



# Merit School of Music

Financial Statements  
Years Ended June 30, 2019 and 2018

# Merit School of Music

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Financial Statements  
Years Ended June 30, 2019 and 2018

# Merit School of Music

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## Independent Auditor's Report

Board of Trustees  
Merit School of Music  
Chicago, Illinois

We have audited the accompanying financial statements of Merit School of Music, which comprise the statements of financial position as of June 30, 2019 and 2018, and the related statements of activities and changes in net assets, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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*Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Merit School of Music as of June 30, 2019 and 2018, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*BDO USA, LLP*

Chicago Illinois  
November 11, 2019

## Financial Statements

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**Merit School of Music**  
**Statements of Financial Position**

<i>June 30,</i>	2019	2018
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 2,188,754	\$ 495,272
Pledges receivable, current portion	710,325	735,530
Tuition receivable, net	279,897	127,339
<b>Total Current Assets</b>	<b>3,178,976</b>	<b>1,358,141</b>
<b>Property and Equipment, net</b>	<b>8,606,978</b>	<b>8,751,740</b>
<b>Other Assets</b>		
Other Assets	183,323	210,187
Pledges receivable, net- non-current	2,294,341	35,405
Investments	14,509,049	13,639,863
<b>Total Other Assets</b>	<b>16,986,713</b>	<b>13,885,455</b>
<b>Total Assets</b>	<b>\$ 28,772,667</b>	<b>\$ 23,995,336</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 51,673	\$ 167,194
Accrued expenses	174,732	167,048
Line of credit	-	250,000
Deferred tuition revenue	198,329	163,776
Capital lease obligation, current portion	15,459	14,780
<b>Total Current Liabilities</b>	<b>440,193</b>	<b>762,798</b>
<b>Long-term Liabilities</b>		
Annuity contract obligation	42,471	42,471
Capital lease obligation, less current maturities	47,767	63,226
<b>Total Long-term Liabilities</b>	<b>90,238</b>	<b>105,697</b>
<b>Total Liabilities</b>	<b>530,431</b>	<b>868,495</b>
<b>Net Assets</b>		
Without donor restrictions:		
General	7,271,215	7,165,669
Designated by board	10,069,547	9,439,021
	17,340,762	16,604,690
With donor restrictions	10,901,474	6,522,151
<b>Total Net Assets</b>	<b>28,242,236</b>	<b>23,126,841</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 28,772,667</b>	<b>\$ 23,995,336</b>

*See accompanying notes to financial statements.*

**Merit School of Music**  
**Statements of Activities and Changes in Net Assets**

<i>Year ended June 30, 2019</i>	Without Donor Restriction	With Donor Restriction	Total
<b>Revenues, Gains and Other Support</b>			
Contributions	\$ 1,254,905	\$ 4,715,244	\$ 5,970,149
Government grants	46,130	-	46,130
Student fees, net of \$844,257 in financial aid	1,352,046	-	1,352,046
School contracts	545,170	-	545,170
Fundraising events, net of expenses of \$198,024	1,235,653	-	1,235,653
Rental income	423,085	-	423,085
Miscellaneous income	12,836	-	12,836
Interest and dividends, net	466,890	24,207	491,097
<b>Total Revenues, Gains and Other Support Before Net Assets</b>			
Released from Restrictions	5,336,715	4,739,451	10,076,166
<b>Net Assets Released from Restrictions</b>	<b>356,928</b>	<b>(356,928)</b>	<b>-</b>
<b>Total Revenues, Gains, and Other Support</b>	<b>5,693,643</b>	<b>4,382,523</b>	<b>10,076,166</b>
<b>Expenses</b>			
Program services	4,222,538	-	4,222,538
Administration	1,327,192	-	1,327,192
Development	499,231	-	499,231
<b>Total expenses</b>	<b>6,048,961</b>	<b>-</b>	<b>6,048,961</b>
<b>Change in Net Assets Before</b>			
Investment Gain	(355,318)	4,382,523	4,027,205
Realized and change in unrealized gain (loss) on investments	1,091,390	(3,200)	1,088,190
<b>Change in Net Assets</b>	<b>736,072</b>	<b>4,379,323</b>	<b>5,115,395</b>
<b>Net Assets, beginning of year</b>	<b>16,604,690</b>	<b>6,522,151</b>	<b>23,126,841</b>
<b>Net Assets, end of year</b>	<b>\$ 17,340,762</b>	<b>\$ 10,901,474</b>	<b>\$ 28,242,236</b>

