

Consolidated Financial Statements and Report of
Independent Certified Public Accountants

The Philadelphia Orchestra Association

August 31, 2018 and 2017

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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We have audited the accompanying consolidated financial statements of The Philadelphia Orchestra Association and its wholly-owned subsidiary (collectively, the “Association”), which comprise the consolidated statements of financial position as of August 31, 2018 and 2017, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management’s responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Association’s preparation and fair presentation of the consolidated 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 Association’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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Philadelphia Orchestra Association and its wholly-owned subsidiary as of August 31, 2018 and 2017, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information contained in the schedules of changes in unrestricted net assets from operating activities for the years ended August 31, 2018 and 2017 and The Academy of Music of Philadelphia, Inc.'s statement of financial position and statement of activities as of and for the year ended August 31, 2018 are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Grant Thornton LLP

Philadelphia, Pennsylvania

February 5, 2019

The Philadelphia Orchestra Association

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

August 31,

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
ASSETS		
Cash and cash equivalents	\$ 12,997	\$ 12,844
Trade accounts receivable, net	1,051	1,982
Prepaid expenses and other assets	2,686	2,375
Pledges receivable, net	11,766	15,926
Notes receivable	259	24
Investments	113,590	109,805
Beneficial interests in trusts	5,917	5,615
Investment in joint venture	668	607
Property and equipment, net	<u>35,327</u>	<u>36,734</u>
 Total assets	 <u>\$ 184,261</u>	 <u>\$ 185,912</u>
 LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 538	\$ 688
Accrued expenses and other liabilities	1,124	1,416
Deferred revenue	6,862	7,448
Annuities payable	1,577	956
Accrued postretirement benefit obligation	<u>9,210</u>	<u>8,910</u>
 Total liabilities	 19,311	 19,418
 NET ASSETS		
Unrestricted	39,067	38,921
Temporarily restricted	14,424	18,274
Permanently restricted	<u>111,459</u>	<u>109,299</u>
 Total net assets	 <u>164,950</u>	 <u>166,494</u>
 Total liabilities and net assets	 <u>\$ 184,261</u>	 <u>\$ 185,912</u>

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended August 31, 2018

	Unrestricted	Temporarily restricted	Permanently restricted	Total
	(Dollars in thousands)			
PERFORMANCE REVENUE				
Philadelphia concerts	\$ 8,971	\$ -	\$ -	\$ 8,971
Summer concerts	1,818	-	-	1,818
Other concerts	3,680	-	-	3,680
Tours	1,304	-	-	1,304
Recording, radio and television	210	-	-	210
	<u>15,983</u>	<u>-</u>	<u>-</u>	<u>15,983</u>
PERFORMANCE EXPENSE				
Orchestra and concert production	35,410	-	-	35,410
Concert promotion expenses	2,455	-	-	2,455
Recording, radio and television	345	-	-	345
	<u>38,210</u>	<u>-</u>	<u>-</u>	<u>38,210</u>
PERFORMANCE DEFICIT	(22,227)	-	-	(22,227)
OTHER OPERATING REVENUE				
Annual public support	17,318	3,763	-	21,081
Volunteer project revenue	506	474	-	980
Spending policy draw, designated for current operations	7,554	-	-	7,554
Income from beneficial interests in trusts	231	-	-	231
Other revenues	2,104	-	-	2,104
Gifts in kind	9	11	-	20
Equity earnings in joint venture	206	-	-	206
Academy Ball revenue, net	147	-	-	147
Net assets released from restrictions	8,781	(8,781)	-	-
TOTAL OTHER OPERATING REVENUE	36,856	(4,533)	-	32,323
OTHER OPERATING EXPENSE				
Fundraising expenses				
Annual fundraising	2,002	-	-	2,002
Volunteer project	304	-	-	304
	<u>2,306</u>	<u>-</u>	<u>-</u>	<u>2,306</u>
Management and general				
Administrative expense	11,198	-	-	11,198
Global initiatives and government relations	523	-	-	523
Bad debt	169	-	9	178
Depreciation	383	-	-	383
TOTAL OTHER OPERATING EXPENSE	14,579	-	9	14,588
CHANGES IN NET ASSETS FROM OPERATING ACTIVITIES	50	(4,533)	(9)	(4,492)
NONOPERATING REVENUE (EXPENSE)				
Endowment contributions	-	-	1,700	1,700
Investment gain net of spending policy	42	724	157	923
Spending policy draw, designated for Academy of Music	777	-	-	777
Academy of Music revenue	4,049	383	-	4,432
Academy of Music expense, including depreciation of \$2,460	(5,137)	-	-	(5,137)
Funds with deficiencies	-	(312)	312	-
Net assets released from restrictions - Academy of Music	112	(112)	-	-
Change in postretirement benefit obligation	253	-	-	253
TOTAL NONOPERATING REVENUE	96	683	2,169	2,948
CHANGES IN NET ASSETS	146	(3,850)	2,160	(1,544)
NET ASSETS, BEGINNING	38,921	18,274	109,299	166,494
NET ASSETS, ENDING	\$ 39,067	\$ 14,424	\$ 111,459	\$ 164,950

The accompanying notes are an integral part of this consolidated financial statement.

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended August 31, 2017

	Unrestricted	Temporarily restricted	Permanently restricted	Total
	(Dollars in thousands)			
PERFORMANCE REVENUE				
Philadelphia concerts	\$ 9,262	\$ -	\$ -	\$ 9,262
Summer concerts	1,934	-	-	1,934
Other concerts	3,572	-	-	3,572
Tours	2,208	-	-	2,208
Recording, radio and television	210	-	-	210
	<u>17,186</u>	<u>-</u>	<u>-</u>	<u>17,186</u>
PERFORMANCE EXPENSE				
Orchestra and concert production	33,688	-	-	33,688
Concert promotion expenses	2,653	-	-	2,653
Recording, radio and television	355	-	-	355
	<u>36,696</u>	<u>-</u>	<u>-</u>	<u>36,696</u>
PERFORMANCE DEFICIT	(19,510)	-	-	(19,510)
OTHER OPERATING REVENUE				
Annual public support	18,367	9,975	-	28,342
Volunteer project revenue	529	446	-	975
Spending policy draw, designated for current operations	7,536	-	-	7,536
Income from beneficial interests in trusts	181	-	-	181
Other revenues	2,007	-	-	2,007
Gifts in kind	98	62	-	160
Equity earnings in joint venture	145	-	-	145
Academy Ball revenue, net	317	-	-	317
Net assets released from restrictions	4,537	(4,537)	-	-
TOTAL OTHER OPERATING REVENUE	33,717	5,946	-	39,663
OTHER OPERATING EXPENSE				
Fundraising expenses				
Annual fundraising	1,964	-	-	1,964
Volunteer project	383	-	-	383
	<u>2,347</u>	<u>-</u>	<u>-</u>	<u>2,347</u>
Management and general				
Administrative expense	10,242	-	-	10,242
Global initiatives and government relations	970	-	-	970
Bad debt	188	-	200	388
Depreciation	414	-	-	414
TOTAL OTHER OPERATING EXPENSE	14,161	-	200	14,361
CHANGES IN NET ASSETS FROM OPERATING ACTIVITIES	46	5,946	(200)	5,792
NONOPERATING REVENUE (EXPENSE)				
Endowment contributions	-	-	857	857
Investment gain net of spending policy	243	5,667	245	6,155
Spending policy draw, designated for Academy of Music	788	-	-	788
Academy of Music revenue	2,454	111	-	2,565
Academy of Music expense, including depreciation of \$2,416	(5,159)	-	-	(5,159)
Funds with deficiencies	-	(2,921)	2,921	-
Net assets released from restrictions - Academy of Music	118	(118)	-	-
Change in postretirement benefit obligation	816	-	-	816
TOTAL NONOPERATING (EXPENSE) REVENUE	(740)	2,739	4,023	6,022
CHANGES IN NET ASSETS	(694)	8,685	3,823	11,814
NET ASSETS, BEGINNING	39,615	9,589	105,476	154,680
NET ASSETS, ENDING	\$ 38,921	\$ 18,274	\$ 109,299	\$ 166,494

The accompanying notes are an integral part of this consolidated financial statement.

