



MUSIC ACADEMY OF THE WEST

FINANCIAL STATEMENTS

December 31, 2013



INDEPENDENT AUDITORS' REPORT

To Board of Directors
Music Academy of the West
Santa Barbara, California

We have audited the accompanying financial statements of Music Academy of the West (a California nonprofit organization), which comprise the statement of financial position as of December 31, 2013, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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.

Report on Summarized Comparative Information

We have previously audited the Music Academy's 2012 financial statements, and our report dated April 29, 2013, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2012 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Music Academy of the West as of December 31, 2013, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Stoltey & Associates

May 19, 2014
Los Olivos, California

Music Academy of the West

STATEMENT OF FINANCIAL POSITION

Statement of Financial Position

December 31, 2013

(With Comparative Totals for December 31, 2012)

ASSETS

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2013</u>	<u>2012</u>
CURRENT ASSETS					
Cash and equivalents	\$ 1,697,038	\$ 709,192	\$ -	\$ 2,406,230	\$ 3,668,460
Pledges receivable (Notes 2C and 4)	-	1,416,696	-	1,416,696	1,183,513
Prepaid expenses and other current assets	141,197	-	-	141,197	156,557
Total Current Assets	1,838,235	2,125,888	-	3,964,123	5,008,530
 Property and equipment, Net (Notes 2D and 6)	 30,990,829	 -	 -	 30,990,829	 31,895,233
OTHER ASSETS					
Investments (Notes 2B and 5)	31,045,730	-	-	31,045,730	26,515,117
Pledges receivable (Notes 2C and 4)	-	1,619,996	-	1,619,996	1,331,011
Bequests receivable (Note 4)	-	5,617,681	666,971	6,284,652	6,161,548
Unamortized note payable issuance costs	282,588	-	-	282,588	295,032
Other investment (Note 12)	427,598	-	-	427,598	427,598
Contributions in trust (Note 10)	-	4,213,116	-	4,213,116	4,075,425
Total Other Assets	31,755,916	11,450,793	666,971	43,873,680	38,805,731
 TOTAL ASSETS	 \$ 64,584,980	 \$ 13,576,681	 \$ 666,971	 \$ 78,828,632	 \$75,709,494

MUSIC ACADEMY OF THE WEST

Statement of Financial Position

December 31, 2013

(With Comparative Totals for December 31, 2012)

LIABILITIES AND NET ASSETS

	Unrestricted	Temporarily Restricted	Permanently Restricted	2013	2012
CURRENT LIABILITIES					
Accounts payable	\$ 61,661	\$ -	\$ -	\$ 61,661	\$ 69,622
Accrued expenses	151,101	-	-	151,101	158,531
Deposits	4,799	-	-	4,799	6,866
Deferred revenue	93,890	-	-	93,890	122,355
Current portion of long-term debt (Note 14)	<u>420,578</u>	<u>-</u>	<u>-</u>	<u>420,578</u>	<u>406,947</u>
 Total Current Liabilities	 <u>732,029</u>	 <u>-</u>	 <u>-</u>	 <u>732,029</u>	 <u>764,321</u>
 LONG-TERM LIABILITIES					
Notes payable, net of current portion (Note 14)	<u>14,255,989</u>	<u>-</u>	<u>-</u>	<u>14,255,989</u>	<u>14,675,056</u>
 Total Long-Term Liabilities	 <u>14,255,989</u>	 <u>-</u>	 <u>-</u>	 <u>14,255,989</u>	 <u>14,675,056</u>
 Total Liabilities	 <u>14,988,018</u>	 <u>-</u>	 <u>-</u>	 <u>14,988,018</u>	 <u>15,439,377</u>
 NET ASSETS (Notes 8 and 15)					
Unrestricted	18,551,233	-	-	18,551,233	19,243,313
Unrestricted - board designated	31,045,729	-	-	31,045,729	27,711,007
Temporarily restricted	-	13,576,681	-	13,576,681	12,648,826
Permanently restricted	<u>-</u>	<u>-</u>	<u>666,971</u>	<u>666,971</u>	<u>666,971</u>
Total Net Assets	<u>49,596,962</u>	<u>13,576,681</u>	<u>666,971</u>	<u>63,840,614</u>	<u>60,270,117</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 64,584,980</u></u>	<u><u>\$ 13,576,681</u></u>	<u><u>\$ 666,971</u></u>	<u><u>\$ 78,828,632</u></u>	<u><u>\$ 75,709,494</u></u>