# Merit School of Music

## Statements of Activities and Changes in Net Assets

<i>Year ended June 30, 2018</i>	Without Donor Restrictions	With Donor Restrictions	Total
<b>Revenues, Gains and Other Support</b>			
Contributions	\$ 1,568,744	\$ 117,650	\$ 1,686,394
Government grants	41,200	-	41,200
Student fees, net of \$959,447 in financial aid	1,279,529	-	1,279,529
School contracts	581,309	-	581,309
Fundraising events, net of expenses of \$202,933	1,021,188	-	1,021,188
Rental income	375,167	-	375,167
Miscellaneous income	8,563	-	8,563
Interest and dividends, net	371,435	6,920	378,355
<b>Total Revenues, Gains and Other Support Before Net Assets</b>			
Released from Restrictions	5,247,135	124,570	5,371,705
<b>Net Assets Released from Restrictions</b>	<b>707,334</b>	<b>(707,334)</b>	<b>-</b>
<b>Total Revenues, Gains, and Other Support</b>	<b>5,954,469</b>	<b>(582,764)</b>	<b>5,371,705</b>
<b>Expenses</b>			
Program services	4,388,373	-	4,388,373
Administration	988,912	-	988,912
Development	657,944	-	657,944
<b>Total expenses</b>	<b>6,035,229</b>	<b>-</b>	<b>6,035,229</b>
<b>Change in Net Assets Before</b>			
Investment and Annuity Gain	(80,760)	(582,764)	(663,524)
Realized and change in unrealized gain (loss) on investments	1,047,978	(197)	1,047,781
<b>Change in Net Assets</b>	<b>967,218</b>	<b>(582,961)</b>	<b>384,257</b>
<b>Net Assets, beginning of year</b>	<b>15,637,472</b>	<b>7,105,112</b>	<b>22,742,584</b>
<b>Net Assets, end of year</b>	<b>\$ 16,604,690</b>	<b>\$ 6,522,151</b>	<b>\$ 23,126,841</b>

*See accompanying notes to financial statements.*

# Merit School of Music

## Statements of Functional Expenses

Year ended June 30, 2019	Program Services								Support Services			Total	
	Tuition-free Conservatory	Merit Music in Communities	Instrumental Music Program	Private Lessons	Early Childhood	Summer	Academic & Student Support	CMPI	Total Program Services	Development	Administration		Total Support Services
<b>Functional Expenses</b>													
Compensation & Staff-related expenses	\$ 521,897	\$ 656,230	\$ 397,548	\$ 965,431	\$ 50,060	\$ 104,995	\$ 570,997	\$ 63,546	\$ 3,330,704	\$ 405,814	\$ 916,722	\$ 1,322,536	\$ 4,653,240
Program expenses	28,577	56,590	15,620	2,552	3,134	23,266	104,306	36,518	270,563	22,062	700	22,762	293,325
Office expenses	13,241	12,740	12,050	14,289	4,214	4,191	78,577	904	140,206	49,088	12,179	61,267	201,473
Marketing expenses	-	-	-	-	748	-	-	9,000	9,748	4,910	30,092	35,002	44,750
Maintenance & Operations	98,610	11,824	20,220	34,878	12,315	4,482	26,163	500	208,992	-	54,312	54,312	263,304
Outside Services	1,738	3,044	2,444	-	-	-	119	-	7,345	3,800	115,010	118,810	126,155
Financial expenses	-	-	383	-	-	-	29,009	-	29,392	13,557	97,018	110,575	139,967
Depreciation expense	60,583	35,520	12,422	21,428	7,566	2,754	85,315	-	225,588	-	99,743	99,743	325,331
Miscellaneous	-	-	-	-	-	-	-	-	-	-	1,416	1,416	1,416
<b>Total Functional Expenses</b>	<b>\$ 724,646</b>	<b>\$ 775,948</b>	<b>\$ 460,687</b>	<b>\$ 1,038,578</b>	<b>\$ 78,037</b>	<b>\$ 139,688</b>	<b>\$ 894,486</b>	<b>\$ 110,468</b>	<b>\$ 4,222,538</b>	<b>\$ 499,231</b>	<b>\$ 1,327,192</b>	<b>\$ 1,826,423</b>	<b>\$ 6,048,961</b>

# Merit School of Music

## Statements of Functional Expenses

<i>Year ended June 30, 2018</i>	Program Services						Support Services			Total
	Tuition-free Conservatory	Merit Music in Communities	Instrumental Music Program	Private Lessons	Other Programs	Total Program Services	Development	Administration	Total Support Services	
<b>Functional Expenses</b>										
Compensation & Staff-related expenses	\$ 621,685	\$ 768,027	\$ 501,248	\$ 1,175,656	\$ 416,610	\$ 3,483,226	\$ 481,788	\$ 579,030	\$ 1,060,818	\$ 4,544,044
Program expenses	35,594	118,310	29,174	-	246,567	429,645	1,168	390	1,558	431,203
Office expenses	19,617	25,250	21,950	29,122	23,692	119,631	61,455	101,907	163,362	282,993
Marketing expenses	-	-	-	-	710	710	2,272	42,561	44,833	45,543
Maintenance & Operations	91,484	17,626	24,084	35,088	15,006	183,288	4,967	117,252	122,219	305,507
Outside Services	-	12	-	90	-	102	11,587	67,868	79,455	79,557
Financial expenses	-	20,765	793	7,135	31	28,724	81,175	17,525	98,700	127,424
Depreciation expense	64,014	15,918	20,342	29,304	12,771	142,349	11,154	56,043	67,197	209,546
Miscellaneous	481	-	-	-	217	698	2,378	6,336	8,714	9,412
<b>Total Functional Expenses</b>	<b>\$ 832,875</b>	<b>\$ 965,908</b>	<b>\$ 597,591</b>	<b>\$ 1,276,395</b>	<b>\$ 715,604</b>	<b>\$ 4,388,373</b>	<b>\$ 657,944</b>	<b>\$ 988,912</b>	<b>\$ 1,646,856</b>	<b>\$ 6,035,229</b>

