

MANHATTAN SCHOOL OF MUSIC

FINANCIAL STATEMENTS

(Including Single Audit)

Years ended June 30, 2017 and 2016

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FINANCIAL STATEMENTS
(Including Single Audit)
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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Manhattan School of Music
New York, New York

Report on the Financial Statements

We have audited the accompanying financial statements of Manhattan School of Music, which comprise the statements of financial position as of June 30, 2017 and 2016, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 organization'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 organization'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.

(Continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Manhattan School of Music as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2017 on our consideration of Manhattan School of Music's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Manhattan School of Music's internal control over financial reporting and compliance.

Crowe Horwath LLP

Crowe Horwath LLP

New York, New York
October 27, 2017

MANHATTAN SCHOOL OF MUSIC
STATEMENTS OF FINANCIAL POSITION
June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash and cash equivalents	\$ 7,646,422	\$ 5,340,205
Contributions receivable, net	836,507	4,918,523
Prepaid expenses and other assets	661,837	712,277
Student loans receivable	768,326	863,749
Investments	27,274,196	23,618,528
Property, plant, and equipment, net	<u>56,688,039</u>	<u>53,727,902</u>
 Total assets	 <u>\$ 93,875,327</u>	 <u>\$ 89,181,184</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 2,657,785	\$ 2,425,170
Unearned tuition and fees	1,581,631	1,655,059
Equipment financing obligation	1,651,188	1,948,870
U.S. government grants refundable	509,364	513,083
Bonds payable	31,987,345	33,557,312
Asset retirement obligation	<u>313,377</u>	<u>417,612</u>
 Total liabilities	 <u>38,700,690</u>	 <u>40,517,106</u>
Net assets		
Unrestricted	24,438,251	21,482,492
Temporarily restricted	4,969,147	2,540,777
Permanently restricted	<u>25,767,239</u>	<u>24,640,809</u>
 Total net assets	 <u>55,174,637</u>	 <u>48,664,078</u>
 Total liabilities and net assets	 <u>\$ 93,875,327</u>	 <u>\$ 89,181,184</u>

See accompanying notes to financial statements.

MANHATTAN SCHOOL OF MUSIC
STATEMENTS OF ACTIVITIES
Year ended June 30, 2017 with comparative totals for 2016

	2017			Total	2016
	Unrestricted	Temporarily restricted	Permanently restricted		
Operating activities					
Revenue					
Student tuition and fees	\$ 47,979,903	\$ -	\$ -	\$ 47,979,903	\$ 45,887,125
Less scholarships	<u>(16,373,563)</u>	<u>-</u>	<u>-</u>	<u>(16,373,563)</u>	<u>(14,437,637)</u>
Net tuition and fees	31,606,340	-	-	31,606,340	31,449,488
Auxiliary services	7,213,343	-	-	7,213,343	7,391,028
Investment return appropriated for operations	1,343,294	-	-	1,343,294	1,367,640
Other revenue	1,436	-	-	1,436	1,784
Net assets released from restrictions related to operating activities	<u>1,493,969</u>	<u>(1,493,969)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total operating revenue	<u>41,658,382</u>	<u>(1,493,969)</u>	<u>-</u>	<u>40,164,413</u>	<u>40,209,940</u>
Expenses					
Program services					
Instruction	18,475,927	-	-	18,475,927	17,702,542
Academic support	4,773,937	-	-	4,773,937	4,239,623
Student services	3,298,547	-	-	3,298,547	3,798,978
Auxiliary services	<u>4,124,220</u>	<u>-</u>	<u>-</u>	<u>4,124,220</u>	<u>4,617,182</u>
Total program services	<u>30,672,631</u>	<u>-</u>	<u>-</u>	<u>30,672,631</u>	<u>30,358,325</u>
Supporting services					
General and administrative	5,908,657	-	-	5,908,657	5,905,474
Fund-raising	<u>929,951</u>	<u>-</u>	<u>-</u>	<u>929,951</u>	<u>974,630</u>
Total supporting services	<u>6,838,608</u>	<u>-</u>	<u>-</u>	<u>6,838,608</u>	<u>6,880,104</u>
Total expenses	<u>37,511,239</u>	<u>-</u>	<u>-</u>	<u>37,511,239</u>	<u>37,238,429</u>
Excess (deficiency) of operating revenue over expenses	4,147,143	(1,493,969)	-	2,653,174	2,971,511
Nonoperating activities					
Contributions and private grants	1,965,219	1,911,158	1,126,430	5,002,807	2,242,394
Government grants	222,005	-	-	222,005	214,128
Investment gain (loss) in excess of amount appropriated for operations	(254,966)	2,021,181	-	1,766,215	(2,657,355)
Depreciation and amortization expense	(2,934,272)	-	-	(2,934,272)	(2,710,713)
Other	<u>(199,370)</u>	<u>-</u>	<u>-</u>	<u>(199,370)</u>	<u>(157,767)</u>
	<u>(1,201,384)</u>	<u>3,932,339</u>	<u>1,126,430</u>	<u>3,857,385</u>	<u>(3,069,313)</u>
Net assets released from restrictions for capital expenditures	<u>10,000</u>	<u>(10,000)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Change in net assets	2,955,759	2,428,370	1,126,430	6,510,559	(97,802)
Net assets, beginning of year	<u>21,482,492</u>	<u>2,540,777</u>	<u>24,640,809</u>	<u>48,664,078</u>	<u>48,761,880</u>
Net assets, end of year	<u>\$ 24,438,251</u>	<u>\$ 4,969,147</u>	<u>\$ 25,767,239</u>	<u>\$ 55,174,637</u>	<u>\$ 48,664,078</u>