MUSIC ACADEMY OF THE WEST

Statement of Activities
For the Year Ended December 31, 2013
(With Comparative Totals for December 31, 2012)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2013</u>	<u>2012</u>
PUBLIC SUPPORT					
Contributions	\$ 3,531,455	\$ 1,636,172	\$ -	\$ 5,167,627	\$ 6,098,393
Concert program advertising	49,500	-	-	49,500	49,000
Other support	<u>8,972</u>	<u>-</u>	<u>-</u>	<u>8,972</u>	<u>8,453</u>
TOTAL PUBLIC SUPPORT	<u>3,589,927</u>	<u>1,636,172</u>	<u>-</u>	<u>5,226,099</u>	<u>6,155,846</u>
REVENUE CENTERS					
Rack and Treasure House sales	222,577	-	-	222,577	223,202
Rack and Treasure House expenses	<u>(118,961)</u>	<u>-</u>	<u>-</u>	<u>(118,961)</u>	<u>(115,084)</u>
TOTAL REVENUE CENTERS	<u>103,616</u>	<u>-</u>	<u>-</u>	<u>103,616</u>	<u>108,118</u>
SPECIAL EVENTS					
Gross revenue	949,376	-	-	949,376	870,131
Direct costs	<u>(286,248)</u>	<u>-</u>	<u>-</u>	<u>(286,248)</u>	<u>(274,802)</u>
SPECIAL EVENTS, NET	<u>663,128</u>	<u>-</u>	<u>-</u>	<u>663,128</u>	<u>595,329</u>
REVENUE					
Concerts, recitals and master classes	720,512	-	-	720,512	634,544
Fees	242,057	-	-	242,057	267,367
Rentals and miscellaneous	140,256	-	-	140,256	122,519
Gain (loss) on sale of assets	(81,509)	-	-	(81,509)	40,500
Other revenue	4,873	-	-	4,873	-
Investment income	<u>4,181,648</u>	<u>-</u>	<u>-</u>	<u>4,181,648</u>	<u>2,939,145</u>
Total Revenue	<u>5,207,837</u>	<u>-</u>	<u>-</u>	<u>5,207,837</u>	<u>4,004,075</u>
TOTAL PUBLIC SUPPORT AND REVENUE	<u>9,564,508</u>	<u>1,636,172</u>	<u>-</u>	<u>11,200,680</u>	<u>10,863,368</u>
Assets Released From Restriction	<u>708,317</u>	<u>(708,317)</u>	<u>-</u>	<u>-</u>	<u>-</u>
FUNCTIONAL EXPENSES					
Program Expenses:					
Summer School and Festival	6,058,179	-	-	6,058,179	6,351,805
Supporting Services	740,529	-	-	740,529	758,146
Management and general	831,475	-	-	831,475	829,687
Fundraising	<u>7,630,183</u>	<u>-</u>	<u>-</u>	<u>7,630,183</u>	<u>7,939,638</u>
Total Functional Expenses	<u>7,630,183</u>	<u>-</u>	<u>-</u>	<u>7,630,183</u>	<u>7,939,638</u>
CHANGES IN NET ASSETS	<u>\$ 2,642,642</u>	<u>\$ 927,855</u>	<u>\$ -</u>	<u>\$ 3,570,497</u>	<u>\$ 2,923,730</u>

MUSIC ACADEMY OF THE WEST
STATEMENT OF CHANGES IN NET ASSETS
For the Year Ended December 31, 2013
(With Comparative Totals for 2012)

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>2013</u>	<u>2012</u>
Beginning Balance	\$ 46,954,320	\$ 12,648,826	\$ 666,971	\$ 60,270,117	\$ 57,346,387
Changes in Net Assets	<u>2,642,642</u>	<u>927,855</u>	<u>-</u>	<u>3,570,497</u>	<u>2,923,730</u>
Ending Balance	<u>\$ 49,596,962</u>	<u>\$ 13,576,681</u>	<u>\$ 666,971</u>	<u>\$ 63,840,614</u>	<u>\$ 60,270,117</u>

MUSIC ACADEMY OF THE WEST

STATEMENT OF FUNCTIONAL EXPENSES
 For the Year Ended December 31, 2013
 (with comparative Totals for 2012)