*See accompanying notes to financial statements.*

# Merit School of Music

## Statements of Cash Flows

<i>Years Ended June 30,</i>	2019	2018
<b>Operating Activities</b>		
Change in net assets	\$ 5,115,395	\$ 384,257
Adjustments to reconcile change in net assets to cash and cash equivalents provided by operating activities:		
Provisions for allowance for bad debts	37,602	116,235
Depreciation and amortization	325,331	306,008
Realized and unrealized gain on investments	(1,088,190)	(1,047,781)
Contributions of donated stock	(149,717)	(102,093)
Changes in operating assets and liabilities:		
Pledges Receivable	(2,247,288)	396,799
Tuitions receivable	(176,603)	(26,596)
Other assets	26,864	(71,989)
Accounts payable and accrued expenses	(107,837)	113,672
Deferred tuition revenue	34,553	(58,027)
<b>Net cash and cash equivalents provided by operating activities</b>	<b>1,770,110</b>	<b>10,485</b>
<b>Investing Activities</b>		
Purchases of property and equipment	(180,569)	(162,264)
Purchases of investments	(806,380)	(1,217,998)
Proceeds from sales and maturities of investments	1,175,101	1,368,869
<b>Net cash and cash equivalents provided by (used in) investing activities</b>	<b>188,152</b>	<b>(11,393)</b>
<b>Financing Activities</b>		
Proceeds from line of credit	711,465	115,000
Repayment of line of credit	(961,465)	-
Annuity contract obligation payment	-	(11,607)
Principal payments on capital lease obligations	(14,780)	(2,399)
<b>Net cash and cash equivalents (used in) provided by financing activities</b>	<b>(264,780)</b>	<b>100,994</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>1,693,482</b>	<b>100,086</b>
<b>Cash and Cash Equivalents, beginning of year</b>	<b>495,272</b>	<b>395,186</b>
<b>Cash and Cash Equivalents, end of year</b>	<b>\$ 2,188,754</b>	<b>\$ 495,272</b>
<b>Cash Paid During the Year for Interest</b>	<b>\$ -</b>	<b>\$ 10,813</b>
<b>Supplemental Disclosure of Non-Cash Financing and Investing Activities</b>		
Assets acquired under capital lease obligation	\$ -	\$ 80,405

*See accompanying notes to financial statements.*

# Merit School of Music

## Notes to Financial Statements

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### 1. Summary of Significant Accounting Policies

#### *Nature of Activities*

Merit School of Music (“Merit”) is a nationally accredited nonprofit organization in Chicago that removes barriers to high-quality music education. Its main objective is to offer sustained introductory, preparatory, and conservatory level music instruction—including classical and jazz, and featuring band, voice, and orchestra, as well as guitar and piano—to students from birth to 18 years of age. Merit’s administrative and program facility is the Joy Faith Knapp Music Center at 38 S. Peoria in Chicago, Illinois.

Merit’s programs include the following:

The Alice S. Pfaelzer Tuition-free Conservatory (the Conservatory), which requires and represents the highest level of achievement, provides students, selected by audition, with a curriculum in music theory, chamber music, instrumental technique, and large ensembles. Students attend Saturday classes including a weekly assembly where student, faculty and guest artist performances are featured.

The Merit Music in Communities Program brings Merit’s faculty to Chicago Public Schools, private schools, and other community sites each year, where they provide instruction in early childhood, band, strings, chorus, and general music.

The Instrumental and Vocal Music program provides musical preparation for the Conservatory to primary school age students. Curriculum is comprised of music theory, music history, musicianship as well as student participation in small technique and large ensemble classes.

Merit's Private Lesson program makes private instruction available to all students from beginner to the most advanced musician. Students gain additional experience through participation in private lesson recitals.

Early childhood includes classes for babies to preschoolers. This program supports a child’s first steps in a lifetime journey of musical appreciation that inspires them to participate in our Instrumental Music program and eventually the Alice S. Pfaelzer Tuition-free Conservatory.

Summer includes camps designed to provide young musicians with the opportunity to continue building musical skills in a focused, nurturing environment outside of their school program or private lesson routine. Camps, ensembles and one-day workshops are offered with a focus on instrumental improvement or ensemble play for almost every instrument and ensemble type there is.

