

SAN FRANCISCO  
CONSERVATORY OF MUSIC

JUNE 30, 2013

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INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

# San Francisco Conservatory of Music

## Independent Auditors' Report and 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 financial statements of **SAN FRANCISCO CONSERVATORY OF MUSIC (SFCM)** which comprise the statement of financial position as of June 30, 2013, and the related statements of activities 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 presentati

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 SFCM as of June 30, 2013, and the changes in its net assets and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

**Report on Summarized Comparative Information**

We have previously audited SFCM's June 30, 2012 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated October 11, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012, is



# San Francisco Conservatory of Music

## Statement of Financial Position (in thousands)

<i>June 30, 2013 (with comparative totals for 2012)</i>	2013	2012
<b>Assets</b>		
Cash and equivalents	\$ 1,267	\$ 2,633
Restricted cash	117	89
Investments	34,619	32,591
Receivables:		
Accounts receivable, net	95	245
Notes receivable (less allowance for doubtful accounts of \$108 for 2013 and \$115 for 2012)	890	914
Contributions and grants, net	2,472	3,111
Bequests	-	241
Trusts	367	375
Interest	3	9
Other assets	266	152
Property, plant and equipment, net	71,765	72,950
<b>Total Assets</b>	<b>\$ 111,861</b>	<b>\$ 113,310</b>
<b>Liabilities and Net Assets</b>		
<b>Liabilities:</b>		
Accounts payable and other liabilities	\$ 491	\$ 384
Deposits and deferred income	408	451
Line of credit	1,750	3,000
Term loan	6,000	6,375
Accumulated postretirement benefit obligation	2,527	2,810
Government advances for loan program	717	710
<b>Total liabilities</b>	<b>11,893</b>	<b>13,730</b>
<b>Net Assets:</b>		
Unrestricted:		
Undesignated	6,394	5,808
Designated - Quasi endowment	102	104
Underwater endowment funds	(2,120)	(2,169)
Federal loan fund	177	177
Investment in plant	53,539	54,894
<b>Total unrestricted net assets</b>	<b>58,092</b>	<b>58,814</b>
Temporarily restricted:		
Program and time restrictions	2,580	3,046
Appreciation on endowments	1,619	1,379
<b>Total temporarily restricted net assets</b>	<b>4,199</b>	<b>4,425</b>
Permanently restricted:		
Permanent endowments	37,677	36,341
<b>Total net assets</b>	<b>99,968</b>	<b>99,580</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 111,861</b>	<b>\$ 113,310</b>

The accompanying notes are an integral part of this statement.

# San Francisco Conservatory of Music

## Statement of Activities (in thousands)

Year Ended June 30, 2013 (with comparative totals for 2012)

	2013			Total	2012 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
<b>Operating Revenue and Support:</b>					
Tuition and fees	\$ 17,253			\$ 17,253	\$ 15,587
Less: Scholarships	(7,520)			(7,520)	(6,188)
Net tuition and fees	9,733			9,733	9,399
Private contributions and government grants	2,363	291		2,654	2,736
Other educational revenue	509			509	471
Fundraising events	471			471	480
Net investment and endowment income	10	1,760		1,770	1,632
Net assets released from restrictions	2,316	(2,316)		-	-
Total operating revenue and support	15,402	(265)		15,137	14,718
<b>Expenses:</b>					
Program services:					
Instruction	7,856			7,856	7,436
Student services	736			736	718
Academic support	728			728	714
Public programs	142			142	131
Total program services	9,462			9,462	8,999
Fund-raising:					
General fund-raising	619			619	623
Fund-raising events	185			185	188
Total fund-raising	804			804	811
General management and administration	2,831			2,831	2,375
Maintenance of plant	1,922			1,922	1,866
Depreciation	1,444			1,444	1,501
Interest expense	208			208	241
Total expenses	16,671			16,671	15,793
Change in net assets from operations	(1,269)	(265)		(1,534)	(1,075)
<b>Nonoperating Activities:</b>					
Endowment contributions			\$ 1,350	1,350	4,285
Capital campaign donations				-	38
Gain (loss) on sale of assets	15			15	(120)
Investment income (loss), net of fees		288		288	(2,633)

