

SAN FRANCISCO  
CONSERVATORY OF MUSIC

JUNE 30, 2015

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INDEPENDENT AUDITORS' REPORT

AND

CONSOLIDATED FINANCIAL STATEMENTS

# **San Francisco Conservatory of Music**

## **Independent Auditors' Report and Consolidated Financial Statements**

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## **Independent Auditors' Report**

THE BOARD OF TRUSTEES  
SAN FRANCISCO CONSERVATORY OF MUSIC  
San Francisco, California

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of **SAN FRANCISCO CONSERVATORY OF MUSIC (SFCM)** which comprise the consolidated statement of financial position as of June 30, 2015, and the consolidated related statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Consolidated 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.

### **Auditor's 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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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 financial statements referred to above present fairly, in all material respects, the financial position of the SFCM as of June 30, 2015, 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.

### **Report on Summarized Comparative Information**

We have previously audited SFCM's June 30, 2014 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated October 23, 2014. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2014, is consistent, in all material respects, with the audited financial statements from which it has been derived.

*Hood & Strong LLP*

San Francisco, California  
November 10, 2015

# San Francisco Conservatory of Music

## Consolidated Statement of Financial Position (in thousands)

<i>June 30, 2015 (with comparative totals for 2014)</i>	2015	2014
<b>Assets</b>		
Cash	\$ 2,927	\$ 4,075
Restricted cash	414	285
Investments	38,346	38,447
Receivables:		
Accounts receivable (less allowance for doubtful accounts of \$23 for 2015 and \$20 for 2014)	659	237
Notes receivable (less allowance for doubtful accounts of \$98 for 2015 and \$108 for 2014)	722	733
Contributions and grants, net	12,276	15,209
Bequests	1,277	28
Trusts	380	388
Other assets	381	95
Property, plant and equipment, net	85,502	70,964
<b>Total Assets</b>	<b>\$ 142,884</b>	<b>\$ 130,461</b>
<b>Liabilities and Net Assets</b>		
<b>Liabilities:</b>		
Accounts payable and other liabilities	\$ 603	\$ 652
Deposits and deferred income	1,321	504
Line of credit	14,900	2,000
Term loan	5,250	5,625
Accumulated postretirement benefit obligation	2,945	3,153
Government advances for loan program	733	726
<b>Total liabilities</b>	<b>25,752</b>	<b>12,660</b>
<b>Net Assets:</b>		
Unrestricted:		
Undesignated	7,768	6,609
Designated - Quasi endowment	102	107
Underwater endowment funds	(1,877)	(1,290)
Federal loan fund	175	181
Investment in plant	50,858	52,367
<b>Total unrestricted net assets</b>	<b>57,026</b>	<b>57,974</b>
Temporarily restricted:		
Purpose and time restrictions	17,953	17,423
Appreciation on endowments	1,914	3,084
<b>Total temporarily restricted net assets</b>	<b>19,867</b>	<b>20,507</b>
Permanently restricted:		
Permanent endowments	40,239	39,320
<b>Total net assets</b>	<b>117,132</b>	<b>117,801</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 142,884</b>	<b>\$ 130,461</b>

The accompanying notes are an integral part of this statement.

# San Francisco Conservatory of Music

## Consolidated Statement of Activities (in thousands)

*Year Ended June 30, 2015 (with comparative totals for 2014)*

	2015			Total	2014 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
<b>Operating Revenue and Support:</b>					
Tuition and fees	\$ 17,492			\$ 17,492	\$ 17,396
Less: Scholarships	(7,603)			(7,603)	(7,331)
Net tuition and fees	9,889			9,889	10,065
Private contributions and government grants	4,244	\$ 1,372		5,616	4,920
Other educational revenue	343			343	483
Fundraising events	657			657	-
Auxiliary services	1,275			1,275	-
Net investment and endowment income		1,784		1,784	1,677
Net assets released from restrictions	2,676	(2,676)		-	-
<b>Total operating revenue and support</b>	<b>19,084</b>	<b>480</b>		<b>19,564</b>	<b>17,145</b>
<b>Expenses:</b>					
Program services:					
Instruction	8,048			8,048	7,956
Student services	1,145			1,145	920
Academic support	865			865	841
Public programs	266			266	-
Auxiliary services	1,186			1,186	198
<b>Total program services</b>	<b>11,510</b>			<b>11,510</b>	<b>9,915</b>
Fund-raising:					
General fund-raising	1,072			1,072	973
Fund-raising events	218			218	-
<b>Total fund-raising</b>	<b>1,290</b>			<b>1,290</b>	<b>973</b>
General management and administration	3,199			3,199	3,120
Maintenance of plant	1,812			1,812	1,964
Depreciation	1,331			1,331	1,342
Interest expense	194			194	181
<b>Total expenses</b>	<b>19,336</b>			<b>19,336</b>	<b>17,495</b>
<b>Change in net assets from operations</b>	<b>(252)</b>	<b>480</b>		<b>228</b>	<b>(350)</b>
<b>Nonoperating Activities:</b>					
Endowment and capital campaign contributions		255	\$ 928	1,183	16,630
Student housing project expenses				-	(115)
Independent operation revenues	315			315	-
Independent operation expenses	(825)			(825)	-
Gain (loss) on sale of assets	(12)			(12)	4
Investment income (loss), net of fees		(1,757)		(1,757)	2,296
Change in value of trust receivable			(9)	(9)	(6)
Postretirement health plan obligation	208			208	(626)
Net assets released from restrictions	205	(205)		-	-
Underwater endowment fund adjustment	(587)	587		-	-
<b>Change in net assets from nonoperating activities</b>	<b>(696)</b>	<b>(1,120)</b>	<b>919</b>	<b>(897)</b>	<b>18,183</b>
<b>Total Change in Net Assets</b>	<b>(948)</b>	<b>(640)</b>	<b>919</b>	<b>(669)</b>	<b>17,833</b>
<b>Net Assets - beginning of year</b>	<b>57,974</b>	<b>20,507</b>	<b>39,320</b>	<b>117,801</b>	<b>99,968</b>
<b>Net Assets - end of year</b>	<b>\$ 57,026</b>	<b>\$ 19,867</b>	<b>\$ 40,239</b>	<b>\$ 117,132</b>	<b>\$ 117,801</b>