(Continued)

MANHATTAN SCHOOL OF MUSIC
STATEMENT OF ACTIVITIES
Year ended June 30, 2016

	<u>Unrestricted</u>	<u>2016</u>		<u>Total</u>
		<u>Temporarily restricted</u>	<u>Permanently restricted</u>	
Operating activities				
Revenue				
Student tuition and fees	\$ 45,887,125	\$ -	\$ -	\$ 45,887,125
Less scholarships	<u>(14,437,637)</u>	<u>-</u>	<u>-</u>	<u>(14,437,637)</u>
Net tuition and fees	31,449,488	-	-	31,449,488
Auxiliary services	7,391,028	-	-	7,391,028
Investment return appropriated for operations	1,367,640	-	-	1,367,640
Other revenue	1,784	-	-	1,784
Net assets released from restrictions related to operating activities	<u>194,500</u>	<u>(194,500)</u>	<u>-</u>	<u>-</u>
Total operating revenue	<u>40,404,440</u>	<u>(194,500)</u>	<u>-</u>	<u>40,209,940</u>
Expenses				
Program services				
Instruction	17,702,542	-	-	17,702,542
Academic support	4,239,623	-	-	4,239,623
Student services	3,798,978	-	-	3,798,978
Auxiliary services	<u>4,617,182</u>	<u>-</u>	<u>-</u>	<u>4,617,182</u>
Total program services	<u>30,358,325</u>	<u>-</u>	<u>-</u>	<u>30,358,325</u>
Supporting services				
General and administrative	5,905,474	-	-	5,905,474
Fund-raising	<u>974,630</u>	<u>-</u>	<u>-</u>	<u>974,630</u>
Total supporting services	<u>6,880,104</u>	<u>-</u>	<u>-</u>	<u>6,880,104</u>
Total expenses	<u>37,238,429</u>	<u>-</u>	<u>-</u>	<u>37,238,429</u>
Excess (deficiency) of operating revenue over expenses	3,166,011	(194,500)	-	2,971,511
Nonoperating activities				
Contributions and private grants	1,537,843	128,775	575,776	2,242,394
Government grants	214,128	-	-	214,128
Investment gain (loss) in excess of amount appropriated for operations	(4,572,064)	1,914,709	-	(2,657,355)
Depreciation and amortization expense	(2,710,713)	-	-	(2,710,713)
Other	<u>(157,767)</u>	<u>-</u>	<u>-</u>	<u>(157,767)</u>
Change in net assets	(2,522,562)	1,848,984	575,776	(97,802)
Net assets, beginning of year	<u>24,005,054</u>	<u>691,793</u>	<u>24,065,033</u>	<u>48,761,880</u>
Net assets, end of year	<u>\$ 21,482,492</u>	<u>\$ 2,540,777</u>	<u>\$ 24,640,809</u>	<u>\$ 48,664,078</u>