The Philadelphia Orchestra Association

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended August 31,

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Changes in net assets	\$ (1,544)	\$ 11,814
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities		
Depreciation	2,843	2,830
Provision for bad debt expense	143	451
Change in equity earnings in joint venture	(61)	29
Permanently restricted contributions received	(1,700)	(857)
Net realized and unrealized loss (gain) on investments	5,705	(10,268)
Change in beneficial interests in trusts	(302)	(269)
Change in postretirement benefit obligation	253	816
Changes in assets and liabilities		
Trade accounts receivable	931	(674)
Prepaid expenses and other assets	(311)	(497)
Pledges receivable	4,017	(4,076)
Accounts payable and accrued expenses	(442)	(829)
Deferred revenues	(586)	(122)
Annuities payable	621	(11)
Accrued postretirement benefit obligation	47	(907)
Net cash provided by (used in) operating activities	<u>9,614</u>	<u>(2,570)</u>
Cash flows from investing activities		
Purchases of investments	(10,983)	(8,859)
Proceeds from sales of investments	1,493	11,895
Purchase of property, plant and equipment	(1,436)	(679)
Loan disbursements to employees	(250)	-
Repayments of employee loans	15	21
Net cash (used in) provided by investing activities	<u>(11,161)</u>	<u>2,378</u>
Cash flows from financing activities		
Permanently restricted contributions received	1,700	857
Net cash provided by financing activities	<u>1,700</u>	<u>857</u>
Net increase in cash and cash equivalents	153	665
Cash and cash equivalents		
Beginning of year	<u>12,844</u>	<u>12,179</u>
End of year	<u>\$ 12,997</u>	<u>\$ 12,844</u>
Supplemental cash flow data		
Noncash investing activities		
Change in accrued construction expenses	<u>\$ 24</u>	<u>\$ (3)</u>

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2018 and 2017

NOTE A - NATURE OF OPERATIONS

1. Organization

These consolidated financial statements include the accounts of The Philadelphia Orchestra Association (the “Orchestra”) and its wholly-owned subordinate entity, The Academy of Music of Philadelphia, Inc. (the “Academy”) (collectively, the “Association”). All significant intercompany balances and transactions have been eliminated. The Academy was organized to operate, manage and maintain the Academy of Music, a concert hall. The Association has contracted with the Kimmel Center, Inc. (“KCI”), an unaffiliated organization, to manage the operations of the Academy. In addition, the Association has invested in a nonprofit joint venture which provides ticket sales and servicing operations for events held in the Academy of Music, Kimmel Center and other venues (“Ticket Philadelphia”). This venture is accounted for as an equity investment.

2. Definition of Operating Activities

The operations of the Orchestra, including all concerts, recording, and touring activities, are presented in the operating activities section of the consolidated statements of activities. Also included with operating activities are all Orchestra annual fundraising activities and investment income designated for operations.

Included in nonoperating revenue and expense are endowment contributions, investment income, net of spending policy and changes in postretirement benefit obligation. In addition, all activities of the Academy are included in nonoperating.

Operating results for activities such as concerts and other events that take place at the Academy of Music building under the auspices of KCI are not included in these financial statements as they are part of KCI’s operations. KCI leases the property of the Academy for a dollar per year through 2031. The lease contains various options to extend at current market rates through 2090.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Presentation

The consolidated financial statements of the Association have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). U.S. GAAP requires that net assets and revenues, gains, expenses and losses be classified as unrestricted, temporarily restricted or permanently restricted based on the existence or absence of donor-imposed restrictions as follows:

- Unrestricted - Net assets that are not subject to donor-imposed restrictions. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors. Approximately \$4,225,000 and \$4,183,000 of the Association’s unrestricted net assets as of August 31, 2018 and 2017, respectively, have been designated by the Board of Directors to function as endowment.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- Temporarily Restricted - Net assets whose use by the Association is subject to donor-imposed restrictions that can be fulfilled by actions of the Association pursuant to those restrictions or that expire by the passage of time. Temporarily restricted net assets consist primarily of contributions receivable and accumulated endowment gains which can be expended, but for which restrictions have not yet been met.
- Permanently Restricted - Net assets subject to donor-imposed restrictions that they be maintained permanently by the Association or are permanently maintained in the control of third-party trustees or administrators. Permanently restricted net assets are primarily comprised of original endowment gifts given to the Association by donors. Generally, the donors of these assets permit the Association to use all or part of the income on these assets.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are generally reported as decreases in unrestricted net assets. Expirations of donor-imposed restrictions that simultaneously increase one class of net assets and decrease another are reported as releases between the applicable classes of net assets.

2. Cash and Cash Equivalents

Cash and cash equivalents include short-term investments with original maturities of three months or less. The Association maintains cash accounts which, at times, may exceed federally insured limits. The Association has not experienced any losses from maintaining cash accounts in excess of federally insured limits. Management believes that it is not exposed to any significant credit risk on its cash accounts.

3. Trade Accounts Receivable

Trade accounts receivable are reported at their net realizable value and consist of performance-related receivables, royalties, Academy Ball program receivables and other amounts.

4. Investments

The Association records its investments at fair value. Debt securities, equity securities and mutual funds are valued at quoted market prices, except for certain alternative investments for which quoted market prices are not available. The estimated fair value of alternative investments is based upon net asset value ("NAV") as a practical expedient, which is provided by external investment managers as of August 31, 2018 and 2017. Because such investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Gains and losses on investments are determined using an average cost method for securities and the specific identification method for other investments. Gains and losses are based on the trade date for investments.

The principal objective of the Association's alternative investment selection is to enhance the risk-adjusted returns of the Association's total asset portfolio. The Association manages this investment exposure through a process of careful selection of experienced external fund managers, detailed initial due diligence, continuing periodic diligence and monitoring (including on-site visitations by an investment consultant engaged by the Association), limitation of exposure to any investment strategy or manager, and the employment of outside experts. At August 31, 2018 and 2017, the largest alternative investment exposure to any product and/or manager was 0.7% of total long-term investments, which reflected a real estate partnership investment.

Within the asset allocation category classified as alternative investments, a majority of the underlying investments were publicly traded stocks, debt instruments, preferred securities, and other instruments for which a ready market quote exists. The investments have been classified as alternative investments because the investment managers engaged by the Association to manage said investments may not be registered pursuant to the Investment Company Act of 1940 and because the investment instruments are limited partnerships.

5. Fair Value Measurements

The Association has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the hierarchy are described below:

- Level 1 Financial assets and liabilities whose values are based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2 Financial assets and liabilities whose values are based on one or more of the following:
 - 1. Quoted prices for similar assets or liabilities in active markets;
 - 2. Quoted prices for identical or similar assets or liabilities in non-active markets;
 - 3. Pricing models whose inputs are observable for substantially the full term of the asset or liability;
or
 - 4. Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability.
- Level 3 Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Association's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Both observable and unobservable inputs may be used to determine the fair value of positions that the Association has classified within the Level 3 category. As a result, the unrealized gains and losses for assets and liabilities within the Level 3 category may include changes in fair value that were attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in unobservable long-dated volatilities) inputs.

A review of the fair value hierarchy classifications is conducted on an annual basis. Changes in the type of inputs may result in a reclassification for certain financial assets or liabilities.

6. Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided based upon management's judgment, including such factors as prior collection history and type of receivable. The Association writes off receivables when they become uncollectible, and payments subsequently received on such receivables, if any, are credited to the allowance for doubtful accounts.

7. Pledges Receivable

Contributions received, including unconditional promises to give, are recognized as revenues when the donor's commitment has been received. Unconditional promises to give are recognized at the established present value of the future cash flows, net of allowances. Contributions, which are received subject to restrictions imposed by donors, are reported as either permanently restricted or temporarily restricted net assets in the accompanying consolidated financial statements. Contributions for which the restrictions expire with the passage of time or occurrence of specific events are classified as temporarily restricted. When the restriction expires with the passage of time or upon occurrence of the specified event, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions. Temporarily restricted funds expended in the fiscal year in which received are recorded as unrestricted. Conditional promises are recorded when donor conditions are substantially met. The Association had conditional promises of \$500,000 at August 31, 2018 which will be recorded when donor conditions are substantially met.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

8. Notes Receivable

The Association makes loans to members of the Orchestra for the purpose of acquiring instruments to be used when performing with the Orchestra. The Association makes individual loans for amounts up to \$15,000, which are non-interest-bearing for a maximum term of 5 years. The total outstanding amount of these loans must not exceed \$125,000. The Association also makes individual loans, which bear interest at the ten-year Treasury note rate plus 1% for amounts up to \$125,000 with a maximum term of 10 years. The ten-year Treasury note rate was 2.86% and 2.12% at August 31, 2018 and 2017, respectively. The total outstanding amount of these loans must not exceed \$500,000. In addition, during the year ended August 31, 2018, the Association provided a housing relocation loan to an officer in the amount of \$250,000. The loan is secured, interest bearing and is repayable over five years.

9. Property and Equipment, Net

Property and equipment, net is recorded at cost as of the date of acquisition or fair value as of the date of receipt in the case of gifts. Depreciation is recorded as an expense using the straight-line method over the estimated useful lives of the respective assets. The useful lives are as follows:

Office condominium, building and building improvements	30 years
Equipment and other	5-10 years
Office equipment	3-10 years

The cost and accumulated depreciation of property sold or retired is removed from the related asset, and accumulated depreciation amounts, and any resulting gain or loss, is recorded in the period of disposal.

