

SCHOOL OF AMERICAN BALLET, INC.

FINANCIAL STATEMENTS

AUGUST 31, 2016



INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
School of American Ballet, Inc.

We have audited the accompanying financial statements of School of American Ballet, Inc. (a nonprofit organization), which comprise the statement of financial position as of August 31, 2016, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair 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 auditors' 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 School of American Ballet, Inc. as of August 31, 2016, 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 School of American Ballet, Inc.'s 2015 financial statements, and our report dated January 8, 2016, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended August 31, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Lotz + Carr, LLP

New York, New York
December 16, 2016

SCHOOL OF AMERICAN BALLET, INC.

STATEMENT OF FINANCIAL POSITION

AUGUST 31, 2016 WITH COMPARATIVE TOTALS FOR 2015

	<u>2016</u>	<u>2015</u>
Assets		
Current Assets		
Cash and cash equivalents (Notes 1b and 3)	\$ 1,154,392	\$ 1,207,847
Tuition, interest and other receivables	12,564	108,430
Unconditional promises to give (Notes 1c and 4)	3,239,764	3,376,626
Prepaid expenses and other current assets	<u>166,021</u>	<u>135,331</u>
Total Current Assets	4,572,741	4,828,234
Other Assets		
Investments, at fair value (Notes 1e, 1f and 5)	61,532,869	61,885,705
Unconditional promises to give (Notes 1c and 4)	5,759,825	5,170,780
Property, equipment and land, at cost, less accumulated depreciation (Notes 1d, 6, 7 and 8)	<u>19,015,795</u>	<u>19,547,692</u>
Total Assets	<u>\$90,881,230</u>	<u>\$91,432,411</u>
Liabilities and Net Assets		
Liabilities		
Current Liabilities		
Accounts payable and other liabilities	\$ 1,596,792	\$ 3,532,428
Deferred income (Note 1g)	<u>1,231,639</u>	<u>1,213,223</u>
Total Current Liabilities	2,828,431	4,745,651
Financing obligation payable, net of deferred financing costs (Notes 1h and 8)	8,553,594	8,295,482
Obligation under interest rate swap (Note 8)	<u>-</u>	<u>138,439</u>
Total Liabilities	<u>11,382,025</u>	<u>13,179,572</u>
Commitments (Notes 6 and 13)		
Net Assets (Note 2)		
Unrestricted	42,383,505	43,030,516
Temporarily restricted	2,045,719	1,873,721
Permanently restricted	<u>35,069,981</u>	<u>33,348,602</u>
Total Net Assets	<u>79,499,205</u>	<u>78,252,839</u>
Total Liabilities and Net Assets	<u>\$90,881,230</u>	<u>\$91,432,411</u>

See notes to financial statements.

SCHOOL OF AMERICAN BALLET, INC.

STATEMENT OF ACTIVITIES

YEAR ENDED AUGUST 31, 2016 WITH COMPARATIVE TOTALS FOR 2015

	2016			2015
	Unrestricted	Temporarily Restricted (Note 2b)	Permanently Restricted (Note 2c)	Total
Revenue				
Tuition and fees (Note 1g)	\$ 3,323,016	\$ -	\$ -	\$ 3,323,016
Room and board fees	1,629,075	-	-	1,629,075
Scholarships applied (Note 10)	(1,714,852)	-	-	(1,714,852)
Net tuition, fees, room and board fees	3,237,239	-	-	3,036,835
Other income	192,785	114	98,371	326,520
Total Revenue	3,430,024	114	98,371	3,363,355
Support				
Contributions (Note 6)	3,649,119	1,203,516	2,348,213	13,595,728
Special events revenue (Note 11)	2,472,132	-	-	2,799,835
Less: Special events direct expenses (Note 11)	(384,381)	-	-	(377,136)
Net assets released from restrictions				
Satisfaction of time and program restrictions (\$483,384 in 2015)	869,290	(869,290)	-	-
Redesignation of contribution	1,000,000	-	(1,000,000)	-
Total Support	7,606,160	334,226	1,348,213	16,018,427
Investment Income Available for Operations				
Board approved appropriation of endowment earnings for expenditure (Notes 5 and 9)	2,936,301	-	-	2,830,914
Total Revenue, Support and Investment Income Available for Operations	13,972,485	334,340	1,446,584	22,212,696
Expenses				
Program Services				
Teaching and other artistic programs	5,914,745	-	-	5,425,053
Student services and residence	4,038,700	-	-	3,678,220
Supporting Services				
General administration	2,070,605	-	-	1,684,607
Development	1,703,336	-	-	1,583,502
Total Expenses	13,727,386	-	-	12,371,382
Increase in Net Assets Before Non-Operating Activities (carried forward)	245,099	334,340	1,446,584	9,841,314

See notes to financial statements.