Academic and student support represents the programmatic staff and resources utilized to support all our students through their journey along the Merit pathway from Early Childhood to the Alice S. Pfaelzer Tuition-free Conservatory.

# Merit School of Music

## Notes to Financial Statements

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### *Basis of Presentation*

The accompanying financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

### *Net Assets*

Merit maintains its financial accounts internally in accordance with the principles and practices of fund accounting, the procedure by which resources for various purposes are classified for accounting purposes in accordance with Merit's activities or objectives. For financial reporting purposes, Merit's funds and its activities are classified as Without Donor Restrictions or With Donor Restrictions based on the existence or absence of donor-imposed restrictions, as follows:

#### *Net Assets Without Donor Restrictions:*

Net assets that are not subject to donor-imposed restrictions including the carrying value of all physical properties (property and equipment). Items that increase or decrease this net asset category include amounts received from government agencies, student fees, school contracts and all expenses associated with the core activities of Merit. In addition to these transactions, changes in this category of net assets include certain types of philanthropic support, namely unrestricted contributions and foundation grants, investment income and restricted contributions and foundation grants whose donor-imposed restrictions were met during the fiscal period. Board-designated amounts are also part of net assets without donor restrictions (See Note 7).

#### *Net Assets With Donor Restrictions:*

Net assets subject to donor-imposed restrictions that may or will be met either by actions of Merit or the passage of time. Items that affect this net asset category are restricted contributions and grants, including pledges for future years. These amounts are reclassified to net assets without donor restrictions when such restrictions are met or have expired. Some assets with donor restrictions may include a stipulation that assets provided be maintained permanently (perpetual in nature) by Merit. Merit is required to maintain the historical value of the initial investment, with earnings from the investment available for operations. Earnings from permanently restricted net assets are recorded as with restriction, then released to net assets without donor restrictions as related expenditures are incurred.

### *Use of Estimates*

The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

# Merit School of Music

## Notes to Financial Statements

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### *Revenue Recognition*

Merit records tuition and student fees in the period in which they are earned. Tuition and student fees received in advance for program activities which will be conducted in the subsequent fiscal year (principally tuition deposits) are recorded as deferred tuition revenue in the Statements of Financial Position. Rental income is recognized on a monthly basis when earned.

Contributions and unconditional pledges are recognized as revenue in the fiscal year received and are measured at their fair values and reported as an increase in net assets. Conditional promises to give are not recognized as revenue until the conditions on which they depend are substantially met. Merit reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the assets, or if they are designated as support for future periods. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the Statements of Activities and Changes in Net Assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as without donor restriction support.

### *Cash and Cash Equivalents*

Merit considers highly liquid investments with initial maturities of three months or less to be cash equivalents. Money markets funds maintained in investment accounts are included with cash and cash equivalents.

### *Concentration of Credit Risk*

Merit maintains its cash and cash equivalents at several financial institutions. All deposit accounts at Federal Deposit Insurance Corporation insured institutions are insured up to \$250,000. At times during the year, Merit's bank balances may have exceeded the federally insured limits; however, it has not experienced any losses with respect to its bank balances in excess of government provided insurance, and management believes Merit is not exposed to any unusual credit risk.

### *Pledges Receivable*

Pledges receivable represents promises to give which have been made by donors but are unpaid as of the fiscal year-end and consist primarily of unconditional pledges from individuals, corporations and foundations. Pledges receivable are recorded net of an allowance for uncollectible pledges and are also recorded net of a discount to present value applied to the long-term portion of any multi-year pledge. The discount rate used is an estimate made by management and represents a risk-free rate of return that ranges from 1.71% to 1.92% depending on the life of the pledge. The discount is amortized over the term of the pledge, and amortization is recorded as contribution revenue. Management determines the allowance based on historical experience and an analysis of specific accounts. Uncollectible accounts are written off in the year they are deemed to be worthless.

As of June 30, 2019 and 2018, 80% and 73% of total pledges receivable were receivable from three and four donors, respectively.

# Merit School of Music

## Notes to Financial Statements

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### *Tuition Receivable*

Tuition receivable represents uncollateralized customer obligations due under normal trade terms and consists of amounts due from schools and students for music education classes. Uncollectible amounts are written off at the time the individual receivable is determined to be uncollectible. Allowance for doubtful accounts for the years ended June 30, 2019 and 2018 was \$22,150 and is based on estimates made by management and Merit's historical collection experience.

### *Investments*

Investments are stated at fair value as of the reporting date. Investments received as contributions of \$149,717 and \$102,093 for the years ended June 30, 2019 and 2018, respectively, are recorded at fair value, which is based upon quoted market prices and which is the basis for the amount of contribution revenue recognized by Merit. Investment income and realized and unrealized gains and losses are reported as increases or decreases in net assets and are reflected as changes in net assets without restrictions or net assets with restrictions, as appropriate.