	<u>Program Expenses</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>2013 Total</u>	<u>2012 Total</u>
Salaries	\$ 1,375,130	\$ 121,847	\$ 243,694	\$ 1,740,671	\$ 1,594,410
Pension plan contributions	44,503	3,943	7,887	56,333	58,609
Other employee benefits	187,421	16,607	33,214	237,242	222,313
Payroll taxes	107,774	9,550	19,099	136,423	125,544
Fees:					
Accounting and legal	-	31,473	-	31,473	43,999
Investment	-	148,320	-	148,320	73,644
Other	284,900	16,759	33,518	335,177	305,914
Advertising and promotion	221,679	19,642	39,285	280,606	223,187
Office expenses	68,110	6,035	12,070	86,215	114,235
Information technology	138,400	12,263	24,527	175,190	148,457
Occupancy	951,590	55,976	111,952	1,119,518	996,363
Travel	183,145	16,228	32,456	231,829	232,170
Interest	428,567	37,974	75,949	542,490	651,975
Depreciation and amortization	741,925	148,385	37,096	927,406	1,498,555
Insurance	51,331	4,548	9,097	64,976	64,141
Festival productions	1,273,704	90,979	151,631	1,516,314	1,586,122
 Total Expenses	 <u>\$ 6,058,179</u>	 <u>\$ 740,529</u>	 <u>\$ 831,475</u>	 <u>\$ 7,630,183</u>	 <u>\$ 7,939,638</u>

The accompanying notes are an integral part of these financial statements

MUSIC ACADEMY OF THE WEST

STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2013
(with comparative Totals for 2012)

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 3,570,497	\$ 2,923,730
Adjustments to reconcile change in net assets to net cash provided in operating activities:		
Depreciation and amortization	927,406	1,498,555
Loss (gain) on value of securities	569,173	(2,859,068)
Loss (gain) on sale of securities	(4,606,410)	(65,144)
Loss (gain) on sale of fixed assets	81,509	(40,500)
Loss (gain) on value of charitable trusts	(137,691)	(262,071)
Noncash contribution of charitable trusts	-	(1,447,027)
(Increase) decrease in operating assets:		
Pledges and interest receivable	(645,272)	(656,592)
Prepaid expenses	27,804	(274,991)
Increase (decrease) in operating liabilities:		
Accounts payable	(7,961)	23,456
Accrued expenses	(7,430)	(509,185)
Deposits	(2,067)	2,880
Deferred revenue	<u>(28,465)</u>	<u>(34,196)</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>(258,907)</u>	<u>(1,700,153)</u>
 CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of long-term investments	(22,626,517)	(1,053,165)
Proceeds from maturity and sale of long-term investments	22,133,141	2,720,173
Payments for property and equipment	(104,511)	(984,310)
Proceeds from sale property plant and equipment	<u>-</u>	<u>40,500</u>
NET CASH FROM INVESTING ACTIVITIES	<u>(597,887)</u>	<u>723,198</u>
 CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of notes payable	-	15,200,000
Defeasement payments on bonds payable	-	(16,203,250)
Principal payments on notes payables	<u>(405,436)</u>	<u>(117,997)</u>
NET CASH FLOWS FROM FINANCING ACTIVITIES	<u>(405,436)</u>	<u>(1,121,247)</u>
 NET INCREASE (DECREASE) IN CASH	 (1,262,230)	 (2,098,202)
 CASH - Beginning of year	 <u>3,668,460</u>	 <u>5,766,662</u>
End of year	<u>\$ 2,406,230</u>	<u>\$ 3,668,460</u>
 SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for interest	<u>\$ 542,490</u>	<u>\$ 651,975</u>

MUSIC ACADEMY OF THE WEST

NOTES TO FINANCIAL STATEMENTS

Note 1 - ORGANIZATION

Founded in 1947, the Music Academy of the West (Academy) is an 8-week summer school and festival located in Santa Barbara, California. The academy provides training for exceptionally talented musicians from around the world and presents distinguished faculty and visiting artists in public masterclasses and performances. The festival offers more than 200 events for the community annually. At least half of the events are free and open to the public.

The academy annually provides 140 musicians (fellows) full scholarship for the summer school and festival, including tuition, room, and board. Fellows are selected from more than 1,600 worldwide applicants to study with eminent faculty and visiting guest artists. Fellows participate in one of five programs: instrumental (strings, woodwinds, brass, and percussion), solo piano, collaborative piano, vocal piano, and voice. The voice program, led by legendary mezzo-soprano Marilyn Horne, has been featured in a fully staged opera production presented in the community every year since 1997.

