total expenses	<u>8,602,300</u>	<u>-</u>	<u>-</u>	<u>8,602,300</u>	<u>8,767,673</u>
Change in net assets from operating activities	<u>276,914</u>	<u>860,462</u>	<u>-</u>	<u>1,137,376</u>	<u>1,727,530</u>
NONOPERATING					
Contributions	-	-	8,695	8,695	191,707
Loss on uncollectible contributions receivable	-	(9,491)	(299)	(9,790)	(28,025)
Loss on sale of assets held for sale	-	-	-	-	(27,650)
Investment income (loss)	189,542	-	742,590	932,132	(27,727)
Endowment spending policy distribution	(67,005)	-	(257,995)	(325,000)	(335,000)
Change in value of split-interest agreements	<u>-</u>	<u>18,594</u>	<u>-</u>	<u>18,594</u>	<u>18,046</u>
Change in net assets from nonoperating activities	<u>122,537</u>	<u>9,103</u>	<u>492,991</u>	<u>624,631</u>	<u>(208,649)</u>
CHANGE IN NET ASSETS	<u>399,451</u>	<u>869,565</u>	<u>492,991</u>	<u>1,762,007</u>	<u>1,518,881</u>
NET ASSETS					
Beginning of year	<u>13,669,027</u>	<u>3,202,947</u>	<u>5,978,474</u>	<u>22,850,448</u>	<u>21,331,567</u>
End of year	<u>\$ 14,068,478</u>	<u>\$ 4,072,512</u>	<u>\$ 6,471,465</u>	<u>\$ 24,612,455</u>	<u>\$ 22,850,448</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended June 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING				
Public support, revenues and gains				
Public support				
Contributions, bequests and grants	\$ 1,840,153	\$ 3,170,918	\$ -	\$ 5,011,071
Special event	363,204	-	-	363,204
Net assets released from restrictions	<u>2,313,402</u>	<u>(2,313,402)</u>	-	-
Total public support	<u>4,516,759</u>	<u>857,516</u>	<u>-</u>	<u>5,374,275</u>
Revenues and gains				
Tuition and registration fees	4,580,110	-	-	4,580,110
Endowment spending policy distribution	335,000	-	-	335,000
Rental and miscellaneous income	<u>205,818</u>	<u>-</u>	<u>-</u>	<u>205,818</u>
Total revenues and gains	<u>5,120,928</u>	<u>-</u>	<u>-</u>	<u>5,120,928</u>
Total public support, revenues and gains	<u>9,637,687</u>	<u>857,516</u>	<u>-</u>	<u>10,495,203</u>
Expenses				
Program services				
Instruction and student activities	5,290,638	-	-	5,290,638
Non-Core programs	<u>1,669,395</u>	<u>-</u>	<u>-</u>	<u>1,669,395</u>
Total program services	<u>6,960,033</u>	<u>-</u>	<u>-</u>	<u>6,960,033</u>
Supporting services				
Management and general	1,250,372	-	-	1,250,372
Fundraising	<u>557,268</u>	<u>-</u>	<u>-</u>	<u>557,268</u>
Total supporting services	<u>1,807,640</u>	<u>-</u>	<u>-</u>	<u>1,807,640</u>
Total expenses	<u>8,767,673</u>	<u>-</u>	<u>-</u>	<u>8,767,673</u>
Change in net assets from operating activities	<u>870,014</u>	<u>857,516</u>	<u>-</u>	<u>1,727,530</u>
NONOPERATING				
Contributions	-	-	191,707	191,707
Loss on uncollectible contributions receivable	-	(3,025)	(25,000)	(28,025)
Loss on sale of assets held for sale	(27,650)	-	-	(27,650)
Investment loss	(5,911)	-	(21,816)	(27,727)
Endowment spending policy distribution	(83,851)	-	(251,149)	(335,000)
Change in value of split-interest agreements	<u>-</u>	<u>18,046</u>	<u>-</u>	<u>18,046</u>
Change in net assets from nonoperating activities	<u>(117,412)</u>	<u>15,021</u>	<u>(106,258)</u>	<u>(208,649)</u>
CHANGE IN NET ASSETS	<u>752,602</u>	<u>872,537</u>	<u>(106,258)</u>	<u>1,518,881</u>
NET ASSETS				
Beginning of year	<u>12,916,425</u>	<u>2,330,410</u>	<u>6,084,732</u>	<u>21,331,567</u>
End of year	<u>\$ 13,669,027</u>	<u>\$ 3,202,947</u>	<u>\$ 5,978,474</u>	<u>\$ 22,850,448</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

