Merit School of Music

Financial Statements
and Supplementary Information
14 Months Ended August 31, 2020

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Merit School of Music

Contents

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Independent Auditor's Report

The Board of Trustees
Merit School of Music
Chicago, Illinois

We have audited the accompanying financial statements of Merit School of Music, which comprise the statement of financial position as of August 31, 2020, and the related statements of activities and changes in net assets, functional expenses, and cash flows for the 14 months 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 the 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 the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Merit School of Music as of August 31, 2020, and the change in its net assets and its cash flows for the period then ended, in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

December 14, 2020

Financial Statements

Merit School of Music

Statement of Financial Position

August 31, 2020	
Assets	
Current Assets	
Cash and cash equivalents	$ 5,651,276
Pledges receivable, current portion	376,900
Tuition receivable, net	209,754
Total Current Assets	6,237,930
Property and Equipment, Net	8,395,867
Other Assets	
Other assets	181,344
Pledges receivable, net - non-current	609,126
Investments	15,812,874
Total Other Assets	16,603,344
Total Assets	$ 31,237,141
Liabilities and Net Assets	
Current Liabilities	
Accounts payable	$ 19,859
Accrued expenses	226,911
Deferred tuition revenue	207,822
Capital lease obligation, current portion	16,169
Total Current Liabilities	470,761
Long-Term Liabilities	
Annuity contract obligation	44,303
Capital lease obligation, less current maturities	28,953
Paycheck Protection Program loan	814,593
Total Long-Term Liabilities	887,849
Total Liabilities	1,358,610
Net Assets	
Without donor restrictions:	
General	7,600,501
Designated by board	11,605,332
	19,205,833
With donor restrictions	10,672,698
Total Net Assets	29,878,531
Total Liabilities and Net Assets	$ 31,237,141

See accompanying notes to financial statements.

Merit School of Music

Statement of Activities and Changes in Net Assets

14 months ended August 31, 2020

	Without Donor Restriction	With Donor Restriction	Total
Revenues, Gains and Other Support			
Contributions	$ 1,846,921	$ 1,107,707	$ 2,954,628
Government grants	46,900	-	46,900
Student fees, net of $832,660 in financial aid	1,838,087	-	1,838,087
School contracts	382,700	-	382,700
Fundraising events, net of expenses of $92,231	1,011,788	40,000	1,051,788
Rental income	422,243	-	422,243
Miscellaneous income	9,807	-	9,807
Interest and dividends, net	410,014	29,686	439,700
Total Revenues, Gains and Other Support, before net assets released from restrictions	5,968,460	1,177,393	7,145,853
Net Assets Released from Restrictions	1,406,169	(1,406,169)	-
Total Revenues, Gains and Other Support	7,374,629	(228,776)	7,145,853
Expenses			
Program services	5,360,749	-	5,360,749
Administration	1,321,441	-	1,321,441
Development	595,256	-	595,256
Total Expenses	7,277,446	-	7,277,446
Change in Net Assets, before gain (loss) on investments	97,183	(228,776)	(131,593)
Realized and Change in Unrealized Gain on Investments	1,767,888	-	1,767,888
Change in Net Assets	1,865,071	(228,776)	1,636,295
Net Assets, beginning of year	17,340,762	10,901,474	28,242,236
Net Assets, end of year	$ 19,205,833	$ 10,672,698	$ 29,878,531

See accompanying notes to financial statements.