Renewals and improvements, which extend the useful lives of assets, are capitalized at cost. Maintenance and repairs are included as expenses in the consolidated statements of activities.

Fine instruments have been recognized at their estimated fair value based upon appraisals or similar valuations at the date of acquisition or donation. Fine instruments are not depreciated. The aggregate carrying value of such assets at both August 31, 2018 and 2017 was approximately \$295,000.

10. Annuities Payable

Liabilities related to charitable gift annuities received by the Association are recorded at the present value of the future interest payments based on the donor's life expectancy. Amounts donated in excess of the liability are recorded as restricted donations in the consolidated statements of activities. The present value of the annuities, discounted at the respective rate under Internal Revenue Code ("IRC") Section 7520(a), is calculated at the time of the donation.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

11. Revenue Recognition

Revenues from concert, recording, touring and rental activities are recognized as earned using the accrual method of accounting. Revenue from sales of subscriptions and single tickets for the upcoming concert season is deferred until the performance of the related concerts. Revenues related to advertising for the annual Academy Ball fundraising event are deferred until earned.

12. Tax Status

Under provisions of the IRC, Section 501(c)(3), and the applicable income tax regulations of Pennsylvania, the Association is exempt from taxes on income other than unrelated business income.

The Association recognizes or derecognizes a tax position based on a “more likely than not” threshold. This applies to positions taken or expected to be taken in a tax return. The Association does not believe its consolidated financial statements include any material uncertain tax positions. Any interest and penalties, if applicable, would be recorded in administrative expenses.

13. Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and utilize assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. The most significant management estimates and assumptions relate to the determination of allowances for doubtful trade accounts, pledges and notes receivable, discounts on pledges receivable and annuities, alternative investment values, useful lives of fixed assets, assumptions related to the accrued benefit obligation, assumptions related to the annuities payable, and the reported fair values of certain of the Association’s assets and liabilities. Actual results could differ from those estimates.

14. Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for these goods and services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early application is permitted. An entity will apply the amendments in this update using either a full retrospective application, which applies the standard to each prior period presented, or under the modified retrospective application, in which an entity recognizes the cumulative effect of initially applying the new standard as an

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

adjustment to the opening balance sheet of retained earnings at the date of initial application. Revenue in periods presented before that date will continue to be reported under guidance in effect before the change. Due to the nature of its revenue sources, the Association believes that the standard will have minimal impact on its consolidated financial statements but continues to evaluate the impact of ASU 2014-09.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires that most leased assets be recognized on the balance sheet as assets and liabilities for the rights and obligations created by these leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2019. Early application is permitted. An entity is required to apply the amendments in ASU 2016-02 under the modified retrospective transition approach. This approach includes a number of optional practical expedients, which are described in the final standard. Under these practical expedients, an organization will continue to account for leases that commence before the effective date in accordance with current U.S. GAAP, unless the lease is modified. However, lessees are required to recognize on the balance sheet leased assets and liabilities for operating leases at each reporting date. The Association has determined that the impact of ASU 2016-02 will be minimal.

In August 2016, the FASB issued a new standard related to the presentation of financial statements of not-for-profit entities. This standard intends to make certain improvements to the current reporting requirements for not-for-profit entities including: (1) the presentation for two classes of net assets at the end of the period, rather than the currently required three classes, as well as the annual change in each of the two classes; (2) the removal of the requirement to present or disclose the indirect method (reconciliation) when using the direct method for the statement of cash flows; and (3) the requirement to provide various enhanced disclosures relating to various not-for-profit specific topics. The new standard is effective for annual financial statements beginning after December 15, 2017. The Association will comply with the new standard as required.

In August 2018, the FASB issued ASU 2018-08, *Not-for-profit Entities: Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, which intends to clarify and improve the scope and accounting guidance for contributions received and contributions made. The amendment provides (1) a framework for determining whether a transaction should be accounted for as a contribution or as an exchange transaction, including how to evaluate whether a resource provider is receiving commensurate value in an exchange transaction, and (2) guidance to assist entities in determining whether a contribution is either conditional or unconditional. Guidance applies to both recipients and resource providers. For contributions received, the new standard is effective for annual financial statements beginning after December 15, 2018. The Association does not anticipate that the adoption of ASU 2018-08 will have a significant effect on the consolidated financial statements.

15. Adoption of New Accounting Standard

In May 2015, the FASB issued ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)*, which modifies certain provisions of FASB Accounting Standards Codification (“ASC”) Topic 820, *Fair Value Measurements*. The new guidance eliminates an inconsistency in how items are categorized in the fair value hierarchy by excluding investments measured in the NAV practical expedient from classification within the hierarchy because it will result in differences between subtotals in the table and

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

specific line items on the statement of activities. The guidance is effective for fiscal years beginning after December 15, 2016. The adoption of this guidance only amended footnote disclosure requirements and did not have any impact on the Association's consolidated financial statements for the years ended August 31, 2018 and 2017.

Investments using NAV as fair value, and not a practical expedient for fair value, will still be listed in the fair value hierarchy; for example, investments where NAV per share is determined and published and the basis for current transactions is fair value.

The investments that fit under the new guidance are Level 3 investments previously listed in the fair value hierarchy. Because investments measured at NAV as a practical expedient will no longer be included in the fair value hierarchy, they will no longer appear in the associated disclosures, including the roll forward of Level 3 investments.

NOTE C - PLEDGES RECEIVABLE

Pledges receivable at August 31, 2018 and 2017 were expected to be collected as follows (in thousands):

	2018			
	Operating Fund	Academy of Music	Endowment Fund	Total
Due within				
One year	\$ 6,133	\$ 256	\$ 558	\$ 6,947
Two to five years	4,023	-	1,100	5,123
After five years	<u>-</u>	<u>-</u>	<u>68</u>	<u>68</u>
Total pledges receivable	10,156	256	1,726	12,138
Less allowance for uncollectible pledges	<u>(135)</u>	<u>(4)</u>	<u>(10)</u>	<u>(149)</u>
Subtotal	10,021	252	1,716	11,989
Less unamortized discount	<u>(145)</u>	<u>-</u>	<u>(78)</u>	<u>(223)</u>
Net present value of pledges receivable	<u>\$ 9,876</u>	<u>\$ 252</u>	<u>\$ 1,638</u>	<u>\$ 11,766</u>
Activity during year				
Balance, beginning of year	\$ 13,402	\$ 178	\$ 2,346	\$ 15,926
Cash received	(10,836)	(2,121)	(1,410)	(14,367)
New pledges received	7,225	2,158	612	9,995
Bad debt expense	(101)	37	(9)	(73)
Change in discount	<u>186</u>	<u>-</u>	<u>99</u>	<u>285</u>
Balance, end of year	<u>\$ 9,876</u>	<u>\$ 252</u>	<u>\$ 1,638</u>	<u>\$ 11,766</u>

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE C - PLEDGES RECEIVABLE - Continued

	2017			Total
	Operating Fund	Academy of Music	Endowment Fund	
Due within				
One year	\$ 7,921	\$ 228	\$ 668	\$ 8,817
Two to five years	5,931	-	1,614	7,545
After five years	<u>-</u>	<u>-</u>	<u>290</u>	<u>290</u>
Total pledges receivable	13,852	228	2,572	16,652
Less allowance for uncollectible pledges	<u>(120)</u>	<u>(50)</u>	<u>(50)</u>	<u>(220)</u>
Subtotal	13,732	178	2,522	16,432
Less unamortized discount	<u>(330)</u>	<u>-</u>	<u>(176)</u>	<u>(506)</u>
Net present value of pledges receivable	<u>\$ 13,402</u>	<u>\$ 178</u>	<u>\$ 2,346</u>	<u>\$ 15,926</u>
Activity during year				
Balance, beginning of year	\$ 9,287	\$ 190	\$ 2,824	\$ 12,301
Cash received	(11,271)	(766)	(692)	(12,729)
New pledges received	15,843	818	375	17,036
Bad debt expense	(188)	(64)	(200)	(452)
Change in discount	<u>(269)</u>	<u>-</u>	<u>39</u>	<u>(230)</u>
Balance, end of year	<u>\$ 13,402</u>	<u>\$ 178</u>	<u>\$ 2,346</u>	<u>\$ 15,926</u>

The Association used rates ranging from 1% - 5% to discount pledges receivable for the years ended August 31, 2018 and 2017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE D - INVESTMENTS

At August 31, 2018 and 2017, the fair value of investments was as follows (in thousands):

	2018		2017	
	Fair value	Cost	Fair value	Cost
Cash and cash equivalents	\$ 5,774	\$ 5,774	\$ 3,331	\$ 3,331
Mutual funds				
Fixed income	1,033	1,057	888	894
Inflation hedges	43	44	45	44
Equities	<u>105,924</u>	<u>104,381</u>	<u>104,394</u>	<u>97,434</u>
Total mutual funds	<u>107,000</u>	<u>105,482</u>	<u>105,327</u>	<u>98,372</u>
Alternative investments				
Limited partnerships - real estate	798	3,189	1,126	3,172
Multi-strategy/absolute return	<u>18</u>	<u>2</u>	<u>21</u>	<u>3</u>
Total alternative investments	<u>816</u>	<u>3,191</u>	<u>1,147</u>	<u>3,175</u>
Total fair value of investments	<u>\$ 113,590</u>	<u>\$ 114,447</u>	<u>\$ 109,805</u>	<u>\$ 104,878</u>

The above amounts include approximately \$21,032,000 and \$20,842,000 of endowment funds for the benefit of the Academy of Music at August 31, 2018 and 2017, respectively.