Year ended June 30, 2017

	Mary Louise Curtis Branch	Germantown Branch	Northeast Branch	Willow Grove Branch	Wynnfield Branch	Camden Branch	Non-Core Programs	Total	Management and General	Fundraising	Total
Salaries, wages and related expenses											
Faculty											
Salaries and wages	\$ 666,954	\$ 315,444	\$ 435,380	\$ 363,554	\$ 312,902	\$ 51,278	\$ 851,640	\$ 2,997,152	\$ -	\$ -	\$ 2,997,152
Benefits and payroll taxes	83,224	36,210	47,727	53,683	32,011	6,089	132,836	391,780	-	-	391,780
	<u>750,178</u>	<u>351,654</u>	<u>483,107</u>	<u>417,237</u>	<u>344,913</u>	<u>57,367</u>	<u>984,476</u>	<u>3,388,932</u>	<u>-</u>	<u>-</u>	<u>3,388,932</u>
Staff											
Salaries and wages	279,164	197,884	258,326	163,051	252,504	80,011	309,283	1,540,223	706,067	301,203	2,547,493
Benefits and payroll taxes	45,202	24,234	29,310	23,999	24,858	10,696	26,641	184,940	89,346	32,354	306,640
	<u>324,366</u>	<u>222,118</u>	<u>287,636</u>	<u>187,050</u>	<u>277,362</u>	<u>90,707</u>	<u>335,924</u>	<u>1,725,163</u>	<u>795,413</u>	<u>333,557</u>	<u>2,854,133</u>
Total salaries, wages and related expenses	<u>1,074,544</u>	<u>573,772</u>	<u>770,743</u>	<u>604,287</u>	<u>622,275</u>	<u>148,074</u>	<u>1,320,400</u>	<u>5,114,095</u>	<u>795,413</u>	<u>333,557</u>	<u>6,243,065</u>
Occupancy											
Heat and utilities	42,082	25,317	23,852	35,506	20,543	-	19,086	166,386	1,972	1,468	169,826
Insurance	31,708	32,095	14,487	25,315	15,735	-	15,076	134,416	1,486	1,106	137,008
Repairs and maintenance	35,019	36,187	10,486	22,979	32,085	12,956	13,352	163,064	1,641	1,221	165,926
Total occupancy	<u>108,809</u>	<u>93,599</u>	<u>48,825</u>	<u>83,800</u>	<u>68,363</u>	<u>12,956</u>	<u>47,514</u>	<u>463,866</u>	<u>5,099</u>	<u>3,795</u>	<u>472,760</u>
Administrative and other											
Office costs	33,443	19,421	18,771	18,280	20,559	8,145	35,021	153,640	128,035	42,898	324,573
Music expenses and contract services	5,154	1,880	2,110	2,790	599	8,963	177,145	198,641	6,299	115,672	320,612
Insurance, taxes and professional fees	259	50	1,353	60	36	150	22,346	24,254	161,926	35,246	221,426
Interest expense and fees	50,582	22,321	6,842	90,976	7,409	11	2,717	180,858	3,201	2,702	186,761
Automobile, conferences and dues	1,877	1,635	1,605	3,603	1,364	348	8,642	19,074	45,501	11,862	76,437
Advertising and publicity	705	550	1,242	395	75	975	1,315	5,257	9,084	1,847	16,188
Miscellaneous and other	925	700	144	462	527	-	29,081	31,839	17,118	3,030	51,987
Total administrative and other	<u>92,945</u>	<u>46,557</u>	<u>32,067</u>	<u>116,566</u>	<u>30,569</u>	<u>18,592</u>	<u>276,267</u>	<u>613,563</u>	<u>371,164</u>	<u>213,257</u>	<u>1,197,984</u>
Total expenses before depreciation	<u>1,276,298</u>	<u>713,928</u>	<u>851,635</u>	<u>804,653</u>	<u>721,207</u>	<u>179,622</u>	<u>1,644,181</u>	<u>6,191,524</u>	<u>1,171,676</u>	<u>550,609</u>	<u>7,913,809</u>
Depreciation	<u>165,193</u>	<u>146,542</u>	<u>28,396</u>	<u>240,262</u>	<u>64,233</u>	<u>2,938</u>	<u>34,407</u>	<u>681,971</u>	<u>5,716</u>	<u>804</u>	<u>688,491</u>
	<u>\$ 1,441,491</u>	<u>\$ 860,470</u>	<u>\$ 880,031</u>	<u>\$ 1,044,915</u>	<u>\$ 785,440</u>	<u>\$ 182,560</u>	<u>\$ 1,678,588</u>	<u>\$ 6,873,495</u>	<u>\$ 1,177,392</u>	<u>\$ 551,413</u>	<u>\$ 8,602,300</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