SCHOOL OF AMERICAN BALLET, INC.

STATEMENT OF ACTIVITIES

YEAR ENDED AUGUST 31, 2016 WITH COMPARATIVE TOTALS FOR 2015

	2016			2015	
	Unrestricted	Temporarily Restricted (Note 2b)	Permanently Restricted (Note 2c)	Total	
Increase in Net Assets Before Non-Operating Activities (brought forward)	\$ 245,099	\$ 334,340	\$ 1,446,584	\$ 2,026,023	\$ 9,841,314
Non-Operating Activities					
Investment income (Notes 1e and 5)	591,484	362,460	46,192	1,000,136	5,474,965
Net unrealized gains (losses) on investments (Notes 1e and 5)	1,029,434	568,410	280,292	1,878,136	(8,933,550)
Direct investment expenses	(252,846)	(95,719)	(51,689)	(400,254)	(334,939)
Capital campaign expenses	(364,432)	-	-	(364,432)	(400,876)
Gift annuity expense	(16,073)	-	-	(16,073)	(21,138)
Change in fair value of interest rate swap (Note 8)	59,131	-	-	59,131	41,394
	<u>1,046,698</u>	<u>835,151</u>	<u>274,795</u>	<u>2,156,644</u>	<u>(4,174,144)</u>
Board approved appropriation of endowment earnings for expenditure (Note 9)					
Board designated endowment earnings	(1,938,808)	-	-	(1,938,808)	(1,622,502)
Donor restricted endowment earnings	-	(997,493)	-	(997,493)	(1,208,412)
	<u>(892,110)</u>	<u>(162,342)</u>	<u>274,795</u>	<u>(779,657)</u>	<u>(7,005,058)</u>
Increase (Decrease) in Non-Operating Activities					
Increase (decrease) in net assets	(647,011)	171,998	1,721,379	1,246,366	2,836,256
Net assets, beginning of year	<u>43,030,516</u>	<u>1,873,721</u>	<u>33,348,602</u>	<u>78,252,839</u>	<u>75,416,583</u>
Net Assets, End of Year	<u>\$42,383,505</u>	<u>\$ 2,045,719</u>	<u>\$35,069,981</u>	<u>\$79,499,205</u>	<u>\$78,252,839</u>

See notes to financial statements.

SCHOOL OF AMERICAN BALLET, INC.

STATEMENT OF CASH FLOWS

YEAR ENDED AUGUST 31, 2016 WITH COMPARATIVE TOTALS FOR 2015

	<u>2016</u>	<u>2015</u>
Cash Flows From Operating Activities		
Increase in net assets	\$1,246,366	\$2,836,256
Adjustments to reconcile increase in net assets to net cash provided (used) by operating activities:		
Depreciation	1,134,601	959,351
Amortization of bond issuance costs	13,447	12,263
Amortization of swap transaction costs	1,501	3,001
Write off of deferred financing costs	285,891	-
Net realized and unrealized (gains) losses on investments	(2,201,163)	4,228,234
Change in fair value of interest rate swap	(138,439)	(41,394)
Cash received from permanently restricted contributions and other income	(3,036,649)	(1,858,237)
Write off of property and equipment	9,502	-
(Increase) decrease in:		
Tuition, interest and other receivables	95,866	(26,571)
Unconditional promises to give	(452,183)	(6,508,884)
Prepaid expenses and other current assets	(30,690)	117,788
Increase (decrease) in:		
Accounts payable and other liabilities	329,523	323,143
Deferred income	18,416	10,887
Net Cash Provided (Used) By Operating Activities	<u>(2,724,011)</u>	<u>55,837</u>
Cash Flows From Investing Activities		
Sales (purchases) of investments, net	2,553,999	341,306
Disbursements for property and equipment	(2,877,365)	(1,602,614)
Cash received from permanently restricted contributions and other income	<u>3,036,649</u>	<u>1,858,237</u>
Net Cash Provided By Investing Activities	<u>2,713,283</u>	<u>596,929</u>
Cash Flows From Financing Activities		
Proceeds from financing obligation payable	8,845,000	-
Repayment of financing obligation payable	(8,600,000)	-
Payments of financing costs	<u>(287,727)</u>	<u>(10,996)</u>
Net Cash Used By Financing Activities	<u>(42,727)</u>	<u>(10,996)</u>
Net increase (decrease) in cash and cash equivalents	(53,455)	641,770
Cash and cash equivalents, beginning of year	<u>1,207,847</u>	<u>566,077</u>
Cash and Cash Equivalents, End of Year	<u><u>\$1,154,392</u></u>	<u><u>\$1,207,847</u></u>
Supplemental Information		
Interest paid (bond issue and related interest swap)	<u>\$ 229,062</u>	<u>\$ 213,897</u>

See notes to financial statements.

