SAN FRANCISCO CONSERVATORY OF MUSIC

JUNE 30, 2017

INDEPENDENT AUDITORS' REPORT

AND

CONSOLIDATED FINANCIAL STATEMENTS

San Francisco Conservatory of Music

Independent Auditors' Report
and Consolidated Financial Statements

HOOD & STRONG LLP
A CENTURY STRONG · 1917-2017
CERTIFIED PUBLIC ACCOUNTANTS

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, 2017, 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.

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 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.

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, 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.

Report on Summarized Comparative Information

We have previously audited SFCM's June 30, 2016 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated November 8, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Hood & Strong LLP

San Francisco, California
October 23, 2017

San Francisco Conservatory of Music

Consolidated Statement of Financial Position
(in thousands)

June 30, 2017 (with comparative totals for 2016)		2017		2016
Assets				
Cash	$	2,066	$	1,603
Restricted cash		85		97
Receivables:				
Accounts receivable (less allowance for doubtful accounts of $18 for 2017 and $16 for 2016)		1,739		802
Notes receivable (less allowance for doubtful accounts of $105 for 2017 and $102 for 2016)		774		755
Contributions and grants, net		43,080		11,365
Trusts		270		361
Investments		39,843		36,279
Other assets		845		647
Property, plant and equipment, net		87,251		86,434
Total Assets	$	175,953	$	138,343
Liabilities and Net Assets				
Liabilities:				
Accounts payable and other liabilities	$	1,030	$	1,031
Deposits and deferred income		2,511		1,453
Line of credit		9,000		12,400
Term loan		4,500		4,875
Accumulated postretirement benefit obligation		3,761		4,104
Government advances for loan program		683		677
Total liabilities		21,485		24,540
Net Assets:				
Unrestricted:				
Undesignated		7,912		7,215
Designated - Quasi endowment		95		90
Underwater endowment funds		(3,042)		(4,343)
Federal loan fund		176		174
Investment in plant		47,984		49,173
Total unrestricted net assets		53,125		52,309
Temporarily restricted:				
Purpose and time restrictions		57,136		20,110
Appreciation on endowments		897		395
Total temporarily restricted net assets		58,033		20,505
Permanently restricted:				
Permanent endowments		43,310		40,989
Total net assets		154,468		113,803
Total Liabilities and Net Assets	$	175,953	$	138,343

See accompanying notes to financial statement.

San Francisco Conservatory of Music

Consolidated Statement of Activities
(in thousands)

Year Ended June 30, 2017 (with comparative totals for 2016)

	2017				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	2016 Total
Operating Revenue and Support:					
Tuition and fees	$ 19,349			$ 19,349	$ 18,132
Less: Scholarships	(8,877)			(8,877)	(8,054)
Net tuition and fees	10,472			10,472	10,078
Private contributions and government grants	4,438	$ 1,080		5,518	6,800
Other educational revenue	497			497	324
Fundraising events	681			681	911
Auxiliary services	3,132			3,132	2,478
Net investment and endowment income		2,273		2,273	1,938
Net assets released from restrictions	4,860	(4,860)		-	-
Total operating revenue and support	24,080	(1,507)		22,573	22,529
Expenses:					
Program services:					
Instruction	9,447			9,447	8,817
Student services	1,405			1,405	1,285
Academic support	796			796	779
Public programs	418			418	160
Auxiliary services	2,974			2,974	2,324
Total program services	15,040			15,040	13,365
Fund-raising:					
General and Capital Campaign fund-raising	1,254			1,254	1,313
Fund-raising events	233			233	264
Total fund-raising	1,487			1,487	1,577
General management and administration	4,209			4,209	3,655
Maintenance of plant	2,085			2,085	1,892
Depreciation	1,317			1,317	1,426
Interest expense	221			221	193
Total expenses	24,359			24,359	22,108
Change in net assets from operations	(279)	(1,507)		(1,786)	421
Nonoperating Activities:					
Endowment and capital campaign contributions		38,891	$ 2,292	41,183	2,139
Independent operation revenues	328			328	605
Independent operation expenses, including depreciation	(1,251)			(1,251)	(1,308)
Gain (loss) on sale of assets	5			5	(20)
Investment income (loss), net of fees	8	1,804		1,812	(3,986)
Change in value of trust receivable			29	29	(20)
Net assets released from restriction	359	(359)		-	-
Postretirement health plan obligation	345			345	(1,160)
Underwater endowment fund adjustment	1,301	(1,301)		-	-
Change in net assets from nonoperating activities	1,095	39,035	2,321	42,451	(3,750)
Total Change in Net Assets	816	37,528	2,321	40,665	(3,329)
Net Assets, beginning of year	52,309	20,505	40,989	113,803	117,132
Net Assets, end of year	$ 53,125	$ 58,033	$ 43,310	$ 154,468	$ 113,803

See accompanying notes to financial statement.