From 2014-2018, the Music Academy of the West is partnering with the New York Philharmonic to provide educational opportunities for academy fellows and concerts for the community. New York Philharmonic musicians will teach and perform during the summer festival, the New York Philharmonic will perform during the festival, and Academy fellows will perform in New York City with the New York Philharmonic in concert.

Music Academy of the West alumni are members of major symphony orchestras, chamber ensembles, opera companies, and university and conservatory faculties worldwide. More than 65 alumni participate in careers with the Metropolitan Opera, LA Opera, and San Francisco Opera. The New York Philharmonic, Los Angeles Philharmonic, Chicago Symphony Orchestra, and San Francisco Symphony have a total of more than 50 Academy alumni on their current rosters. Legendary and esteemed artists including Burt Bacharach, Marilyn Horne, Thomas Hampson, Donald McInnes, Paul Schenly, and David Shifrin attended the Academy and have received its highest honor, the Distinguished Alumni Award.

Note 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

The Academy follows the accrual method of accounting. It is the Academy's policy to recognize revenue when it is earned and to record expenses when incurred. Unconditional pledges and irrevocable bequests are recorded and recognized as revenue upon receipt of the promise or notification of the irrevocable bequest.

B. Investments

As required by generally accepted accounting principles, investments in marketable securities with readily determinable fair values and all investments in marketable debt securities are valued at their fair values as of the date of the statement of financial position. Investments that do not meet the definition of marketable securities, which include limited partnerships and hedge funds, are valued at cost. Unrealized gains and losses in marketable securities are included in the change in net assets.

C. Pledges and Irrevocable Bequests Receivable

Unconditional pledges and irrevocable bequests receivable are recorded and recognized

MUSIC ACADEMY OF THE WEST

NOTES TO FINANCIAL STATEMENTS

as revenue upon receipt of the pledge or notification of the irrevocable bequest. No allowances have been recorded as management feels that all receivables are materially collectible. All pledges and irrevocable bequests receivable due in more than one year have been recorded at present value using a discount rate of 2.5%.

D. Property and Equipment

Land, building and equipment are recorded at cost or, if donated, at fair market value at the time of the donation. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specified purpose. Assets donated with explicit restrictions regarding their use, and contributions of cash that must be used to acquire property and equipment, are reported as permanently restricted support. Absent donor stipulations regarding how long those donated assets must be maintained, the Academy reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. The Academy reclassifies temporarily restricted net assets to unrestricted net assets at that time.

Depreciation is computed using the straight-line method over the useful lives of the related assets. Buildings and artwork are depreciated over 50 years. Musical equipment and library texts are depreciated over twenty-five years, and the remaining assets are depreciated over five years.

E. Fair Value of Financial Instruments

The estimated fair values of the Organization's short-term financial instruments, including cash, cash equivalents, and accounts payables arising in the ordinary course of business, approximate their individual carrying amounts due to the relatively short period of time between their origination and expected realization. The fair value of the marketable securities is based on quoted market rates.

F. Donated Services

During the year ended December 31, 2013, numerous volunteers donated their time and services. The donated services were not recognized in the financial statements because they do not meet the criteria for recognition under generally accepted accounting principles.

G. Use of Contributions

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. However, if a restriction is fulfilled in the same time period in which the contribution is received, the Academy reports the support as unrestricted.

H. Functional Expenses

The Academy allocates its expenses on a functional basis among its various programs and support services. Expenses that can be identified with a specific program and support service are allocated directly according to their natural expenditure classification. The Academy's policy is for the management and general functional expense category to be

MUSIC ACADEMY OF THE WEST

NOTES TO FINANCIAL STATEMENTS

used for expenses that can't be directly allocated to other functional expense categories.

I. Cash and Cash Equivalents

For the purpose of statement of the cash flows, the Academy considers all short-term investments with an original maturity of three months or less to be cash equivalents.

J. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

K. Income Taxes

The Academy is exempt from income taxes under Internal Revenue Code section 501(c)(3), however income tax is imposed on income from a business enterprise of a non-profit organization that is not related to its tax-exempt status. There is no tax for the year ended December 31, 2013. As a California nonprofit school, the Academy is exempt from state income taxes. Contributions to the Academy are deductible by the donors as provided by the Internal Revenue Code.