SCHOOL OF AMERICAN BALLET, INC.**NOTES TO FINANCIAL STATEMENTS****AUGUST 31, 2016****Note 1 - Organization and Summary of Significant Accounting Policies****a - Organization**

The School of American Ballet, Inc. ("School") was founded in 1934 by George Balanchine and Lincoln Kirstein. It is incorporated in the State of New York as a not-for-profit institution. The School is the preeminent classical dance academy in the United States and is known both nationally and internationally for its professional training curriculum.

b - Cash and Cash Equivalents

The School considers all short-term highly liquid investments, such as money market funds and certificates of deposit with maturities of six months or less, to be cash equivalents, except for cash and short-term investments managed by the School as part of its long-term investment strategies.

c - Contributions and Unconditional Promises to Give

Contributions are recognized when the donor makes a promise to give to the School that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

The School uses the allowance method to determine uncollectible promises to give. The allowance is based on prior years' experience and management's analysis of specific promises made. No reserve for uncollectible amounts was required at August 31, 2016 or 2015.

d - Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets.

e - Investments

The School reflects investments at fair value in the statement of financial position. Interest, dividends and realized and unrealized gains and losses on investments are reflected in the statement of activities as increases and decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law. Investment income restricted by the donor is reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the income is recognized.

SCHOOL OF AMERICAN BALLET, INC.**NOTES TO FINANCIAL STATEMENTS****AUGUST 31, 2016****Note 1 - Organization and Summary of Significant Accounting Policies (continued)****e - Investments (continued)**

The fair values of investment funds and limited partnership investments not publicly traded on national security exchanges represent the School's pro rata interest in the net assets of each investment and are based on financial information determined and reported by investment managers, subject to review, evaluation, and adjustment by the management of the School or on the basis of other information developed, obtained, and evaluated periodically by the School. Because of inherent uncertainties in the valuation of certain alternative investments, those estimated fair values may differ significantly from the values that would have been used had a ready market for the investments existed.

f - Fair Value Measurements

Fair value is an estimate of the exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (i.e., the exit price at the measurement date). Fair value measurements are not adjusted for transaction costs. A fair value hierarchy prioritizes inputs to valuation techniques used to measure fair value into three levels.

Unadjusted quoted prices in active markets for identical assets or liabilities are referred to as Level 1 inputs. Inputs other than quoted market prices that are observable, either directly or indirectly, and reasonably available are referred to as Level 2 inputs. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the School. Unobservable inputs reflect the assumptions developed by the School based on available information about what market participants would use in valuing the asset or liability and are referred to as Level 3.

An asset or liability's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Availability of observable inputs can vary and is affected by a variety of factors. Establishing the value of Level 3 assets and liabilities involves greater judgment than Level 1 or Level 2 assets or liabilities.

g - Deferred Income

Deferred income includes tuition, room and board fees and other revenues relating to future periods and are recognized in the period the classes or other services take place.

SCHOOL OF AMERICAN BALLET, INC.**NOTES TO FINANCIAL STATEMENTS****AUGUST 31, 2016****Note 1 - Organization and Summary of Significant Accounting Policies (continued)****h - Capitalized Financing Costs**

The School incurred financing costs in connection with the long term financing obligation. These costs are included in financing obligation payable and are being amortized over the life of the obligation. Accumulated amortization was \$7,316 and \$122,118 at August 31, 2016 and 2015, respectively.

i - Financial Statement Presentation

The School reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

j - Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

k - Tax Status

The School is a not-for-profit corporation exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and has been designated as a corporation which is not a private foundation. Contributions to the School are tax deductible to contributors as provided by law.

l - Subsequent Events

The School has evaluated subsequent events through December 16, 2016, the date that the financial statements are considered available to be issued.

m - New Accounting Pronouncements

In May 2015, the FASB issued Accounting Standards Update ASU No. 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)* which amends disclosure requirements of Accounting Standards Codification Topic 820, Fair Value Measurement, for reporting entities that measure the fair value of an investment using the net asset value per share (or its equivalent) as a practical expedient. The amendments remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient, and also remove the requirements to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. The ASU is effective for the fiscal years beginning after December 15, 2016, with early application permitted. The School elected to adopt ASU 2015-07 as of August 31, 2016.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 1 - Organization and Summary of Significant Accounting Policies (continued)**m - New Accounting Pronouncements (continued)**

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ASU No. 2015-03, "*Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*". This amends previous pronouncements to require that debt issuance costs be presented as a reduction of the carrying amount of the debt rather than as an asset. In addition, the amortization of the debt issuance costs are to be reported as interest expense. The ASU is effective for the fiscal years beginning after December 15, 2015, with early application permitted. The School elected to adopt ASU 2015-03 as of August 31, 2016.