San Francisco Conservatory of Music

Consolidated Statement of Cash Flows
(in thousands)

Year Ended June 30, 2017 (with comparative totals for 2016)	2017	2016
Operating Activities:		
Change in net assets	$ 40,665	$ (3,329)
Adjustments to reconcile change in net assets to net cash (used) provided by operating activities:		
Depreciation	1,679	1,788
Net realized and unrealized (gain) loss on investments	(3,736)	2,325
(Gain) loss on sale of assets	(5)	20
Contributions of equipment	(43)	(370)
Contributions received for long-term investment and acquisition of long lived assets	(9,737)	(3,724)
Changes in operating assets and liabilities:		
Receivables	(32,580)	2,004
Other assets	(198)	(266)
Accounts payable and accrued liabilities	(342)	1,586
Government advances for loan program	6	(55)
Deposits and deferred income	1,058	132
Net cash (used) provided by operating activities	(3,233)	111
Investing Activities:		
Property and equipment:		
Proceeds from sales	7	13
Purchases and capital expenditures	(2,455)	(2,384)
Investments:		
Proceeds from sales	20,044	27,597
Purchases	(19,874)	(27,827)
Net cash used by investing activities	(2,278)	(2,601)
Financing Activities:		
Contributions received for long-term investment and acquisition of long lived assets	9,737	3,724
Line of credit proceeds	2,100	2,500
Line of credit payments	(5,500)	(5,000)
Term loan payment	(375)	(375)
Net cash provided by financing activities	5,962	849
Net Change in Cash and Equivalents and Restricted Cash	451	(1,641)
Cash and Cash Equivalents, beginning of year	1,700	3,341
Cash and Cash Equivalents, end of year	$ 2,151	$ 1,700
Supplemental Cash Flow Information:		
Interest paid	$ 579	$ 605
Components of Cash and Cash Equivalents:		
Cash	$ 2,066	$ 1,603
Restricted Cash	$ 85	$ 97

See accompanying notes to financial statement.

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.

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 at an applicable rate at the time of contribution.

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.

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.

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.

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

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%.

The Conservatory's Board approved a revised Endowment Investment Policy in June 2015. The new policy has a long-term spending goal of 4% of a 3-year average. However, the specific draw shall be determined by the Board on an annual basis considering the performance of the endowment and the needs of the Conservatory. A protective collar is utilized as an overlay to the spending policy. The protective collar calculations will be based on the value of the endowment at the end of each fiscal year. The application of the collar will mitigate the effects of extreme market outcomes and limit the amount of money that can be distributed from the endowment if there is a one year or a period of years of underperformance or negative performance. Under this collar, the Conservatory takes into consideration the market value of the endowment at the most recent fiscal year-end. The collar states that the draw must fall within a range that is at least 4% and not more than 6% of the Endowment Market Value at year end, even if the amount that could be drawn is higher or lower under the 3-year moving average calculation. 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 $3,042,000 as of June 30, 2017. 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.

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.

m. Government Advances for Loan Program

SFCM records the portion of federally funded student loan payments received as 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. Advertising expense incurred in the year ended June 30, 2017 was $166,000.

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, 2017, 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.

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, 2016, from which the information was derived.

t. Collective Bargaining Agreement

Approximately 3.7% of full time staff and faculty are covered by a collective bargaining agreement as of June 30, 2017. The current bargaining agreement expires on August 31, 2023.

u. Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize, at commencement date, a lease liability representing the lessee's obligation to make payments arising from the lease and a right-of-use asset representing the lessee's right to use, or control the use of, a specified asset for the lease term. This guidance is effective for fiscal years beginning after December 15, 2019. SFCM is currently evaluating the impact the new standard will have on its financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments change presentation and disclosure requirements for not-for-profit entities to provide more relevant information about their resources, and the changes in those resources, to the users of the financial statements. The standard is effective for fiscal years beginning after December 15, 2017 and early adoption is permitted. SFCM is currently evaluating the impact the new standard will have on its financial statements.

v. Subsequent Events

SFCM evaluated subsequent events from June 30, 2017 through October 23, 2017, the date these financial statements were available to be issued, and has determined that no adjustments are necessary to the amounts reported in the accompanying financial statements and no subsequent events have occurred, the nature of which would require disclosure.

