



**MUSIC ACADEMY OF THE WEST**

**FINANCIAL STATEMENTS**

**December 31, 2017**



## **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, 2017, and the related statements of activities, net assets, 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 of the West's financial statements, and our report dated May 30, 2017, 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, 2016 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, 2017, 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 23, 2018  
Orcutt, California

## Music Academy of the West

### STATEMENT OF FINANCIAL POSITION December 31, 2017 (With Comparative Totals for December 31, 2016)

#### ASSETS

	Unrestricted	Temporarily Restricted	Permanently Restricted	2017	2016
<b>CURRENT ASSETS</b>					
Cash and equivalents	\$ 3,674,139	\$ 719,590	\$ 10,000	\$ 4,403,729	\$ 6,352,834
Pledges receivable (Note 4)	-	1,830,166	100,000	1,930,166	4,840,675
Accounts receivable	27,435	-	-	27,435	-
Other receivables	56,143	-	-	56,143	-
Prepaid expenses and other current assets	127,551	-	-	127,551	231,425
Total Current Assets	3,885,268	2,549,756	110,000	6,545,024	11,424,934
Property and equipment, net (Note 6)	39,252,301	-	-	39,252,301	36,509,883
<b>OTHER ASSETS</b>					
Investments (Note 5)	33,799,544	2,334,334	300,000	36,433,878	33,078,395
Pledges receivable (Note 4)	-	1,278,923	92,860	1,371,783	2,441,022
Bequests receivable (Note 4)	-	7,240,533	-	7,240,533	6,066,725
Other investment (Note 7)	427,598	-	-	427,598	427,598
Contributions in trust (Note 8)	-	4,173,645	-	4,173,645	3,986,891
Total Other Assets	34,227,142	15,027,435	392,860	49,647,437	46,000,631
<b>TOTAL ASSETS</b>	<b>\$ 77,364,711</b>	<b>\$ 17,577,191</b>	<b>\$ 502,860</b>	<b>\$ 95,444,762</b>	<b>\$93,935,448</b>

# MUSIC ACADEMY OF THE WEST

## STATEMENT OF FINANCIAL POSITION

December 31, 2017

(With Comparative Totals for December 31, 2016)

### LIABILITIES AND NET ASSETS

	Unrestricted	Temporarily Restricted	Permanently Restricted	2017	2016
<b>CURRENT LIABILITIES</b>					
Accounts payable	\$ 61,409	\$ -	\$ -	\$ 61,409	\$ 336,902
Accrued expenses	152,338	-	-	152,338	191,413
Deposits	705	-	-	705	170
Deferred revenue	80,911	-	-	80,911	104,870
Current portion of long-term debt (Note 9)	488,234	-	-	488,234	470,761
<b>Total Current Liabilities</b>	<b>783,597</b>	<b>-</b>	<b>-</b>	<b>783,597</b>	<b>1,104,116</b>
<b>LONG-TERM LIABILITIES</b>					
Notes payable, net of current portion (Note 9)	12,171,221	-	-	12,171,221	12,646,947
<b>Total Long-Term Liabilities</b>	<b>12,171,221</b>	<b>-</b>	<b>-</b>	<b>12,171,221</b>	<b>12,646,947</b>
<b>Total Liabilities</b>	<b>12,954,818</b>	<b>-</b>	<b>-</b>	<b>12,954,818</b>	<b>13,751,063</b>
<b>NET ASSETS (Note 10)</b>					
Unrestricted	30,462,145	-	-	30,462,145	27,077,440
Unrestricted - board designated	33,947,748	-	-	33,947,748	31,098,259
Temporarily restricted	-	17,577,191	-	17,577,191	21,708,686
Permanently restricted	-	-	502,860	502,860	300,000
<b>Total Net Assets</b>	<b>64,409,893</b>	<b>17,577,191</b>	<b>502,860</b>	<b>82,489,944</b>	<b>80,184,385</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 77,364,711</b>	<b>\$ 17,577,191</b>	<b>\$ 502,860</b>	<b>\$ 95,444,762</b>	<b>\$ 93,935,448</b>