In June 2006, the Financial Accounting Standards Board issued ASC 740-10 (formerly known as FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes), which prescribed a comprehensive model for how an organization should measure, recognize, present, and disclose in its financial statements uncertain tax positions that an organization has taken or expects to take on a tax return. The Academy has adopted ASC 740-10. There was no impact to the Academy's financial statements as a result of the implementation of ASC 740-10.

L. Comparative Amounts

The amounts shown for 2012 in the accompanying financial statements are included to provide a basis for comparison with 2013 and are not intended to present all information necessary for a fair presentation of the 2012 financial statements in conformity with generally accepted accounting principles.

Certain amounts in the 2012 financial statements have been reclassified to conform to 2013 financial statement presentation.

Note 3 - CONCENTRATION OF RISK

Credit Risk

The Academy occasionally has in excess of \$250,000 on deposit with one bank. The FDIC only insures the first \$250,000 on deposit with any one bank.

Geographic Risk

The Academy historically has derived a large percentage of its donations from

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NOTES TO FINANCIAL STATEMENTS

individuals, foundations and companies in Southern California, principally in Southern Santa Barbara County.

Note 4 - PLEDGES AND BEQUESTS RECEIVABLE

Pledges Receivable

The collection schedule of non-current pledges receivable is as follows:

Year ending December 31:	
2014	\$ 1,416,696
2015	1,056,000
2016	455,000
2017	41,500
2018	16,500
Thereafter	<u>205,000</u>
Total pledges receivable	3,190,696
Less allowance for uncollectible Pledges receivable	(10,652)
Less present value discount	<u>(143,352)</u>
Total Pledges Receivable	<u>\$ 3,036,692</u>

Bequests Receivable

The collection schedule of non-current bequests receivable is as follows:

Year ending December 31:	
2014	\$ -
2015	-
2016	500,000
2017	-
2018	565,000
Thereafter	<u>6,500,000</u>
Total bequests receivable	7,565,000
Less present value discount	<u>(1,280,348)</u>
Total Bequests Receivable	<u>\$ 6,284,652</u>

Note 5 - INVESTMENTS

Marketable Securities

Investments considered to be marketable securities are presented in the financial statements at fair market value derived from quoted market prices in active markets (all level 1 measurements).

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NOTES TO FINANCIAL STATEMENTS

At December 31, 2013 marketable securities consisted of the following:

	<u>Cost</u>	<u>Market Value</u>	<u>Excess of Market over Cost</u>
Common stock - domestic	\$ 6	\$ 3,768	\$ 3,762
Mutual funds - balanced	<u>13,650,108</u>	<u>13,782,198</u>	<u>132,090</u>
Total	<u>\$ 13,650,114</u>	<u>\$ 13,785,966</u>	<u>\$ 135,852</u>

Alternative Investments

Alternative investments include non-marketable securities which consist primarily of limited partnerships and hedge funds. The Academy has reported these investments at cost which totaled \$17,259,764 at December 31, 2013. Management believes there has been no permanent impairment to value. Management has estimated the fair market value of these investments at December 31, 2013 to be \$19,540,783. Management's estimate is based on the reported values provided by the fund managers.

Investment Income

Investment income is summarized as follows:

Interest income	\$ 144,411
Realized gain on securities	4,606,410
Unrealized gain on securities	<u>(569,173)</u>
Total	<u>\$ 4,181,648</u>

The Academy Board of Directors elected to make a transition to a new investment manager in the year ended December 31, 2013. This action resulted in a partial redemption of the Academy's total hedge funds, and yielded a significant realized gain on securities due to the redeemed hedge funds book value being reported at the historical cost basis. The Academy's investment manager transition and associated assets transfer, is scheduled to be complete in the year ended December 31, 2014.

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NOTES TO FINANCIAL STATEMENTS

Note 6 - PROPERTY AND EQUIPMENT

A summary of land, building and equipment as of December 31, 2013, is as follows:

Land and improvements	\$ 230,245
Buildings	33,981,976
Furniture, fixtures and equipment	761,493
Construction in process	26,519
Library text and music	18,612
Instruments	1,674,384
Vehicles	<u>43,153</u>
	36,736,382
Less accumulated depreciation	<u>(5,745,553)</u>
Net Property and Equipment	<u>\$ 30,990,829</u>

Depreciation expense for the year ended December 31, 2013 totaled \$927,406.