Merit School of Music

Statement of Functional Expenses

14 months ended August 31, 2020

	Program Services									Support Services			
	Tuition-Free Conservatory	Merit Music in Communities	Instrumental Music Program	Private Lessons	Early Childhood	Summer	Academic and Support	CMPI	Total Program Services	Administration	Development	Total Support Services	Total
Functional Expenses													
Compensation and staff-related expenses	$ 539,754	$ 689,251	$ 458,312	$ 1,205,814	$ 67,211	$ 79,329	$ 668,895	$ 313,294	$ 4,021,860	$ 985,041	$ 528,255	$ 1,513,296	$ 5,535,156
Program expenses	23,802	63,883	5,989	-	2,029	1,824	89,826	385,586	572,939	-	-	-	572,939
Office expenses	9,322	10,098	10,098	12,293	3,512	3,512	46,625	4,902	100,362	53,667	41,037	94,704	195,066
Marketing expenses	1,313	-	1,275	368	2,516	3,695	199	3,978	13,344	16,589	-	16,589	29,933
Maintenance and operations	93,931	17,080	24,706	36,011	14,599	2,310	14,768	-	203,405	65,846	1,677	67,523	270,928
Outside services	7,708	5,470	4,341	5,971	258	396	9,964	23,491	57,599	49,829	5,846	55,675	113,274
Financial expenses	50	(866)	464	3,298	-	-	55,052	60	58,058	84,652	11,355	96,007	154,065
Depreciation expense	167,522	48,523	26,496	37,532	14,556	3,630	33,590	-	331,849	63,507	7,356	70,863	402,712
Miscellaneous	3,000	-	-	-	-	-	(2,587)	920	1,333	2,310	(270)	2,040	3,373
Total Functional Expenses	$ 846,402	$ 833,439	$ 531,681	$ 1,301,287	$ 104,681	$ 94,696	$ 916,332	$ 732,231	$ 5,360,749	$ 1,321,441	$ 595,256	$ 1,916,697	$ 7,277,446

See accompanying notes to financial statements.

Merit School of Music

Statement of Cash Flows

14 months ended August 31, 2020		
Cash Flows from Operating Activities		
Change in net assets	$	1,636,295
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Provisions for allowance for bad debts		30,000
Depreciation		402,712
Realized and unrealized gain on investments		(1,767,888)
Contributions of donated stock		(89,383)
Changes in operating assets and liabilities:		
Pledges receivable		1,988,640
Tuitions receivable		70,143
Other assets		1,979
Accounts payable and accrued expenses		20,365
Deferred tuition revenue		9,493
Net Cash and Cash Equivalents Provided by Operating Activities		2,302,356
Cash Flows from Investing Activities		
Purchases of property and equipment		(191,601)
Purchases of investments		(158,150)
Proceeds from sales and maturities of investments		711,596
Net Cash and Cash Equivalents Provided by Investing Activities		361,845
Cash Flows from Financing Activities		
Proceeds from line of credit		230,000
Repayments on line of credit		(230,000)
Net proceeds from PPP loan		814,593
Change in annuity contract obligation		1,832
Principal payments on capital lease obligations		(18,104)
Net Cash and Cash Equivalents Provided by Financing Activities		798,321
Net Increase in Cash and Cash Equivalents		3,462,522
Cash and Cash Equivalents, beginning of year		2,188,754
Cash and Cash Equivalents, end of year	$	5,651,276

See accompanying notes to financial statements.

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 and 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, and 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 the students through their journey along the Merit pathway from Early Childhood to the Alice S. Pfaelzer Tuition-Free Conservatory.

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).

Reporting Period

In fiscal year 2020, Merit elected to change its year-end from June 30th to August 31st. The accompanying financial statements are therefore for the 14 months ended August 31, 2020.

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 – This class consists of 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 8).

Net Assets with Donor Restrictions – This class consists of 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.

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 that will be conducted in the subsequent fiscal year (principally tuition deposits) are recorded as deferred tuition revenue in the statement 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, those with a measurable performance or other barrier and a right of return, 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 statement 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, Net

Pledges receivable represents promises to give that 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 .16% to .49% 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 August 31, 2020, 81% of total pledges receivable were receivable from three donors.

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 14 months ended August 31, 2020 was $34,515 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 $89,383 for the 14 months ended August 31, 2020 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 statement of activities and changes in net assets.

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 that 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.

Functional Expenses

In the statement of functional expenses, the costs that 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 administrative 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 14 months ended August 31, 2020.

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),* which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 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. In June 2020, the FASB issued ASU 2020-05, *Revenue from Contracts with Customers,* which defers the effective date of the new revenue recognition standard by one year. This pronouncement is effective for Merit in fiscal 2021 and is to be applied using one of two retrospective application methods, with early adoption permitted. Merit is currently evaluating the impact of ASU 2014-09 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-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 Merit's fiscal year 2023 with early adoption permitted. Merit is currently evaluating the impact of the ASU on its financial statements.