The accompanying notes are an integral part of this statement.

# San Francisco Conservatory of Music

## Consolidated Statement of Cash Flows (in thousands)

<i>Year Ended June 30, 2015 (with comparative totals for 2014)</i>	2015	2014
<b>Operating Activities:</b>		
Change in net assets	\$ (669)	\$ 17,833
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Forgiveness of note receivable		(110)
Depreciation	1,536	1,342
Net realized and unrealized loss (gain) on investments	307	(3,516)
(Gain) loss on sale of assets	12	(4)
Contributions of equipment	(110)	(61)
Contributions received for long-term investment and acquisition of long lived assets	(3,394)	(5,473)
Changes in operating assets and liabilities:		
Receivables	1,281	(12,658)
Other assets	(286)	171
Accounts payable and accrued liabilities	(257)	787
Government advances for loan program	7	8
Deposits and deferred income	817	97
Net cash used by operating activities	(756)	(1,584)
<b>Investing Activities:</b>		
Property and equipment:		
Proceeds from sales	8	
Purchases and capital expenditures	(15,984)	(475)
Investments:		
Proceeds from sales	8,231	13,553
Purchases	(8,437)	(13,866)
Net cash used by investing activities	(16,182)	(788)
<b>Financing Activities:</b>		
Contributions received for long-term investment and acquisition of long lived assets	3,394	5,473
Line of credit proceeds	24,700	1,250
Line of credit payments	(11,800)	(1,000)
Term loan payment	(375)	(375)
Net cash provided by financing activities	15,919	5,348
<b>Net Change in Cash and Equivalents and Restricted Cash</b>	<b>(1,019)</b>	<b>2,976</b>
<b>Cash and Cash Equivalents, beginning of year</b>	<b>4,360</b>	<b>1,384</b>
<b>Cash and Cash Equivalents, end of year</b>	<b>\$ 3,341</b>	<b>\$ 4,360</b>
<b>Supplemental Cash Flow Information:</b>		
Interest paid	\$ 445	\$ 181
<b>Components of Cash and Cash Equivalents:</b>		
Cash	\$ 2,927	\$ 4,075
Cash and cash equivalents - restricted	\$ 414	\$ 285

The accompanying notes are an integral part of this statement.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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### Note 1 - Organization and Operations:

San Francisco Conservatory of Music (SFCM) is an independent college of music located in San Francisco, California. SFCM offers undergraduate and graduate degree programs, music instruction for adults and children and other public programs.

SFCM's operations are primarily funded through revenue generated by tuition and fees. Private contributions received from donors increase SFCM's ability to provide instruction.

SFCM assists students in the financing of their education through private and institutional scholarships as well as federally-funded student aid programs.

SFCM is accredited by the Western Association of Schools and Colleges (WASC). Federally funded student aid programs require the accreditation to be maintained. This accreditation is subject to periodic review and renewal.

### Note 2 - Significant Accounting Policies:

SFCM's significant accounting policies include the following:

#### a. Basis of Presentation and Description of Net Assets

The accompanying consolidated financial statements include the accounts of SFCM and its single member LLCs (collectively, "SFCM") after elimination of intercompany accounts and transactions.

SFCM's financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles for not-for-profit organizations which utilize unrestricted, temporarily restricted, and permanently restricted classifications for presentation.

*Unrestricted net assets* represent unrestricted resources that are not subject to donor-imposed restrictions and are available to support all activities of SFCM. Unrestricted net assets include Board designated net assets for endowment (see note 13).

*Temporarily restricted net assets* represent contributions that are limited in use by SFCM in accordance with donor-imposed stipulations that either expire with the passage of time or can be fulfilled and removed by activities conducted by SFCM pursuant to those stipulations.

*Permanently restricted net assets* represent contributions to be held as investments in perpetuity as directed by the original donor.



# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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### b. Revenue Recognition

Student tuition accounts receivable are recorded when students are billed. Tuition revenue is recorded as earned, on a pro rata basis over the applicable teaching period. Payments received for tuition for future periods are reported as deferred revenue. Collection or development of payment plans for tuition is required prior to registration for the following term.

All contributions and grants, whether or not restricted, are recognized as revenue when they are received by or unconditionally pledged to SFCM. SFCM classifies gifts of cash and other assets as temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When such donor restrictions expire, that is, when stipulated time restrictions end or purpose restrictions are accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying Statements of Activities as net assets released from restrictions.