(Continued)

MANHATTAN SCHOOL OF MUSIC
STATEMENTS OF CASH FLOWS
Years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities		
Change in net assets	\$ 6,510,559	\$ (97,802)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Contributions restricted for endowment and capital	(4,155,812)	(126,522)
Depreciation and amortization expense	2,904,240	2,680,681
Net change in fair value of investments	(2,103,052)	2,960,857
Changes in operating assets and liabilities		
Contributions receivable, net	485,008	(67,764)
Prepaid expenses and other assets	50,440	(142,467)
Accounts payable and accrued expenses	232,615	356,423
Unearned tuition and fees	(73,428)	307,405
Asset retirement obligation	<u>(104,235)</u>	<u>(249,909)</u>
Net cash provided by operating activities	<u>3,746,335</u>	<u>5,620,902</u>
Cash flows from investing activities		
Purchases of property, plant, and equipment	(5,864,376)	(2,336,678)
Student loans issued	-	(80,855)
Student loans repaid	95,423	111,085
Purchases of investments	(3,614,360)	(21,409,730)
Proceeds from sales of investments	<u>2,061,744</u>	<u>19,541,051</u>
Net cash used in investing activities	<u>(7,321,569)</u>	<u>(4,175,127)</u>
Cash flows from financing activities		
Contributions restricted for endowment and capital	4,155,812	126,522
Decrease (increase) in contributions receivable related to endowment and capital	3,597,007	(50,264)
Decrease in U.S. government grants refundable	(3,719)	(44,156)
Payment of bonds payable	(1,600,000)	(1,715,000)
Bond issuance costs incurred	30,033	(78,968)
Payment of equipment financing obligation	<u>(297,682)</u>	<u>(94,834)</u>
Net cash provided by (used in) financing activities	<u>5,881,451</u>	<u>(1,856,700)</u>
Net increase (decrease) in cash and cash equivalents	2,306,217	(410,925)
Cash and cash equivalents, beginning of year	<u>5,340,205</u>	<u>5,751,130</u>
Cash and cash equivalents, end of year	<u>\$ 7,646,422</u>	<u>\$ 5,340,205</u>
Supplemental disclosure of cash flow information		
Interest paid	\$ 1,014,766	\$ 1,036,730
Equipment acquired through capital lease obligations	\$ -	\$ 2,000,000

See accompanying notes to financial statements.

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization: Manhattan School of Music (the School) is a preeminent international conservatory of music granting Bachelor of Music, Master of Music, Doctor of Musical Arts degrees, and postgraduate degree certificates. The School, which was founded in 1917, serves more than 950 college students from more than 40 countries, and more than 470 students in the age group of 5 – 18 in the precollege division, as well as provides a summer music camp by audition to approximately 120 students who have completed grades 6 – 11. The School employs an artist-teacher faculty of approximately 275 professional musicians.

Financial Statement Presentation: The School prepares its financial statements on the accrual basis of accounting. Net assets and revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the School and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets that are not subject to donor-imposed restrictions.

Temporarily restricted net assets – Net assets subject to donor-imposed restrictions that will be met by either actions of the School and/or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed restrictions that stipulate that they be maintained permanently by the School. Generally, the donors of these assets permit the School to use all or a part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless their use is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Expiration of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) except for those restrictions met in the same fiscal year as received, which are reported as revenues of the unrestricted net assets category, are reported as net assets released from restrictions.

The statement of activities distinguishes between operating and nonoperating activities. Nonoperating activities include contributions and grants, depreciation and amortization expense, amounts released from restrictions for capital, nonrecurring items, real estate taxes, and the difference between total investment return and the amount appropriated for operations.

Tax Status: The School is exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

The School recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Income generated from activities unrelated to the School's exempt purpose is subject to tax under Internal Revenue Code Section 511. The School did not recognize any unrelated business income tax liability for the years ended June 30, 2017 and 2016.

