

Settlement Music School of Philadelphia

Consolidated Financial Statements
Years Ended June 30, 2019 and 2018



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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, 2019 and 2018, 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 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 Settlement Music School of Philadelphia as of June 30, 2019 and 2018, 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
November 25, 2019

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
ASSETS		
CURRENT ASSETS		
Cash	\$ 1,635,239	\$ 2,720,841
Accounts receivable	93,534	117,497
Contributions receivable		
Grants receivable	601,250	115,000
Pledges and bequests receivable, net of allowance for doubtful accounts of \$25,000 in 2019 and 2018	335,643	374,155
Prepaid expenses	<u>119,153</u>	<u>119,553</u>
Total current assets	<u>2,784,819</u>	<u>3,447,046</u>
PROPERTY AND EQUIPMENT, NET	<u>16,696,133</u>	<u>17,173,338</u>
INVESTMENTS	<u>7,637,540</u>	<u>7,830,174</u>
NONCURRENT ASSETS		
Life insurance policies	300,000	300,000
Beneficial interest in charitable remainder unitrust	668,841	649,098
Contributions receivable		
Grants receivable, due beyond one year	295,000	-
Pledges and bequests receivable, due beyond one year	<u>2,251,108</u>	<u>1,650,773</u>
Total noncurrent assets	<u>3,514,949</u>	<u>2,599,871</u>
	<u>\$ 30,633,441</u>	<u>\$ 31,050,429</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 173,070	\$ 228,293
Agency obligations	579,435	535,100
Deposits and advance payments	487,207	440,657
Current portion of term loans	<u>149,197</u>	<u>150,184</u>
Total current liabilities	<u>1,388,909</u>	<u>1,354,234</u>
NONCURRENT LIABILITIES		
Agency obligations, net of current portion	-	578,650
Term loans, net of current portion	<u>4,783,125</u>	<u>4,942,319</u>
Total noncurrent liabilities	<u>4,783,125</u>	<u>5,520,969</u>
Total liabilities	<u>6,172,034</u>	<u>6,875,203</u>
NET ASSETS		
Without donor restrictions	12,900,953	13,650,134
With donor restrictions	<u>11,560,454</u>	<u>10,525,092</u>
Total net assets	<u>24,461,407</u>	<u>24,175,226</u>
Total liabilities and net assets	<u>\$ 30,633,441</u>	<u>\$ 31,050,429</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended June 30, 2019 with comparative totals for 2018

	Without Donor Restrictions	With Donor Restrictions	Totals	
			2019	2018
OPERATING				
Public support, revenues and gains				
Public support				
Contributions, bequests and grants	\$ 647,382	\$ 2,527,364	\$ 3,174,746	\$ 2,808,477
Special event	398,412	-	398,412	346,840
Net assets released from restrictions	2,378,342	(2,378,342)	-	-
Total public support	3,424,136	149,022	3,573,158	3,155,317
Revenues and gains				
Tuition and registration fees	4,680,202	-	4,680,202	4,498,259
Endowment spending policy distribution	325,000	-	325,000	325,000
Rental and miscellaneous income	218,533	-	218,533	149,313
Total revenues and gains	5,223,735	-	5,223,735	4,972,572
Total public support, revenues and gains	8,647,871	149,022	8,796,893	8,127,889
Expenses				
Program services				
Instruction and student activities	5,470,234	-	5,470,234	5,304,918
Non-Core programs	1,879,656	-	1,879,656	1,833,073
Total program services	7,349,890	-	7,349,890	7,137,991
Supporting services				
Management and general	1,424,820	-	1,424,820	1,355,926
Fundraising	637,675	-	637,675	606,848
Total supporting services	2,062,495	-	2,062,495	1,962,774
Total expenses	9,412,385	-	9,412,385	9,100,765
Change in net assets from operating activities	(764,514)	149,022	(615,492)	(972,876)
NONOPERATING				
Contributions	-	817,143	817,143	245,159
Loss on uncollectible contributions receivable	-	-	-	(2,950)
Investment income	68,370	321,417	389,787	598,980
Endowment spending policy distribution	(53,037)	(271,963)	(325,000)	(325,000)
Change in value of split-interest agreements	-	19,743	19,743	19,458
Change in net assets from nonoperating activities	15,333	886,340	901,673	535,647
CHANGE IN NET ASSETS	(749,181)	1,035,362	286,181	(437,229)
NET ASSETS				
Beginning of year	13,650,134	10,525,092	24,175,226	24,612,455
End of year	\$ 12,900,953	\$ 11,560,454	\$ 24,461,407	\$ 24,175,226