Note 2 - Net Assets

Net assets consist of the following:

	2016			2015	
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>	<u>Total</u>
Operating	\$ 11,544	\$1,268,007	\$ -	\$ 1,279,551	\$ 981,930
Board designated endowment	35,422,037	-	-	35,422,037	34,774,032
Operating reserve	730,526	-	-	730,526	1,681,956
Plant	9,846,228	-	-	9,846,228	9,953,746
Permanently donor restricted funds	(3,626,830)	777,712	35,069,981	32,220,863	30,861,175
Total 2016	<u>\$42,383,505</u>	<u>\$2,045,719</u>	<u>\$35,069,981</u>	<u>\$79,499,205</u>	
Total 2015	<u>\$43,030,516</u>	<u>\$1,873,721</u>	<u>\$33,348,602</u>		<u>\$78,252,839</u>

a - Board Designated

The School's Board of Directors has directed that certain unrestricted funds be treated as funds functioning as endowment to support the School's on-going programs and ensure its ability to meet future needs. Following the School's spending policy, as described in Notes 5 and 9, a portion of the income from the board designated endowment is applied to scholarships, faculty salaries and other operating expenses.

In addition, the School's Board has designated funds as an operating reserve, which provides for operating and capital contingencies.

As more fully described in Note 9, there is a deficiency in donor restricted endowment funds. This deficiency is currently offset by the board designated endowment.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 2 - Net Assets (continued)**b - Temporarily Restricted Net Assets**

Temporarily restricted net assets are restricted for the following:

	<u>2016</u>	<u>2015</u>
Future programs	\$1,024,103	\$ 756,944
Future periods	243,904	176,723
Accumulated endowment earnings	<u>777,712</u>	<u>940,054</u>
	<u>\$2,045,719</u>	<u>\$1,873,721</u>

c - Permanently Restricted

Permanently restricted net assets consist of donor restricted funds restricted for endowment.

Note 3 - Concentration of Credit Risk

The School maintains significant cash balances at two financial institutions, which at times exceed federally insured limits.

Note 4 - Unconditional Promises to Give

Unconditional promises to give are due as follows:

	<u>2016</u>				<u>2015</u>	
	<u>Unrestricted</u>		<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>	<u>Total</u>
	<u>General Operations</u>	<u>Board Designated</u>				
Due in less than one year	\$1,037,818	\$ 378,446	\$368,500	\$1,455,000	\$3,239,764	\$3,376,626
Due in one to five years	600,000	908,094	85,000	4,545,000	6,138,094	5,536,573
Less: Discount to present value	<u>(40,347)</u>	<u>(72,638)</u>	<u>(3,824)</u>	<u>(261,460)</u>	<u>(378,269)</u>	<u>(365,793)</u>
	<u>559,653</u>	<u>835,456</u>	<u>81,176</u>	<u>4,283,540</u>	<u>5,759,825</u>	<u>5,170,780</u>
Total 2016	<u>\$1,597,471</u>	<u>\$1,213,902</u>	<u>\$449,676</u>	<u>\$5,738,540</u>	<u>\$8,999,589</u>	
Total 2015	<u>\$1,035,340</u>	<u>\$ 403,526</u>	<u>\$686,564</u>	<u>\$6,421,976</u>		<u>\$8,547,406</u>

Unconditional promises to give due after one year have been discounted to net present value using a discount rate of 3% per annum.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 4 - Unconditional Promises to Give (continued)

During 2016, the School was approved for a grant of \$2,000,000 to be used to endow the Diversity Initiative to be matched one-half-to-one with newly received gifts of cash. The school has secured matching pledges of \$1,100,000. The grant will be recorded as support if and when payments from the matching gifts are received.

Note 5 - Investments

Investments are reflected at fair value and are summarized as follows:

	<u>2016</u>		<u>2015</u>	
	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>
Cash held for investment	\$ 1,841,780	\$ 1,841,780	\$ 5,516,364	\$ 5,516,364
Investment Funds				
Equity	34,782,245	35,606,522	33,052,563	36,037,832
Fixed income	7,486,315	7,435,692	7,313,145	7,442,691
Alternative Investments				
Hedge fund investments	16,540,457	15,431,673	15,001,752	13,387,667
Real estate	<u>882,072</u>	<u>910,103</u>	<u>1,001,881</u>	<u>1,072,676</u>
	<u>\$61,532,869</u>	<u>\$61,225,770</u>	<u>\$61,885,705</u>	<u>\$63,457,230</u>

Included in alternative investments are investment funds and limited partnerships which hold investments in domestic and international equities, debt securities and real estate. The operating activities of some of these limited partnerships and investment funds may involve trading, directly or indirectly, in derivative financial investments that involve varying degrees of market and credit risk.