SFCM reports gifts of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, SFCM reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Contributions of services are recorded as revenue and recognized when received if the services create or enhance nonfinancial assets, or if they require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Corresponding amounts are also recorded as expenses.

Contributions of assets other than cash are recorded at their estimated fair value. Contributions and grants receivable represent amounts committed by donors that have not been received by SFCM. Contributions and grants are discounted to their estimated net present value using a discount rate averaging 1.65%.

### c. Cash Equivalents

SFCM considers all instruments with a maturity of three months or less at the time of purchase to be cash equivalents for the purposes of the statement of cash flow, except for cash equivalents included in and managed with SFCM's investments.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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d. Restricted Cash

Restricted cash represents cash that is restricted for specific purposes, unlent cash in the SFCM's Perkins loan program, and cash held separately for projects and programs in accordance with donors' restrictions. SFCM had cash restricted for the Perkin's loan program in the amount of \$448,000 as of June 30, 2015.

e. Investments

Marketable securities are recorded at fair value based on quoted market prices. The fair value of alternative investments has been estimated using the net asset values as reported by the fund managers. SFCM believes the carrying amount of these investments is a reasonable estimate of its fair value. The timing of the ultimate liquidation of this investment is restricted to certain time periods, and is limited to sale to the fund. Due to inherent uncertainty of valuation of such investment, the estimated value may differ significantly from the value that would have been used had a ready market for such funds existed.

Other investments, primarily a real estate interest, are carried at cost basis. Investments received as gifts are recorded at estimated fair value at the date of the donation. Gains and losses that result from market fluctuations are recognized in the period such fluctuations occur. Realized gains or losses resulting from sales or maturities are calculated on an adjusted cost basis. Adjusted cost is the estimated fair value of the security at the beginning of the year, or the cost if purchased during the year. Dividend and interest income are accrued when earned.

f. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In addition, SFCM reports certain investments using the Net Assets Value (NAV) per share as determined by investment managers under the so-called "practical expedient." The practical expedient allows net asset value per share to represent fair value for reporting purposes when the criteria for using this method are met.

SFCM classifies its financial assets and liabilities measured at fair value on a recurring basis based on a fair value hierarchy with three levels of inputs. Level 1 values are based on unadjusted quoted prices in active markets for identical securities. Level 2 values are based on significant observable market inputs, such as quoted prices for similar securities and quoted prices in inactive markets. Level 3 values are based on significant unobservable inputs that reflect SFCM's determination of assumptions that market participants might reasonably use in valuing the securities. The valuation levels are not necessarily an indication of the risk or liquidity associated with the assets and liabilities measured at fair value.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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g. Endowment Funds

SFCM's endowments include donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

*Interpretation of UPMIFA*

The Board of Trustees of SFCM has interpreted California's 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, SFCM 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 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 California's UPMIFA. In accordance with California's UPMIFA, SFCM 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 SFCM
- 7) The needs of SFCM and the fund to make distributions and to preserve capital
- 8) The expected tax consequences
- 9) The role that each investment or course of action plays within the overall Fund
- 10) The investment policies of SFCM

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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### *Investment Objectives and Spending Policy*

SFCM 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. Under this policy, as approved by the Board of Trustees, the performance of the endowment fund shall be measured by total return. It is the desire of the Board of Trustees to realize a return (net of fees) of CPI + 4%.

SFCM has a spending goal of 4% of the 20 quarter moving average market value of the Fund calculated December 31st of each year. The spending rate for the year ending June 30, 2014 was calculated on the prior policy of the average market value of the endowment for the previous three years, calculated on December 31st. The specific income requirement shall be determined by the Board of Trustees on an annual basis and may be approved at a higher level depending on the need of the program. This is consistent with SFCM's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

### *Strategies Employed for Achieving Objectives*

To satisfy its long-term rate-of-return objectives, SFCM 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). SFCM's endowment fund is invested in a portfolio of stocks, bonds, alternative investments and other investments which shall provide maximum flexibility and safety through diversification of investments.

From time to time, the fair value of assets associated with individual donor-restricted funds may fall below the level that the donor or UPMIFA requires SFCM to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were approximately \$1,877,000 as of June 30, 2015. These deficiencies resulted from unfavorable market fluctuations and continued appropriation for programs that were deemed prudent by the Board of Trustees.

#### h. Accounts Receivable and Notes Receivable

Accounts receivable consist principally of student accounts receivable that are carried at the unpaid balance of the original amount billed to students. Notes receivable consist principally of Federal student loans which bear interest of 3 to 5 percent annually. Receivables are less an estimate made for doubtful accounts based on SFCM's past experience with the accounts. The allowance for doubtful account are disclosed in the statement of financial position.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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Student accounts receivable are written off when deemed uncollectible and student loans receivable may be assigned to the U.S. Department of Education. Late fees are charged on student accounts receivable after the posted registration dates.