Note 3 - Notes Receivable:

At June 30, 2017, notes receivable consisted of the following:

	Perkins Loans
Notes receivable	$ 879,000
Less allowance for doubtful accounts:	
Beginning of year	(102,000)
Increase	(3,000)
End of year	(105,000)
Notes receivable, net	$ 774,000

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 $661,000 at June 30, 2017 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 $184,000 at June 30, 2017.

Note 4 - Contributions and Grants Receivable:

Contributions and grants receivable are as follows at June 30:

	2017	2016
Within one year	$ 8,130,000	$ 3,459,000
One to five years	37,540,000	9,340,000
	45,670,000	12,799,000
Discount on multi-year contributions	(1,542,000)	(167,000)
Allowance for uncollectible contributions	(1,048,000)	(1,267,000)
Contributions and grants receivable, net	$ 43,080,000	$ 11,365,000

Receivables include $37,802,000 for the capital campaign, net of allowance and discount at June 30, 2017. See Note 14 for related party contribution receivables.

Note 5 - Investments:

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

	2017		2016	
	Fair Value	Cost	Fair Value	Cost
Cash and equivalents	$ 367,000	$ 367,000	$ 2,689,000	$ 2,689,000
Domestic equities and funds	11,704,000	10,725,000	9,693,000	9,135,000
International mutual and commingled trust funds	10,954,000	9,854,000	8,595,000	9,006,000
Domestic fixed income funds	5,809,000	5,761,000	5,901,000	5,897,000
Multi-strategy alternative funds	750,000	775,000	700,000	775,000
Hedge funds	9,962,000	9,563,000	8,394,000	7,889,000
Partnerships	52,000	101,000	62,000	101,000
	39,598,000	37,146,000	36,034,000	35,492,000
Other investments:				
Real estate – interest	245,000	245,000	245,000	245,000
	$ 39,843,000	$ 37,391,000	$ 36,279,000	$ 35,737,000

Total investment return for the year ended June 30, 2017 is comprised of net realized and unrealized gain of $3,736,000, dividends and interest income of $471,000, and investment fees of $122,000 which is reflected in operating and non-operating revenue in the statement of activities.

Note 6 - Fair Value Measurements:

The table below presents the assets and liabilities measured at fair value at June 30, 2017 on a recurring basis.

	Level 1	Level 2	NAV(a)	Total
Assets:				
Investments:				
Cash and equivalents	$ 367,000			$ 367,000
Domestic equities and funds	11,691,000	$ 13,000		11,704,000
International and funds	8,572,000			8,572,000
Domestic fixed income funds	5,809,000			5,809,000
Hedge funds	1,127,000			1,127,000
Net Asset Value Funds (a)			$ 12,019,000	12,019,000
Other Assets:				
Trusts receivable		270,000		270,000
Total assets measured at fair value	$ 27,566,000	$ 283,000	$ 12,019,000	$ 39,868,000
Liabilities:				
Post-retirement medical benefit obligation (Note 11)			$ 3,761,000	$ 3,761,000
Total liabilities measured at fair value			$ 3,761,000	$ 3,761,000

(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.

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, 2017:

Strategies	# of Funds	Valuation	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Hedge fund – multi-strategy (a)	1	$ 146,000	None	Quarterly	65 days
Hedge fund – multi-strategy (b)	1	1,285,000	None	Quarterly	95 days
Hedge fund – multi-advisor (c)	2	4,110,000	None	Quarterly	45 days
Hedge fund - multi-strategy (d)	1	345,000	None	Semi-annual	95 days
Hedge fund – multi-strategy (e)	1	1,154,000	None	1 year lock up	65 days
Hedge fund – multi-strategy (f)	1	1,303,000	None	Quarterly	65 days
Hedge fund – multi-strategy (g)	1	1,242,000	None	Monthly	35 days
Comingled Trust (h)	1	2,382,000	None	Monthly	28 days
Venture capital fund (i)	1	47,000	None	None	
Real estate mortgage fund (j)	1	5,000	None	None	
	11	$ 12,019,000			

(a) 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.