# San Francisco Conservatory of Music

## Statement of Cash Flows (in thousands)

<i>Year Ended June 30, 2013 (with comparative totals for 2012)</i>	2013	2012
<b>Operating Activities:</b>		
Change in net assets	\$ 388	\$ (170)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Forgiveness of note receivable	(10)	(10)
Depreciation	1,444	1,501
Net realized and unrealized loss (gain) on investments	(1,801)	1,301
(Gain) loss on sale of assets	(15)	120
Contributions of equipment	(62)	(145)
Contributions received for long-term investment and acquisition of long lived assets	(1,902)	(2,645)
Changes in operating assets and liabilities:		
Receivables	1,069	(475)
Other assets	(116)	(36)
Accounts payable and accrued liabilities	(174)	746
Government advances for loan program	7	-
Deposits and deferred income	(34)	24
<b>Net cash (used) provided by operating activities</b>	<b>(1,206)</b>	<b>211</b>
<b>Investing Activities:</b>		
Property and equipment:		
Proceeds from sales	63	63
Purchases and capital expenditures	(245)	(164)
Investments:		
Proceeds from sales	28,115	4,084
Purchases	(28,342)	(4,756)
<b>Net cash used by investing activities</b>	<b>(409)</b>	<b>(773)</b>
<b>Financing Activities:</b>		
Contributions received for long-term investment and acquisition of long lived assets	1,902	2,645
Line of credit payments	(1,250)	-
Term loan payment	(375)	(370)
<b>Net cash provided by financing activities</b>	<b>277</b>	<b>2,275</b>
<b>Net Change in Cash and Equivalents and Restricted Cash</b>	<b>(1,338)</b>	<b>1,713</b>
<b>Cash and Equivalents and Restricted Cash, beginning of year</b>	<b>2,722</b>	<b>1,009</b>
<b>Cash and Equivalents and Restricted Cash, end of year</b>	<b>\$ 1,384</b>	<b>\$ 2,722</b>
<b>Supplemental Cash Flow Information:</b>		
Interest paid	\$ 208	\$ 241
<b>Components of Cash and Cash Equivalents:</b>		
Cash and cash equivalents	1,267	2,633
Cash and cash equivalents - restricted	117	89

The accompanying notes are an integral part of this statement.





# San Francisco Conservatory of Music

## Notes to 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

# San Francisco Conservatory of Music

## Notes to Financial Statements

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e. Investments

Marketable securities are recorded at fair value based on quoted market prices. The fair value of alternative investments has been est

# San Francisco Conservatory of Music

## Notes to Financial Statements

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### *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

# San Francisco Conservatory of Music

## Notes to Financial Statements

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### *Strategies Employed for Achieving Objectives*

To satisfy its long-term rate-of-return objectives, SFCM relies on a total return strategy in

# San Francisco Conservatory of Music

## Notes to Financial Statements

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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

# San Francisco Conservatory of Music

## Notes to Financial Statements

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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, 2013, 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 2009 and 2008, 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.

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, 2012, from which the information was derived.

t. Collective Bargaining Agreement

Approximately 4% of full time staff and faculty are covered by a collective bargaining agreement as of June 30, 2013. The current bargaining agreement expires on August 31,

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## Notes to Financial Statements

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### Effective in the future:

In October 2012, FASB issued the Accounting Standards Update No. 2012-05 – Statement of Cash Flows (Topic 230) *Not-for-Profit Entities – Classifications of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows*. The update requires a not-for-profit entity to classify sale proceeds of donated financial assets consistent with cash donations as an operating activity, if such assets were converted nearly immediately into cash, unless the donor restricted the use of the proceeds to long-term purposes, in which case those cash receipts should be classified as a financing activity. If those assets were not immediately converted to cash, the proceeds upon sale should be classified as an investing activity. This guidance is effective prospectively for annual periods, beginning after June 15, 2013. SFCM is currently evaluating the effect of adoption on its financial statements.

### v. Subsequent Events

SFCM evaluated subsequent events through October 14, 201

# San Francisco Conservatory of Music

## Notes to Financial Statements

The principal amount past due under the Perkins loan program was approximately \$119,000 at June 30, 2013. No balances were past due under the faculty and staff loans, see Note 14 for a description of these loans.

### Note 4 - Investments:

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

	2013		2012	
	Fair Value	Cost	Fair Value	Cost
Cash and equivalents	\$ 11,036,000	\$ 11,036,000	\$ 1,055,000	\$ 1,055,000
Domestic equities and funds	6,138,000	5,272,000	7,235,000	5,851,000
International equities and funds	3,803,000	3,831,000	287,000	218,000
Domestic fixed income funds	5,159,000	5,192,000	19,155,000	19,056,000
International fixed income funds	1,329,000	1,374,000		
Asset allocation funds	590,000	613,000		
Commodities fund	122,000	128,000		
Real assets funds	3,573,000	3,684,000		
Gold participation fund			1,358,000	2,000,000
Hedge funds	2,500,000	2,395,000	1,069,000	1,000,000
Partnerships	124,000	101,000	2,187,000	2,101,000
	34,374,000	33,626,000	32,346,000	31,281,000
Other investments:				
Real estate – interest	245,000	245,000	245,000	245,000
	\$ 34,619,000	\$ 33,871,000	\$ 32,591,000	\$ 31,526,000

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, 2013 was \$34,880,000.

Total investment return for the year ended June 30, 2013 is comprised of net realized and unrealized loss of \$1,803,000, dividends and interest income of \$493,000, and investment fees of \$233,000 which is reflected in operating and non-operating revenue in the statement of activities.