Use of Estimates: The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Significant estimates made in the preparation of the financial statements include the fair value of alternative investments, the net realizable value of contributions receivable, the useful lives of fixed assets, the functional allocation of expenses, and the estimate of the asset retirement obligation. Actual results could differ from those estimates.

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NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Measurements: Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) No. 820, Fair Value Measurement, also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, including inputs in markets that are not considered to be active.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

At June 30, 2017 and 2016, the carrying values of the School's cash equivalents, receivables, prepaid expenses and other assets, and accounts payable and accrued expenses approximate their fair values because of the terms and relatively short maturities of these financial instruments.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand and temporary investments purchased with original maturities of three months or less.

Contributions: Contributions, which include unconditional promises to give, are recognized as revenue when received. Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk adjusted interest rates (ranging from 1.24% to 5.80%) applicable to the years in which the promises are received.

Investments: The School's investments in fixed income funds, equity funds, and equity securities are carried at fair value based on quoted market prices. Alternative investments consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. The School's investments in alternative investments are stated, as a practical expedient, at the net asset value as provided by the investment managers and evaluated for reasonableness by the School's management.

The School invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and could affect the amounts reported in the statement of financial position.

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Deferred Bond Issue Costs: Costs incurred for issuance of bonds are capitalized and amortized over the term of the related bonds.

Property, Plant and Equipment: Property, plant, and equipment are recorded at cost or, if donated, at fair value on the date of contribution. Depreciation of assets is computed on the straight-line method over the estimated useful lives of 3 to 40 years. The statement of activities does not present depreciation and amortization expense by function. Depreciation and amortization expense is incurred primarily in support of auxiliary services.

Unearned Tuition Fees: Tuition revenue is recognized on a pro rata basis over the length of the program, based on the percentage of time completed. The School records unearned tuition and fees related to prepayments of future tuition as liabilities.

U.S. Government Grants Refundable: The School participates in the Perkins Loan Program (the Program) sponsored by the U.S. Department of Education. Funds provided by the U.S. government under the Program are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the U.S. government and are presented in the accompanying statement of financial position as U.S. government grants refundable.

Asset Retirement Obligation: Management has identified asbestos abatement as a conditional asset retirement obligation and has recorded a liability in the accompanying statement of financial position for such obligation. The School incurred remediation costs of \$104,235 and \$249,909 in 2017 and 2016, respectively.

Expense Classification: Expenses have been classified as program services, management and general, and fundraising based on the actual direct expenditures and estimated cost allocations based upon time and nature of expenses. The breakdown of total functional expenses based on these categories including depreciation and amortization is:

	<u>2017</u>	<u>2016</u>
Program services	\$ 33,132,957	\$ 32,627,605
Management and general	6,382,604	6,346,907
Fundraising	<u>929,950</u>	<u>974,630</u>
 Total functional expenses	 <u>\$ 40,445,511</u>	 <u>\$ 39,949,142</u>

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 2 – INVESTMENTS

The following tables present the School's fair value hierarchy for investments, which are the only financial instruments measured at fair value as of June 30, 2017 and 2016 and investments reported at net asset value:

<u>2017</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Fixed income funds	\$ 6,864,744	\$ 6,864,744	\$ -	\$ -
Equity funds				
Real estate	3,140,809	3,140,809	-	-
Domestic	8,826,333	8,826,333	-	-
International	<u>5,537,215</u>	<u>5,537,215</u>	-	-
Total	24,369,101	<u>\$ 24,369,101</u>	<u>\$ -</u>	<u>\$ -</u>
Investments reported at net asset value				
Private equity	1,180,081			
Hedge funds	<u>1,725,014</u>			
Total investments reported at net asset value	<u>2,905,095</u>			
Total	<u>\$ 27,274,196</u>			