The accompanying consolidated financial statements also include assets held in trust that are under the control of outside trustees. The fair value of the investments held in the trusts was approximately \$5,917,000 and \$5,615,000 on August 31, 2018 and 2017, respectively.

Components of investment return for the year ended August 31, 2018 were as follows (in thousands):

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Net realized (losses) gains	\$ (1)	\$ 164	\$ -	\$ 163
Change in unrealized gains and losses	<u>(287)</u>	<u>(5,604)</u>	<u>302</u>	<u>(5,589)</u>
	(288)	(5,440)	302	(5,426)
Change in charitable gift annuity	-	-	(145)	(145)
Dividends and interest received	<u>490</u>	<u>11,765</u>	<u>-</u>	<u>12,255</u>
Total	<u>\$ 202</u>	<u>\$ 6,325</u>	<u>\$ 157</u>	<u>\$ 6,684</u>

The change in unrealized gains and losses is net of investment expenses of approximately \$131,000.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE D - INVESTMENTS - Continued

Components of investment return for the year ended August 31, 2017 were as follows (in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net realized gains	\$ 48	\$ 1,314	\$ -	\$ 1,362
Change in unrealized gains and losses	<u>317</u>	<u>8,589</u>	<u>269</u>	<u>9,175</u>
	365	9,903	269	10,537
Change in charitable gift annuity	-	-	(24)	(24)
Dividends and interest received	<u>30</u>	<u>1,326</u>	<u>-</u>	<u>1,356</u>
Total	<u>\$ 395</u>	<u>\$ 11,229</u>	<u>\$ 245</u>	<u>\$ 11,869</u>

The change in unrealized gains and losses is net of investment expenses of approximately \$121,000.

Certain of the Orchestra's investments are valued using NAV (or its equivalent unit) as a practical expedient of fair value. This applies to investments i) which do not have a readily determinable fair value, and ii) the financial statements of which were prepared by the respective investment managers in a manner consistent with the measurement principles applied in the preparation of the financial statements of the investment company. Investments that are valued using NAV per share (or its equivalent unit) are not required to be categorized within the fair value hierarchy.

The following tables present information about the Association's assets measured at fair value on a recurring basis, as described in Note B.5, as of August 31, 2018 and 2017 and indicate the fair value hierarchy of the valuation techniques utilized by the Association to determine such fair value (in thousands):

<u>Description</u>	<u>Assets at fair value at August 31, 2018</u>				<u>Total</u>
	<u>Quoted prices in active markets (Level 1)</u>	<u>Significant other observable inputs (Level 2)</u>	<u>Significant unobservable inputs (Level 3)</u>	<u>Investments valued at NAV as a practical expedient</u>	
Cash surrender value of life insurance	\$ -	\$ 6	\$ -	\$ -	\$ 6
Investments					
Cash and cash equivalents	5,774	-	-	-	5,774
Mutual funds - fixed income	983	50	-	-	1,033
Mutual funds - inflation hedges	43	-	-	-	43
Mutual funds - equities	27,895	78,029	-	-	105,924
Limited partnerships - real estate	-	-	-	798	798
Multi-strategy/absolute return	<u>-</u>	<u>-</u>	<u>-</u>	<u>18</u>	<u>18</u>
Total investments	34,695	78,079	-	816	113,590
Beneficial interests in trusts	<u>-</u>	<u>-</u>	<u>5,917</u>	<u>-</u>	<u>5,917</u>
Total recurring financial assets	<u>\$ 34,695</u>	<u>\$ 78,085</u>	<u>\$ 5,917</u>	<u>\$ 816</u>	<u>\$ 119,513</u>

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE D - INVESTMENTS - Continued

Description	Assets at fair value at August 31, 2017				Total
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Investments valued at NAV as a practical expedient	
Cash surrender value of life insurance	\$ -	\$ 6	\$ -	\$ -	\$ 6
Investments					
Cash and cash equivalents	3,331	-	-	-	3,331
Mutual funds - fixed income	553	335	-	-	888
Mutual funds - inflation hedges	45	-	-	-	45
Mutual funds - equities	23,185	81,209	-	-	104,394
Limited partnerships - real estate	-	-	-	1,126	1,126
Multi-strategy/absolute return	-	-	-	21	21
Total investments	27,114	81,544	-	1,147	109,805
Beneficial interests in trusts	-	-	5,615	-	5,615
Total recurring financial assets	\$ 27,114	\$ 81,550	\$ 5,615	\$ 1,147	\$ 115,426

The following table presents additional information about assets measured at fair value on a recurring basis and for which the Association has utilized Level 3 inputs to determine fair value for the years ended August 31, 2018 and 2017 (in thousands):

	Beneficial interests in trusts	
	2018	2017
Balance, beginning of year	\$ 5,615	\$ 5,346
Unrealized gains	302	269
Balance, end of year	\$ 5,917	\$ 5,615

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

In reference to the investments and other financial instruments held by the Association, the following provides a brief description of the types of financial instruments, the methodology for estimating fair value, and the level within the hierarchy of the estimate.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE D - INVESTMENTS - Continued

The following are financial assets that are valued on a recurring basis:

1. Cash Surrender Value of Life Insurance

From time to time, the Orchestra receives gifts of life insurance policies (the “gifted policies”), wherein the Orchestra is both an owner as well as a named beneficiary. The cash surrender value of gifted policies are valued at the cash value quoted by the insurance carrier, which is generally a function of policy premiums paid and dividends declared. The Association considers this a market approach. These financial instruments are considered to be Level 2 in the fair value hierarchy.

2. Investments

Cash and Cash Equivalents: Cash and cash equivalents include short-term, highly liquid investments with a maturity of three months or less at the time of purchase. Cash and cash equivalents are reported using a market approach. These financial instruments are considered to be Level 1 in the fair value hierarchy.

Mutual Funds - Fixed Income: Mutual funds (open to the general public with quoted prices in active markets) investing in high yielding, non-investment grade publicly traded fixed income securities with quoted prices in active markets. Fixed income mutual funds are valued using a market approach. These financial instruments are considered to be Level 1 and Level 2 in the fair value hierarchy.

Mutual Funds - Inflation Hedges: Mutual funds (open to the general public with quoted prices in active markets) investing in a combination of commodity-linked derivative instruments (such as commodity-linked notes) and fixed income securities, index funds which measure the performance of inflation-protected public obligations of the U.S. Treasury otherwise known as “TIPS” and in funds that invest at least 80% of their assets in inflation-indexed bonds issued by the U.S. Government, its agencies and instrumentalities, and corporations. These financial instruments, valued using the market approach, are considered to be valued using a market approach with Level 1 inputs in the fair value hierarchy.

Mutual Funds - Equities: Mutual funds (open to the general public with quoted prices in active markets) investing in domestic and/or foreign equity securities with quoted prices in active markets. Equity mutual funds are valued using a market approach. These financial instruments are considered to be Level 1 and Level 2 in the fair value hierarchy.

Limited Partnerships: As a “fund-of-funds,” the partnership’s investments consist of underlying funds that invest in office, apartment, retail, industrial or other commercial real estate, or in real estate-related securities within the U.S., Europe, and Asia. These partnerships are valued at net asset values as determined by the fund managers. These financial instruments are valued using NAV per share (or its equivalent unit).

3. Beneficial Interests in Trusts

The underlying investments of the trust include: money market funds, equity securities, fixed income securities, and mortgage securities. The interest in the trust is valued using a market approach. These financial instruments are considered to be Level 3 in the fair value hierarchy.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE D - INVESTMENTS - Continued

Fair Value Measurements of Investments That Calculate Net Asset Value per Share

Fair value measurements of investments in certain entities that calculate NAV as of August 31, 2018 and 2017 are as follows (in thousands):

	<u>Fair value</u>		<u>Unfunded commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
	<u>2018</u>	<u>2017</u>			
Limited partnerships ^(a)	\$ 798	\$ 1,126	\$ 315	(a)	(a)
Multi-strategy/absolute return	18	21	-	-	-
Short-term fixed income ^(b)	50	335	-	Daily	Daily
Multi-asset ^(c)	<u>78,029</u>	<u>81,209</u>	<u>-</u>	Daily	Daily
	<u>\$ 78,895</u>	<u>\$ 82,691</u>	<u>\$ 315</u>		

(a) Limited Partnerships - Metropolitan Real Estate Partners Global II (“MREP II”) was formed on November 19, 2007. This fund is a Delaware limited partnership that invests in certain private real estate funds; these funds invest primarily in office, apartment, industrial or other commercial real estate, or in real estate securities. The fair values have been estimated using the NAV per share of the investments. The partnerships will end on the later of 1) December 31, 2015, or 2) the time it takes to reasonably wind down the affairs of the partnerships after the partnership assets have been liquidated.