After a student is no longer enrolled in an institution of higher education and after a grace period, interest is charged on student loans receivable and is recognized as it is charged. Late charges are charged if payments are not paid by the payment due date and are recognized as they are charged. Student loans receivable are considered to be past due if a payment is not made within 90 days of the payment due date. After receivables become past due, the accrual of late charges is suspended. Students may be granted a deferment, forbearance or cancellation of their student loan receivable based on eligibility requirements defined by the U.S. Department of Education.

i. Trusts Receivable

Trusts receivable are gifts and bequests held by SFCM or a trustee of which the income is paid to a beneficiary specified by the donor during the beneficiary's lifetime. Upon maturation, the principal becomes available for use by SFCM in accordance with the donor's specified purpose. Currently all recorded trusts contain provisions permanently restricting the corpus of the trust, at maturity. Trusts receivable include charitable remainder trusts, which are carried at the estimated net present value of SFCM's remainder interest in irrevocable trusts. The net present value was actuarially determined a rate of 2%.

j. Property, Plant and Equipment

Property, plant and equipment are stated at cost, if purchased, or fair market value at date of acquisition, if donated. Depreciation is recorded using the straight-line method over estimated useful lives of 80 years for buildings, 20-40 years for building improvements, and 3-10 years for all other depreciable assets. Included in property and plant assets are musical instruments SFCM maintains and records as a collection, and accordingly, no depreciation is recognized in operations.

k. Collections

SFCM has capitalized its collection of musical instruments since its inception. If purchased, items accessioned into the collection are capitalized at cost, and if donated, they are capitalized at their fair value on the accession date. Gains or losses on the deaccession of collection items are classified on the statement of activities as unrestricted or temporarily restricted support depending on donor restrictions, if any, placed on the item at the time of accession.

l. Deposits and Deferred Income

Deposits and deferred income represent tuition that has not been earned at year-end and will be recognized in subsequent periods.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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m. Government Advances for Loan Program

SFCM records the portion of federally funded student loan payments received as a refundable advances. The amount includes principle and interest earned on the loans less certain allowable costs.

n. Non-Operating Revenue and Gains

Non-operating revenue and gains includes gifts and grants restricted or designated for endowment or plant and the related investment income and net realized gains on investments in excess of the allocated income under the endowment spending policy.

o. Advertising Expenses

SFCM's policy is to expense advertising costs as they are incurred.

p. Functional Expense Allocations

Certain expenses, such as depreciation and amortization expense, building services, and personnel, are allocated among program services and supporting services based primarily on direct payroll charges and other direct expenses.

q. Income Taxes

SFCM operates as a not-for-profit corporation and is exempt from income taxes on related income under provisions of the U.S. Internal Revenue Code, Section 501(c)(3) and the California Tax Code. Accordingly, no provision for income taxes has been reflected in these financial statements.

SFCM follows the guidance of the Financial Accounting Standards Board (FASB) ASC Topic 740 for accounting for uncertainty in income taxes. As of June 30, 2015, management evaluated SFCM's tax positions and concluded that SFCM had maintained its tax exempt status and had taken no uncertain tax positions that require adjustment to the financial statements. Therefore, no provision or liability for income taxes has been included in the financial statements. With few exceptions, SFCM is no longer subject to income tax examinations by federal or state authorities for years before 2012 and 2011, respectively.

r. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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s. Comparative Financial Statements

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information and certain disclosures do not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the organization's financial statements for the year ended June 30, 2014, from which the information was derived.

t. Collective Bargaining Agreement

Approximately 3.8% of full time staff and faculty are covered by a collective bargaining agreement as of June 30, 2015. The current bargaining agreement expires on August 31, 2017.

u. Recent Accounting Pronouncements

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). The amendments in this Update apply to reporting entities that elect to measure the fair value of an investment using the net asset value per share (or its equivalent) as a practical expedient. Under Topic 820, a reporting entity is permitted, as a practical expedient, to estimate the fair value of certain investments using those investments' NAV per share. Prior to ASU 2015-07, these investments were categorized in the fair value hierarchy based on whether the investment was redeemable with the investee at net asset value on measurement date, never redeemable with the investee at net asset value, or redeemable with the investee at net asset value at a future date. These criteria were different from the criteria used for all other investments. All other investments are categorized based on inputs to the fair value.

To alleviate inconsistencies in the categorization of investments within the hierarchy, ASU 2015-07 removes the requirement to categorize all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also clarify that certain disclosure requirements are limited to investments for which the entity has elected to measure fair value using that practical expedient, and not all investments eligible to be measured at fair value using the practical expedient. The amendments in this update will generally be effective for fiscal periods beginning after December 15, 2016, for non public entities, however early application is permitted. San Francisco Conservatory of Music early adopted ASU 2015-07 as of June 30, 2015.

v. Subsequent Events

SFCM evaluated subsequent events through November 10, 2015, the date these financial statements were available to be issued. On October 9, 2015 SFCM entered into a sublease for student housing (See Note 16). There were no material subsequent events that required recognition or additional disclosure in these financial statements.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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### Note 3 - Notes Receivable:

At June 30, 2015, notes receivable consisted of SFCM's financing receivable and consisted of the following:

	Perkins Loans
Notes receivable	\$ 819,000
Less allowance for doubtful accounts:	
Beginning of year	(108,000)
Decrease	11,000
<hr/>	
End of year	(97,000)
<hr/>	
Notes receivable, net	\$ 722,000
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The availability of funds for loans under the Perkins loan program is dependent on reimbursements to the pool from repayments on outstanding loans. Funds advanced by the Federal government of \$819,000 at June 30, 2015 are ultimately refundable to the government and are classified as liabilities in the statement of financial position. Outstanding loans cancelled under the program result in a reduction of the funds available for loan and a decrease in the liability to the government.