Year ended June 30, 2016

	Mary Louise Curtis Branch	Germantown Branch	Northeast Branch	Willow Grove Branch	Wynnfield Branch	Camden Branch	Non-Core Programs	Total	Management and General	Fundraising	Total
Salaries, wages and related expenses											
Faculty											
Salaries and wages	\$ 636,972	\$ 321,894	\$ 456,931	\$ 372,938	\$ 322,772	\$ 60,113	\$ 822,149	\$ 2,993,769	\$ -	\$ -	\$ 2,993,769
Benefits and payroll taxes	90,372	40,356	55,883	57,782	46,714	8,014	112,602	411,723	-	-	411,723
	<u>727,344</u>	<u>362,250</u>	<u>512,814</u>	<u>430,720</u>	<u>369,486</u>	<u>68,127</u>	<u>934,751</u>	<u>3,405,492</u>	<u>-</u>	<u>-</u>	<u>3,405,492</u>
Staff											
Salaries and wages	263,362	189,040	246,431	206,157	178,433	76,542	292,797	1,452,762	752,495	321,545	2,526,802
Benefits and payroll taxes	33,213	25,904	32,498	31,687	21,018	11,389	24,132	179,841	91,476	41,964	313,281
	<u>296,575</u>	<u>214,944</u>	<u>278,929</u>	<u>237,844</u>	<u>199,451</u>	<u>87,931</u>	<u>316,929</u>	<u>1,632,603</u>	<u>843,971</u>	<u>363,509</u>	<u>2,840,083</u>
Total salaries, wages and related expenses	<u>1,023,919</u>	<u>577,194</u>	<u>791,743</u>	<u>668,564</u>	<u>568,937</u>	<u>156,058</u>	<u>1,251,680</u>	<u>5,038,095</u>	<u>843,971</u>	<u>363,509</u>	<u>6,245,575</u>
Occupancy											
Heat and utilities	40,700	25,196	30,032	35,228	24,864	6,320	19,350	181,690	2,944	1,418	186,052
Insurance	31,639	32,026	14,600	25,260	15,701	9,060	15,043	143,329	1,483	1,104	145,916
Repairs and maintenance	46,466	51,968	13,839	23,907	28,241	15,420	12,906	192,747	17,513	1,600	211,860
Total occupancy	<u>118,805</u>	<u>109,190</u>	<u>58,471</u>	<u>84,395</u>	<u>68,806</u>	<u>30,800</u>	<u>47,299</u>	<u>517,766</u>	<u>21,940</u>	<u>4,122</u>	<u>543,828</u>
Other											
Office costs	35,663	25,872	22,429	24,749	26,100	23,674	23,074	181,561	93,535	39,787	314,883
Music expenses and contract services	5,942	1,024	646	1,277	803	12,643	223,596	245,931	159	103,514	349,604
Insurance, taxes and professional fees	336	94	50	71	50	10,614	35,987	47,202	214,519	23,250	284,971
Interest expense and fees	56,574	34,786	7,576	101,423	8,248	18	3,005	211,630	3,193	3,005	217,828
Automobile, conferences and dues	2,481	1,566	2,225	3,303	1,788	886	14,888	27,137	44,773	10,794	82,704
Advertising and publicity	400	250	1,979	2,484	100	3,880	3,082	12,175	9,815	84	22,074
Miscellaneous and other	-	239	218	86	440	2,971	32,281	36,235	14,268	8,669	59,172
Total administrative and other	<u>101,396</u>	<u>63,831</u>	<u>35,123</u>	<u>133,393</u>	<u>37,529</u>	<u>54,686</u>	<u>335,913</u>	<u>761,871</u>	<u>380,262</u>	<u>189,103</u>	<u>1,331,236</u>