(b) The Short-Term Fund of The Investment Fund for Foundations (“TIFF”) - The Short-Term Fund is a registered mutual fund. The fund invests principally in securities issued by the U.S. Government, its agencies, or its instrumentalities and typically maintains an overall quality rating of AAA by Standard & Poor’s Corporation (or deemed equivalent). The Association is able to redeem full and fractional shares in TIFF’s Short-Term Fund on any business day.

(c) The Multi-Asset Fund of TIFF - The Multi-Asset Fund is a registered mutual fund. Its investment objective is to achieve a total return (price appreciation plus dividends) that, over a majority of market cycles, exceeds inflation, as measured by the Consumer Price Index (“CPI”) plus 5% per annum. The fund’s strategy is to invest in a comprehensive asset allocation that includes cash, global stocks, fixed income securities and high yield bonds, inflation hedges, including commodities and REITs, and all-purpose hedges, including inflation-linked bonds. The Association is able to redeem full and fractional shares of the fund on any business day.

NOTE E - ENDOWMENTS

As required by U.S. GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE E - ENDOWMENTS - Continued

The Association's endowment consists of a portfolio of actively managed funds established to provide both a source of operating funds as well as long-term financial stability. The endowment includes donor-restricted endowment funds and endowment funds designated by the Board of Trustees to function as quasi-endowments, held in investments, plus the following where the assets have been designated for endowment: pledges receivable, split-interest agreements, accounts payable related to endowment and other net assets.

1. Interpretation of Relevant Law

The Board of Trustees of the Association follows the interpretation of Commonwealth of Pennsylvania Act 141 as requiring the preservation of the original gift as a fund of permanent duration as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary, except as described in Note E.2 below. As a result of this interpretation, the Association classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets and is regarded as "net appreciation" is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Association in a manner consistent with the Association's spending policy.

2. Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the "historic dollar value." Deficiencies of this nature are reported by a charge to permanently restricted net assets and a corresponding increase to temporarily restricted net assets. These charges totaled approximately \$-0- and \$312,000 as of August 31, 2018 and 2017, respectively. These deficiencies may result from unfavorable market fluctuations that occur shortly after the investment of new permanently restricted contributions. Over time, these may reverse due to appreciation of the underlying investments.

3. Endowment Investment Guidelines

The Association's Investment Guidelines are to invest the Association's endowment assets in a generally accepted prudential manner and produce an average annual total return on investments over a five-year period of at least the sum of the spending formula distribution rate plus the direct cost of investing these funds (investment advisor, brokerage, investment manager, custodial fees, etc.) plus the current rate of inflation as measured by the U.S. Department of Labor's Consumer Price Index. The Investment and Endowment Committee of the Board of Trustees is responsible for the oversight of the Association's endowment and pension assets.

The intent of the guidelines is to provide a predictable stream of funding to the Association's programs from its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Association must hold in perpetuity, board-designated funds, plus the following assets which have been designated for endowment: pledges receivable, split-interest agreements and other assets.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE E - ENDOWMENTS - Continued

4. Endowment Spending Policy

The Association determines its spending policy on an annual basis. As approved by the Investment and Endowment Committee and in accordance with Commonwealth of Pennsylvania Act 141 ("PA Act 141"), the amount is calculated based on the average of the preceding thirteen quarter unit values for each endowment pool multiplied by the average number of units for the preceding twelve months. The approved spending percentage is applied to each pool and, pursuant to PA Act 141, shall not be less than 2.0% or more than 7.0%. The Board has approved a spending percentage of 5.5% for fiscal years 2018 and 2017. This policy is applied to all endowments absent donor stipulations to the contrary.

The Association has an endowment agreement with the Annenberg Foundation (the "Foundation") for capital improvements to the Academy of Music, which caps the spending rate at 5.5% annually.

The Association has a separate endowment agreement with the Foundation for Orchestra activities, which also caps the spending rate at 5.5% after June 30, 2008. The Association applied a 5.5% spending rate in fiscal years 2018 and 2017 to these and all other endowment pools.

5. Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Association relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Management of the investments is provided on a fully discretionary basis by competent external money management firms selected by the Investment and Endowment Committee with the guidance of third-party investment advisors. Different investment managers have been employed over the years and have included a wide range of investments, including alternative strategies. The rationale for including alternative strategy managers for the Association's portfolio is to reduce some volatility, consistent with a goal of generating absolute return.

The Association has adopted an endowment spending policy which designates a portion of the cumulative investment return for support of current operations. The remainder is retained to support operations of future years and to offset potential market declines and is classified within temporarily restricted net assets. This policy provides for spending a percentage of the average market value of the funds (as of August 31) for the prior thirteen quarters immediately preceding the fiscal year. Commonwealth of Pennsylvania law permits organizations to allocate to income each year a portion of permanently restricted investment net gains under a total return spending rate policy. The Association authorized a spending rate of 5.5% for fiscal years 2018 and 2017 for both its unrestricted and permanently restricted endowment investments unless the donor agreement differs.

The spending amount calculated on the Academy's endowment that is transferred to the Orchestra is capped at 12.4% of the value of the rent agreement with KCI, which amounted to approximately \$238,000 and \$216,000 at August 31, 2018 and 2017, respectively.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE E - ENDOWMENTS - Continued

To the extent that actual income from permanently restricted investments is less than the predetermined amount, accumulated gains are made available for operations to fund the difference. For financial statement purposes, any excess accumulated gains or accumulated losses are recorded as temporarily restricted net assets. When accumulated gains are less than the calculated spending rate, funds are made available from permanently restricted net assets. Investment return in excess of or less than the spending distribution is reported as a component of nonoperating revenue.

For unrestricted endowment, investment return in excess of or less than the spending distribution is reported as a component of nonoperating revenue.

6. Endowment Fund Activity

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
	(in thousands)			
<u>August 31, 2018</u>				
Donor-restricted endowment funds	\$ -	\$ 3,414	\$ 111,459	\$ 114,873
Board-designated funds	<u>4,225</u>	<u>-</u>	<u>-</u>	<u>4,225</u>
	<u>\$ 4,225</u>	<u>\$ 3,414</u>	<u>\$ 111,459</u>	<u>\$ 119,098</u>
<u>September 1, 2017</u>				
Net assets, beginning of year	\$ 4,183	\$ 3,004	\$ 109,299	\$ 116,486
Investment return				
Investment income	490	11,765	-	12,255
Net realized (losses) gains	(1)	164	-	163
Net unrealized (losses) gains	<u>(287)</u>	<u>(5,604)</u>	<u>302</u>	<u>(5,589)</u>
Net investment gains	202	6,325	302	6,829
Contributions	-	-	1,700	1,700
Appropriation of endowment assets for operations (draw)	(160)	(5,603)	-	(5,763)
Other changes				
Change in estimate for annuities payable	-	-	(145)	(145)
Provision for bad debt on contributions receivable	-	-	(9)	(9)
Deficiencies in historical values	<u>-</u>	<u>(312)</u>	<u>312</u>	<u>-</u>
Total other changes	<u>-</u>	<u>(312)</u>	<u>158</u>	<u>(154)</u>
Net assets, end of year	<u>\$ 4,225</u>	<u>\$ 3,414</u>	<u>\$ 111,459</u>	<u>\$ 119,098</u>

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE E - ENDOWMENTS - Continued

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
	(in thousands)			
<u>August 31, 2017</u>				
Donor-restricted endowment funds	\$ -	\$ 3,004	\$ 109,299	\$ 112,303
Board-designated funds	<u>4,183</u>	<u>-</u>	<u>-</u>	<u>4,183</u>
	<u>\$ 4,183</u>	<u>\$ 3,004</u>	<u>\$ 109,299</u>	<u>\$ 116,486</u>
<u>September 1, 2016</u>				
Net assets, beginning of year	\$ 3,939	\$ 258	\$ 105,476	\$ 109,673
Investment return				
Investment income	30	1,326	-	1,356
Net realized gains	48	1,314	-	1,362
Net unrealized gains	<u>317</u>	<u>8,589</u>	<u>269</u>	<u>9,175</u>
Net investment gains	395	11,229	269	11,893
Contributions	-	-	857	857
Appropriation of endowment assets for operations (draw)	(151)	(5,562)	-	(5,713)
Other changes				
Change in estimate for annuities payable	-	-	(24)	(24)
Provision for bad debt on contributions receivable	-	-	(200)	(200)
Deficiencies in historical values	<u>-</u>	<u>(2,921)</u>	<u>2,921</u>	<u>-</u>
Total other changes	<u>-</u>	<u>(2,921)</u>	<u>2,697</u>	<u>(224)</u>
Net assets, end of year	<u>\$ 4,183</u>	<u>\$ 3,004</u>	<u>\$ 109,299</u>	<u>\$ 116,486</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE F - ENDOWMENT ASSETS HELD BY OTHERS

The Association is the beneficiary of a number of irrevocable perpetual trusts held by third parties. The Association records the fair value of its interest in these trusts at approximately \$5,917,000 at August 31, 2018 and \$5,615,000 at August 31, 2017 in the accompanying consolidated statements of financial position. Distributions received from these trusts (approximately \$231,000 and \$181,000 in 2018 and 2017, respectively) are reported in the consolidated statements of activities. Changes in fair value of the trusts are reported as increases or decreases in permanently restricted net assets.