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended June 30, 2018

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
OPERATING			
Public support, revenues and gains			
Public support			
Contributions, bequests and grants	\$ 748,958	\$ 2,059,519	\$ 2,808,477
Special event	346,840	-	346,840
Net assets released from restrictions	<u>2,578,723</u>	<u>(2,578,723)</u>	<u>-</u>
Total public support	<u>3,674,521</u>	<u>(519,204)</u>	<u>3,155,317</u>
Revenues and gains			
Tuition and registration fees	4,498,259	-	4,498,259
Endowment spending policy distribution	325,000	-	325,000
Rental and miscellaneous income	<u>149,313</u>	<u>-</u>	<u>149,313</u>
Total revenues and gains	<u>4,972,572</u>	<u>-</u>	<u>4,972,572</u>
Total public support, revenues and gains	<u>8,647,093</u>	<u>(519,204)</u>	<u>8,127,889</u>
Expenses			
Program services			
Instruction and student activities	5,304,918	-	5,304,918
Non-Core programs	<u>1,833,073</u>	<u>-</u>	<u>1,833,073</u>
Total program services	<u>7,137,991</u>	<u>-</u>	<u>7,137,991</u>
Supporting services			
Management and general	1,355,926	-	1,355,926
Fundraising	<u>606,848</u>	<u>-</u>	<u>606,848</u>
Total supporting services	<u>1,962,774</u>	<u>-</u>	<u>1,962,774</u>
Total expenses	<u>9,100,765</u>	<u>-</u>	<u>9,100,765</u>
Change in net assets from operating activities	<u>(453,672)</u>	<u>(519,204)</u>	<u>(972,876)</u>
NONOPERATING			
Contributions	-	245,159	245,159
Loss on uncollectible contributions receivable	(2,950)	-	(2,950)
Investment income	99,545	499,435	598,980
Endowment spending policy distribution	(61,267)	(263,733)	(325,000)
Change in value of split-interest agreements	<u>-</u>	<u>19,458</u>	<u>19,458</u>
Change in net assets from nonoperating activities	<u>35,328</u>	<u>500,319</u>	<u>535,647</u>
CHANGE IN NET ASSETS	<u>(418,344)</u>	<u>(18,885)</u>	<u>(437,229)</u>
NET ASSETS			
Beginning of year	<u>14,068,478</u>	<u>10,543,977</u>	<u>24,612,455</u>
End of year	<u>\$ 13,650,134</u>	<u>\$ 10,525,092</u>	<u>\$ 24,175,226</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