Investment income is shown net of investment fees on the Statements of Activities and Changes in Net Assets. Total investment fees were \$67,452 and \$58,857 for the years ended June 30, 2019 and 2018, respectively.

### *Property and Equipment*

Property and equipment are stated at cost or, in the case of contributions, fair value at the date of receipt, and are being depreciated over the estimated useful lives of the assets, using the straight-line method. In general, Merit capitalizes all property and equipment purchases over \$1,000. Major repairs and improvements are also capitalized. General maintenance and repairs which do not improve or extend the lives of the assets are expensed.

### *Annuity Contract Obligation*

In fiscal year 2006, Merit entered into a charitable remainder annuity trust agreement. Upon the issuance of the annuity, a liability was recorded at the present value of the estimated future payments to be made to the annuitants and revenue was recognized to the extent the amount of the annuity gift received exceeded the computed liability. The liability portion of the annuity was computed using discount rates established by the Internal Revenue Service ("IRS"), which approximated market rates. The difference between the amount of the annuity and the computed liability, representing the gift portion, was recorded as restricted revenue.

The present value discount used at the time the annuity was issued was based on IRS regulations and the rate paid the annuitants was based on the ages of the annuitants. Each year, payments to the annuitants are recorded as a reduction of the liability. In addition, the liability is adjusted at the end of each fiscal year for the recomputed present value of estimated future payments using a discount rate determined by management. Upon the death of the annuitants, the residuum remains the property of Merit.

# Merit School of Music

## Notes to Financial Statements

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### *Functional Expenses*

In the Statement of Functional Expenses, the costs which are directly associated with a particular program or supporting service are charged to that functional category. Additionally, certain costs have been allocated among the programs and supporting services benefited based on staff time devoted to the functional areas or other appropriate allocation methods determined by management.

### *Income Taxes*

Merit is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code ("IRC") and applicable state law, except for net income derived from unrelated business activities. In addition, Merit qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and has been classified as an organization other than a private foundation under IRC Section 509(a). Merit files annual information returns in the U.S. federal jurisdiction and the state of Illinois.

Merit's income tax filings are subject to audit by various taxing authorities. In evaluating Merit's activities, management believes its position of tax-exempt status is based on current facts and circumstances, and there have been no uncertain positions taken related to recording income taxes. In the opinion of management, there are no activities unrelated to the purpose of the organization and, therefore, no tax is to be recognized.

It is the policy of Merit to include in management and general expenses penalties and interest assessed by income taxing authorities. There are no penalties or interest from taxing authorities included in management and general expenses for the years ended June 30, 2019 and 2018.

### *New Accounting Standard Update*

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "*Revenue from Contracts with Customers (Topic 606)*". This update, along with ASU 2016-08, "*Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*", ASU 2016-10, "*Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*", and ASU 2016-12, "*Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*", establishes a comprehensive revenue recognition standard. The core principle of the 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 those goods or services. FASB issued ASU 2015-14 that deferred the effective date for the Organization until annual periods beginning after December 15, 2018. Earlier adoption is permitted subject to certain limitations. The amendments in this update are required to be applied retrospectively to each prior reporting period presented or with the cumulative effect being recognized at the date of initial application. Merit is currently evaluating the impact of these ASUs on its financial statements.

In February 2016, the FASB issued ASU 2016-02, "*Leases (Topic 842)*". This update, along with ASU 2018-10, "*Codification Improvements to Topic 842: Leases*", ASU 2018-11, "*Leases (Topic 842): Targeted Improvements*", and ASU 2018-20, "*Leases (Topic 842): Narrow-Scope Improvements for Lessors*", establishes a comprehensive leasing standard. These updates require the recognition of lease assets and lease liabilities on the statement of financial position and disclosure of key information about leasing arrangements for lessees and lessors. The new standard applies a right-

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of-use (“ROU”) model that requires, for leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset for the lease term and a liability to make lease payments to be recorded. The guidance also expands the required quantitative and qualitative lease disclosures as well as provides entities with an additional (and optional) transition method to adopt the new standard. The ASU is effective for the Organization’s fiscal years beginning after December 15, 2019 with early adoption permitted. Merit is currently evaluating the impact of these ASUs on its financial statements.

***Accounting Pronouncements Adopted***

In August 2016, the FASB issued ASU 2016-14, “Not-for-Profit Entities (Topic 958) - Presentation of Financial Statements of Not-for-Profit Entities”. The update addresses the complexity and understandability of net asset classification, provides information about liquidity and availability of resources and improves the type of information provided about expenses and investment return. The Organization has applied the ASU retrospectively to all periods presented except the Organization has opted to present the liquidity and availability information for the year ended June 30, 2019 only as permitted under the ASU. Other than the changes to the financial statement presentation and disclosures described above, adoption of the ASU did not have a significant impact on the financial statements. There was no effect on the change in net assets for the year ended June 30, 2019.