The Association also is the beneficiary of a grant from the Foundation contributed in 2003. This grant is restricted to establish funds for Education, Touring, Media & Technology and Artistic Endeavors. During 2012, the Foundation and the Association collaborated on a new trust agreement to redefine the parameters and reiterate the restrictions on those endowment funds, which provided for the transfer of these grant assets to The Northern Trust Company, as trustee, for the continued use and benefit of the Association, on terms and conditions set forth in the Trust Agreement. The Trust Agreement contains conditional terms that preclude the Association from recording these assets on the consolidated statement of financial position as either investments or beneficial interest in trust. A spending rate of 5.5% was applied for fiscal years 2018 and 2017. This draw from the Annenberg Endowment funds amounted to approximately \$2,574,000 for 2018 and \$2,614,000 for 2017 and is included in spending policy draw, designated for current operations in the consolidated statements of activities. The fair value of the Foundation assets held by The Northern Trust Company was approximately \$50,366,000 for August 31, 2018 and \$49,227,000 at August 31, 2017.

NOTE G - PROPERTY AND EQUIPMENT

The components of property and equipment at August 31, 2018 and 2017 were as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Philadelphia Orchestra		
Office condominium	\$ 1,590	\$ 1,554
Building improvements	591	587
Equipment and other	7,600	6,962
Fine instruments	295	295
Construction in progress	<u>-</u>	<u>47</u>
Total	10,076	9,445
Less accumulated depreciation	<u>(6,356)</u>	<u>(5,973)</u>
Total Philadelphia Orchestra	<u>3,720</u>	<u>3,472</u>

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE G - PROPERTY AND EQUIPMENT - Continued

	<u>2018</u>	<u>2017</u>
Academy of Music		
Land	\$ 630	\$ 630
Building and building improvements	81,845	81,023
Office equipment	995	995
Construction in progress	<u>-</u>	<u>17</u>
Total	83,470	82,665
Less accumulated depreciation	<u>(51,863)</u>	<u>(49,403)</u>
Total Academy of Music	<u>31,607</u>	<u>33,262</u>
Total property and equipment, net	<u>\$ 35,327</u>	<u>\$ 36,734</u>

Depreciation expense related to the Philadelphia Orchestra was approximately \$383,000 and \$414,000 for the years ended August 31, 2018 and 2017, respectively. Depreciation expense related to the Academy of Music is reflected in the Academy of Music expense on the consolidated statements of activities in the amount of approximately \$2,460,000 and \$2,416,000 for the years ended August 31, 2018 and 2017, respectively.

NOTE H - POSTRETIREMENT BENEFIT OBLIGATION

The Association provides its employees with postretirement health care and, for former employees of the Academy who were union members, severance pay based on the number of years of employment.

Postretirement health insurance is provided to Association employees who retire generally with 10 years of service after age 50 for musicians and age 55 for staff. Postretirement health insurance is provided to former Academy employees who are members of the International Association of Theatrical Stage Employees Union, generally for employees who retire after age 62 and with 30 years of service. Premiums to be paid by the Association for these benefits are generally limited to \$2,000 per year for musicians and \$1,600 per year for all others.

The Academy also provides a severance benefit based on years of employment to retiring unionized box office employees, ranging up to 15 or 20 years of service or amount of severance. At August 31, 2018 and 2017, the total severance pay benefit obligation was approximately \$93,000 and \$90,000, respectively.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE H - POSTRETIREMENT BENEFIT OBLIGATION - Continued

The Association's actuary has performed the computations for the postretirement health care obligation as of August 31, 2018 and 2017. Other changes recognized in other comprehensive income shown in the following tables is presented on the consolidated statements of activities in nonoperating revenue (expense) as "change in postretirement benefit obligation." The calculation is as follows (in thousands):

	2018			
	Postretirement Plans			Total
	Orchestra	Admin	Academy	
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 8,445	\$ 398	\$ 67	\$ 8,910
Service cost	283	-	-	283
Interest cost	336	15	3	354
Actuarial (gain) loss	(129)	7	7	(115)
Benefits paid	<u>(183)</u>	<u>(32)</u>	<u>(7)</u>	<u>(222)</u>
Benefit obligation at end of year	<u>8,752</u>	<u>388</u>	<u>70</u>	<u>9,210</u>
Change in plan assets				
Fair value of plan assets at beginning of year	-	-	-	-
Contributions by the Association	183	32	7	222
Benefits paid	<u>(183)</u>	<u>(32)</u>	<u>(7)</u>	<u>(222)</u>
Fair value of plan assets at end of year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Funded status at year-end	<u>\$ (8,752)</u>	<u>\$ (388)</u>	<u>\$ (70)</u>	<u>\$ (9,210)</u>
Net amounts recognized in the consolidated statement of financial position consist of:				
Accrued postretirement benefit obligation	<u>\$ (8,752)</u>	<u>\$ (388)</u>	<u>\$ (70)</u>	<u>\$ (9,210)</u>
Amounts recognized in net assets but not yet recognized in net periodic benefit costs consist of:				
Accumulated (loss) gain	\$ (1,258)	\$ 163	\$ 18	\$ (1,077)
Cumulative employer contributions in excess of net periodic benefit cost	<u>(7,494)</u>	<u>(551)</u>	<u>(88)</u>	<u>(8,133)</u>
	<u>\$ (8,752)</u>	<u>\$ (388)</u>	<u>\$ (70)</u>	<u>\$ (9,210)</u>
Components of net periodic benefit cost				
Service cost	\$ 283	\$ -	\$ -	\$ 283
Interest cost	336	15	3	354
Actuarial loss (gain)	<u>155</u>	<u>(16)</u>	<u>(1)</u>	<u>138</u>
Net periodic benefit cost	<u>\$ 774</u>	<u>\$ (1)</u>	<u>\$ 2</u>	<u>\$ 775</u>
Other changes recognized in other comprehensive income				
Net (gain) loss arising during period	\$ (129)	\$ 7	\$ 7	\$ (115)
Actuarial (loss) gain	<u>(155)</u>	<u>16</u>	<u>1</u>	<u>(138)</u>
Total recognized in other comprehensive income	<u>\$ (284)</u>	<u>\$ 23</u>	<u>\$ 8</u>	<u>\$ (253)</u>

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE H - POSTRETIREMENT BENEFIT OBLIGATION - Continued

	2017			
	Postretirement Plans			
	Orchestra	Admin	Academy	Total
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 8,501	\$ 429	\$ 71	\$ 9,001
Service cost	370	-	-	370
Interest cost	315	16	3	334
Actuarial gain	(586)	(20)	(2)	(608)
Benefits paid	<u>(155)</u>	<u>(27)</u>	<u>(5)</u>	<u>(187)</u>
Benefit obligation at end of year	<u>8,445</u>	<u>398</u>	<u>67</u>	<u>8,910</u>
Change in plan assets				
Fair value of plan assets at beginning of year	-	-	-	-
Contributions by the Association	155	27	5	187
Benefits paid	<u>(155)</u>	<u>(27)</u>	<u>(5)</u>	<u>(187)</u>
Fair value of plan assets at end of year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Funded status at year-end	<u>\$ (8,445)</u>	<u>\$ (398)</u>	<u>\$ (67)</u>	<u>\$ (8,910)</u>
Net amounts recognized in the consolidated statement of financial position consist of:				
Accrued postretirement benefit obligation	<u>\$ (8,445)</u>	<u>\$ (398)</u>	<u>\$ (67)</u>	<u>\$ (8,910)</u>
Amounts recognized in net assets but not yet recognized in net periodic benefit costs consist of:				
Accumulated (loss) gain	\$ (1,542)	\$ 185	\$ 27	\$ (1,330)
Cumulative employer contributions in excess of net periodic benefit cost	<u>(6,903)</u>	<u>(583)</u>	<u>(94)</u>	<u>(7,580)</u>
	<u>\$ (8,445)</u>	<u>\$ (398)</u>	<u>\$ (67)</u>	<u>\$ (8,910)</u>
Components of net periodic benefit cost				
Service cost	\$ 370	\$ -	\$ -	\$ 370
Interest cost	315	16	3	334
Actuarial loss (gain)	<u>223</u>	<u>(13)</u>	<u>(2)</u>	<u>208</u>
Net periodic benefit cost	<u>\$ 908</u>	<u>\$ 3</u>	<u>\$ 1</u>	<u>\$ 912</u>
Other changes recognized in other comprehensive income				
Net gain arising during period	\$ (586)	\$ (20)	\$ (2)	\$ (608)
Actuarial (loss) gain	<u>(223)</u>	<u>13</u>	<u>2</u>	<u>(208)</u>
Total recognized in other comprehensive income	<u>\$ (809)</u>	<u>\$ (7)</u>	<u>\$ -</u>	<u>\$ (816)</u>