Note 7 - SCHOLARSHIP PLEDGE

The Academy has been named as a beneficiary of the Estate of Sima Mannick. In accordance with the last will and testament of Mrs. Mannick, the Academy will receive annually an amount equivalent to the Academy's cost of two students' attendance. The funds to pay the tuition will be paid from the income of an endowment trust set up at the University of Southern California.

Note 8 - RESTRICTIONS OF NET ASSETS

Board Designated Funds

Board designated funds include amounts placed into the Academy's endowment fund for the following purposes:

Future building maintenance	\$ 1,854,754
Loan repayment	4,536,317
Future operations	<u>24,654,658</u>
	<u>\$ 31,045,729</u>

Temporarily Restricted Funds

Temporarily restricted net assets represent donor restriction for which the restriction has not been met at December 31, 2013. Temporary restricted net assets as of December 31, 2013 consist of the following:

Campus renovation plan	\$ 1,652,578
Various program activities	2,031,692
Time restricted	<u>9,829,411</u>
	<u>\$ 13,576,681</u>

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NOTES TO FINANCIAL STATEMENTS

Permanently Restricted Funds

Permanently restricted net assets consist of bequests receivable the proceeds of which are to be held indefinitely.

Note 9 - FOUNDATION PLEDGE

On September 1, 1990, the Ridley - Tree Foundation set up a scholarship fund of \$50,000 in the name of the Academy. The Ridley - Tree Foundation has subsequently added an additional \$275,000 to the original contribution amount. The earnings of the fund are paid to the Academy semiannually. Due to the revocable nature of the arrangement the principal amount held by Paine Webber has not been recorded as an asset of the Academy, nor has the principal been recorded as a contribution to the Academy.

Note 10 - CONTRIBUTIONS IN TRUST

During the year ended September 30, 1991, a pooled income trust fund was established. The present value of the trust as of the date of the contribution was \$4,444. At December 31, 2013, the fair market value of the Academy's share of trust assets was \$14,186. These assets are recorded as permanently restricted assets.

During the year ended December 31, 2005 the Academy was named as a 20% beneficiary of the Maximus Fund to be held by the Santa Barbara Foundation. The Academy is to receive an annual payment equal to 5% of the fund's fair market value as determined on January 1 of each year. The estimated fair market value of the gift has been determined to equal the underlying assets at the time of the gift. The Academy has recorded the gift as an increase to temporarily restricted net assets. The Academy's share of the net assets of the fund at December 31, 2013 was \$2,738,303.

During the year ended December 31, 2012 the Academy was named as a 20% beneficiary of the Thomas E & Elenor H. Hugunin Endowment Fund to be held by the Santa Barbara Foundation. The Academy is to receive an annual payment equal to 5% of the fund's fair market value as determined on January 1 of each year. The estimated fair market value of the gift has been determined to equal the underlying assets at the time of the gift. The Academy has recorded the gift as an increase to temporarily restricted net assets. The Academy's share of the net assets of the fund at December 31, 2013 was \$1,460,627.

Note 11 - PENSION PLAN

In 2001, the Academy adopted The Music Academy of the West Tax-Deferred Annuity Plan under section 403(b) of the Internal Revenue Code. Eligible employees are at minimum twenty-one years of age, have completed one year of service, and work full time. The Academy matches employee contributions 100% for the first 5% of deferred salary. Pension plan contributions and operating expenses for the year ended December 31, 2013 was \$58,961.

Note 12 - OTHER INVESTMENT

The Academy is the beneficiary of a second trust deed of \$427,598, secured by real property located in Santa Barbara, California. As stated in the second trust deed there is no interest charged on the principal and the Academy will share in the appreciation of the

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real property upon sale in the future.