In September 2020, the FASB issued ASU 2020-07, *Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets (Topic 958).* This update addresses presentation and disclosure of contributed nonfinancial assets. This update will require a nonprofit to present contributed nonfinancial assets as a separate line item in the statement of activities, apart from contributions of cash and other financial assets, disclose contributed nonfinancial assets recognized within the statement of activities disaggregated by category that depicts the type of contributed nonfinancial assets, and for each category of contributed nonfinancial assets recognized, include the following: qualitative information about whether the contributed nonfinancial assets were either monetized or utilized during the reporting period (if utilized, to disclose a description of the programs or other activities in which those assets were used), Merit's policy (if any) about monetizing rather than utilizing contributed nonfinancial assets, a descriptions of any donor-imposed restrictions associated with the contributed nonfinancial assets, a description of the valuation techniques and inputs used to arrive at a fair value measure at initial recognition, and the principal market used to arrive at a fair value measure if it is a market in which the recipient is prohibited by a donor-imposed restriction from selling or using the contributed nonfinancial assets. The ASU is to be applied on a retrospective basis and is effective for annual periods beginning after June 15, 2021, and interim periods within annual periods beginning after June 15, 2022. Earlier adoption is permitted. Merit is currently evaluating the impact of this ASU on its financial statements.

Accounting Pronouncements Adopted

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958)*: *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The update clarifies and improves current guidance by providing criteria for determining whether the resource provider is receiving commensurate value in return for the resources transferred, which, depending on the outcome, determines whether Merit follows contribution guidance or exchange transactions guidance under the new revenue recognition guidance and other applicable standards. The update also provides a more robust framework for determining whether a contribution is conditional or unconditional, and for distinguishing a donor-imposed condition from a donor-imposed restriction. The guidance is effective for the 14 months ended August 31, 2020, and the adoption of this update did not have a material impact on Merit's financial statements.

Subsequent Events

Merit has evaluated subsequent events through December 14, 2020, the date the financial statements were available to be issued. Subsequent to year-end, Merit received full forgiveness of the Paycheck Protection Program (PPP) loan from the Small Business Administration (SBA) in the amount of $814,593. No other events have occurred subsequent to August 31, 2020 that required recognition or disclosure in the financial statements besides the matters disclosed above.

2. Pledges Receivable

Pledges receivable consists of the following as of August 31, 2020:

2021	$	376,900
2022		397,635
2023		382,633
2024		12,000
2025		8,000
Thereafter		4,000
Total Pledges Receivable		1,181,168
Less:		
Allowance for doubtful accounts		(193,557)
Unamortized discount on pledges		(1,585)
	$	986,026

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 - This level consists of valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that Merit has the ability to access.

Level 2 – This level consists of 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 – This level consists of 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 14 months ended August 31, 2020.

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.

The following table presents Merit's assets and liabilities measured at fair value on a recurring basis:

August 31, 2020

	Level 1	Level 2	Level 3	Total
Assets				
Common stock	$ 11,484,107	$ -	$ -	$ 11,484,107
Mutual funds	1,039,982	-	-	1,039,982
Fixed income	3,069,373	-	-	3,069,373
Corporate notes	-	20,092	-	20,092
Real estate investment trusts	-	199,320	-	199,320
	$ 15,593,462	$ 219,412	$ -	$ 15,812,874
Liabilities				
Annuity contract obligation	$ -	$ (44,303)	$ -	$ (44,303)

4. Property and Equipment

Property and equipment consist of the following:

August 31, 2020

		Depreciable Lives (Years)
Land	$ 4,450,000	
Building and improvements	5,597,761	7-40
Furniture and fixtures	489,931	5-10
Office equipment	636,222	3-7
Musical instruments and equipment	1,828,597	5-10
Construction in process	2,410	-
	13,004,921	
Less: accumulated depreciation	(4,609,054)	
	$ 8,395,867	

Depreciation expense for the 14 months ended August 31, 2020 totaled $402,712.

5. Line of Credit

Merit has a revolving line of credit that allows for maximum borrowings up to $750,000 with a maturity date of December 15, 2020. Outstanding borrowings bear interest at the prime rate less 0.5% (2.75% at August 31, 2020) and are secured by a certain investment account of Merit. As of August 31, 2020, there were no outstanding borrowings on the line of credit.