<u>2016</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Fixed income funds	\$ 5,752,687	\$ 5,752,687	\$ -	\$ -
Equity funds				
Real estate	2,611,355	2,611,355	-	-
Domestic	7,172,514	7,172,514	-	-
International	<u>4,285,592</u>	<u>4,285,592</u>	-	-
Total	19,822,148	<u>\$ 19,822,148</u>	<u>\$ -</u>	<u>\$ -</u>
Investments reported at net asset value				
International equity	88,897			
Multi-strategy fund of funds	763,729			
Private equity	975,333			
Hedge funds	<u>1,968,421</u>			
Total investments reported at net asset value	<u>3,796,380</u>			
Total	<u>\$ 23,618,528</u>			

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 2 – INVESTMENTS (Continued)

Information with respect to the strategies and redemption provisions of those investment funds that are reported at estimated fair value based upon net asset value per share (or its equivalent) is as follows:

International equity – invests primarily in publicly traded equity securities and seeks capital appreciation by focusing primarily on mid-cap companies.

Multi-strategy fund of funds – focuses on relative value and other nondirectional investment strategies and seeks capital preservation and low-volatility returns, which are uncorrelated to the broader markets.

Hedge funds – objective is to achieve maximum capital appreciation, independent of the returns of the overall equity and debt markets, by the use of a variety of securities trading strategies. Fundamental analysis is utilized to attempt to capitalize on specific situations such as distressed investing, credit opportunities, special situations, merger arbitrage, reorganizations, bankruptcies, distressed debt, post-bankruptcy equities, and balance sheet arbitrage.

<u>Redemption Period</u>	<u>Notice</u>	<u>Private Equity</u>	<u>Hedge Funds</u>
Quarterly	45 – 60 days	\$ -	\$ 1,270,805
Annual	45 – 60 days	-	454,209
Subject to lock-up		<u>1,180,081</u>	<u>-</u>
Total		<u>\$ 1,180,081</u>	<u>\$ 1,725,014</u>

The School had unfunded commitments of \$337,865 and \$420,903 with respect to its alternative investments as of June 30, 2017 and 2016, respectively.

The School reports as operating revenue the amount of investment return appropriated by the Board of Trustees for spending. This amount includes return on investments held as part of a long-term investment strategy as well as return on cash and cash equivalents. The difference between the actual return and the authorized spending level is reported as nonoperating. Investment return, net for the years ended June 30, 2017 and 2016 consists of the following:

	<u>2017</u>	<u>2016</u>
Interest and dividends	\$ 920,282	\$ 400,715
Net change in fair value of investments	2,308,219	(1,618,478)
Investment advisory fees	<u>(118,992)</u>	<u>(71,952)</u>
Total investment gain (loss)	3,109,509	(1,289,715)
Amount appropriated for operations	<u>(1,343,294)</u>	<u>(1,367,640)</u>
Investment gain (loss) in excess of amount appropriated for operations	<u>\$ 1,766,215</u>	<u>\$ (2,657,355)</u>

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 3 – CONTRIBUTIONS RECEIVABLE

Contributions receivable are scheduled to be collected as follows at June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Within one year	\$ 152,428	\$ 4,266,558
One to five years	<u>708,818</u>	<u>673,389</u>
	861,246	4,939,947
Discount to present value	<u>(24,739)</u>	<u>(21,424)</u>
Contributions receivable, net	<u>\$ 836,507</u>	<u>\$ 4,918,523</u>

Approximately 67% of the contributions receivable at June 30, 2017 are from two donors. Approximately 82% of the contributions receivable at June 30, 2016 are from an individual donor. That contribution of \$4,000,000 was subsequently received on July 22, 2016.

NOTE 4 – STUDENT LOANS RECEIVABLE

Student loans receivable consist of amounts due from students under the School's federally-sponsored Perkins student loan program. A reasonable estimate of the fair value of loans receivable from students under government loan programs could not be made because the notes cannot be sold and can only be assigned to the U.S. government or its designees. The fair value of notes receivable from students under the School's other student loan programs approximates carrying value.