Note 13 – ASSETS VALUED AT FAIR VALUE

Fair Value Measurements at December 31, 2013 are summarized as follows:

	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>Recurring fair value measurements:</i>			
Equity securities:			
Domestic common stock	\$ 3,768	\$ -	\$ -
Mutual funds:			
Balanced income	<u>13,782,198</u>	<u>-</u>	<u>-</u>
Total investments	13,785,966	-	-
Beneficial Interest in perpetual trust	<u>-</u>	<u>-</u>	<u>4,213,116</u>
Total	<u>\$ 13,785,966</u>	<u>\$ -</u>	<u>\$ 4,213,116</u>

Fair value for the contribution receivable from the beneficial interest in perpetual trusts is measured using the fair value of the assets held in the trust as reported by the trustee as of December 31, 2013. The Academy considers the measurement of its beneficial interest in the trusts to be a Level 3 measurement within the fair value hierarchy because even though that measurement is based on the unadjusted fair values of the trust assets reported by the trustee, the Academy will never receive those assets or have the ability to direct the trustee to redeem them.

The Academy recognizes transfers in between levels in the fair value hierarchy at the end of the reporting period. There were no transfers between the levels in the fair value hierarchy during the year ended December 31, 2013.

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The table below presents information about fair value measurements that use significant unobservable inputs (level 3):

Beneficial interest in perpetual trust

Balance at December 31, 2012	\$ 4,075,425
Additional beneficial interest received	-
Total Gains(Losses) Included In Changes in Net Assets	<u>137,691</u>
Balance at December 31, 2013	<u>\$ 4,213,116</u>

Note 14 - NOTE PAYABLE

In September 2012, the Academy entered into a note payable agreement with First Republic Bank. Under the agreement the Academy borrowed \$15,200,000. The agreement called for an annual interest rate of 3.65%. The note payable is to be repaid with monthly principal and interest payments of \$79,221. The note payable matures September 2036. In association with the note payable the Academy incurred \$298,661 of issuance costs which are being amortized over the life of the note. At December 31, 2013 the Academy reported unamortized loan issuance costs of \$282,588. The proceeds of the note were used to retire \$14,884,925 of certificates of participation. The note payable is secured by a UCC-1 filing. Minimum maturities of the note payable are as follows:

2014	\$ 420,578
2015	437,717
2016	452,551
2017	470,761
2018	488,234
Thereafter	<u>12,406,726</u>
	<u>\$ 14,676,567</u>

Note 15 - ENDOWMENT

The Academy's endowment has been established for general operating purposes, building maintenance and loan repayment. Its endowment consists exclusively of board designated endowment funds. As required by generally accepted accounting principles (GAAP), net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Directors of the Academy has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, The Organization classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent

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endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization.

Endowment net asset composition by type of fund as of June 30, 2013:

Unrestricted (Designated)	Temporarily Restricted	Permanently Restricted	Total
<u>\$ 31,045,729</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$31,045,729</u>

Changes in endowment net assets for the fiscal year ended June 30, 2013 are as follows:

	Unrestricted (Designated)	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 27,711,007	\$ -	\$ -	\$ 27,711,007
Contributions	800,000	-	-	800,000
Investment Income	4,180,699	-	-	4,180,699
Expenditures:				
Buildings	(113,295)	-	-	(113,295)
Loan Repayment	(225,000)	-	-	(225,000)
Programs	(1,159,362)	-	-	(1,159,362)
Investment Expenses	<u>(148,320)</u>	<u>-</u>	<u>-</u>	<u>(148,320)</u>
Endowment net assets, ending of year	<u>\$ 31,045,729</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31,045,729</u>

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or SPMIFA requires the Organization to retain as a fund of perpetual duration. No such deficiencies existed at December 31, 2013.

Return Objectives and Risk Parameters

The Academy has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity.

Strategies Employed for Achieving Objectives

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

Spending Policy

The Academy has adopted a spending policy which allows expenditures equal to 4.75% of the five year endowment average balance.

Note 16 - COMMITMENTS

The Academy leases a private residence located in Santa Barbara, California. The lease expires June 30, 2015 and requires monthly payments of \$3,500. The Academy considers the lease to be an operating lease.

Note 17 - SUBSEQUENT EVENTS

Management has evaluated events through May 19, 2014, which is the date the financial statements were available to be issued. Management has determined that no subsequent event, with the exception of the event described below, requiring disclosure or significantly impacting disclosure has occurred.

On February 3, 2014, the Academy acquired a \$1,500,000 secured line of credit. The line of credit incurs interest at a variable rate equal to the rate of interest published in the Western Edition of The Wall Street Journal as the U.S. "prime rate" rounded upward to the nearest one-eighth (1/8th) of one percentage point. The line of credit agreement expires January 31, 2015. This line of credit is renewable each year and is for the purposes of the Academy's short term cash needs for operating activities.