# MUSIC ACADEMY OF THE WEST

## STATEMENT OF ACTIVITIES

For the Year Ended December 31, 2017

(With Comparative Totals for December 31, 2016)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2017	2016
<b>PUBLIC SUPPORT</b>					
Contributions (note 1)	\$ 4,742,419	\$ 937,947	\$ 202,860	\$ 5,883,226	\$ 9,603,398
Concert program advertising	43,125	-	-	43,125	30,738
Other support	-	-	-	-	4,190
<b>TOTAL PUBLIC SUPPORT</b>	<u>4,785,544</u>	<u>937,947</u>	<u>202,860</u>	<u>5,926,351</u>	<u>9,638,326</u>
<b>REVENUE CENTERS</b>					
Rack and Treasure House sales	266,011	-	-	266,011	252,398
Rack and Treasure House expenses	(158,513)	-	-	(158,513)	(127,721)
<b>TOTAL REVENUE CENTERS</b>	<u>107,498</u>	<u>-</u>	<u>-</u>	<u>107,498</u>	<u>124,677</u>
<b>SPECIAL EVENTS</b>					
Gross revenue	850,708	-	-	850,708	909,127
Direct costs	(208,421)	-	-	(208,421)	(261,240)
<b>SPECIAL EVENTS, NET</b>	<u>642,287</u>	<u>-</u>	<u>-</u>	<u>642,287</u>	<u>647,887</u>
<b>REVENUE</b>					
Concerts, recitals and master classes	912,643	-	-	912,643	754,367
Fees	224,918	-	-	224,918	217,150
Rentals	216,951	-	-	216,951	125,267
Gain (loss) on sale of assets	17,537	-	-	(17,537)	(37,231)
Other revenue	47,248	-	-	47,248	-
Investment income (note 5)	4,696,170	365,891	-	5,062,061	1,446,710
<b>Total Revenue</b>	<u>6,080,393</u>	<u>365,891</u>	<u>-</u>	<u>6,446,284</u>	<u>2,506,263</u>
<b>TOTAL PUBLIC SUPPORT AND REVENUE</b>	<u>11,615,722</u>	<u>1,303,838</u>	<u>202,860</u>	<u>13,122,420</u>	<u>12,917,153</u>
Assets Released From Restriction	<u>5,435,333</u>	<u>(5,435,333)</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>FUNCTIONAL EXPENSES</b>					
Program Expenses:					
Summer School and Festival (note 1)	8,805,207	-	-	8,805,207	7,266,171
Supporting Services					
Management and general	831,531	-	-	831,531	695,738
Fundraising	1,180,123	-	-	1,180,123	996,956
<b>Total Functional Expenses</b>	<u>10,816,861</u>	<u>-</u>	<u>-</u>	<u>10,816,861</u>	<u>8,958,865</u>
<b>CHANGES IN NET ASSETS</b>	<u>\$ 6,234,194</u>	<u>\$ (4,131,495)</u>	<u>\$ 202,860</u>	<u>\$ 2,305,559</u>	<u>\$ 3,958,288</u>

**MUSIC ACADEMY OF THE WEST**  
**STATEMENT OF CHANGES IN NET ASSETS**  
For the Year Ended December 31, 2017  
(With Comparative Totals for 2016)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2017</u>	<u>2016</u>
Beginning Balance	\$ 58,175,699	\$ 21,708,686	\$ 300,000	\$ 80,184,385	\$ 76,226,097
Changes in Net Assets	<u>6,234,194</u>	<u>(4,131,495)</u>	<u>202,860</u>	<u>2,305,559</u>	<u>3,958,288</u>
Ending Balance	<u><u>\$ 64,409,893</u></u>	<u><u>\$ 17,577,191</u></u>	<u><u>\$ 502,860</u></u>	<u><u>\$ 82,489,944</u></u>	<u><u>\$ 80,184,385</u></u>