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment at June 30, 2017 and 2016 consist of the following:

	<u>2017</u>	<u>2016</u>
Land	\$ 1,240,000	\$ 1,240,000
Buildings	80,356,963	74,607,986
Furniture and equipment	8,531,486	4,731,569
Musical instruments and audio equipment	4,725,692	4,492,389
Library books, music, and art work	1,199,953	1,199,953
Construction in progress	<u>744,230</u>	<u>4,662,049</u>
	96,798,324	90,933,946
Accumulated depreciation	<u>(40,110,285)</u>	<u>(37,206,044)</u>
	<u>\$ 56,688,039</u>	<u>\$ 53,727,902</u>

Construction in progress is scheduled to complete on December 31, 2017. Additional unspent commitments to complete these projects total approximately \$14,255,770 at June 30, 2017.

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 6 – INDEBTEDNESS

The School has financed the construction of a mixed use building primarily for a dormitory for the School's students through long term debt. In May 2009, the Trust for Cultural Resources of the City of New York (the Trust) issued Revenue Bonds, Series 2009A Bonds (Series 2009A Bonds) in the amount of \$42,300,000 on behalf of the School.

In December 2010, the School converted the bonds from a variable rate to a fixed rate and entered into a Continuing Covenant Agreement with Wells Fargo whereby Wells Fargo purchased all of the bonds. The initial credit facility with Wells Fargo was terminated, and all obligations of the Reimbursement Agreement, with the exception of Surviving Obligations as described in the Reimbursement Agreement, were terminated. The bonds are subject to sinking fund redemption on the schedule outlined in the Reimbursement Agreement. Instead of the bonds being subject to a weekly adjustable interest rate, the post conversion rate was set at a fixed rate of 3.05% for the four years ended December 14, 2014.

On October 30, 2014, the Israel Discount Bank of New York (the Bank) purchased the outstanding principal balance of the Series 2009A Bonds totaling \$35,670,000. In October 2014, the School entered into an Amended and Restated Continuing Covenant Agreement with the Bank. The interest rate is set at a fixed rate of 2.92% for a 15 year term through October 2029. The maturity schedule does not change under the new agreement. The Amended and Restated Continuing Covenant Agreement requires that the School maintain specific financial ratios, as well as other financial and operational standards.

In connection with the refinancing, issuance costs of \$450,486 were capitalized and are being amortized over the life of the bond. Interest expense on bonds outstanding during 2017 and 2016 was \$988,888 and \$1,027,695, respectively.

The maturities of the bonds payable are as follows:

Year ending June 30:	
2018	\$ 1,705,000
2019	1,805,000
2020	1,920,000
2021	2,035,000
Thereafter	<u>24,890,000</u>
	32,355,000
Less unamortized bond issuance costs	<u>(367,655)</u>
	<u>\$ 31,987,345</u>

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 7 – EQUIPMENT FINANCING OBLIGATION

On April 21, 2016, the School entered into an equipment lease obligation with First American Equipment Finance, A City National Bank Company, for the sole purpose of financing the purchase and installation of various HVAC equipment in the amount of \$2,000,000. Installments of \$30,500 are due monthly, and the payment schedule of principal and interest is calculated at an annualized interest rate of 3.21%, including a final payment of \$360,000 due to be paid in 2021.

NOTE 8 – NET ASSETS AND ENDOWMENT

Temporarily restricted net assets are available for the following purposes at June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Scholarships	\$ 2,159,468	\$ 1,683,196
Capital purchases	2,232,305	10,000
Educational programs	318,682	173,996
General operations of the School	<u>258,692</u>	<u>673,585</u>
	<u>\$ 4,969,147</u>	<u>\$ 2,540,777</u>

Such amounts restricted for capital are released from restriction when the asset is placed into service.

The income from permanently restricted net assets balances, as detailed below, is expendable to support the following at June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Educational programs	\$ 2,340,693	\$ 2,239,193
Scholarships	20,855,465	19,905,327
General operations of the School	<u>2,571,081</u>	<u>2,496,289</u>
	<u>\$ 25,767,239</u>	<u>\$ 24,640,809</u>

The School follows the provisions of the New York Prudent Management of Institutional Funds Act (NYPMIFA) in managing its donor-restricted endowment. The School has interpreted NYPMIFA as allowing it to appropriate for expenditure or accumulate so much of the donor-restricted endowment fund as is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument absent explicit donor stipulations to the contrary. The School has no board-designated endowment funds.