Total expenses before depreciation	1,244,120	750,215	885,337	886,352	675,272	241,544	1,634,892	6,317,732	1,246,173	556,734	8,120,639
Depreciation	<u>165,908</u>	<u>107,203</u>	<u>28,900</u>	<u>237,810</u>	<u>63,015</u>	<u>4,962</u>	<u>34,503</u>	<u>642,301</u>	<u>4,199</u>	<u>534</u>	<u>647,034</u>
	<u>\$ 1,410,028</u>	<u>\$ 857,418</u>	<u>\$ 914,237</u>	<u>\$ 1,124,162</u>	<u>\$ 738,287</u>	<u>\$ 246,506</u>	<u>\$ 1,669,395</u>	<u>\$ 6,960,033</u>	<u>\$ 1,250,372</u>	<u>\$ 557,268</u>	<u>\$ 8,767,673</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
<i>Change in net assets</i>	\$ 1,762,007	\$ 1,518,881
<i>Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities</i>		
Net realized and unrealized (gain) loss	(734,358)	126,104
Loss on uncollectible contributions receivable	9,790	28,025
Loss on sale of assets held for sale	-	27,650
Depreciation	688,491	647,034
Amortization of loan issuance costs	14,998	14,998
Change in value of split-interest agreements	(18,594)	(18,046)
(Increase) decrease in		
Accounts receivable	(23,149)	17,914
Contributions receivable	(706,541)	(948,226)
Prepaid expenses	(44,293)	(779)
Increase (decrease) in		
Accounts payable and accrued expenses	(435,356)	243,061
Agency obligations	1,562,363	-
Deposits and advance payments	(20,896)	(130,113)
Annuity obligations	-	(48,138)
Net cash provided by operating activities	<u>2,054,462</u>	<u>1,478,365</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale and maturity of investments	652,290	2,384,603
Purchase of investments	(635,440)	(1,743,082)
Proceeds from sale of property and equipment	-	1,472,350
Purchase of property and equipment	(331,709)	(1,591,374)
Net cash provided by (used for) investing activities	<u>(314,859)</u>	<u>522,497</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings (repayments) on line of credit, net	(125,000)	125,000
Payments of long-term debt	(306,269)	(1,431,508)
Net cash used for financing activities	<u>(431,269)</u>	<u>(1,306,508)</u>
Net change in cash	1,308,334	694,354
CASH		
Beginning of year	<u>1,470,759</u>	<u>776,405</u>
End of year	<u>\$ 2,779,093</u>	<u>\$ 1,470,759</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	<u>\$ 171,763</u>	<u>\$ 173,583</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

(1) NATURE OF OPERATIONS

Settlement Music School of Philadelphia ("**SMS**") is a nonprofit organization that provides instruction in music, including special programs for the disabled and disadvantaged, to residents of Philadelphia and surrounding communities. Operating facilities are located in South Philadelphia, Germantown, Northeast Philadelphia, Wynnefield and Willow Grove, Pennsylvania, and Camden, New Jersey.