## MUSIC ACADEMY OF THE WEST

### STATEMENT OF FUNCTIONAL EXPENSES

For the Year Ended December 31, 2017

(with comparative Totals for 2016)

	<u>Program Expenses</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>2017 Total</u>	<u>2016 Total</u>
Salaries	\$ 1,860,526	\$ 164,857	\$ 329,713	\$ 2,355,096	\$ 2,239,371
Pension plan contributions	61,165	5,420	10,839	77,424	76,480
Other employee benefits	170,980	15,150	30,300	216,430	222,268
Payroll taxes	132,187	11,713	23,426	167,326	156,828
Fees:					
Accounting and legal	-	54,826	-	54,826	28,655
Investment	-	-	-	-	12,284
Other	327,544	19,267	38,534	385,345	364,609
Advertising and promotion	236,607	20,965	41,930	299,502	288,587
Office expenses	68,067	6,031	12,063	86,161	96,842
Information technology	133,652	11,843	23,685	169,180	143,228
Occupancy	1,551,975	91,293	182,585	1,825,853	1,552,408
Travel	248,646	22,032	44,064	314,742	289,669
Interest	378,016	33,495	66,990	478,501	496,769
Depreciation	884,271	176,854	44,214	1,105,339	979,149
Insurance	72,407	6,416	12,832	91,655	87,923
Festival productions	2,679,164	191,369	318,948	3,189,481	1,923,795
Total Expenses	<u>\$ 8,805,207</u>	<u>\$ 831,531</u>	<u>\$ 1,180,123</u>	<u>\$ 10,816,861</u>	<u>\$ 8,958,865</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, 2017  
(with comparative Totals for 2016)

	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 2,305,559	\$ 3,958,288
Adjustments to reconcile change in net assets to net cash provided in operating activities:		
Depreciation	1,105,339	979,149
Amortization of loan issuance costs	12,444	12,445
Loss (gain) on value of securities	(6,250,193)	(522,258)
Loss (gain) on sale of securities	1,539,335	(1,946)
Loss (gain) on sale of fixed assets	17,537	37,231
Loss (gain) on value of charitable trusts	(186,754)	11,301
(Increase) decrease in operating assets:		
Pledges receivable	2,805,940	(870,006)
Accounts and other receivables	(83,578)	-
Prepaid expenses	103,874	(78,200)
Increase (decrease) in operating liabilities:		
Accounts payable	(275,493)	(127,815)
Accrued expenses	(39,075)	4,641
Deposits	535	-
Deferred revenue	(23,959)	(116)
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>1,031,511</b>	<b>3,402,714</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of long-term investments	(32,076,183)	(403,224)
Proceeds from maturity and sale of long-term investments	33,431,558	822,466
Payments for property and equipment	(3,865,294)	(6,501,834)
<b>NET CASH FROM INVESTING ACTIVITIES</b>	<b>(2,509,919)</b>	<b>(6,082,592)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal payments on notes payables	(470,697)	(452,497)
<b>NET CASH FLOWS FROM FINANCING ACTIVITIES</b>	<b>(470,697)</b>	<b>(452,497)</b>
<b>NET INCREASE IN CASH</b>	<b>(1,949,105)</b>	<b>(3,132,375)</b>
CASH - Beginning of year	6,352,834	9,485,209
End of year	<b>\$ 4,403,729</b>	<b>\$ 6,352,834</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid during the year for interest	<b>\$ 448,584</b>	<b>\$ 484,324</b>

# 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 master classes 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 1,800 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 performed during the 2017 festival, and Academy fellows will perform in New York City with the New York Philharmonic in concert. The Academy has committed to fund this partnership which will result in increased festival production expenses that will vary year over year based on programming.

During the year ended December 31, 2016 the Academy completed a capital campaign to fund Phase 3 of the campus renovation. As a result of the campaign the Academy received a significant increase in contributions for the renovation of the Main House and the construction of the New Teaching Studio during the year ended December 31, 2016.