# San Francisco Conservatory of Music

## Notes to Financial Statements

### Note 5 - Fair Value Measurements:

The table below presents the assets and liabilities measured at fair value at June 30, 2013 on a recurring basis.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Investments:				
Cash and cash equivalents	\$ 11,036,000			\$ 11,036,000
Domestic equities and funds:				
Consumer	1,368,000	\$		1,368,000
Health care	483,000	230,000		713,000
Technology	414,000			414,000
Utilities	196,000			196,000
Financials	586,000			586,000
Industrials	353,000			353,000
Materials	162,000			162,000
Energy	262,000			262,000
Communications	216,000	45,000		261,000
Telecommunications	194,000			194,000
Equity funds	1,621,000	8,000		1,629,000
International equities and funds:				
Health care	90,000			90,000
International equity funds:	3,713,000			3,713,000
Domestic fixed income funds:				
Total return funds	2,763,000			2,763,000
Corporate/government funds	254,000			254,000
Asset backed securities fund	153,000			153,000
Income focused bonds	1,989,000			1,989,000
International fixed income funds	1,329,000			1,329,000
Asset allocation funds	590,000			590,000
Commodities fund	122,000			122,000
Real asset funds	3,573,000			3,573,000
Hedge fund - small cap access		1,086,000		1,086,000
Hedge fund – multi-strategy			\$ 1,016,320	1,016,320

**San Francisco Conservatory of Music**

**Notes to Financial Statements**

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Level 1

Level 2

# San Francisco Conservatory of Music

## Notes to Financial Statements

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- (b) The fund is a mutual fund 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

# San Francisco Conservatory of Music

## Notes to Financial Statements

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The majority of the receivables are for the endowment, \$1,945,000 net of allowance for present value and uncollectible pledges of \$279,000; and special projects including \$357,000 net of allowance for present value and uncollectible pledges of \$48,000 for the previous capital campaign as of June 30, 2013. See Note 13 for related party contribution receivables.

**Note 7 - Property and Plant:**

Property and plant consist of the following at June 30:

	2013	2012
Land	\$ 9,861,000	\$ 9,861,000
Building and improvements	64,597,000	64,533,000

**San Francisco Conservatory of Music**

**Notes to Financial Statements**

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# San Francisco Conservatory of Music

## Notes to 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 4% of total faculty and staff of SFCM at June 30, 2013. 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, 2012, 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 2012 and 2011 is for the plan years ending in 2011 and 2010, 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>2012</u>	<u>2011</u>		<u>2012</u>	<u>2011</u>	
Stationary Engineers Local 39 Trust Funds	94-6118939/001	Green	Yellow	N/A	\$ 53,000	\$ 50,000	8/31/17

There have been no other significant changes that affect the comparability of 2012 and 2011 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 Financial Statements

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SFCM did not provide more than 5% of the total contributions to the plan during 2012 or 2011, the date of the plan's most recently available annual reports. Additionally, there were no surcharges in effect for any of the plan.

At the date these financial statements were issued, Forms 5500 were not available for the plan years ending in 2012.

**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





# San Francisco Conservatory of Music

## Notes to Financial Statements

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**Note 13 - Net Assets:**

Net assets consisted of the following at June 30:

\_\_\_\_\_ 2013 \_\_\_\_\_

# San Francisco Conservatory of Music

## Notes to Financial Statements

Changes in endowment net assets for the year ended June 30, 2013:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, beginning of year	\$ (2,066,000)	\$ 1,379,000	\$ 36,341,000	\$ 35,654,000
Investment return:				
Investment income		260,000		260,000
Net realized and unrealized gain (loss) on investments, net of fees	4,000	1,784,000	(14,000)	1,774,000
Underwater endowment funds adjustment	49,000	(49,000)		
Total investment return	53,000	1,995,000	(14,000)	2,034,000
New gifts			1,350,000	1,350,000
Appropriation of endowment	(5,000)	(1,755,000)		(1,760,000)
Net assets, end of year	\$ (2,018,000)	\$ 1,619,000	\$ 37,677,000	\$ 32,278,000

### Note 14 - Related Party Transactions:

SFCM has equity participation residential down payment loans under promissory notes from officers of \$110,000 at June 30, 2013. Interest on the loans is accrued at a contractual rate of 7%. Each year ending June 30 that the officers are actively employed, SFCM has agreed to forgive \$10,000 of principal under the promissory note and all monthly interest payments under the note terms.

SFCM received contributions from members of its board of trustees of approximately \$1,663,000 for the fiscal year ended June 30, 2013. Contributions receivable related to current and prior years' contributions from board members totaled approximately \$774,000 at June 30, 2013.

In April 2013, SFCM signed an agreement with John Harris and The Harris Guitar Foundation (the Foundation). The Harris Guitar 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, 2013.