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE H - POSTRETIREMENT BENEFIT OBLIGATION - Continued

	2018		
	Postretirement Plans		
	Orchestra	Admin	Academy
Weighted-average assumptions used to determine net periodic benefit cost were:			
Discount rate	3.77%	3.77%	3.77%
Weighted-average assumptions used to determine benefit obligations were:			
Discount rate	4.16%	4.16%	4.16%
Measurement date	8/31/18	8/31/18	8/31/18
	2017		
	Postretirement Plans		
	Orchestra	Admin	Academy
Weighted-average assumptions used to determine net periodic benefit cost were:			
Discount rate	3.57%	3.57%	3.57%
Weighted-average assumptions used to determine benefit obligations were:			
Discount rate	3.77%	3.77%	3.77%
Measurement date	8/31/17	8/31/17	8/31/17

The following amounts will be amortized from accumulated other comprehensive income (which is part of “accrued postretirement benefit obligation” on the consolidated statement of financial position) into net periodic benefit cost over the next fiscal year:

	Other postretirement plans
Actuarial loss	\$ 21,000

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE H - POSTRETIREMENT BENEFIT OBLIGATION - Continued

For measurement purposes, a 7.18% and 7.56% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2018 and 2017, respectively. The rate was assumed to decrease to a rate of 4.50% (in 2038) by various percentage points annually.

Estimated future benefit payments for years ending after August 31, 2018 are as follows (in thousands):

Postretirement

<u>Years ending August 31,</u>	<u>Orchestra</u>	<u>Administrative</u>	<u>Academy</u>
2019	\$ 282	\$ 45	\$ 8
2020	291	46	9
2021	312	49	9
2022	331	52	10
2023	347	55	10
Next 5 years	2,118	334	62

Contributions

For postretirement plans, the expected contributions for the next fiscal year are as follows:

	<u>Orchestra</u>	<u>Administrative</u>	<u>Academy</u>
2019	\$ 282	\$ 45	\$ 8

NOTE I - DEFINED CONTRIBUTION RETIREMENT SAVINGS PLAN

The Association has a retirement savings plan (the "Retirement Plan") which was established in 2011 under the provisions of Internal Revenue Code Section 403(b) and which is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended. The Retirement Plan is a non-contributory, defined contribution pension plan covering all staff and musicians of the Association, the Plan Sponsor. All staff and musicians are eligible to participate in the Retirement Plan upon hire. The Association contributes 8% of compensation each pay period to employees classified as staff. Musicians receive Association contributions of 8 - 10.5% depending on their age on December 1, 2011. Participants direct the investment of their contributions into various investment options offered by the Retirement Plan. A staff participant is 100% vested after one year of service, if hired on or after November 1, 2011. A staff participant hired before November 1, 2011 and musicians are 100% vested at all times. The Association's contribution to the Retirement Plan for the years ended August 31, 2018 and 2017 was approximately \$1,667,000 and \$1,622,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE J - LINE OF CREDIT

The Association had available a \$3,100,000 revolving credit facility. Under the agreement with the bank, the interest rate is 5.00%. The facility is available for working capital and general operating and capital expenditures in the ordinary course of business. This agreement also requires the Association to maintain \$350,000 in a deposit account with the lender, and among other things, limits additional indebtedness and the disposition of certain property. This line of credit expired on October 31, 2018 and was extended through October 31, 2019. The Association had no borrowings during the year and had \$-0- outstanding on this line of credit at August 31, 2018 and 2017.

NOTE K - NET ASSETS

Temporarily restricted net assets consisted of the following at August 31, 2018 and 2017 (in thousands):

	<u>2018</u>	<u>2017</u>
Time and purpose restricted contributions	\$ 10,395	\$ 14,843
Cumulative unspent investment gains, net	<u>4,029</u>	<u>3,431</u>
	<u>\$ 14,424</u>	<u>\$ 18,274</u>

Permanently restricted net assets consisted of the following at August 31, 2018 and 2017 (in thousands):

	<u>2018</u>	<u>2017</u>
Third-party trust assets	\$ 5,917	\$ 5,615
Pledges related to the endowment	1,538	2,346
Investments restricted in perpetuity	<u>104,004</u>	<u>101,338</u>
	<u>\$ 111,459</u>	<u>\$ 109,299</u>

NOTE L - JOINT VENTURE

On July 1, 2001, the Association invested \$70,000 in a nonprofit joint venture. The joint venture ("Ticket Philadelphia") was entered into along with KCI to handle all aspects of the ticketing function for all events held at the Academy of Music, Kimmel Center, and other venues in the Philadelphia area. This venture replaced the Association's ticketing operations. Operating results are to be shared in accordance with a formula agreed to by the parties. The Association is using the equity method of accounting to account for its share of the joint venture's activity. At August 31, 2018 and 2017, the Association's interest in the net assets of the joint venture was approximately \$668,000 and \$607,000, respectively. During the years ended August 31, 2018 and 2017, the Association recorded revenue of approximately \$206,000 and \$145,000, respectively, from Ticket Philadelphia for its share of profits from Ticket Philadelphia's fiscal year 2018 and 2017 operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE M - CONTINGENCIES

The Association is subject to various claims and legal proceedings arising out of the ordinary course of business. Management believes the resolution of claims and pending litigation will not have a material effect, individually or in the aggregate, on the consolidated financial position of the Association.

NOTE N - COMMITMENTS

The Orchestra and the Academy are parties to a Master Lease between the Academy and Regional Performing Arts Center, Inc. (now KCI) and a Sublease dated as of February 11, 2001 between Regional Performing Arts Center, Inc. and the Orchestra, which govern the Orchestra's use of Verizon Hall at the Kimmel Center and KCI's use of the Academy of Music. The Orchestra, the Academy and KCI (collectively, the "Parties") executed an Agreement and Modification of Sublease on May 21, 2012 and a Memorandum of Understanding on January 26, 2016 (collectively, the "Lease Modifications"), which are designed to improve and make more efficient the working relationship between the Parties and resolve certain claims that had arisen among them as a result of the Orchestra's bankruptcy.

Commencing with the 2013 Orchestra Season through and including the 2027 Orchestra Season, Annual Rent under the Sublease as modified by the Lease Modifications shall be as follows:

- a. Fixed Component - For Orchestra Seasons 2013 through 2017, inclusive, the Annual Rent before any stagehand credit shall be \$1,580,000, \$1,620,000, \$1,660,000, \$1,700,000 and \$1,740,000, respectively. Commencing with the 2018 Orchestra Season and annually thereafter through and including the 2027 Orchestra Season, Annual Rent (in the amount of \$1,740,000) shall increase or decrease by an amount equal to the increase or decrease in the Consumer Price Index.
- b. Revenue Sharing - Commencing with the 2018 Orchestra Season and annually thereafter through and including the 2027 Orchestra Season, Annual Rent shall be the greater of: (i) the Annual Rent then in effect or (ii) sixteen percent (16%) of the Orchestra's ticket revenue from Verizon Hall concerts and Perelman Theater concerts.

In fiscal year 2018, Annual Rent expense before stagehand credit was \$1,906,000, of which \$1,803,000 was equivalent to sixteen percent (16%) of the Orchestra's ticket revenue from Verizon Hall concerts and Perelman Theater concerts (the greater of the two aforementioned Revenue Sharing options).

The Lease Modifications also call for certain additional performance fees to be paid by the Orchestra under the Sublease and provide for modification to the scheduling protocol of the Sublease.

The Association has several commitments under contract for renovations of the Academy of Music. Portions of these contracts not completed at year-end are not reflected in the consolidated financial statements. These unrecorded commitments totaled approximately \$1,191,000 at August 31, 2018.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE N - COMMITMENTS - Continued

On December 26, 2012, the Association simultaneously entered into a Sublease Agreement (the “Sublease”) with PNC Bank, National Association (the “Sublessor”) and an Office Lease (the “Lease”) with Broad One, L.P. (the “Prime Landlord”) for 16,139 square feet of administrative office space on the 14th floor of One South Broad Street in Philadelphia, Pennsylvania (the “Premises”).