Accounting guidance requires the portion of a donor-restricted endowment fund that is not classified as permanently restricted to be classified as temporarily restricted net assets until appropriated for expenditure in a manner consistent with the standard of prudence prescribed by NYPMIFA. If the fair value of assets associated with individual donor-restricted endowment funds have fallen below the fund's historic dollar value, deficiencies of this nature are reported in unrestricted net assets.

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 8 – NET ASSETS AND ENDOWMENT (Continued)

The following table presents the changes in donor-restricted endowments by net asset class (excluding permanently restricted contributions receivable of \$20,199 and \$4,372,138 at June 30, 2017 and 2016) for the years ended June 30, 2017 and 2016:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2015	\$ (1,246,882)	\$ -	\$ 19,858,159	\$ 18,611,277
Investment gain	1,246,882	3,282,349	-	4,529,231
Contributions	-	-	410,512	410,512
Appropriation per spending policy	<u>-</u>	<u>(1,367,640)</u>	<u>-</u>	<u>(1,367,640)</u>
Endowment net assets, June 30, 2016	\$ -	\$ 1,914,709	\$ 20,268,671	\$ 22,183,380
Investment gain	-	2,021,181	-	2,021,181
Contributions	-	-	5,478,369	5,478,369
Appropriation per spending policy	<u>-</u>	<u>(1,343,294)</u>	<u>-</u>	<u>(1,343,294)</u>
Endowment net assets, June 30, 2017	<u>\$ -</u>	<u>\$ 2,592,596</u>	<u>\$ 25,747,040</u>	<u>\$ 28,339,636</u>

The School's investment objective is to provide that future growth of the portfolio is sufficient to offset normal inflation plus reasonable spending, thereby preserving the constant dollar value and purchasing power of the endowment fund. In order to achieve this goal, the School's investment policy guidelines are structured for long term growth while incurring only a prudent level of risk. The School has a spending policy of appropriating for distribution each year 5.0% of the endowment fund, depending on performance of the investment portfolio as well as considering the factors included in NYPMIFA.

NOTE 9 – BENEFIT PLANS

The School sponsors a defined contribution plan established under the provisions of Section 403(b) of the Internal Revenue Code, which includes a qualified deferred arrangement, for the benefit of eligible employees of the School. The plan also provides for tax-deferred elective contributions for eligible employees. The School's policy is to fund, on a current basis, pension costs accrued under this plan. Total annual costs under this plan for the years ended June 30, 2017 and 2016 amounted to approximately \$996,000 and \$994,000, respectively.

The School participates in a multiemployer union pension plan, Building Service 32BJ Pension Fund. The Employer Identification Number is 13-1879376, and the three-digit Pension Plan number is 001. The most recent Pension Protection Act (PPA) zone status is red at July 1, 2016, which is for the plan year ended June 30, 2015. The zone status is based on information that the School received from the plan sponsor and, as required by the PPA, is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are less than 80% funded, and plans in the green zone are at least 80% funded. The plan's sponsor has indicated that a rehabilitation plan has been implemented, as required by the PPA. The expiration date of the collective bargaining agreement requiring contributions to the plan is December 31, 2019. The contributions by the School to the union pension fund were approximately \$46,000 and \$43,000 for the years ended June 30, 2017 and 2016. These contributions represent 100% fulfillment of the School's contractual obligations to the union pension fund for each of the respective years.

(Continued)

MANHATTAN SCHOOL OF MUSIC
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 9 – BENEFIT PLANS (Continued)

At the date the financial statements were issued, Form 5500 was not available for the plan for the years ended June 30, 2017 and 2016.

The School also participates in a multiemployer union health fund, Building Service 32BJ Health Fund. The Employer Identification Number is 13-2928869, and the three-digit Pension Plan number is 501. The contributions by the School to the union health fund were approximately \$193,000 and \$140,000 for the years ended June 30, 2017 and 2016. At the date the financial statements were issued, Form 5500 was not available for the plan years ended June 30, 2017 and 2016.

The School further participates in three other multiemployer plans, the amounts of which are insignificant to the financial statements.