(b) 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.

(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.

(d) 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.

(e) The fund is a registered multi-strategy hedge fund registered under the Mutual Funds Law of the Cayman Islands. The fund aims to deliver consistently positive risk-adjusted returns through a low-net/low-beta approach. Capital preservation is the priority.

(f) The fund is an exempted company with limited liability incorporated under the laws of the Cayman Islands. The fund is a relative-value, absolute return strategy and allocates capital across four core investment strategies; global equities, fundamental long/short credit, global macro, and systematic & quantitative. The fund trades in equity, credit, fixed income, and currency markets as well as their related derivatives while having low correlation to other hedge funds.

(g) The fund is a hedge fund domiciled in Ireland. It seeks to deliver a return stream to investors which draws on multiple sources of alpha and beta from selected global equities. The investment objective is to provide investors with above average absolute returns by utilizing a leveraged long/short equity strategy. The majority of the fund's assets are invested in equities listed or traded on a recognized exchange and equity related investments which include options, warrants, futures, and other derivative contracts.

(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.

(i) 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 was scheduled to terminate on December 31, 2014. Liquidity is expected in the form of distributions from the fund when the underlying assets are sold.

(j) 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.

Note 7 - Property and Plant:

Property and plant consist of the following at June 30:

	2017	2016
Land	$ 23,253,000	$ 23,253,000
Building and improvements	66,270,000	66,206,000
Books, furnishings and equipment	6,643,000	6,165,000
Musical instrument collection	4,329,000	4,286,000
	100,495,000	99,910,000
Less accumulated depreciation and amortization	(17,582,000)	(15,931,000)
	82,913,000	83,979,000
Construction in progress	4,338,000	2,455,000
	$ 87,251,000	$ 86,434,000

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

Depreciation expense were $1,679,000 and $1,788,000 for the years ended June 30, 2017 and 2016, respectively.

The Conservatory purchased two buildings during fiscal year 2015 utilizing the line of credit (see Note 8) and restricted funds. The Conservatory intends to utilize the buildings as a future residence hall (see Note 17) and educational space after reconstruction of each building. The purchase costs of the buildings are included in the land and building and improvements above. Construction in progress, above, represents architectural and design, legal, planning and other entitlement costs for the residence hall project.

Note 8 - Credit Agreement:

SFCM has a credit agreement for $18,000,000 with Union Bank. SFCM's property and land are pledged as collateral for the credit agreement. The credit agreement requires SFCM to maintain 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, 2017, SFCM is in compliance with financial and non-financial covenants.

The 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, 2017 was $9,000,000.

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, 2017 is $4,500,000.

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

Year ending June 30:	
2018	$ 375,000
2019	375,000
2020	3,750,000
	$ 4,500,000

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 $254,000 for the year ended June 30, 2017.

SFCM implemented a 457(b) plan for certain management personnel. The employees may elect to defer a certain portion of their salary. SFCM contributed $18,000 during the fiscal year 2017.

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 $67,000 for the year ended June 30, 2017.

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 3.7% of total full-time faculty and staff of SFCM at June 30, 2017. 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, 2016, 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 2017 and 2016 is for the plan years ending in 2016 and 2015, 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.

Pension Fund	EIN/Pension Plan Number	Pension Protection Act Zone Status 2016	Pension Protection Act Zone Status 2015	FIP/RP Status Pending or Implemented	The Conservatory Contributions 2017	The Conservatory Contributions 2016	Expiration Date Date of Collective Bargaining Agreement
Stationary Engineers Local 39 Trust Funds	94-6118939/ 001	Green	Green	N/A	$ 67,000	$ 64,000	8/31/23

There have been no other significant changes that affect the comparability of 2017 and 2016 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.

SFCM did not provide more than 5% of the total contributions to the plan during 2016 or 2015, 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	$	4,104,000
Service cost		235,000
Interest cost		147,000
Actuarial loss		(672,000)
Benefits paid		(53,000)
Accumulated benefit obligation at end of year	$	3,761,000
Unfunded status of the plan at end of year	$	3,761,000

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,		
2018	$	55,000
2019		60,000
2020		69,000
2021		78,000
2022		88,000
2023 - 2027		635,000

Weighted average assumptions as of June 30, 2017:	
Discount Rate	3.86%

SFCM's projected medical cost trend rate related to its noncontributory postretirement health benefit plan in 2017 was 7.35% (Hartford/Kaiser) The assumed medical cost trend rate is expected to gradually decrease in subsequent years to 4.5% in 2037 and thereafter.