The following summarizes the fair value of the investments measured at August 31:

	<u>2016</u>			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments Measured at Fair Value				
Cash held for investment	\$ 1,841,780	\$ 1,841,780	\$ -	\$ -
Investment Funds				
Equity	22,296,402	22,296,402	-	-
Fixed income	<u>5,707,304</u>	<u>5,707,304</u>	-	-
Total Assets in Fair Value Hierarchy	29,845,486	<u>\$29,845,486</u>	<u>\$ -</u>	<u>\$ -</u>
Investments measured at net asset value	<u>31,687,383</u>			
Total Investments	<u>\$61,532,869</u>			

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 5 - Investments (continued)

	2015			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments Measured at Fair Value				
Cash held for investment	\$ 5,516,364	\$ 5,516,364	\$ -	\$ -
Investment Funds				
Equity	21,614,709	21,614,709	-	-
Fixed income	<u>5,352,567</u>	<u>5,352,567</u>	-	-
Total Assets in Fair Value Hierarchy	32,483,640	<u>\$32,483,640</u>	<u>\$ -</u>	<u>\$ -</u>
Investments measured at net asset value	<u>29,402,065</u>			
Total Investments	<u>\$61,885,705</u>			

The alternative investments included in the School's investment portfolios are redeemable based upon the following terms and conditions at August 31, 2016:

Daily redemption	\$ 1,246,696
Monthly redemption	1,695,823
Quarterly redemption	10,581,258
Annual redemption	1,942,664
No opportunity for discretionary redemption	1,951,416
Investment redeemed - waiting for release	<u>4,672</u>
	<u>\$17,422,529</u>

Management estimates that the majority of the alternative investments for which there is no opportunity for discretionary redemption could be liquidated within five years.

The School recognizes transfers between levels of the fair value hierarchy on the date of the event or changes in circumstances that caused the transfer. There were no transfers to or from level 1.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 5 - Investments (continued)

The following summarizes investment return in the statement of activities as of August 31:

	<u>2016</u>	<u>2015</u>
Interest and dividends	\$ 676,621	\$ 769,649
Net realized gains	<u>323,027</u>	<u>4,705,316</u>
Investment Income	999,648	5,474,965
Net unrealized gains (losses) on investments	1,878,624	(8,933,550)
Direct investment expenses	<u>(400,254)</u>	<u>(334,939)</u>
Total Investment Return	<u>\$2,478,018</u>	<u>\$(3,793,524)</u>

The School's alternative investments are diversified across two basic investment strategies as follows:

Hedge Fund Investments

The School invests in a range of hedge fund strategies that encompass both direct fund investments as well as fund of funds investments. The underlying investments of this alternative asset category encompass a broad spectrum of strategies primarily involving marketable securities and with an ultimate objective of taking advantage of market mispricings to generate attractive risk-adjusted returns with limited market sensitivity. The mix of underlying investments includes event-driven strategies seeking to exploit mispricings driven by shorter term market events such as a merger, spinoff, corporate reorganization or transition. Underlying investments also include strategies seeking to benefit from providing capital to companies in distress, working through bankruptcy or requiring short term infusions of liquidity. Further, the hedge funds' strategies also incorporate long/short equity investments in which managers seek to generate returns on both long and short positions in marketable equities, thereby seeking equity-like returns with reduced volatility and greater downside protection.

Real Estate

The School invests in illiquid, limited partnership investments in real estate opportunities via funds of funds. The underlying partnerships invest in the debt and equity of real estate investments focused on the purchase and development, improvement, and management of residential, commercial and industrial real estate. Value added is sought through improvements in rental income and gains from the eventual property sales.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 6 - Constituency Agreements

- a - The School of American Ballet, Inc. is an official Constituent of Lincoln Center for the Performing Arts, Inc. ("Lincoln Center"). As a Constituent, the School remains independent but is entitled to representation on various Lincoln Center boards and councils and may use the Lincoln Center name. Lincoln Center, in turn, is allowed to name the School as a Constituent. The School participates in the Lincoln Center Corporate Fund drive. In fiscal years 2016 and 2015, the Corporate Fund drive paid \$129,113 for each year to the School for operating support and in return, the School solicited corporate contributions only for special purposes. In addition, during 2016 the School received \$53,037 from the Lincoln Center Alternative Investment Industry Gala.
- b - The School entered into an agreement (the "Agreement") with various institutions and Lincoln Center (the "Participants") whereby they participated in the construction of The Samuel B. and David Rose Building at Lincoln Center, which is owned by Lincoln Center, and used for educational, performing and residential purposes. Each Participant was responsible for its agreed-upon share of design and construction costs. The School occupies educational and residential space in the Rose Building under the terms of a proprietary lease with Lincoln Center. The initial lease term will expire on December 31, 2085 and may be renewed at the lessee's option for any number of 99-year terms. The monthly charges are based on the School's share of the costs to operate the completed facility.