(2) SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

Settlement Music School of Philadelphia is the sole member of Camden School of Musical Arts, Inc. ("**CSMA**"), a New Jersey corporation. CSMA is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and was established for the purpose of providing quality education in the arts to the southern New Jersey community.

The consolidated financial statements for the years ended June 30, 2017 and 2016 include the accounts of Settlement Music School of Philadelphia and Camden School of Musical Arts (together, the "**School**"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of Accounting

The consolidated financial statements of the School have been prepared using the accrual basis of accounting in accordance with U.S. generally accepted accounting principles ("**GAAP**").

Financial Statement Presentation

The School reports information regarding its financial position and activities according to the following three classes of net assets:

Unrestricted net assets

Net assets that are not subject to donor-imposed restrictions.

Temporarily restricted net assets

Net assets that are subject to donor-imposed restrictions that will be satisfied by actions of the School and/or the passage of time. When a restriction is satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as "**net assets released from restrictions.**"

Permanently restricted net assets

Net assets that are subject to donor-imposed restrictions that such assets be maintained indefinitely.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

Fair Value Measurements of Assets and Liabilities

GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. GAAP establishes a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the School. Unobservable inputs reflect the School's assumptions about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities that the School has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these assets and liabilities does not entail a significant degree of judgment.

Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 – Valuations based on inputs that are unobservable, that is, inputs that reflect the School's own assumptions.

Property and Equipment

Property and equipment purchased is stated at cost and donated property and equipment is recorded at estimated fair market value on the date of receipt. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 50 years.

Investments and Investment Income

Investments in marketable securities with readily determinable fair values and all investments in debt securities are stated at fair value in the consolidated financial statements of financial position, as determined by quoted market prices. Unrealized gains and losses are included in the consolidated statements of activities. Dividend and interest income is recorded as earned. Donated investments are recorded at fair value at the date of receipt.

The School investments in a professionally-managed portfolio that contains various types of securities (**See Note 5**). Such investments are exposed to market and credit risks. Due to the level of risk associated with such investments, and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in the near term would materially affect the investment balances and the amounts reported in the consolidated financial statements.

Loan Issuance Costs

Costs incurred in connection with the issuance of the term loans are deferred and amortized over the term of the bonds. In 2017, the Center retroactively adopted the requirements of a new accounting standard that requires loan issuance costs to be presented as a reduction of the carrying amount of the related debt rather than as an asset. As a result, the 2016 financial statements have been reclassified to eliminate loan issuance costs and reduce bonds payable by \$119,978.

Amortization of loan issuance costs was \$14,998 for 2017 and 2016 and accumulated amortization was \$44,992 at June 30, 2017 and \$29,994 at June 30, 2016.

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

Beneficial Interest in Charitable Remainder Unitrust

The beneficial interest in the charitable remainder unitrust has been estimated based upon the fair value of the assets in the trust, the expected return on the assets in the trust, and the payments to be made to the lead beneficiaries during their lifetimes.

Life Insurance Policies

The School is the owner and beneficiary of two life insurance policies. These policies have been recorded at fair value using the income method.

Agency Obligations

During the year ended June 30, 2017, the School, along with nine other local musical education organizations, was awarded a \$2,532,000 grant from The Andrew W. Mellon Foundation. Pursuant to the grant terms, the School is charged with administering the total grant. Management has recorded a liability for the amounts related to the nine other local musical education organizations on the statement of financial position.

Contributions

Contributions, bequests and grants received are recorded as unrestricted, temporarily restricted or permanently restricted net assets depending on the absence or existence and nature of any donor restrictions.

Unconditional contributions, bequests and grants are recognized when the related promise to give is received. Conditional contributions, bequests and grants are recognized when the conditions are satisfied.

Tuition and Registration Fees

Tuition and registration fees are recognized in the period in which the related instruction is performed. Deposits and advance payments principally represent tuition fees received in the current year that apply to the following school year.

Functional Allocation of Expenses

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

Concentration of Credit Risk

Financial instruments that potentially subject the School to concentration of credit risk are cash, accounts receivable and contributions receivable. The School maintains its cash in bank deposit accounts that, at times, may exceed federally insured limits. The School has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk. Accounts receivable are owed from various sources and are expected to be collected in 2018. Grants receivable are expected to be collected in 2018. Pledges and bequests receivable are further described in Note 3.