***Subsequent Events***

Merit has evaluated subsequent events through November 11, 2019, the date the financial statements were available to be issued. No events have occurred subsequent to June 30, 2019 that required recognition or disclosure in the financial statements.

**2. Pledges Receivable**

Pledges receivable consists of the following:

<i>June 30,</i>	2019	2018
2019	\$ -	\$ 735,530
2020	710,325	112,000
2021	604,416	26,000
2022	1,770,852	16,000
2023	132,633	16,000
2024	12,000	24,000
Thereafter	12,000	-
Total pledges receivable	3,242,226	929,530
Less allowance for doubtful accounts	(163,557)	(150,000)
Less unamortized discount on pledges	(74,003)	(8,595)
	<b>\$ 3,004,666</b>	<b>\$ 770,935</b>

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### 3. Fair Value Disclosures

Merit records its assets and liabilities at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Merit utilizes valuation techniques to maximize the use of observable inputs and minimize the use of unobservable inputs. Assets and liabilities recorded at fair value are categorized within the fair value hierarchy based upon the level of judgment associated with the inputs used to measure their value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability.

The three levels of the fair value hierarchy are described below:

- |         |   |
|---------|---|
| Level 1 | Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that Merit has the ability to access.  |
| Level 2 | Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.   |
| Level 3 | Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The inputs into the determination of fair value are based upon the best information in the circumstances and may require significant management judgment or estimation. |

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Merit'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 investment. The inputs or methodology used for valuing financial instruments are not necessarily an indication of the risks associated with investing in those instruments. Investments are exposed to various risks such as interest rate, market and credit risks. It is reasonably possible that changes in values of investments will occur in the near term and that such changes could materially affect the amounts reported.

Merit assesses the levels of the investments at each measurement date and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with Merit's accounting policy regarding recognition of transfers between levels of the fair value hierarchy. There were no such transfers for the years ended June 30, 2019 and 2018.

Merit's investments in common stocks, mutual funds, and bond funds traded on a national securities exchange, or reported on the NASDAQ national market, are stated at the last reported sales price on the day of valuation. Merit's investments in corporate notes and real estate investment trusts are traded on a national securities exchange or market and are valued at the mean between the current "bid" and "asked" quotations on that day.

Each year the annuity contract obligation is adjusted at the end of each fiscal year for the recomputed present value of estimated future payments using a discount rate determined by management.

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## Notes to Financial Statements

The following tables present Merit's assets and liabilities measured at fair value on a recurring basis as of June 30, 2019 and 2018:

	2019			
	Fair Value Measurements			Total
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Common stock	\$ 10,388,901	\$ -	\$ -	\$ 10,388,901
Mutual funds	1,069,814	-	-	1,069,814
Fixed income	2,855,854	-	-	2,855,854
Corporate notes	-	20,697	-	20,697
Real estate investment trusts	-	173,783	-	173,783
	\$ 14,314,569	\$ 194,480	\$ -	\$ 14,509,049
<b>Liabilities</b>				
Annuity contract obligation	\$ -	\$ (42,471)	\$ -	\$ (42,471)

	2018			
	Fair Value Measurements			Total
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Common stock	\$ 6,572,563	\$ -	\$ -	\$ 6,572,563
Mutual funds	3,514,236	-	-	3,514,236
Fixed income	3,535,269	-	-	3,535,269
Corporate notes	-	17,795	-	17,795
	\$ 13,622,068	\$ 17,795	\$ -	\$ 13,639,863
<b>Liabilities</b>				
Annuity contract obligation	\$ -	\$ (42,471)	\$ -	\$ (42,471)

### 4. Property and Equipment

Property and equipment consists of the following:

<i>June 30,</i>	Depreciable Lives	2019	2018
Land		\$ 4,450,000	\$ 4,450,000
Building and improvements	7-40	5,529,010	5,498,446
Furniture and fixtures	5-10	489,931	489,931
Office equipment	3-7	611,366	545,787
Musical instruments and equipment	5-10	1,733,015	1,648,589
		12,813,322	12,632,753
Less accumulated depreciation		(4,206,344)	(3,881,013)
		\$ 8,606,978	\$ 8,751,740

# Merit School of Music

## Notes to Financial Statements

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Depreciation expense for the years ended June 30, 2019 and 2018 totaled \$325,331 and \$306,008, respectively.

### 5. Line of Credit

During fiscal year 2019, Merit renewed its revolving line of credit with its existing bank which allows for maximum borrowings up to \$750,000 with a maturity date of December 15, 2019. Outstanding borrowings, which amounted to \$0 and \$250,000 at June 30, 2019 and 2018, respectively, bear interest at the prime rate less 0.5% (5% and 4.5% at June 30, 2019 and 2018, respectively) and are secured by a certain investment account of Merit.