Rose Building operating expenses for fiscal years 2016 and 2015 were \$2,298,753 and \$2,273,541, respectively. This amount is allocated to the appropriate departments to represent normal operating usage patterns partially based on cubic feet and partially based on additional building projects undertaken, relating directly to specific departments. The totals per department were:

	<u>2016</u>	<u>2015</u>
1) Teaching and other artistic programs	\$ 792,022	\$ 780,991
2) Student services and residence	1,202,107	1,192,169
3) General administration	142,158	140,178
4) Development	<u>162,466</u>	<u>160,203</u>
	<u>\$2,298,753</u>	<u>\$2,273,541</u>

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 7 - Property, Equipment and Land

Property, equipment and land consist of the following:

	<u>Life</u>	<u>2016</u>	<u>2015</u>
Furniture, equipment and computers	3-10 years	\$ 3,414,729	\$ 2,992,143
Capitalized construction costs:			
Interior costs	20 years	13,163,427	9,804,899
Core and shell costs	20-40 years	19,725,944	19,500,264
New studio construction costs	30 years	7,307,784	7,307,784
Building renovations in progress		<u>-</u>	<u>3,432,595</u>
		43,611,884	43,037,685
Less: Accumulated depreciation		<u>(26,663,136)</u>	<u>(25,557,040)</u>
		16,948,748	17,480,645
Land		<u>2,067,047</u>	<u>2,067,047</u>
		<u>\$19,015,795</u>	<u>\$19,547,692</u>

Total depreciation expense for the years ended August 31, 2016 and 2015 was \$1,134,601 and \$959,351, respectively.

In fiscal year 2016, the City of New York spent \$465,656 for capital appropriations relating to the School's locker room renovation. The City's investment of capital funding obligated the School to operate the facility and/or maintain equipment for the respective bonding term as a non-profit entity, open to and used and maintained for the benefit of the people of the City of New York for cultural, educational or artistic uses and/or related purposes approved by the City.

Note 8 - Financing Obligation

In 2016, the School refinanced bonds payable that had been issued in 2006 to finance construction of studios and other capital improvements. On March 3, 2016, The Trust for Cultural Resources of the City of New York (the "Trust") issued Revenue Bonds ("Bonds") in the amount of \$8,845,000. The bonds refinanced previously issued bonds by the Trust in the amount of \$8,600,000. The balance of the new bond proceeds were used for transaction costs. The Bonds were purchased by a bank and mature July 1, 2036. Interest is due monthly at a rate of 2.95% per annum. Bond interest expense for the year ended August 31, 2016 on the refinanced bonds was \$131,913. Interest expense for the year ended August 31, 2016 on the retired bonds was \$ 471.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 8 - Financing Obligation (continued)

The Bonds are secured with the School's assets except for those assets specifically limited by donor restriction or other agreement.

Simultaneous with redemption of the 2006 series, which bore interest at a variable rate, the School also terminated an associated swap agreement.

The financing obligation payable is reduced by deferred financing costs. At August 31, 2016 and 2015, the deferred financing costs have a balance of \$291,406 and \$304,518, net of accumulated amortization of \$7,316 and \$122,118, respectively. Amortization expense for the years ended August 31, 2016 and 2015 was \$14,948 and \$15,264, respectively.

At August 31, 2016 and 2015, the financing bond payables are as follows:

	<u>2016</u>	<u>2015</u>
Bond principal as issued	\$8,845,000	\$8,600,000
Deferred financing costs (net of amortization)	<u>(291,406)</u>	<u>(304,518)</u>
Financing Obligation Payable	<u>\$8,553,594</u>	<u>\$8,295,482</u>

Note 9 - Endowment Funds

The School's endowment consists of numerous individual funds established for a variety of purposes and includes both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. Endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Consistent with the New York Prudent Management of Institutional Funds Act ("NYPMIFA"), the School classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment and (b) the original value of subsequent gifts to the permanent endowment. In addition, certain gifts specify that realized and unrealized gains and losses be retained in permanently restricted net assets. The fair value of these gifts and accumulated realized and unrealized gains and losses were \$9,177,902 and \$8,903,107 at August 31, 2016 and 2015, respectively.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 9 - Endowment Funds (continued)

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 School.

The income earned on the permanently restricted net assets is used for the general operations of the School or the restricted purposes designated by the donor. Such restricted purposes include: scholarships, apprentice support, faculty chairs, Workshop performance, and the physical therapy program.