The principal amount past due under the Perkins loan program was approximately \$175,000 at June 30, 2015.



# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

**Note 4 - Investments:**

SFCM's investments consisted of the following at June 30:

	2015		2014	
	Fair Value	Cost	Fair Value	Cost
Cash and equivalents	\$ 291,000	\$ 291,000	\$ 333,000	\$ 333,000
Domestic equities funds	7,790,000	6,625,000	7,395,000	4,598,000
International mutual and commingled trust funds	9,510,000	8,826,000	9,625,000	6,781,000
Domestic fixed income funds	5,706,000	5,578,000	5,732,000	4,021,000
International fixed income funds	1,762,000	1,921,000	1,893,000	1,825,000
Alternative investment funds	670,000	670,000	622,000	594,000
Commodities fund	44,000	66,000	106,000	103,000
Real assets funds	4,787,000	5,086,000	5,464,000	5,257,000
Hedge funds of funds and mutual funds	7,463,000	6,580,000	6,927,000	5,807,000
Partnerships	78,000	101,000	105,000	101,000
	38,101,000	35,744,000	38,202,000	29,420,000
Other investments:				
Real estate – interest	245,000	245,000	245,000	245,000
	\$ 38,346,000	\$ 35,989,000	\$ 38,447,000	\$ 29,665,000

Investments and cash are held for the benefit of endowments and Board designated funds. The total of such funds at fair value on June 30, 2015 was \$38,859,000.

Total investment return for the year ended June 30, 2015 is comprised of net realized and unrealized loss of \$ 307,000, dividends and interest income of \$543,000, and investment fees of \$213,000 which is reflected in operating and non-operating revenue in the statement of activities.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

**Note 5 - Fair Value Measurements:**

The table below presents the assets and liabilities measured at fair value at June 30, 2015 on a recurring basis.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Investments:				
Cash and equivalents	\$ 291,000			\$ 291,000
Domestic equities and funds	7,779,000	\$ 11,000		7,790,000
International equities and funds	7,211,000			7,211,000
Domestic fixed income funds	5,706,000			5,706,000
International fixed income funds	1,762,000			1,762,000
Alternative investment funds:				
Commodities fund	44,000			44,000
Real assets funds	4,787,000			4,787,000
Hedge funds	2,215,000			2,215,000
Net Asset Value Funds (a)				8,295,000
Other Assets:				
Trusts receivable		380,000		380,000
<hr/>				
Total assets measured at fair value	\$ 29,795,000	\$ 391,000		\$ 38,481,000
<hr/>				
Liabilities:				
Post retirement medical benefit obligation (Note 11)			\$ 2,945,000	\$ 2,945,000
<hr/>				
Total liabilities measured at fair value			\$ 2,945,000	\$ 2,945,000
<hr/>				

(a) In accordance with FASB ASC Subtopic 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Statement of Financial Position.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

SFCM uses the Net Asset Value (NAV) to determine the fair value of all the underlying investments which do not have readily determinable fair value. The following table lists investments by major category as of June 30, 2015:

Strategies	# of Funds	Valuation	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Hedge fund - small cap access (a)	1	\$ 1,148,000	None	Quarterly	45 days
Hedge fund – multi-strategy (b)	1	\$ 1,450,000	None	Quarterly	65 days
Hedge fund – multi-strategy (d)	1	\$ 1,151,000	None	Quarterly	95 days
Hedge fund – multi-advisor (c)	2	\$ 1,835,000	None	Quarterly	45 days
Hedge fund - multi-strategy (g)	1	\$ 333,000	None	1 year lock up	95 days
Comingled Trust (h)	1	\$ 2,299,000	None	Monthly	28 days
Venture capital fund (e)	1	\$ 74,000	None	None	
Real estate mortgage fund (f)	1	\$ 5,000	None	None	
	9	\$ 8,295,000			

- (a) The fund registered under the Mutual Funds Law of the Cayman Islands. The fund was formed to provide clients with access to the Chilton Small Cap International Fund Ltd. The Fund invests substantially all of its assets in Chilton Small Cap, Class H and Class I, which may hold illiquid investments.
- (b) The fund is registered under the Mutual Funds Law of the Cayman Islands. The fund's investment objective is to seek attractive, absolute and relative returns with volatility that is lower than that of the equity market and returns that demonstrate a low to moderate correlation to both the equity and fixed income markets. The fund invests among a diversified group of hedge funds and separately managed accounts managed by portfolio managers with differing styles and strategies and cash held by each class and subtracting all of its liabilities. The fund has a one year lock up period.
- (c) The funds are registered multi-strategy fund of hedge funds. The funds' investment objective is to seek attractive risk-adjusted returns and capital appreciation by investing in 30-35 hedge funds. The fund have quarterly liquidity with no lock up period.
- (d) The fund is a single manager multi-strategy hedge fund registered under the Mutual Funds Law of the Cayman Islands. The Fund's investment objective is to deliver repeatable alpha-driven returns with minimal volatility and market correlation. The Fund has a one year soft lock-up period. After one year, 25% of a participant's interests may be withdrawn quarterly and the entire balance may be withdrawn over 4 quarters with 95 days notice.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