### 6. Endowment Funds

Merit's endowment fund is comprised of contributions from donors for the creation of Merit's permanent endowment consisting of the Joy Faith Knapp Endowment Fund, the General Purposes Fund and the Scholarship Fund. Income from the Joy Faith Knapp Endowment Fund and the General Purposes Fund is unrestricted, with the income from the Scholarship Fund being restricted for scholarships. In addition, net assets without donor restrictions which are subject to the oversight of Merit's Board of Trustees are also included in Merit's endowment fund. All endowment assets are invested in Merit's investment portfolio. As required by U.S. GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

#### *Interpretation of Relevant Law*

Merit follows the Illinois Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). The Board of Trustees of Merit has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary.

As a result of this interpretation, Merit continues to classify 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 was added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanent is classified as net assets with donor restrictions until those amounts are appropriated for expenditure by Merit in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Merit considers the following factors in making a determination to appropriate or accumulate earnings on its donor-restricted endowment fund:

- 1) The duration and preservation of the fund;
- 2) The purpose of Merit and the donor-restricted endowment fund;
- 3) General economic conditions;
- 4) The possible effect of inflation and deflation;
- 5) The expected total return from income and the appreciation of investments;
- 6) Other resources of Merit; and
- 7) The investment policies of Merit.

# Merit School of Music

## Notes to Financial Statements

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### *Return Objectives and Risk Parameters*

The investment committee of the Board, which oversees the investment portfolio of Merit with the assistance of Merit's investment consultants, operates under an investment policy that attempts to provide a predictable stream of income and investment returns. Under these policies, the endowment assets are invested. To satisfy its long-term rate-of-return objectives, Merit 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). Merit targets a diversified asset allocation that may place a greater emphasis on equity and fixed-income-based investments to achieve its long-term return objectives within prudent risk constraints. The 4.5 percent annual distribution (spending policy) on the investment portfolio of Merit is attributable to the endowment assets as these assets are pooled with the assets without donor restrictions within the investment portfolio. In 2019 and 2018, all investment earnings (realized and unrealized) from the permanent endowment were appropriately transferred into the without donor restriction and with donor restriction funds based upon donor stipulation.

### *Funds with Deficiencies*

From time to time, the fair value of assets associated with the endowment fund may fall below the level that the donor or Illinois UPMIFA requires Merit to retain as a fund of perpetual duration. This deficiency would result from unfavorable market fluctuations, the timing of new contributions received and continued appropriation from the permanent endowment. Deficiencies of this nature would be reported in with or with donor restriction net assets depending on the existence of any donor restrictions applicable to the investment earnings of the permanent gifts.

### *Spending Policy and How the Investment Objectives Relate to Spending Policy*

Merit's policy is to preserve the historical dollar value of permanently restricted contributions and to use any of the investment returns as is prudent, taking into consideration donor restrictions for the usage of investment earnings.

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# Merit School of Music

## Notes to Financial Statements

The endowment fund composition, by type, is as follows for the years ended June 30, 2019 and 2018:

	2019		
	Without Donor Restriction	With Donor Restriction	Total
Donor restricted	\$ -	\$ 23,560	\$ 23,560
Donor restricted- in perpetuity	-	5,924,659	5,924,659
Board designated	10,054,547	-	10,054,547
	<b>\$ 10,054,547</b>	<b>\$ 5,948,219</b>	<b>\$ 16,002,766</b>

	2018		
	Without Donor Restriction	With Donor Restriction	Total
Donor restricted	\$ -	\$ 23,560	\$ 23,560
Donor restricted- in perpetuity	-	5,924,659	5,924,659
Board designated	9,439,021	-	9,439,021
	<b>\$ 9,439,021</b>	<b>\$ 5,948,219</b>	<b>\$ 15,387,240</b>

The changes in endowment net assets were as follows for the years ended June 30, 2019 and 2018:

	2019		
	Without Donor Restrictions Board Designated	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ 9,439,021	\$ 5,948,219	\$ 15,387,240
Contributions and other revenue	-	-	-
Investment earnings	838,470	716,291	1,554,761
Other changes			
Releases of restrictions	21,520	(21,520)	-
Endowment distribution	(671,778)	-	(671,778)
Board designated expenditures	(267,457)	-	(267,457)
Transfer of investment earnings to operations as stipulated by donors	694,771	(694,771)	-
	<b>(222,944)</b>	<b>(716,291)</b>	<b>(939,235)</b>
<b>Endowment Net Assets, end of year</b>	<b>\$ 10,054,547</b>	<b>\$ 5,948,219</b>	<b>\$ 16,002,766</b>

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## Notes to Financial Statements

	2018		Total
	Without Donor Restrictions Board Designated	With Donor Restrictions	
Endowment net assets, beginning of year	\$ 8,330,843	\$ 5,948,219	\$ 14,279,062
Contributions and other revenue	242,264	-	242,264
Investment earnings	748,743	670,671	1,419,414
Other changes			
Releases of restrictions	20,150	(20,150)	-
Endowment distribution	(553,500)	-	(553,500)
Transfer of investment earnings to operations as stipulated by donors	650,521	(650,521)	-
	117,171	(670,671)	(553,500)
<b>Endowment Net Assets, end of year</b>	<b>\$ 9,439,021</b>	<b>\$ 5,948,219</b>	<b>\$ 15,387,240</b>

For the fiscal years ended June 30, 2019 and 2018, the permanent endowment's share of the total investment gain earned by Merit's investment portfolio totaled \$716,291 and \$670,671, respectively. These investment gains are included in the interest and dividends and realized and change in unrealized gain (loss) on investments in the Statements of Activities and Changes in Net Assets.