Income Tax Status

The School is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. However, income from certain activities not directly related to the School's tax-exempt purpose is subject to taxation as unrelated business income. In addition, the School qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and has been classified as an organization other than a private foundation under Section 509(a)(1).

GAAP prescribes a minimum recognition threshold that a tax position is required to meet in order to be recognized in the financial statements. The School believes that it had no uncertain tax positions as defined in that standard.

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

(3) PLEDGES AND BEQUESTS RECEIVABLE

The School has received pledges, some of which are payable in future years. As of June 30, 2017 and 2016, pledges and bequests receivable, discounted to present value and net of allowance, consisted of the following:

	<u>2017</u>	<u>2016</u>
Receivable in less than one year	\$ 232,320	\$1,066,507
Receivable in one to five years	936,820	615,000
Receivable in more than five years	<u>555,092</u>	<u>595,489</u>
Total pledges	1,724,232	2,276,996
Less discount to net present value	(253,705)	(262,220)
Less allowance for uncollectible accounts	<u>(25,000)</u>	<u>(50,000)</u>
Net pledges and bequests receivable	<u>\$1,445,527</u>	<u>\$1,964,776</u>
Current	\$ 207,320	\$1,016,507
Noncurrent	<u>1,238,207</u>	<u>948,269</u>
	<u>\$1,445,527</u>	<u>\$1,964,776</u>

Pledges, which are receivable in more than one year, are discounted at a risk-free rate of return appropriate for the expected term of the pledge which was 2.8% for each of the years ended June 30, 2017 and 2016.

(4) PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Land	\$ 1,590,357	\$ 1,590,357
Buildings and improvements	22,510,025	22,316,150
Pianos and organs	1,908,869	1,848,149
Other instruments	79,515	79,515
Furniture and equipment	420,469	343,355
Computer hardware and software	<u>1,601,656</u>	<u>1,601,656</u>
	28,110,891	27,779,182
Less accumulated depreciation	<u>(10,456,026)</u>	<u>(9,767,535)</u>
	<u>\$ 17,654,865</u>	<u>\$18,011,647</u>

(5) INVESTMENTS

Investments consisted of the following at June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Money market funds	\$ 36,558	\$ 130,478
Mutual Funds		
Equity	4,918,132	4,439,335
Fixed income	<u>2,617,693</u>	<u>2,285,062</u>
	<u>\$7,572,383</u>	<u>\$6,854,875</u>

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

Investment income was comprised of the following:

	<u>2017</u>	<u>2016</u>
Net realized and unrealized gain (loss)	\$ 734,358	\$ (126,104)
Interest and dividends	227,975	128,542
Investment management fees	<u>(30,201)</u>	<u>(30,165)</u>
	<u>\$ 932,132</u>	<u>\$ (27,727)</u>

The School designates only a portion of total investment return for support of current operations. The remainder is retained to support operations of future years. The amount used to support current operations was computed by using a spending rate policy whereby approximately 4.5% of the fair value of the School's investments over the prior 12 quarters ending with the prior June 30th is made available for operations during the subsequent year.

(6) LINE OF CREDIT

In October 2015, the School opened a \$650,000 bank line of credit. Advances under the credit line are payable on demand, bear interest at the bank's base lending rate plus 0.75% and are secured by the School's real estate. There were advances of \$0 and \$125,000 outstanding at June 30, 2017 and 2016, respectively.