In accordance with NYPMIFA, the School considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (i) the duration and preservation of the endowment fund;
- (ii) the purposes of the School and the endowment fund;
- (iii) general economic conditions;
- (iv) the possible effect of inflation or deflation;
- (v) the expected total return from income and the appreciation of investments;
- (vi) other resources of the School;
- (vii) where appropriate and circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the School; and
- (viii) the investment policy of the School

The composition of the School's invested endowment funds, by type of fund and net asset classification, is summarized as follows:

	2016			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment funds	\$ (3,626,830)	\$777,712	\$29,161,867	\$26,312,749
Board designated endowment funds	<u>33,478,789</u>	-	-	<u>33,478,789</u>
Total Endowment Funds	<u>\$29,851,959</u>	<u>\$777,712</u>	<u>\$29,161,867</u>	<u>\$59,791,538</u>

	2015			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment funds	\$ (3,427,481)	\$940,054	\$26,926,626	\$24,439,199
Board designated endowment funds	<u>33,695,357</u>	-	-	<u>33,695,357</u>
Total Endowment Funds	<u>\$30,267,876</u>	<u>\$940,054</u>	<u>\$26,926,626</u>	<u>\$58,134,556</u>

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 9 - Endowment Funds (continued)

Changes in the School's invested endowment funds are summarized as follows:

	2016			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment funds, beginning of year	<u>\$30,267,876</u>	<u>\$940,054</u>	<u>\$26,926,626</u>	<u>\$58,134,556</u>
Investment Return:				
Investment income, net of fees and other expenses	175,081	184,438	(51,691)	307,828
Net appreciation (realized and unrealized)	<u>1,170,301</u>	<u>650,713</u>	<u>326,484</u>	<u>2,147,498</u>
Total Investment Return	<u>1,345,382</u>	<u>835,151</u>	<u>274,793</u>	<u>2,455,326</u>
Contributions, royalties and payments on pledges	<u>578,385</u>	-	<u>1,960,448</u>	<u>2,538,833</u>
Appropriation of endowment earnings for expenditure	<u>(1,938,808)</u>	<u>(997,493)</u>	-	<u>(2,936,301)</u>
Appropriation for campaign expenses	<u>(400,876)</u>	-	-	<u>(400,876)</u>
Endowment Funds, End of Year	<u>\$29,851,959</u>	<u>\$777,712</u>	<u>\$29,161,867</u>	<u>\$59,791,538</u>
	2015			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment funds, beginning of year	<u>\$33,614,125</u>	<u>\$2,601,713</u>	<u>\$26,068,601</u>	<u>\$62,284,439</u>
Investment Return:				
Investment income, net of fees and other expenses	243,976	218,670	(47,426)	415,220
Net depreciation (realized and unrealized)	<u>(2,338,577)</u>	<u>(671,917)</u>	<u>(958,489)</u>	<u>(3,968,983)</u>
Total Investment Return	<u>(2,094,601)</u>	<u>(453,247)</u>	<u>(1,005,915)</u>	<u>(3,553,763)</u>
Contributions, royalties and payments on pledges	<u>370,854</u>	-	<u>1,863,940</u>	<u>2,234,794</u>
Appropriation of endowment earnings for expenditure	<u>(1,622,502)</u>	<u>(1,208,412)</u>	-	<u>(2,830,914)</u>
Endowment Funds, End of Year	<u>\$30,267,876</u>	<u>\$ 940,054</u>	<u>\$26,926,626</u>	<u>\$58,134,556</u>

SCHOOL OF AMERICAN BALLET, INC.**NOTES TO FINANCIAL STATEMENTS****AUGUST 31, 2016****Note 9 - Endowment Funds (continued)**

The permanently restricted endowment is comprised of a significant number of donor funds. Some of these funds reflect an excess of earnings over appropriations, some reflect deficits of earnings over appropriations, and some have negative earnings because of unrealized losses allocated to the permanently restricted portion of the endowment fund.

The fair value of assets associated with individual donor restricted endowment funds may fall below the level required to be retained as a fund of perpetual duration. The net deficiencies of this nature were \$2,849,118 and \$2,487,427 at August 31, 2016 and 2015, respectively.

The School utilizes a Board-approved spending policy providing income for operations. It is calculated using a twenty-quarter average of the total market value of investments as of the last day of February of the preceding fiscal year. The School's draw of investment income for operations has been set by the School's Board of Directors at 5% based on this formula which is consistent with NYPMIFA guidelines. The Board approved the transfer to operations of \$2,936,301 in 2016 and \$2,830,914 in 2015.

The School has adopted investment and spending policies for endowment assets that endeavor to provide a stream of funding for the School's operations while seeking to preserve the purchasing power of the endowment's assets.