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

## MUSIC ACADEMY OF THE WEST

### NOTES TO FINANCIAL STATEMENTS

position. 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 as revenue upon receipt of the pledge or notification of the irrevocable bequest. 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. Absent donor stipulations regarding how long 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. The Academy has implemented a capitalization threshold of \$2,500.

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 Academy'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. The fair value of investments determined by estimated net asset value is determined by the estimated value of the underlying assets held by the investment fund.

#### F. Donated Services

During the year ended December 31, 2017, 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.

# MUSIC ACADEMY OF THE WEST

## NOTES TO FINANCIAL STATEMENTS

### 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 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, 2017. 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. The Academy is not considered a private foundation.

### L. Comparative Amounts

The amounts shown for 2016 in the accompanying financial statements are included to provide a basis for comparison with 2017 and are not intended to present all information necessary for a fair presentation of the 2016 financial statements in conformity with generally accepted accounting principles.

Certain amounts in the 2016 financial statements have been reclassified to conform to 2017 financial statement presentation.

### M. Advertising Costs

The Organization uses advertising to promote its programs among the audiences it serves. Advertising costs are expensed as incurred. Advertising expense for the year ended December 31, 2017 was \$299,502.

## Note 3 - CONCENTRATION OF RISK

### Credit Risk

Financial instruments that potentially subject the Academy to concentrations of credit

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**NOTES TO FINANCIAL STATEMENTS**

risk consist principally of cash equivalents, marketable securities, short-term deposits, pledges receivable and bequests receivable. The Academy places its cash equivalents and short-term deposits with two high-quality financial institutions. The Academy's donor base consists of a large number of diverse donors.

The FDIC insures deposits according to the ownership category in which funds are insured and how the accounts are titled. The standard deposit insurance coverage limit is \$250,000 per depositor, per FDIC-insured bank, per ownership category. Deposits held in different ownership categories are separately insured, up to at least \$250,000, even if held at the same bank. At December 31, 2017 the Academy held approximately \$3,400,000 of uninsured cash deposits.

Geographic Risk

The Academy historically has derived a large percentage of its donations from individuals, foundations and companies in Southern California, principally in Southern Santa Barbara County.

Note 4 - PLEDGES AND BEQUESTS RECEIVABLE

*Pledges Receivable - Unconditional*

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

	Year ending December 31:
2018	\$ 1,930,166
2019	962,111
2020	355,000
2021	15,000
2022	15,000
Thereafter	<u>175,000</u>
Total pledges receivable	3,452,277
Less allowance for uncollectible Pledges receivable	(5,743)
Less present value discount	<u>(144,585)</u>
Total Pledges Receivable	<u>\$ 3,301,949</u>

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NOTES TO FINANCIAL STATEMENTS

*Bequests Receivable – Unconditional and Irrevocable*

Management estimated collection dates of bequests receivable are as follows:

	Year ending December 31:	
2018		\$ 1,515,000
2019		3,100,000
2020		1,100,000
2021		-
2022		50,000
Thereafter		<u>2,100,000</u>
 Total bequests receivable		 7,865,000
 Less present value discount		 <u>(624,467)</u>
 Total Bequests Receivable		 <u>\$ 7,240,533</u>

*Pledges Receivable – Conditional and Revocable*

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. The value of the pledge can be revoked and as such has not been recorded in the accompanying financial statements.

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 5 - INVESTMENTS

Investments held by the Academy are measured and recorded at fair value. The valuation methodology, derivative activity, investment categories, related commitments and investment income for December 31, 2017 are discussed below. The fair value hierarchy and valuation methodology is discussed in note 11 of these financial statements.