(7) TERM LOANS

In August 2014, the School refinanced its existing debt with a new bank. The refinanced debt consists of two notes. The first note is for \$5,100,000 matures in 25 years, and bears interest at a fixed rate of 2.99% for the first five years of the loan and then a floating rate of 67% of Wall Street Prime Rate plus 1.7%. This note had an outstanding balance of \$4,708,251 at June 30, 2017. The second note is a two-year term loan for \$2,300,000 with interest fixed at 2.18%. This note had an outstanding balance of \$850,000 at June 30, 2017. In July 2016, the two-year term loan was modified to extend its maturity date to December 31, 2017. On December 20, 2017, the School refinanced the two-year term note with Tompkins Vist. The note is due January 1, 2019 with an interest rate of 3.65%. The note had an outstanding balance of \$650,000 at December 20, 2017. These obligations remain secured by substantially all of the School's assets and a first mortgage on the School's real estate. The notes also require the School to comply with certain financial covenants.

These loans are presented net of unamortized loan acquisition costs of \$104,981 and \$119,978 at June 30, 2017 and 2016, respectively, on the statement of financial position.

Annual maturities of term loans payable are as follows:

<u>Year ending June 30,</u>	
2018	\$ 149,899
2019	1,004,897
2020	160,047
2021	165,353
2022	170,820
Thereafter	<u>3,802,254</u>
	<u>\$5,453,270</u>

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

(8) TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets as of June 30, 2017 and 2016 are available for the following purposes or periods:

	<u>July 1, 2016</u>	<u>Additions</u>	<u>Releases from Restrictions</u>	<u>June 30, 2017</u>
Purpose restrictions				
Music and Art Education Programs	\$ 509,000	\$1,573,565	\$ 827,215	\$1,255,350
Transforming Lives Campaign	-	689,767	-	689,767
Restricted for purchase of property and equipment	85,000	130,000	137,500	77,500
Time restrictions				
Pledges, bequests and grants	1,697,901	443,968	1,021,614	1,120,255
Life insurance policies	300,000	-	-	300,000
Beneficial interest in charitable remainder unitrust	<u>611,046</u>	<u>18,594</u>	<u>-</u>	<u>629,640</u>
	<u>\$3,202,947</u>	<u>\$2,855,894</u>	<u>\$1,986,329</u>	<u>\$4,072,512</u>
	<u>July 1, 2015</u>	<u>Additions</u>	<u>Releases from Restrictions</u>	<u>June 30, 2016</u>
Purpose restrictions				
Music and Art Education Programs	\$ 258,000	\$1,068,190	\$ 817,190	\$ 509,000
Debt Reduction Campaign	100,000	-	100,000	-
Restricted for purchase of property and equipment	100,000	1,111,325	1,126,325	85,000
Time restrictions				
Pledges, bequests and grants	979,410	988,378	269,887	1,697,901
Life insurance policies	300,000	-	-	300,000
Beneficial interest in charitable remainder unitrust	<u>593,000</u>	<u>18,046</u>	<u>-</u>	<u>611,046</u>
	<u>\$2,330,410</u>	<u>\$3,185,939</u>	<u>\$2,313,402</u>	<u>\$3,202,947</u>

(9) PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets consist of the following:

	<u>2017</u>	<u>2016</u>
Cash and pledges receivable, net	\$ 435,269	\$ 536,873
Investments at fair value	<u>6,036,196</u>	<u>5,441,601</u>
	<u>\$6,471,465</u>	<u>\$5,978,474</u>

(10) ENDOWMENT FUNDS

An accounting standard exists which provides guidance on the net asset classification of donor-restricted endowment funds for a nonprofit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act ("**UPMIFA**"). The School is not subject to this guidance since Pennsylvania has not enacted a version of UPMIFA. The standard also requires additional disclosures about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA.

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

In accordance with Pennsylvania statutes, the School has adopted investment and spending policies for its endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of these endowment assets over the long-term. The School's spending and investment policies work together to achieve this objective. The investment policy establishes an achievable return objective through diversification of asset classes.