Health Care Trend Rate Sensitivity for Fiscal 2017

	1% Increase	1% Decrease
APBO as of June 30, 2017:	$ 815,000/21.66%	$ (634,000)/16.85%
Service and Interest Cost for fiscal 2017:	$ 120,000/31.50%	$ (88,000)/22.88%

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.

Note 13 - Net Assets:

Net assets consisted of the following at June 30:

	2017				2016
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Endowment:					
Quasi-endowment funds	$ 95,000	$	$	$ 95,000	$ 90,000
True endowment funds:					
General purpose	(180,000)		7,906,000	7,726,000	$ 5,568,000
Scholarship	(2,373,000)	501,000	26,094,000	24,222,000	22,909,000
Faculty support	(469,000)	334,000	8,160,000	8,025,000	7,427,000
Other program support	(20,000)	49,000	970,000	999,000	952,000
Retirement of indebtedness		13,000	180,000	193,000	185,000
True endowment funds	(3,042,000)	897,000	43,310,000	41,165,000	37,041,000
Total endowment funds	(2,947,000)	897,000	43,310,000	41,260,000	37,131,000
Other:	56,072,000	57,136,000		113,208,000	76,672,000
Total net assets	$ 53,125,000	$ 58,033,000	$ 43,310,000	$ 154,468,000	$ 113,803,000

Temporarily restricted net assets restricted for purpose and time restrictions at June 30, 2017 are as follows:

Capital Campaign (Note 17)	54,480,000
Other projects & programs	1,976,000
Time restriction	680,000
	$ 57,136,000

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, 2017:

Utilized for scholarships	$ 1,830,000
Utilized for faculty salaries	589,000
Utilized for capital expenditures	1,220,000
Utilized for other project and program purposes	1,217,000
Expiration of time restrictions	363,000
Total released operating and non-operating	$ 5,219,000

Included in temporarily restricted net assets for programs is $417,000 of funds restricted for the Collegiate Jack H. Lund Scholarship Program. During the year ended June 30, 2017, SFCM released $315,000 funds for this program.

Changes in endowment net assets for the year ended June 30, 2017:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, beginning of year	$ (4,253,000)	$ 395,000	$ 40,989,000	$ 37,131,000
Investment return:				
Investment income		374,000		374,000
Net realized and unrealized gain (loss) on investments, net of fees	11,000	3,696,000	29,000	3,736,000
Underwater endowment funds adjustment	1,301,000	(1,301,000)		
Total investment return	1,312,000	2,769,000	29,000	4,110,000
New gifts			2,292,000	2,292,000
Appropriation of endowment	(6,000)	(2,267,000)		(2,273,000)
Net assets, end of year	$ (2,947,000)	$ 897,000	$ 43,310,000	$ 41,260,000

Note 14 - Related Party Transactions:

SFCM received contributions from members of its board of trustees and related entities of approximately $35,463,000 for the fiscal year ended June 30, 2017. Contributions receivable related to current and prior years' contributions from board members totaled approximately $38,423,000 at June 30, 2017. These board members have no other relationship or business dealings with SFCM.

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, 2017.

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 2017
Instruction	$ 9,447,000	$ 117,000	$ 1,109,000	$ 701,000	$ 11,374,000
Student service	1,405,000	17,000	165,000	104,000	1,691,000
Academic support	796,000	10,000	93,000	59,000	958,000
Public program	418,000	5,000	49,000	31,000	503,000
Fund-raising	1,487,000	18,000	175,000	110,000	1,790,000
General management and administration	4,209,000	54,000	494,000	312,000	5,069,000
Independent operations	530,000	359,000		362,000	1,251,000
	$ 18,292,000	$ 580,000	$ 2,085,000	$ 1,679,000	$ 22,636,000

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, 2017, are as follows:

Year ending June 30:	
2018	$ 2,613,000
2019	2,622,000
2020	437,000
Total	$ 5,672,000

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.

In October 2015, 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.