### 7. Board-Designated Funds

The following is a description of the composition of Merit's board-designated funds included in net assets without donor restrictions:

*Gifts with no restrictions:* The Board has designated certain net assets as being available for investment purposes. These assets are derived from contributions without restrictions from donors. From these assets the Board authorizes an annual 4.50 percent distribution to support current operations. The annual distribution for June 30, 2019 and 2018 totaled \$671,778 and \$553,500, respectively. The Board has designated certain net assets resulting from operating surpluses in the amount of \$15,000 for the year ended June 30, 2019.

*Named scholarship gifts:* Named scholarship gifts result from contributions received in honor or memory of an individual which from the Board has designated the income earned to be used to fund scholarships in the honoree's name. The named scholarship gift balances include accumulated investment income earned on the gifts.

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**Notes to Financial Statements**

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A summary of board-designated net assets is as follows:

<i>June 30,</i>	2019	2018
Gifts with no restriction	\$ 9,152,461	\$ 8,610,027
Named scholarship gifts	917,086	828,994
	<b>\$ 10,069,547</b>	<b>\$ 9,439,021</b>

### 8. Net Assets With Donor Restrictions

Net assets with donor restriction are restricted for the following purposes:

<i>June 30,</i>	2019	2018
Restricted for Andrew W. Mellon Foundation grant	\$ 3,349,535	\$ -
Restricted for programming	872,289	139,295
Pledges and cash for subsequent fiscal years	548,044	290,332
Restricted for scholarships	109,500	113,500
Restricted event donations	40,000	-
Charitable remainder annuity trust	33,583	30,501
Accumulated earnings on Scholarship Fund	23,560	23,560
Restricted for building projects	304	304
	<b>\$ 4,976,815</b>	<b>\$ 597,492</b>

The following is a summary of net assets restricted in perpetuity:

<i>June 30,</i>	2019	2018
Joy Faith Knapp Endowment Fund	\$ 4,000,000	\$ 4,000,000
General Purposes Fund	1,746,659	1,746,659
Scholarship Fund	178,000	178,000
	<b>\$ 5,924,659</b>	<b>\$ 5,924,659</b>

The Joy Faith Knapp Charitable Trust contributed \$4 million to Merit in fiscal year 2005 to establish an endowment fund. To recognize and honor the contribution, Merit named the facility at 38 S. Peoria in Chicago the Joy Faith Knapp Music Center.

### 9. Retirement Plans

The Merit School of Music 401(k) Plan & Trust, a defined-contribution plan, provides retirement benefits to eligible employees of Merit. The 401(k) plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended.

The 401(k) plan is designed as a qualified cash deferral arrangement pursuant to the IRC and provides for both employee-directed and employer contributions. Employee-directed contributions are made by Merit at the direction of the employee and deducted from the employee's direct compensation. The aggregate annual amount of each individual employee-directed contribution is

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limited to federal dollar limits. The 401(k) plan agreement provides for Merit to make a three percent Safe Harbor contribution based upon each participant's base compensation as specified in the 401(k) plan agreement. To be eligible to participate in the 401(k) plan, an employee must be 21 years of age and have one year of service. Participants are immediately vested in their employee-directed contributions and their Safe Harbor contribution received from Merit, including all related earnings thereon. For the years ended June 30, 2019 and 2018, employer contributions to the 401(k) plan totaled \$76,892 and \$78,065, respectively.

### 10. Liquidity and Available Resources

Merit's financial assets available within one year of the Statement of Financial Position date for general expenditure are as follows for June 30, 2019:

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Total assets at year end	\$ 28,772,667
Less nonfinancial assets:	
Property and equipment, net	8,606,978
Other assets	183,323
<hr/>	
Total financial assets available	19,982,366
<hr/>	
Less:	
Amounts unavailable for general expenditures within one year, due to:	
Designated by board with purpose restrictions	(10,069,547)
Restricted in perpetuity endowment fund	(5,924,659)
Restricted by donors with purpose and time restrictions	(4,953,090)
<hr/>	
Total amounts unavailable for general expenditures within one year	(20,947,296)
<hr/>	
<b>Total Financial Assets Available to Management for General Expenditures</b>	
<b>Within One Year</b>	<b>\$ (964,930)</b>

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Merit maintains a policy of structuring its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In the event of a liquidity-need external to budgeted operations, Merit has board designated net assets of \$10,069,547 which would be available for general expenditures upon approval by the Board.