NOTE 10 – SUBSEQUENT EVENTS

The School evaluated events subsequent to October 27, 2017 the date on which the financial statements were available to be issued, and concluded that no additional disclosures are required.

SUPPLEMENTARY INFORMATION

MANHATTAN SCHOOL OF MUSIC
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year ended June 30, 2017

Federal grantor/pass-through grantor/program title	Federal CFDA number	Federal expenditures
Student financial assistance cluster:		
U.S. Department of Education:		
Federal Supplemental Educational Opportunity Grant Program	84.007	\$ 64,547
Federal Work Study Program	84.033	79,622
Federal Perkins Loan Program	84.038	888,737
Federal Pell Grant Program	84.063	307,529
Federal Direct Loan Program	84.268	<u>7,124,956</u>
Total student financial assistance cluster		<u>8,465,391</u>
Total expenditures of federal awards		<u>\$ 8,465,391</u>

The accompanying notes are an integral part of the
 Schedule of Expenditures of Federal Awards.

MANHATTAN SCHOOL OF MUSIC
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2017

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (Schedule) includes the activity of Manhattan School of Music (the "School") for the year ended June 30, 2017, and is presented on the accrual basis of accounting. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the College, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the School.

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. The School has elected to not use the 10-percent de minimis indirect cost rate as allowed under the Uniform Guidance.

NOTE 2 - FEDERAL LOAN PROGRAMS

The amount presented on the schedule of expenditures of federal awards for the Federal Perkins Loan Program represents loan balances outstanding at June 30, 2017 plus current year loan disbursements for which the government imposes continuing compliance requirements. As of June 30, 2017, the School's outstanding Perkins loan balance is \$768,982 plus \$0 in new loans during the year and \$24,988 for the administrative cost allowance.

The School also participates in the Federal Direct Student Loans Program and Federal PLUS Loans (PLUS). The dollar amounts are listed in the schedule of federal awards although the School is not the recipient of the funds. Such programs are considered a component of the student financial assistance cluster.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Trustees
Manhattan School of Music
New York, New York

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Manhattan School of Music (the "School"), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 27, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the School's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control. Accordingly, we do not express an opinion on the effectiveness of the School's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the School's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the School's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the School's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Crowe Horwath LLP

Crowe Horwath LLP

New York, New York
October 27, 2017

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM
AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE

The Board of Trustees
Manhattan School of Music
New York, New York

Report on Compliance for Each Major Federal Program

We have audited Manhattan School of Music's (the "School") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the School's major federal programs for the year ended June 30, 2017. The School's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the School's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the School's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the School's compliance.

Opinion on Each Major Federal Program

In our opinion, Manhattan School of Music complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017.

(Continued)

Report on Internal Control Over Compliance

Management of the School is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the School's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the College's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Crowe Horwath LLP

Crowe Horwath LLP

New York, New York
October 27, 2017

MANHATTAN SCHOOL OF MUSIC
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 June 30, 2017

Section I—Summary of Auditor’s Results

Financial Statements:

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:

Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? Yes No
- Significant deficiencies identified? Yes None reported

Noncompliance material to financial statements noted? Yes No

Federal Awards:

Internal control over major programs:

- Material weakness(es) identified? Yes No
- Significant deficiencies identified? Yes None reported

Type of auditor's report issued on compliance for major programs:

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? Yes No

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
Student Financial Assistance Cluster	
84.007	Federal Supplemental Educational Opportunity Grant Program
84.033	Federal Work-Study Program
84.038	Federal Perkins Loan Program
84.063	Federal Pell Grant Program
84.268	Federal Direct Loan Program

Dollar threshold used to distinguish between type A and type B programs: \$750,000

Auditee qualified as low-risk auditee? Yes No

(Continued)

MANHATTAN SCHOOL OF MUSIC
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
June 30, 2017

Section II—Financial Statement Findings

None reported

Section III—Federal Award Findings and Questioned Costs

None reported

MANHATTAN SCHOOL OF MUSIC
SCHEDULE OF PRIOR AUDIT FINDINGS AND QUESTIONED COSTS
June 30, 2016

None reported