Year ended June 30, 2019

	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	\$ 718,729	\$ 300,666	\$ 455,249	\$ 386,780	\$ 290,262	\$ 38,243	\$ 935,813	\$ 3,125,742	\$ -	\$ -	\$ 3,125,742
Benefits and payroll taxes	93,167	35,034	49,470	53,883	31,757	4,900	142,138	410,349	-	-	410,349
	<u>811,896</u>	<u>335,700</u>	<u>504,719</u>	<u>440,663</u>	<u>322,019</u>	<u>43,143</u>	<u>1,077,951</u>	<u>3,536,091</u>	<u>-</u>	<u>-</u>	<u>3,536,091</u>
Staff											
Salaries and wages	327,288	221,325	272,955	246,972	216,076	41,689	372,648	1,698,953	820,864	384,421	2,904,238
Benefits and payroll taxes	42,116	22,535	37,597	33,078	45,645	5,453	48,900	235,324	117,525	55,973	408,822
	<u>369,404</u>	<u>243,860</u>	<u>310,552</u>	<u>280,050</u>	<u>261,721</u>	<u>47,142</u>	<u>421,548</u>	<u>1,934,277</u>	<u>938,389</u>	<u>440,394</u>	<u>3,313,060</u>
Total salaries, wages and related expenses	<u>1,181,300</u>	<u>579,560</u>	<u>815,271</u>	<u>720,713</u>	<u>583,740</u>	<u>90,285</u>	<u>1,499,499</u>	<u>5,470,368</u>	<u>938,389</u>	<u>440,394</u>	<u>6,849,151</u>
Occupancy											
Heat and utilities	44,100	26,293	27,161	36,128	20,700	-	19,346	173,728	1,933	1,437	177,098
Insurance	28,675	29,252	13,204	23,073	14,341	-	13,634	122,179	1,344	1,000	124,523
Repairs and maintenance	40,516	36,220	12,623	32,517	31,766	9,492	11,327	174,461	3,785	1,372	179,618
Total occupancy	<u>113,291</u>	<u>91,765</u>	<u>52,988</u>	<u>91,718</u>	<u>66,807</u>	<u>9,492</u>	<u>44,307</u>	<u>470,368</u>	<u>7,062</u>	<u>3,809</u>	<u>481,239</u>
Administrative and other											
Office costs	27,392	18,346	18,471	20,516	20,103	8,453	37,050	150,331	123,236	49,846	323,413
Music expenses and contract services	33,483	582	1,314	1,781	638	7,249	209,843	254,890	13,518	95,733	364,141
Insurance, taxes and professional fees	197	-	-	137	-	-	21,790	22,124	229,682	26,662	278,468
Interest expense and fees	53,075	19,656	7,115	94,811	7,782	5	2,408	184,852	3,786	2,817	191,455
Automobile, conferences and dues	1,779	1,604	2,024	1,757	1,187	2,243	15,966	26,560	54,397	8,374	89,331
Advertising and publicity	-	-	356	420	266	-	625	1,667	17,048	-	18,715
Refunds and bad debt	19,560	4,826	5,631	6,578	13,875	729	-	51,199	-	-	51,199
Miscellaneous and other	481	1,922	-	8,429	44	1,237	6,325	18,438	30,234	9,177	57,849
Total administrative and other	<u>135,967</u>	<u>46,936</u>	<u>34,911</u>	<u>134,429</u>	<u>43,895</u>	<u>19,916</u>	<u>294,007</u>	<u>710,061</u>	<u>471,901</u>	<u>192,609</u>	<u>1,374,571</u>
Total expenses before depreciation	<u>1,430,558</u>	<u>718,261</u>	<u>903,170</u>	<u>946,860</u>	<u>694,442</u>	<u>119,693</u>	<u>1,837,813</u>	<u>6,650,797</u>	<u>1,417,352</u>	<u>636,812</u>	<u>8,704,961</u>
Depreciation	<u>167,799</u>	<u>156,537</u>	<u>24,171</u>	<u>239,552</u>	<u>65,925</u>	<u>3,266</u>	<u>41,843</u>	<u>699,093</u>	<u>7,468</u>	<u>863</u>	<u>707,424</u>
	<u>\$ 1,598,357</u>	<u>\$ 874,798</u>	<u>\$ 927,341</u>	<u>\$ 1,186,412</u>	<u>\$ 760,367</u>	<u>\$ 122,959</u>	<u>\$ 1,879,656</u>	<u>\$ 7,349,890</u>	<u>\$ 1,424,820</u>	<u>\$ 637,675</u>	<u>\$ 9,412,385</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