- (e) The fund is a limited partnership that invests in a portfolio consisting primarily of securities of privately held technology companies. The term of the partnership is until December 31, 2014. Liquidity is expected in the form of distributions from the fund when the underlying assets are sold.
- (f) The fund is a limited partnership which makes loans secured primarily by first and second deeds of trust on California real property. The partnership is scheduled to terminate in 2032, unless sooner terminated, as provided in the partnership agreement. There are substantial restrictions on transferability of units and accordingly an investment in the partnership is non-liquid. After the one year lock-up period, limited partners may withdraw all or part of their capital accounts from the partnership in four quarterly installments beginning on the last day of the calendar quarter following the quarter in which the notice of withdrawal is given, subject to a 10% early withdrawal penalty. However, in March 2009, due to the distress in the financial markets, the partnership suspended capital liquidations and is not accepting new liquidation requests until further notice.
- (g) The fund is a registered multi-strategy fund of hedge funds. The fund's investment objective is capital appreciation with limited variability of returns. The Funds attempt to achieve this objective by allocating capital among a number of pooled entities that are generally organized in non-U.S. jurisdictions and classified as corporations for U.S. federal income tax purposes, each managed by an independent investment adviser who invest in a variety of historically uncorrelated and lower volatility strategies
- (h) The fund is a commingled trust. The investment objective of the Fund is to seek to achieve capital growth investment in global equities outside of the United States, including emerging markets.

### Note 6 - Contributions and Grants Receivable:

Contributions and grants receivable are as follows at June 30:

	2015	2014
Within one year	\$ 2,956,000	\$ 4,206,000
One to five years	10,930,000	12,889,000
	13,886,000	17,095,000
Discount on multi-year contributions	(229,000)	(297,000)
Allowance for uncollectible contributions	(1,381,000)	(1,589,000)
Contributions and grants receivable, net	\$ 12,276,000	\$ 15,209,000

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

The majority of the receivables are for the endowment, \$904,000 net of allowance for present value and uncollectible pledges of \$113,000; and capital campaign including \$11,297,000 net of allowance for present value and uncollectible pledges of \$1,498,000. See Note 14 for related party contribution receivables.

### Note 7 - Property and Plant:

Property and plant consist of the following at June 30:

	2015	2014
Land	\$ 23,253,000	\$ 9,861,000
Building and improvements	66,206,000	64,713,000
Books, furnishings and equipment	5,999,000	5,128,000
Musical instrument collection	3,905,000	3,782,000
	99,363,000	83,484,000
Less accumulated depreciation and amortization	(14,160,000)	(12,671,000)
	85,203,000	70,813,000
Construction in progress	299,000	151,000
	\$ 85,502,000	\$ 70,964,000

Land and building are pledged as collateral for the credit agreement (see Note 8).

Depreciation expense were \$1,536,000 and \$1,342,000 for the years ended June 30, 2015 and 2014, respectively.

### Note 8 - Credit Agreement:

On August 25, 2009, SFCM entered into a credit agreement with Union Bank. On December 13, 2012, the credit agreement was amended to extend the maturity date. The original credit agreement consisted of both a term loan of \$7,440,000 and a line of credit of \$4,000,000. On December 5, 2014, the line of credit was amended to \$18,000,000 in funds. SFCM's property and land are pledged as collateral for the credit agreement. The credit agreement requires a current ratio of 2 to 1 and a liquidity ratio on its endowment funds of 2 to 1 to be maintained at all times. The credit agreement also requires a debt service coverage ratio of 1.25 to 1 as of the close of each fiscal quarter on a rolling 4 quarter basis and certain non-financial covenants. At June 30, 2015, SFCM is in compliance with financial and non-financial covenants.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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The amended line of credit is a revolving line of credit and is used for ongoing operating expenses and working capital needs. The line of credit bears interest at 2.75% per annum in excess of Union Bank's LIBOR Rate, payable monthly. The line of credit matures on October 31, 2019. The outstanding balance as of June 30, 2015 was \$14,900,000.

The term loan bears interest at 1.75% over Union Bank's LIBOR Rate, payable monthly. Principal payments are due in yearly installments for seven years. The term loan matures on October 31, 2019 at which time the remaining principal balance is due and payable. The outstanding balance of the term loan as of June 30, 2015 is \$5,250,000.

Future minimum principal payments on the term loan are as follows:

Year ending June 30:	
2016	\$ 375,000
2017	375,000
2018	375,000
2019	375,000
2020	3,750,000
	<hr/>
	\$ 5,250,000

### Note 9 - Retirement Plans:

Employees of SFCM are covered under the Teachers Insurance and Annuity Association and College Retirement Equity Fund Retirement Plan, a defined-contribution plan. Contributions to the Plan are made by the employee and SFCM matches 5% of employee eligible earnings. SFCM contributed \$222,000 for the year ended June 30, 2015.

SFCM implemented a 457(b) plan for certain management personnel. The employees may elect to defer a certain portion of their salary. SFCM contributed \$0 during the fiscal year 2015.