*Valuation Methodology*

To the extent available, the Academy’s investments are recorded at fair value based on quoted prices in active markets on a trade-date basis. The Academy’s investments that are listed on any U.S. or non-U.S. recognized exchanges are valued based on readily available market quotations. When such inputs do not exist, fair value measurements are based on the best available information and usually require a degree of judgment. For alternative investments, which are principally private equity and hedge funds, the value is primarily based on the Net Asset Value (NAV) of the underlying investments. The NAV

## MUSIC ACADEMY OF THE WEST

### NOTES TO FINANCIAL STATEMENTS

is reported by the external investment managers, including general partners, in accordance with their policies as described in their respective financial statements and offering memoranda. The most recent NAV reported is adjusted for capital calls, distributions and significant known valuation changes, if any, of its related portfolio through the end of the fiscal year. These investments are generally less liquid than other investments, and the value reported may differ from the values that would have been reported had a ready market for these investments existed.

The Academy exercises due diligence in assessing the policies, procedures, and controls implemented by its external investment managers and believes the Academy's proportionate share of the carrying amount of these alternative investments is a reasonable estimate of fair value. Such due diligence procedures include, but are not limited to, ongoing communication and review of information from the external investment managers as well as review of performance. In conjunction with these procedures, estimated fair value is determined by consideration of a wide range of factors, such as market conditions, redemption terms and restrictions, and risks inherent in the inputs of the external investment managers' valuation.

For alternative investments which are direct investments in closed ended funds, the Academy considers various factors to estimate fair value, such as, but not limited to, the timing of the transaction, the market in which the company operates, comparable transactions, company performance and projections as well as discounted cash flow analysis. The selection of an appropriate valuation technique may be affected by the availability and general reliability of relevant inputs. In some cases, one valuation technique may provide the best indication of fair value while in other circumstances, multiple valuation techniques may be appropriate. Furthermore, the Academy may review the investment's underlying portfolio as well as engage external appraisers, depending on the nature of the investment.

#### *Derivative Activity*

The Academy has approved the use of derivatives by outside investment managers, based on investment guidelines negotiated at the time of a manager's appointment. The derivatives are used to adjust fixed income durations and rates, to create "synthetic exposures" to certain types of investments, and to hedge inflation fluctuations. The Academy records the fair value of a derivative instrument within the applicable portfolio. The change in the fair value of a derivative instrument held for investment is included in investment return in the statement of activities.

#### *Investment Related Commitments*

The Academy is obligated under certain alternative investment agreements to advance additional funding up to specified levels over a period of several years. At December 31, 2017 the Academy is obligated to advance an additional \$3,446,512 under such agreements.

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NOTES TO FINANCIAL STATEMENTS

At December 31, 2017 investments consisted of the following:

	Market	Cost	Unrealized
Mutual funds – fixed income	\$ 2,852,096	\$ 2,867,500	\$ (15,404)
Mutual funds – equity	17,944,463	17,031,337	913,126
Overlay funds	1,888,716	1,877,605	11,111
Closed ended funds	4,485,085	741,737	3,743,348
Hedge funds	1,900,252	1,900,000	252
Private equity funds	42,256	44,518	(2,262)
Corporate bonds	3,917,610	3,920,491	(2,881)
U.S. federal agencies debt instruments	785,235	789,040	(3,805)
U.S. Treasury notes	815,755	816,377	(622)
Treasury inflation protected securities	<u>1,802,410</u>	<u>1,811,108</u>	<u>(8,698)</u>
<b>Totals</b>	<b><u>\$ 36,433,878</u></b>	<b><u>\$ 31,799,713</u></b>	<b><u>\$ 4,634,165</u></b>

*Investment Income*

Investment income is summarized as follows:

Interest and dividend income	\$ 464,004
Realized loss on securities	(1,539,335)
Unrealized gain on investments	6,250,193
Investment fees	<u>(112,801)</u>
<b>Total</b>	<b><u>\$ 5,062,061</u></b>

Note 6 - PROPERTY AND EQUIPMENT

A summary of land, building and equipment as of December 31, 2017, is as follows:

Land and improvements	\$ 505,736
Buildings	43,091,741
Furniture, fixtures and equipment	1,379,283
Construction in process	1,252
Library text and music	18,612
Instruments	2,554,407
Vehicles	<u>43,153</u>
	47,594,184
Less accumulated depreciation	<u>(8,341,883)</u>
<b>Net Property and Equipment</b>	<b><u>\$ 39,252,301</u></b>

Depreciation expense for the year ended December 31, 2017 totaled \$1,105,339.