Year ended June 30, 2018

	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	\$ 675,562	\$ 313,043	\$ 421,198	\$ 382,002	\$ 311,831	\$ 55,296	\$ 909,761	\$ 3,068,693	\$ -	\$ -	\$ 3,068,693
Benefits and payroll taxes	96,547	40,763	48,485	58,832	35,577	6,701	155,653	442,558	-	-	442,558
	<u>772,109</u>	<u>353,806</u>	<u>469,683</u>	<u>440,834</u>	<u>347,408</u>	<u>61,997</u>	<u>1,065,414</u>	<u>3,511,251</u>	<u>-</u>	<u>-</u>	<u>3,511,251</u>
Staff											
Salaries and wages	303,658	202,219	261,743	231,154	181,275	82,185	358,753	1,620,987	750,802	370,014	2,741,803
Benefits and payroll taxes	40,470	27,105	31,297	32,889	25,874	9,803	32,054	199,492	94,233	48,070	341,795
	<u>344,128</u>	<u>229,324</u>	<u>293,040</u>	<u>264,043</u>	<u>207,149</u>	<u>91,988</u>	<u>390,807</u>	<u>1,820,479</u>	<u>845,035</u>	<u>418,084</u>	<u>3,083,598</u>
Total salaries, wages and related expenses	<u>1,116,237</u>	<u>583,130</u>	<u>762,723</u>	<u>704,877</u>	<u>554,557</u>	<u>153,985</u>	<u>1,456,221</u>	<u>5,331,730</u>	<u>845,035</u>	<u>418,084</u>	<u>6,594,849</u>
Occupancy											
Heat and utilities	43,453	26,457	26,469	36,342	21,155	-	20,737	174,613	1,699	1,508	177,820
Insurance	29,467	29,711	13,411	23,434	14,566	-	14,064	124,653	1,152	1,024	126,829
Repairs and maintenance	39,714	41,482	18,472	29,204	30,155	6,780	11,482	177,289	2,297	1,379	180,965
Total occupancy	<u>112,634</u>	<u>97,650</u>	<u>58,352</u>	<u>88,980</u>	<u>65,876</u>	<u>6,780</u>	<u>46,283</u>	<u>476,555</u>	<u>5,148</u>	<u>3,911</u>	<u>485,614</u>
Administrative and other											
Office costs	29,937	19,644	19,160	19,747	19,795	8,058	34,977	151,318	123,201	38,245	312,764
Music expenses and contract services	4,388	487	2,024	934	872	9,721	176,342	194,768	6,077	108,700	309,545
Insurance, taxes and professional fees	50	138	-	60	5,100	60	31,442	36,850	301,902	17,695	356,447
Interest expense and fees	48,934	18,150	6,623	87,887	7,143	21	3,483	172,241	3,062	2,610	177,913
Automobile, conferences and dues	2,035	2,865	2,041	2,132	1,063	369	16,108	26,613	52,935	12,621	92,169
Advertising and publicity	-	-	356	1,735	274	250	-	2,615	4,700	-	7,315
Refunds and bad debt	6,143	3,136	111	4,895	2,367	210	-	16,862	-	-	16,862
Miscellaneous and other	25	507	45	2,561	1,749	1,161	33,791	39,839	7,267	4,349	51,455
Total administrative and other	<u>91,512</u>	<u>44,927</u>	<u>30,360</u>	<u>119,951</u>	<u>38,363</u>	<u>19,850</u>	<u>296,143</u>	<u>641,106</u>	<u>499,144</u>	<u>184,220</u>	<u>1,324,470</u>
Total expenses before depreciation	1,320,383	725,707	851,435	913,808	658,796	180,615	1,798,647	6,449,391	1,349,327	606,215	8,404,933
Depreciation	165,665	153,409	27,543	239,848	64,652	3,057	34,426	688,600	6,599	633	695,832
	<u>\$ 1,486,048</u>	<u>\$ 879,116</u>	<u>\$ 878,978</u>	<u>\$ 1,153,656</u>	<u>\$ 723,448</u>	<u>\$ 183,672</u>	<u>\$ 1,833,073</u>	<u>\$ 7,137,991</u>	<u>\$ 1,355,926</u>	<u>\$ 606,848</u>	<u>\$ 9,100,765</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
<i>Change in net assets</i>	\$ 286,181	\$ (437,229)
<i>Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities</i>		
Net realized and unrealized gain on investments	(239,987)	(355,009)
Loss on uncollectible contributions receivable	-	2,950
Donated equipment	(85,700)	-
Depreciation	707,424	695,832
Amortization of loan issuance costs	14,090	14,998
Contributions restricted for long-term purposes	(817,143)	(245,159)
Change in value of split-interest agreements	(19,743)	(19,458)
(Increase) decrease in		
Accounts receivable	23,963	(59,636)
Contributions receivable	(571,676)	988,649
Prepaid expenses	400	3,170
Increase (decrease) in		
Accounts payable and accrued expenses	(55,223)	55,498
Agency obligations	(534,315)	(448,613)
Deposits and advance payments	46,550	53,447
Net cash provided by (used for) operating activities	<u>(1,245,179)</u>	<u>249,440</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale and maturity of investments	657,468	851,019
Purchase of investments	(224,847)	(753,801)
Purchase of property and equipment	(144,519)	(214,305)
Net cash provided by (used for) investing activities	<u>288,102</u>	<u>(117,087)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments of long-term debt	(174,271)	(375,764)
Collections of contributions restricted for endowment	45,746	185,159
Net cash used for financing activities	<u>(128,525)</u>	<u>(190,605)</u>
Net change in cash	(1,085,602)	(58,252)
CASH		
Beginning of year	<u>2,720,841</u>	<u>2,779,093</u>
End of year	<u>\$ 1,635,239</u>	<u>\$ 2,720,841</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	<u>\$ 177,365</u>	<u>\$ 162,915</u>