6. Paycheck Protection Program Loan

As described in Note 12, on March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the CARES Act) was signed into law. The CARES Act appropriated funds for the SBA PPP loans that are forgivable in certain situations to promote continued employment to provide liquidity to small businesses harmed by COVID-19. In April, 2020, Merit applied for and received funds under the PPP in the amount of $814,593, which is included in PPP loan on the statement of financial position.

The application for these funds requires Merit to, in good faith, certify that the current economic uncertainty made the loan request necessary to support the ongoing operations of Merit. This certification further requires Merit to take into account the current business activity and ability to access other sources of liquidity sufficient to support ongoing operations in a manner that is not significantly detrimental to the business. The receipt of these funds, and the forgiveness of the loan attendant to these funds, is dependent on Merit having initially qualified for the loan and qualifying for the forgiveness of such loan based on future adherence to the forgiveness criteria. As such, there are uncertainties surrounding the extent to which Merit may be eligible for loan forgiveness, but management continues to analyze and monitor the criteria under the program.

The loan has an interest rate of 1.0% and matures two years from the issuance date. Principal payments are deferred for six months and interest accrues from the date of the loan. On June 5, 2020, the Paycheck Protection Program Flexibility Act was signed into law that amends some provisions of the PPP program. The Paycheck Protection Program Flexibility Act modifies certain provision related to the forgiveness of loans under the PPP. Under the Paycheck Protection Program Flexibility Act, payment of principal and interest are deferred until the date that the amount of forgiveness is remitted to the lender. If Merit has not applied for forgiveness within ten months after the last day of the covered period, payments of principal and interest will begin. With the passage of this act, Merit has classified the PPP loan as long-term on the statement of financial position

Subsequent to year-end, Merit received full forgiveness of the PPP loan from the SBA in the amount of $814,593.

7. 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 that 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:

- The duration and preservation of the fund
- The purpose of Merit and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of Merit
- The investment policies of Merit

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 5% 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 2020, 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.

The endowment fund composition, by type, is as follows:

August 31, 2020

	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	11,605,332	-	11,605,332
	$ 11,605,332	$ 5,948,219	$ 17,553,551

The changes in endowment net assets were as follows:

14 months ended August 31, 2020

	Without Donor Restrictions (Board-Designated)	With Donor Restrictions	Total
Endowment Net Assets, beginning of year	$ 10,069,547	$ 5,948,219	$ 16,017,766
Contributions and other revenue	111,317	-	111,317
Investment earnings	1,807,090	371,476	2,178,566
Other changes:			
Releases of restrictions	11,161	(11,161)	-
Endowment distribution	(751,800)	-	(751,800)
Board-designated expenditures	(2,298)	-	(2,298)
Transfer of investment earnings to operations as stipulated by donors	360,315	(360,315)	-
	(382,622)	(371,476)	(754,098)
Endowment Net Assets, end of year	$ 11,605,332	$ 5,948,219	$ 17,553,551

For the 14 months ended August 31, 2020, the permanent endowment's share of the total investment gain earned by Merit's investment portfolio totaled $371,476. These investment gains are included in the interest and dividends and realized and change in unrealized gain on investments in the statement of activities and changes in net assets.

8. 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 5% distribution to support current operations. The annual distribution for August 31, 2020 totaled $751,800.

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.

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

August 31, 2020	
Gifts with no restriction	$ 10,661,873
Named scholarship gifts	943,459
	$ 11,605,332

9. Net Assets with Donor Restrictions

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

August 31, 2020	
Restricted for Andrew W. Mellon Foundation grant	$ 2,623,081
Pledges and cash for subsequent fiscal years	1,139,154
Restricted for programming	819,416
Restricted for scholarships	84,000
Restricted event donations	40,000
Charitable remainder annuity trust	18,524
Accumulated earnings on Scholarship Fund	23,560
Restricted for building projects	304
	$ 4,748,039

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

August 31, 2020	
Joy Faith Knapp Endowment Fund	$ 4,000,000
General Purposes Fund	1,746,659
Scholarship Fund	178,000
	$ 5,924,659
Total Net Assets with Donor Restrictions	$ 10,672,698

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.