With respect to certain employees, SFCM contributes to a multiemployer pension plan for employees covered by a collective bargaining agreement. This plan is not administered by SFCM and contributions are determined in accordance with provisions of negotiated labor contracts. The Multiemployer Pension Plan Amendments Act of 1980 (The Act) significantly increased the pension responsibilities of participating employers. Under the provisions of The Act, if the plan terminates or SFCM withdraws, SFCM could be subject to a substantial "withdrawal liability." Management has no intention of undertaking any action which could subject SFCM to this obligation. The total pension expense related to these employees was \$60,000 for the year ended June 30, 2015.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

### Note 10 - Multiemployer Pension Plan:

The multiemployer defined benefit pension plan is under the terms of collective-bargaining agreements that cover its union-represented employees which are approximating 3.8% of total faculty and staff of SFCM at June 30, 2015. The risks of participating in these multiemployer plans are different from single-employer plans in the following aspects:

1. Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If SFCM chooses to stop participating in some of its multiemployer plans, SFCM may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

SFCM's participation in this plan for the annual period ended December 31, 2014, is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employee Identification Number (EIN) and the three-digit plan number. The most recent Pension Protection Act (PPA) zone status available in 2014 and 2013 is for the plan years ending in 2014 and 2013, respectively. The zone status is based on information that SFCM received from the plan. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow and orange zones are less than 80% funded, and plans in the green zone are at least 80% funded. The Plan was not certified as endangered or critical status at the beginning of the year for the full plan year. The last column lists the expiration date of the collective-bargaining agreements to which the plans are subject.

<u>Pension Fund</u>	<u>EIN/Pension Plan Number</u>	<u>Pension Protection Act Zone Status</u>		<u>FIP/RP Status Pending or Implemented</u>	<u>The Conservatory Contributions</u>		<u>Expiration Date of Collective Bargaining Agreement</u>
		<u>2014</u>	<u>2013</u>		<u>2014</u>	<u>2013</u>	
Stationary Engineers Local 39 Trust Funds	94-6118939/001	Green	Green	N/A	\$ 53,000	\$ 50,000	8/31/17

There have been no other significant changes that affect the comparability of 2014 and 2013 contributions.

SFCM has not received information from the plans' administrators to determine its share of unfunded vested benefits. SFCM does not, however, anticipate withdrawal from the plan, nor is SFCM aware of any expected plan terminations.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

SFCM did not provide more than 5% of the total contributions to the plan during 2014 or 2013, the date of the plan's most recently available annual reports. Additionally, there were no surcharges in effect for any of the plan.

### Note 11 - Postretirement Health Benefit Plan:

SFCM adopted an unfunded noncontributory postretirement health benefit plan effective July 1, 1997. All qualifying employees will receive a fixed benefit of the cost of health insurance premiums for the individual at age 65 and beyond under the plan. Effective May 1, 2010, the Plan's service requirement for benefit eligibility was changed from 10 years to 20 years. The valuation of the accumulated benefit obligation and accrued benefit costs are as follows:

Accumulated benefit obligation at beginning of year	\$ 3,153,000
Service cost	204,000
Interest cost	138,000
Actuarial loss	(513,000)
Benefits paid	(37,000)
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Accumulated benefit obligation at end of year	\$ 2,945,000
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Unfunded status of the plan at end of year	\$ (2,945,000)

The benefits expected to be paid from SFCM's noncontributory postretirement health benefit plan in each of the next five years, and in aggregate for the five years thereafter are as follows:

Year Ended June 30,	
2016	\$ 46,000
2017	51,000
2018	59,000
2019	64,000
2020	76,000
2021 - 2025	538,000

Weighted average assumptions as of June 30, 2015:

Discount Rate	4.49%
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SFCM's projected medical cost trend rate related to its noncontributory postretirement health benefit plan in 2015 was 7% (Hartford/Kaiser). The assumed medical cost trend rate is expected to gradually decrease in subsequent years to 5% in 2021 and thereafter.



# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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### Health Care Trend Rate Sensitivity for Fiscal 2015

	<u>1% Increase</u>	<u>1% Decrease</u>
APBO as of June 30, 2015:	\$615,000/20.87%	\$(482,000)/(16.37)%
Service and Interest Cost for fiscal 2015:	\$114,000/33.23%	\$(81,000)/(23.62)%

SFCM may decide at any future date to terminate the plan or amend the benefits offered.

#### **Note 12 - Concentrations of Risk:**

The primary concentrations of market risk exist in the cash and investment areas.

Financial instruments, which potentially subject SFCM to credit risk, consist primarily of cash, cash equivalents, and investments. SFCM maintains cash and cash equivalents with major financial institutions. Cash equivalents include investments in money market funds and short-term commercial paper. At times, such amounts may exceed FDIC limits.