See accompanying notes

SETTLEMENT MUSIC SCHOOL OF PHILADELPHIA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019 and 2018

(1) NATURE OF OPERATIONS

Settlement Music School of Philadelphia ("**SMS**" or the "**School**") 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, 2019 and 2018 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 on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles ("**GAAP**"). Net assets, support and revenue and expenses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Without donor restrictions

Net assets available for use in general operations and not subject to donor restrictions. Grants and contributions gifted for recurring programs are not considered "restricted" under GAAP, though for internal reporting, the School tracks such grants and contributions to verify that the disbursement matches the intent. Assets restricted solely through the actions of the Board are reported as net assets without donor restrictions, board-designated.

With donor restrictions

Net assets subject to donor-imposed stipulation that are more restrictive than the School's mission and purpose. Some donor-imposed restrictions are temporary in nature. Donor-imposed restrictions are released when the restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Other donor-imposed restrictions are perpetual in nature, when the donor stipulates that the resources be maintained in perpetuity.

Revenues are reported as increases in net assets without donor restrictions unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in net assets without donor restrictions. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in net assets without donor restrictions unless their use is restricted by explicit donor stipulation or by law. Expirations of donor-imposed restrictions on net assets (that is, the donor-stipulation purpose has been fulfilled or the stipulated time period has elapsed, or both) are reported as reclassification between the applicable classes of their net assets.

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.

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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 equity securities with readily determinable fair values and all investments in debt securities are stated at fair value in the consolidated 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 invests 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 School 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.

Amortization of loan issuance costs was \$14,090 and \$14,998 for 2019 and 2018, respectively, and accumulated amortization was \$74,080 at June 30, 2019 and \$59,990 at June 30, 2018.

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.

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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 consolidated statements of financial position.

Contributions

Contributions and grants are reported as without or with donor restrictions, depending on the existence or nature of any restrictions or both.

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 program and supporting services have been summarized on a functional basis in the consolidated statements of activities and functional expenses. Expenses directly attributable to a specific functional area are reported as expenses of that functional area. Expenses not directly attributable to a specific functional area are allocated. Significant expenses that are allocated include salaries and wages and benefits and payroll taxes which are allocated to functional areas based on estimates of time and effort.

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 2020. Grants receivable are expected to be collected in 2020. 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 consolidated financial statements. The School believes that it had no uncertain tax positions as defined in that standard.

Accounting Pronouncements Adopted

On August 18, 2016, the Financial Accounting Standards Board ("**FASB**") issued ASU 2016-14, Not-for-Profit Entities (Topic 958) – Presentation of Financial Statements of Not-for-Profit Entities. The School has adjusted the presentation of its consolidated financial statements accordingly, applying the changes retrospectively to the comparative period presented. The new standards change the following aspects of the School's consolidated financial statements:

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- The temporarily restricted and permanently restricted net asset classes have been combined into a single net asset class called net assets with donor restrictions.
- The unrestricted net asset class has been renamed net assets without donor restrictions.
- The consolidated financial statements include a new disclosure about liquidity and availability of resources (**Note 12**).

Reclassification

Certain amounts have been reclassified in the 2018 consolidated financial statements to conform with the 2019 presentation.