All of the School's investments are pooled to facilitate their management. The School manages its pooled investments on a total return basis. The School's investment guidelines anticipate allocation of funds across a number of asset classes. Dividends, interest and net realized and unrealized gains (losses) are allocated to the various funds.

Note 10 - Student Financial Aid

Of the combined tuition and room and board fees (Statement of Activities - Revenues and Support), approximately 35% and 36% represents financial aid in fiscal years 2016 and 2015, respectively.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 10 - Student Financial Aid (continued)

The School records the value of tuition and residence scholarships as revenue with a corresponding amount as financial aid expense as follows:

	<u>2016</u>	<u>2015</u>
Tuition	\$1,200,367	\$1,169,880
Room and board fees	<u>514,485</u>	<u>562,962</u>
	1,714,852	1,732,842
External academic expenses and other student aid	<u>348,650</u>	<u>290,776</u>
Total Financial Aid	<u>\$2,063,502</u>	<u>\$2,023,618</u>

Note 11 - Special Events

The following is a summary of the net income generated by fundraising benefits held in fiscal years 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Gross benefit income	\$2,472,132	\$2,799,835
Direct expenses	<u>(384,381)</u>	<u>(377,136)</u>
	2,087,751	2,422,699
Indirect expenses	<u>(252,285)</u>	<u>(269,553)</u>
Net Income from Benefits	<u>\$1,835,466</u>	<u>\$2,153,146</u>

Note 12 - Appropriations

Appropriations for the years ended August 31, 2016 and 2015 are as follows:

	<u>2016</u>			<u>2015</u>		
	<u>General Operations</u>	<u>Board Designated and Other</u>	<u>Plant</u>	<u>General Operations</u>	<u>Board Designated and Other</u>	<u>Plant</u>
Transfer for:						
Rose building plant improvement	\$ -	\$(218,400)	\$218,400	\$ -	\$(152,880)	\$152,880
Bond cost of issuance and swap termination	-	(133,030)	133,030	-	-	-
Board designated operating reserve	600,000	(600,000)	-	(105,000)	105,000	-
Financing obligation fees	<u>(294,464)</u>	<u>-</u>	<u>294,464</u>	<u>(291,365)</u>	<u>-</u>	<u>291,365</u>
	<u>\$305,536</u>	<u>\$(951,430)</u>	<u>\$645,894</u>	<u>\$(396,365)</u>	<u>\$ (47,880)</u>	<u>\$444,245</u>

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 13 - Retirement and Pension Plans

a - Retirement Plan

The School has a retirement plan established for all full-time staff members to which the School, after one year of service, contributes a discretionary amount on behalf of eligible employees toward the purchase of annuity contracts. The School's contributions vest to employees over a period of three years. The retirement plan expense amounted to \$217,856 and \$187,017 during fiscal years 2016 and 2015, respectively. These contributions were based on a contribution rate of 5% of each participant's regular annual compensation.

b - Union Pension Plan

The School contributes to a multiemployer defined benefit pension plan benefitting unionized employees. The School employs orchestra members generally for a week or less. This orchestra accompanies the School's annual workshop performance at the end of the Winter Term. Orchestra personnel are union represented under a collective-bargaining agreement. The risks of participating in this multiemployer plan are:

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

The School's participation in this plan is summarized below. The "EIN/Pension Plan Number" column provides the Employee Identification Number (EIN) and the three-digit plan number, if applicable. The most recent Pension Protection Act (PPA) zone status available in 2016 and 2015 is for the plan's year-end at March 31, 2016 and 2015, respectively. The zone status is based on information that the School received from the plan and 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 "FIP/RP Status Pending/Implemented" column indicates whether a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The last column lists the expiration date of the collective-bargaining agreement to which the plan is subject, as applicable.

SCHOOL OF AMERICAN BALLET, INC.

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2016

Note 13 - Retirement and Pension Plans (continued)

<u>Pension Fund</u>	<u>EIN/Pension Plan Number</u>	<u>Pension Protection Act Zone Status</u>		<u>FIP/RP Status Pending/ Implemented</u>	<u>Contributions of the School</u>		<u>Surcharge Imposed</u>	<u>Expiration Date of Collective Bargaining Agreement</u>
		<u>2016</u>	<u>2015</u>		<u>2016</u>	<u>2015</u>		
Associated Musicians of Greater New York Local 802, American Federation of Musicians AFL-CIO	51-6120204/001	Red	Red	Implemented	<u>\$6,619</u>	<u>\$10,614</u>	Yes	December 31, 2017

The School's contributions to this plan listed above are not greater than 5% of the total plan contributions.

Note 14 - Functional Allocation of Expenses

The cost of providing various programs and supporting services has been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and the supporting services in reasonable ratios determined by management.