The Prime Landlord and Sublessor are currently landlord and tenant, respectively, under a certain lease agreement dated as of November 30, 1999, as amended by a first amendment of lease dated January 27, 2004 (collectively, the “Prime Lease”), pursuant to which Sublessor is leasing 16,139 rentable square feet of office space in the Premises.

The term of the Sublease commenced on December 1, 2012 (the “Commencement Date”) and terminated on March 31, 2014.

The term of the Lease (the “Lease Term”) commenced on April 1, 2014 and shall continue until March 31, 2023.

The minimum rent per annum under the Lease shall be as follows:

<u>Fiscal year</u>	<u>Minimum rent per annum</u>
2019	\$ 374,559
2020	382,629
2021	390,698
2022	398,768
2023	235,360

Minimum rent shall be payable in equal monthly installments commencing on the first day of each month during the Lease Term without demand deduction or set-off, provided that the Association is not in default of its obligations under the Lease Term.

NOTE O - RELATED PARTIES

The Orchestra and the Kimmel Center, in an effort to leverage economies of scale to capitalize on the strength inherent in a larger information technology service model, have entered into an agreement whereby a single, information technology staff provides technology services to each organization according to their respective business needs. Allocable costs are charged to the Kimmel Center by the Orchestra pursuant to the aforementioned agreement.

For the years ended August 31, 2018 and 2017, the Orchestra received payments from the Kimmel Center and Ticket Philadelphia totaling approximately \$1,335,000 and \$1,219,000, respectively, for these services, which are recorded in the consolidated statements of activities.

From time to time, the Orchestra may purchase services from organizations that members of the Board of Directors have an ownership interest in or are employed by. There were no services purchased from organizations that Board members have an ownership interest in for the years ended August 31, 2018 and 2017.

Contribution revenue recorded from members of the Association’s Board of Directors was approximately \$9,602,000 and \$9,873,000 for the years ended August 31, 2018 and 2017, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2018 and 2017

NOTE P - COLLECTIVE BARGAINING AGREEMENTS

The Orchestra had 172 full-time employees as of August 31, 2018, 100 of which were musicians and 3 of which were stagehands. One hundred percent (100%) of the musicians and stagehands were represented by the American Federation of Musicians, Local 77 (“AFM”) and the International Alliance of Theatrical Stage Employees, Local 8 (“IATSE”), respectively. The current collective bargaining agreement with the AFM expires in September 2019, and the collective bargaining agreement with IATSE expired in September 2017 and automatically renews from year to year thereafter unless either party gives written notice of its desire to terminate or amend the agreement. No other full-time employees of the Orchestra are represented by a union.

The aforementioned collective bargaining agreement with the AFM provides for the creation of a Musicians’ Appreciation Fund (the “Fund”) to which certain amounts may be credited by the Association to demonstrate its intention to commit to the future success of the Orchestra. During the term of the agreement, the Association will annually allocate a portion of the positive Change in Unrestricted Net Assets from Operating Activities in each fiscal year, as presented in the consolidated statement of activities of the Association’s audited financial statements (the “Base”), to the Fund. The first allocation to the Fund shall take place upon the completion of the Association’s fiscal 2017 audited financial statements and continue through fiscal year 2019. The allocation to the Fund for a fiscal year shall be equal to (i) 50 percent of the Base for such fiscal year or (ii) \$500,000. In fiscal years 2018 and 2017, 50 percent of the Base amounted to approximately \$50,000 and \$46,000, respectively, which has been recorded as an expense in the consolidated statements of activities.

NOTE Q - SUBSEQUENT EVENTS

The Association evaluated its August 31, 2018 consolidated financial statements for subsequent events through February 5, 2019, the date the consolidated financial statements were available to be issued. Except as disclosed within Note J, the Association is not aware of any subsequent events which would require recognition or disclosure in the accompanying consolidated financial statements.

SUPPLEMENTAL INFORMATION

The Philadelphia Orchestra Association

SCHEDULES OF CHANGES IN UNRESTRICTED NET ASSETS FROM OPERATING ACTIVITIES

Year ended August 31,

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
PERFORMANCE REVENUE		
Philadelphia concerts	\$ 8,971	\$ 9,262
Summer concerts	1,818	1,934
Other concerts	3,680	3,572
Tours	1,304	2,208
Recording, radio and television	<u>210</u>	<u>210</u>
	15,983	17,186
PERFORMANCE EXPENSE		
Orchestra and concert production	35,410	33,688
Concert promotion expenses	2,455	2,653
Recording, radio and television	<u>345</u>	<u>355</u>
	<u>38,210</u>	<u>36,696</u>
PERFORMANCE DEFICIT	(22,227)	(19,510)
OTHER OPERATING REVENUE		
Annual public support	17,318	18,367
Volunteer project revenue	506	529
Spending policy draw, designated for current operations	7,554	7,536
Income from beneficial interests in trusts	231	181
Other revenues	2,104	2,007
Gifts in kind	9	98
Equity earnings in joint venture	206	145
Academy Ball revenue, net	147	317
Net assets released from restrictions	<u>8,781</u>	<u>4,537</u>
TOTAL OTHER OPERATING REVENUE	36,856	33,717
OTHER OPERATING EXPENSE		
Fundraising expenses		
Annual fundraising	2,002	1,964
Volunteer project	<u>304</u>	<u>383</u>
	<u>2,306</u>	<u>2,347</u>
Management and general		
Administrative expense	11,198	10,242
Global initiatives and government relations	523	970
Bad debt	169	188
Depreciation	<u>383</u>	<u>414</u>
TOTAL OTHER OPERATING EXPENSE	<u>14,579</u>	<u>14,161</u>
CHANGES IN NET ASSETS FROM OPERATING ACTIVITIES	<u>\$ 50</u>	<u>\$ 46</u>

The Academy of Music of Philadelphia, Inc.

STATEMENT OF FINANCIAL POSITION

August 31, 2018

(Dollars in thousands)

ASSETS	
Cash and cash equivalents	\$ 2,994
Trade accounts receivable, net	63
Pledges receivable, net	252
Prepaid expenses and other assets	284
Investments	21,032
Property and equipment, net	<u>31,607</u>
Total assets	<u><u>\$ 56,232</u></u>
LIABILITIES AND NET ASSETS	
LIABILITIES	
Accounts payable	\$ 62
Accrued expenses	51
Due to The Philadelphia Orchestra Association	46
Deferred revenue	49
Accrued postretirement benefit obligation	<u>70</u>
Total liabilities	278
NET ASSETS	
Unrestricted	37,882
Temporarily restricted	1,927
Permanently restricted	<u>16,145</u>
Total net assets	<u>55,954</u>
Total liabilities and net assets	<u><u>\$ 56,232</u></u>

The Academy of Music of Philadelphia, Inc.

STATEMENT OF ACTIVITIES

Year ended August 31, 2018

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
REVENUE				
Academy Concert and Ball revenue	\$ 2,127	\$ 346	\$ -	\$ 2,473
Academy Concert and Ball expense	(1,943)	-	-	(1,943)
Transfer of Academy Concert and Ball proceeds to The Philadelphia Orchestra Association	(147)	-	-	(147)
Net assets released for the Academy Concert and Ball	110	(110)	-	-
Academy Concert and Ball revenue, net	<u>147</u>	<u>236</u>	<u>-</u>	<u>383</u>
Annual public support	1,922	38	-	1,960
Spending policy draw	1,014	-	-	1,014
Net assets released from restrictions	2	(2)	-	-
Total other revenue	<u>2,938</u>	<u>36</u>	<u>-</u>	<u>2,974</u>
EXPENSES				
Administrative expenses	327	-	-	327
Fundraising expenses	260	-	-	260
Total expenses	<u>587</u>	<u>-</u>	<u>-</u>	<u>587</u>
CHANGE IN NET ASSETS FROM OPERATIONS	2,498	272	-	2,770
NONOPERATING (EXPENSE) REVENUE				
Depreciation	(2,460)	-	-	(2,460)
Investment gain, net of spending policy	32	141	-	173
Transfer of endowment earnings to The Philadelphia Orchestra Association for Academy of Music base rent	(238)	-	-	(238)
Other changes in benefit obligations	(2)	-	-	(2)
	<u>(2,668)</u>	<u>141</u>	<u>-</u>	<u>(2,527)</u>
CHANGE IN NET ASSETS	(170)	413	-	243
NET ASSETS, BEGINNING OF YEAR	<u>38,052</u>	<u>1,514</u>	<u>16,145</u>	<u>55,711</u>
NET ASSETS, END OF YEAR	<u>\$ 37,882</u>	<u>\$ 1,927</u>	<u>\$ 16,145</u>	<u>\$ 55,954</u>