(3) PLEDGES AND BEQUESTS RECEIVABLE

The School has received pledges, some of which are payable in future years. As of June 30, 2019 and 2018, pledges and bequests receivable, discounted to present value and net of allowance, consisted of the following:

	<u>2019</u>	<u>2018</u>
Receivable in less than one year	\$ 360,642	\$ 399,155
Receivable in one to five years	1,206,465	1,257,500
Receivable in more than five years	<u>1,827,093</u>	<u>702,092</u>
Total pledges and bequests	3,394,200	2,358,747
Less discount to net present value	(782,449)	(308,819)
Less allowance for doubtful accounts	<u>(25,000)</u>	<u>(25,000)</u>
Net pledges and bequests receivable	<u>\$2,586,751</u>	<u>\$2,024,928</u>
Current	\$ 335,643	\$ 374,155
Noncurrent	<u>2,251,108</u>	<u>1,650,773</u>
	<u>\$2,586,751</u>	<u>\$2,024,928</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 4.5% and 2.8% for the years ended June 30, 2019 and 2018, respectively.

(4) PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Land	\$ 1,590,357	\$ 1,590,357
Buildings and improvements	22,655,435	22,590,731
Pianos and organs	1,936,869	1,931,369
Other instruments	159,715	79,515
Furniture and equipment	478,399	436,668
Computer hardware and software	<u>1,736,056</u>	<u>1,696,556</u>
	28,556,831	28,325,196
Less accumulated depreciation	<u>(11,860,698)</u>	<u>(11,151,858)</u>
	<u>\$ 16,696,133</u>	<u>\$ 17,173,338</u>

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(5) INVESTMENTS

Investments consisted of the following at June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Money market funds	\$ 26,066	\$ 42,955
Mutual funds		
Equity	4,954,855	5,092,420
Fixed income	<u>2,656,619</u>	<u>2,694,799</u>
	<u>\$7,637,540</u>	<u>\$7,830,174</u>

Investment income was comprised of the following:

	<u>2019</u>	<u>2018</u>
Net realized and unrealized gain on investments	\$ 239,987	\$ 355,009
Interest and dividends	182,268	277,165
Investment management fees	<u>(32,468)</u>	<u>(33,194)</u>
	<u>\$ 389,787</u>	<u>\$ 598,980</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 no advances outstanding at June 30, 2019 and 2018.

(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%. On December 31, 2018, the School amended the interest rate on this note to a fixed rate of 3.80% until the maturity date of August 1, 2024. This new interest rate is effective February 1, 2019. This note had an outstanding balance of \$4,408,216 at June 30, 2019 and \$4,557,487 at June 30, 2018. The second note was a two-year term loan for \$2,300,000 with interest fixed at 2.18%. On December 31, 2018, the School refinanced the two-year term note extending the maturity date to December 31, 2020 with an interest rate of 4.0%. The note had an outstanding balance of \$600,000 at June 30, 2019 and \$625,000 at June 30, 2018. 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 \$75,893 and \$89,983 at June 30, 2019 and 2018, respectively, on the consolidated statements of financial position.

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Annual maturities of term loans payable are as follows:

<u>Year ending June 30,</u>	
2020	\$ 149,197
2021	754,966
2022	160,959
2023	167,183
2024	173,648
Thereafter	<u>3,602,263</u>
	<u>\$5,008,216</u>

(8) NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions represent amounts received or committed with donor restrictions which have not yet been expended for their designated purposes (purpose-restricted); amounts with donor capital restrictions which will be recognized when the assets are placed in service (capital restricted); amounts for general use in future periods (time restricted); and amounts received from donors with the stipulation that the principal will be held in perpetuity and only the investment income can be spent. In accordance with Pennsylvania law, all earnings and appreciation of a donor-restricted endowment are restricted until appropriated for expenditure by the Board of Trustees.