The School's endowment funds had the following activity for the years ended June 30, 2017 and 2016:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets as of June 30, 2015	\$1,907,933	\$6,084,732	\$7,992,665
Investment income	(10,808)	(21,816)	(32,624)
Contributions	-	191,707	191,707
Withdrawals	(400,000)	-	(400,000)
Loss on uncollectable contributions			
Receivable	-	(25,000)	(25,000)
Spending policy distribution	<u>(83,851)</u>	<u>(251,149)</u>	<u>(335,000)</u>
Endowment net assets as of June 30, 2016	1,413,274	5,978,474	7,391,748
Investment income	189,542	742,590	932,132
Contributions	376	8,695	9,071
Loss on uncollectable contributions			
Receivable	-	(299)	(299)
Spending policy distribution	<u>(67,005)</u>	<u>(257,995)</u>	<u>(325,000)</u>
Endowment net assets as of June 30, 2017	<u>\$1,536,187</u>	<u>\$6,471,465</u>	<u>\$8,007,652</u>

(11) FAIR VALUE MEASUREMENTS

The following tables set forth, by level, the School's assets and liabilities at fair value within the fair value hierarchy, as of June 30, 2017 and 2016:

<u>Description</u>	<u>Balance June 30, 2017</u>	<u>Quoted Prices in Active Markets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets				
Investments				
Money market funds	\$ 36,558	\$ 36,558	\$ -	\$ -
Mutual funds				
Fixed income	2,617,693	2,617,693	-	-
Equity	<u>4,918,132</u>	<u>4,918,132</u>	<u>-</u>	<u>-</u>
Investments	7,572,383	7,572,383	-	-
Life insurance policies	300,000	-	-	300,000
Beneficial interest in charitable remainder unitrust	<u>629,640</u>	<u>-</u>	<u>-</u>	<u>629,640</u>
	<u>\$8,502,023</u>	<u>\$7,572,383</u>	<u>\$ -</u>	<u>\$929,640</u>

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

<u>Description</u>	<u>Balance June 30, 2016</u>	<u>Quoted Prices in Active Markets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets				
Investments				
Money market funds	\$ 130,478	\$ 130,478	\$ -	\$ -
Mutual funds				
Fixed income	2,285,062	2,285,062	-	-
Equity	<u>4,439,335</u>	<u>4,439,335</u>	<u>-</u>	<u>-</u>
Investments	6,854,875	6,854,875	-	-
Life insurance policies	300,000	-	-	300,000
Beneficial interest in charitable remainder unitrust	<u>611,046</u>	<u>-</u>	<u>-</u>	<u>611,046</u>
	<u>\$7,765,921</u>	<u>\$6,854,875</u>	<u>\$ -</u>	<u>\$911,046</u>

(12) PENSION PLAN

The School has a defined-contribution plan, qualified under Section 403(b) of the Internal Revenue Code ("*IRC*"), allowing an eligible participant to direct the employer to contribute a portion of the participant's compensation to the 403(b) plan on a pre-tax basis through payroll deductions into a 403(b)(7) custodial account. An eligible employee may enter the 403(b) plan as an active member on or after the date on which he or she is hired as an employee of the School. Qualified employees, as defined by the 403(b) plan, generally include all employees with the exception of nonresident aliens. There were no employer contributions made to the plan for the years ended June 30, 2017 and 2016.

(13) SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA POOLED INCOME FUND

In May 1992, the Board of Directors of the School established a pooled income fund which has been organized as a separate tax-exempt trust. The trust was formed so that friends of the School may make tax deductible gifts to the School, through the trust, while retaining the right to receive income from the donated property for life. As of June 30, 2017 and 2016, the trust's investments are \$22,161 and \$20,261, respectively, and are not included in the accompanying consolidated financial statements.

(14) TRUSTEE UNDER WILL EMILY E. FAIRCHILD, DECEASED

In 1989, the School began to receive an income distribution from a trust that was established in part to fund financial aid for students to study music. As of June 30, 2017 and 2016 the trust's investments are approximately \$88,000 and \$84,000, respectively, and are not included in the accompanying consolidated financial statements.

The income derived from these investments has been distributed to the School and amounted to \$2,565 and \$1,348 for the years ended June 30, 2017 and 2016, respectively.

(15) SUBSEQUENT EVENTS

Management has evaluated subsequent events through January 15, 2018, the date on which the financial statements were available to be issued. Except as noted in Note 7, no subsequent events have occurred that require recognition in the financial statements.