Note 7 - OTHER INVESTMENT

The Academy is the beneficiary of a second trust deed, of \$427,598, secured by real

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### NOTES TO FINANCIAL STATEMENTS

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 real property upon sale in the future.

#### Note 8 - 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, 2017, the fair market value of the Academy's share of trust assets was \$55,380. These assets are recorded as temporarily 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, 2017 was \$2,621,934.

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, 2017 was \$1,496,331.

For the year ended December 31, 2017, the Academy reported an increase in value in the value of contributions in trust of \$186,754 as part of contributions.

#### Note 9 - 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 note payable bears interest at 3.65% per annum, is to be repaid with monthly principal and interest payments of \$79,221 and matures in September 2036. In connection 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, 2017 the Academy reported unamortized loan issuance costs of \$232,811. The proceeds of the note were used to retire \$14,884,925 of certificates of participation. The note payable is secured by a lien on all of the Academy's assets other than its real property and permanently restricted assets. The note requires the Academy to maintain liquidity of \$14,000,000.

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NOTES TO FINANCIAL STATEMENTS

Minimum maturities of the note payable are as follows:

2018		\$ 488,234
2019		506,355
2020		523,935
2021		544,597
2022		564,810
Thereafter		<u>10,264,335</u>
Total minimum maturities		12,892,266
Less unamortized debt issuance costs		<u>(232,811)</u>
Note payable, net		<u>\$ 12,659,455</u>

The Academy reported \$17,473 of amortization of the debt issuance costs as interest expense.

Note 10 - DESIGNATIONS AND RESTRICTIONS OF NET ASSETS

*Board Designated Funds*

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

Loan repayment		\$ 4,144,291
Future operations		<u>29,803,457</u>
		<u>\$ 33,947,748</u>

*Temporarily Restricted Funds*

Temporarily restricted net assets represent donor restrictions for which the restriction has not been met at December 31, 2017. Temporary restricted net assets as of December 31, 2017 consist of the following:

Artistic Initiative Fund		\$ 457,500
Scholarships		59,884
Building maintenance		1,910,788
Various program activities		261,012
Time restricted		<u>14,888,007</u>
		<u>\$ 17,577,191</u>

*Permanently Restricted Funds*

Permanently restricted net assets consist of contributions to be held indefinitely of which the income is restricted for the purpose of scholarships.

Note 11 - FAIR VALUE MEASUREMENTS

The Academy has adopted Financial Accounting Standards Board *Accounting Standards Codification* (ASC) 820, which clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based

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### NOTES TO FINANCIAL STATEMENTS

measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2—Other inputs that are directly or indirectly observable in the marketplace.
- Level 3—Unobservable inputs that are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability developed from sources independent of the reporting entity, and unobservable inputs reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The following is a description of the valuation methodology used for assets measured at fair value.

- Common stock and mutual funds are principally valued at the regular trading session closing price on the exchange or market in which such funds are principally traded, using the market approach.
- Fixed income (bond) funds are generally valued at the most recent bid price of the equivalent quoted yield for such securities (or those of comparable maturity, quality, and type).

#### *Fair Value of Financial Instruments*

The Academy's financial instruments consist of cash and cash equivalents, investments, receivables, contributions in trust, accounts payable, accrued expenses, and notes payable. Receivables, accounts payable and accrued expenses, and notes payable are stated at cost, which approximates fair value. Investments and contributions in trust are recorded at their fair values.

In accordance with ASC 820, The Academy records cash and cash equivalents and marketable securities at fair value.