	<u>2019</u>	<u>2018</u>
Purpose restricted:		
Music and Art Education Programs	\$ 1,951,616	\$ 1,574,242
Restricted for purchase of property and equipment	50,000	-
Debt reduction	<u>100,000</u>	<u>125,000</u>
	<u>2,101,616</u>	<u>2,699,242</u>
Time restricted:		
Pledges, bequests and grants	671,074	924,426
Life insurance policies	300,000	300,000
Beneficial interest in charitable remainder unitrust	<u>668,841</u>	<u>649,098</u>
	<u>1,639,915</u>	<u>1,873,524</u>
Endowment to be held in perpetuity:		
Income is available for educational programs, scholarships and financial aid. Management is not aware of the Historic Dollar Value of the endowment.	<u>7,818,923</u>	<u>6,952,326</u>
	<u>\$11,560,454</u>	<u>\$10,525,092</u>

Net assets were released from donor restrictions by incurring expenses that satisfy the restricted purpose of by occurrence of the passage of time or other events specified by the donors as follows for the years ended June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Expiration of time restrictions:		
Pledges, bequests and grants	\$ 482,088	\$ 334,320
Satisfaction of purpose restrictions:		
Music and Art Education Programs	1,820,254	2,133,428
Restricted for the purchase of property and equipment	51,000	110,975
Debt reduction	<u>25,000</u>	<u>-</u>
	<u>\$ 2,378,342</u>	<u>\$ 2,578,723</u>

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(9) 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.

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, 2019 and 2018:

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Endowment net assets as of June 30, 2017	\$1,439,590	\$6,471,465	\$7,911,055
Investment income	99,545	499,435	598,980
Contributions	-	245,159	245,159
Withdrawals	(200,000)	-	(200,000)
Spending policy distribution	<u>(61,267)</u>	<u>(263,733)</u>	<u>(325,000)</u>
Endowment net assets as of June 30, 2018	1,277,868	6,952,326	8,230,194
Investment income	62,680	321,417	384,097
Contributions	-	817,143	817,143
Withdrawals	(300,000)	-	(300,000)
Spending policy distribution	<u>(53,037)</u>	<u>(271,963)</u>	<u>(325,000)</u>
Endowment net assets as of June 30, 2019	<u>\$ 987,511</u>	<u>\$7,818,923</u>	<u>\$8,806,434</u>

(10) 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, 2019 and 2018:

<u>Description</u>	<u>Balance June 30, 2019</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	\$ 26,066	\$ 26,066	\$ -	\$ -
Mutual funds				
Equity	4,954,855	4,954,855	-	-
Fixed Income	<u>2,656,619</u>	<u>2,656,619</u>	-	-
Total	7,637,540	7,637,540	-	-
Life insurance policies	300,000	-	-	300,000
Beneficial interest in charitable remainder unitrust	<u>668,841</u>	<u>-</u>	<u>-</u>	<u>668,841</u>
	<u>\$8,606,381</u>	<u>\$7,637,540</u>	<u>\$ -</u>	<u>\$968,841</u>

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<u>Description</u>	<u>Balance June 30, 2018</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	\$ 42,955	\$ 42,955	\$ -	\$ -
Mutual funds				
Equity	5,092,420	5,092,420	-	-
Fixed Income	<u>2,694,799</u>	<u>2,694,799</u>	-	-
Total	7,830,174	7,830,174	-	-
Life insurance policies	300,000	-	-	300,000
Beneficial interest in charitable remainder unitrust	<u>649,098</u>	<u>-</u>	<u>-</u>	<u>649,098</u>
	<u>\$8,779,272</u>	<u>\$7,830,174</u>	<u>\$ -</u>	<u>\$949,098</u>

(11) 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, 2019 and 2018.

(12) LIQUIDITY AND AVAILABILITY OF RESOURCES

The following reflects the School's financial assets as of the statement of financial position date, which has been reduced by financial assets not available within one year.

Cash	\$ 1,635,239
Accounts and contributions receivable	3,576,535
Investments	<u>7,637,540</u>
Total financial assets	12,849,314
Less: financial assets not available for general operations within one year	
Restricted by donor for specific purposes or periods	(2,408,543)
Restricted by donor to be maintained indefinitely	(7,818,923)
Restricted by Central Board for endowment	(987,511)
Add: Endowment payout to use over next twelve months	<u>325,000</u>
Total financial assets available within one year	<u>\$ 1,959,337</u>

Liquidity Management

As part of the School's liquidity management, it invests cash in excess of daily requirements in short-term investments, typically money market funds and fixed income mutual funds.

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(13) SUBSEQUENT EVENTS

Management has evaluated subsequent events through November 25, 2019, the date on which the consolidated financial statements were available to be issued. No subsequent events have occurred that require recognition in the consolidated financial statements.