To address concentration of market risk in the investment area, SFCM maintains a formal investment policy which sets out performance criteria, investment guidelines and requires review of the investment manager's performance. Investments are managed by two investment managers, who have the responsibility for investing the funds in various investment alternatives, and are maintained by a bank trust department.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

### Note 13 - Net Assets:

Net assets consisted of the following at June 30:

	2015			Total	2014 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
<b>Endowment:</b>					
Quasi-endowment funds	\$ 102,000			\$ 102,000	\$ 107,000
True endowment funds:					
General purpose	\$ (122,000)	\$ 267,000	\$ 6,053,000	\$ 6,198,000	\$ 6,159,000
Scholarship	(1,535,000)	1,066,000	25,375,000	24,906,000	25,758,000
Faculty support	(217,000)	464,000	7,670,000	7,917,000	7,953,000
Other program support	(3,000)	93,000	961,000	1,051,000	1,030,000
Retirement of indebtedness		25,000	180,000	205,000	214,000
True endowment funds	(1,877,000)	1,915,000	40,239,000	40,277,000	41,114,000
Total endowment funds	(1,775,000)	1,915,000	40,239,000	40,379,000	41,221,000
<b>Other:</b>	58,801,000	17,952,000		76,753,000	76,580,000
Total net assets	\$ 57,026,000	\$ 19,867,000	\$ 40,239,000	\$ 117,132,000	\$ 117,801,000

Included in other temporarily restricted net assets of \$17,952,000 is \$1,047,000 (Lund Fund) of net assets restricted for the collegiate piano program. During fiscal year 2015, SFCM released \$315,000 from the Lund Fund for the Collegiate Jack H. Lund Scholarship program. Also included in other temporarily restricted net assets is \$15,121,000 related to the newly established capital campaign (see Note 17).

Temporarily restricted net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows for the year ended June 30, 2015:

Utilized for scholarships	\$ 1,565,000
Utilized for faculty salaries	318,000
Utilized for capital expenditures	299,000
Utilized for other project and program purposes	555,000
Expiration of time restrictions	144,000
	<u>\$ 2,881,000</u>

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

Changes in endowment net assets for the year ended June 30, 2015:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, beginning of year	\$ (1,183,000)	\$ 3,084,000	\$ 39,320,000	\$ 41,221,000
Investment return:				
Investment income		333,000		333,000
Net realized and unrealized gain (loss) on investments, net of fees		(294,000)	(9,000)	(303,000)
Underwater endowment funds adjustment	(587,000)	587,000		
Total investment return	(587,000)	626,000	(9,000)	30,000
New gifts			928,000	928,000
Appropriation of endowment	(5,000)	(1,795,000)		(1,800,000)
Net assets, end of year	\$ (1,775,000)	\$ 1,915,000	\$ 40,239,000	\$ 40,379,000

### Note 14 - Related Party Transactions:

SFCM received contributions from members of its board of trustees and related entities of approximately \$2,488,000 for the fiscal year ended June 30, 2015. Contributions receivable related to current and prior years' contributions from board members totaled approximately \$12,881,000 at June 30, 2015.

In April 2013, SFCM signed an agreement with the Harris Guitar Foundation (the Foundation). The Foundation is the supporting organization of SFCM and Bay Area OMNI Foundation for the Performing Arts Inc. There were no significant transactions between SFCM and the Foundation during the fiscal year ending June 30, 2015.

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

### Note 15 - Allocation of Certain Shared Costs:

The following tables show the allocation of interest, operation and maintenance of plant, and depreciation expense to each function based on allocation methods and estimates made by SFCM's management.

	Expenses	Interest Expense	Operation and Maintenance of Plant	Depreciation	Total 2015
Instruction	\$ 8,048,000	\$ 106,000	\$ 984,000	\$ 722,000	\$ 9,860,000
Student service	1,145,000	15,000	140,000	103,000	1,403,000
Academic support	865,000	11,000	106,000	78,000	1,060,000
Public program	266,000	3,000	33,000	24,000	326,000
Fund-raising	1,290,000	17,000	158,000	116,000	1,581,000
General management and administration	3,199,000	42,000	391,000	288,000	3,920,000
Independent operations	369,000	251,000		205,000	825,000
	\$ 15,182,000	\$ 445,000	\$ 1,812,000	\$ 1,536,000	\$ 18,975,000

### Note 16 - Commitment and Contingencies:

#### a. Operating Leases

The SFCM leases equipment and student dormitory spaces under non-cancelable leases, which expire at various dates through 2020.

Future minimum lease payments for all operating leases in excess of one year as of June 30, 2015 are as follows:

Year ending	
June 30:	
2016	\$ 2,099,000
2017	2,520,000
2018	2,520,000
2019	2,520,000
2020	2,520,000
Thereafter	420,000
Total	\$ 12,599,000

# San Francisco Conservatory of Music

## Notes to Consolidated Financial Statements

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In the fiscal year ending June 30, 2015, SFCM entered into a sublease for certain space beginning September 2015 for a period of two years. The sublease provides for a minimum rental income of \$504,000 per year. Subsequent to the year end, SFCM entered into an additional sublease for certain summer months of the year for a period of five years. The sublease provides for a minimum rental income of \$200,000 the first two years of the lease and \$250,000 the remaining years. The maximum to be earned under the sublease is \$400,000 the first two years of the lease and \$500,000 the remaining years.

b. Other

Contingencies SFCM receives funds from and administers various federal government funded programs which are subject to audit by the cognizant governmental agencies. SFCM management believes that the outcome of any such audits will not have a significant effect on the financial position or results of activities of SFCM.

**Note 17 - Capital Campaign:**

The Conservatory has embarked on a capital campaign for a new residence hall. The new facility will provide the physical capacity necessary to sustain a world-class professional educational environment. The building will house the majority of students, furnish practice rooms and include social and study spaces. It will also feature a street-level café as well as a recital hall and housing for guest artists and scholars.