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NOTES TO FINANCIAL STATEMENTS

In accordance with the fair value hierarchy described above, the following table show the fair value of the Academy's financial assets that are required to be measured at fair value at December 31, 2017:

	Level 1	Level 2	Level 3	NAV
Mutual funds – fixed income	\$ 2,852,096	\$ -	\$ -	\$ -
Mutual funds – equity	17,944,463	-	-	-
Overlay funds	-	-	-	1,888,716
Closed ended funds	-	-	-	4,485,085
Hedge funds	-	-	-	1,900,252
Private equity funds	-	-	-	42,256
Corporate bonds	3,917,610	-	-	-
U.S. federal agencies debt instruments	785,235	-	-	-
U.S. Treasury notes	815,755	-	-	-
Treasury inflation protected securities	1,802,410	-	-	-
Contributions in trust	<u>-</u>	<u>-</u>	<u>4,173,645</u>	<u>-</u>
Totals	<u>\$ 28,117,569</u>	<u>\$ -</u>	<u>\$ 4,173,645</u>	<u>\$ 8,316,309</u>

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

	Beginning Balance	Acquisitions	Dispositions	Unrealized Gain (Loss)	Ending Balance
Contributions in trust	<u>\$ 3,986,891</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 184,744</u>	<u>\$ 4,173,645</u>

Note 12 - 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 Uniform Prudent Management of Institutional Funds Act (UPMIFA) 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 Academy 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 endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the

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NOTES TO FINANCIAL STATEMENTS

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 UPMIFA. In accordance with UPMIFA, 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 Academy 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 Academy
- (7) The investment policies of the Academy.

Endowment net asset composition by type of fund as of December 31, 2017:

<b>Unrestricted (Designated)</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
<u>\$ 33,947,748</u>	<u>\$ 3,439,401</u>	<u>\$ 502,860</u>	<u>\$37,890,009</u>

Changes in endowment net assets for the fiscal year ended December 31, 2017 are as follows:

	<b>Unrestricted (Designated)</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets, beginning of year	\$ 31,098,259	\$ 2,042,624	\$ 300,000	\$ 33,440,883
Contributions	170,184	1,120,067	202,860	1,493,111
Investment Income	4,796,511	365,891	-	5,162,402
Expenditures:				
Loan Repayment	(688,567)	-	-	(688,567)
Programs	(1,323,807)	(81,212)	-	(1,405,019)
Investment Expenses	<u>(104,832)</u>	<u>(7,969)</u>	<u>-</u>	<u>(112,801)</u>
Endowment net assets, ending of year	<u>\$ 33,947,748</u>	<u>\$ 3,439,401</u>	<u>\$ 502,860</u>	<u>\$ 37,890,009</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 UPMIFA requires the Academy to retain as a fund of perpetual duration. No such deficiencies existed at December 31, 2017.

## MUSIC ACADEMY OF THE WEST

### NOTES TO FINANCIAL STATEMENTS

#### **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 Academy must hold in perpetuity.

#### **Strategies Employed for Achieving Objectives**

To satisfy its long-term rate-of-return objectives, The Academy 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 Academy 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 13 - RETIREMENT 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. Retirement plan contributions and operating expenses for the year ended December 31, 2017 was \$77,424.

#### Note 14 - COMMITMENTS

##### *Operating Leases*

The Academy leases a private residence located in Santa Barbara, Californian in which the Academy's President and CEO is required to reside under his employment contract. The lease expires June 30, 2018 and requires monthly payments of \$3,500. The Academy considers the lease to be an operating lease.

##### *Line of Credit*

The Academy has available a bank line of credit for any amount up to \$1,500,000 at December 31, 2017. The line of credit is secured by a lien on all of the Academy's assets other than its real property and permanently restricted assets. Draws on the line of credit bear interest at 4.5%. The Academy did not draw on the line during the year ended December 31, 2017. The line of credit expires June 30, 2018. The Academy plans to renew the line of credit upon expiration.

**MUSIC ACADEMY OF THE WEST**

**NOTES TO FINANCIAL STATEMENTS**

**Note 15 - SUBSEQUENT EVENTS**

Management has evaluated events through May 23, 2018, which is the date the financial statements were available to be issued. Management has determined that no subsequent event requiring disclosure or significantly impacting disclosure has occurred.