10. 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 limited to federal dollar limits. The 401(k) plan agreement provides for Merit to make a 3% 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 14 months ended August 31, 2020, employer contributions to the 401(k) plan totaled $95,760.

11. 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:

August 31, 2020	
Total Assets, at year-end	$ 31,237,141
Less:	
Nonfinancial assets:	
Property and equipment, net	8,395,867
Other assets	181,344
Total Financial Assets Available	22,659,930
Amounts unavailable for general expenditures within one year, due to:	
Designated by board with purpose restrictions	(11,605,332)
Restricted in perpetuity endowment fund	(5,924,659)
Restricted by donors with purpose and time restrictions	(4,748,039)
Total Amounts Unavailable for General Expenditures Within One Year	(22,278,030)
Total Financial Assets Available to Management for General Expenditures Within One Year	$ 381,900

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 $11,605,332 that would be available for general expenditures upon approval by the Board.

12. Risks and Uncertainties

COVID-19

On January 30, 2020, the World Health Organization (WHO) announced a global health emergency because of a new strain of coronavirus (the COVID-19 outbreak) and the risks to the international community as the virus spreads globally beyond its point of origin. In March 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally.

Management is actively monitoring the impact of the global situation on the not-for-profit industry, financial conditions, liquidity and operations. Given the daily evolution of the COVID-19 outbreak and the global responses to curb its spread, Merit is not able to estimate the effects of the COVID-19 outbreak on its results of operations, financial condition or liquidity for fiscal year 2021. Although Merit cannot estimate the length or gravity of the impact of the COVID-19 outbreak at this time, if the pandemic continues, it may have an adverse effect on results of future operations, financial position, and liquidity in fiscal years beyond 2021.

CARES Act

On March 27, 2020, the U.S. Government enacted and signed into law the CARES Act. The CARES Act, among other things, includes provisions relating to refundable payroll tax credits, deferment of employer-side social security payments, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations, increased limitations on qualified charitable contributions, and technical corrections to tax depreciation methods for qualified improvement property.

The CARES Act also appropriated funds for the PPP loans that are forgivable in certain situations to promote continued employment, as well as Economic Injury Disaster Loans to provide liquidity to small businesses harmed by COVID-19. See Note 6 for details regarding the PPP loan Merit received.

The CARES Act allows for an employer to defer its share of Social Security taxes. The deferral is available with respect to employment tax deposits due after March 27, 2020 and before January 1, 2021. Merit has not elected to defer payments at this time. Merit continues to examine the impact that the CARES Act may have on the organization.

Supplementary Information

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Independent Auditor's Report on Supplementary Information

Our audit of the financial statements included in the preceding section of this report was conducted for the purpose of forming an opinion on those financial statements as a whole. The supplementary information presented on page 26 is presented for the purposes of additional analysis and is not a required part of those financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and to certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and to other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

BDO USA, LLP

December 14, 2020

Merit School of Music

Schedules of Activities and Changes in Net Assets

Period ended,	Two Months Ended August 31, 2020			12 Months Ended June 30, 2020		
	Without Donor Restriction	**With Donor Restriction**	**Total**	Without Donor Restriction	With Donor Restriction	Total
Revenues, Gains and Other Support						
Contributions	**$ 4,197**	**$ 164,347**	**$ 168,544**	$ 1,842,724	$ 943,360	$ 2,786,084
Government grants	**1,000**	**-**	**1,000**	45,900	-	45,900
Student fees, net of $134,342 and $698,318 in financial aid, respectively	**331,166**	**-**	**331,166**	1,506,921	-	1,506,921
School contracts	**-**	**-**	**-**	382,700	-	382,700
Fundraising events, net of expenses of $3,350 and $88,881, respectively	**(1,645)**	**-**	**(1,645)**	1,013,433	40,000-	1,053,433
Rental income	**48,407**	**-**	**48,407**	373,836	-	373,836
Miscellaneous income	**38**	**-**	**38**	9,769	-	9,769
Interest and dividends, net	**30,519**	**6,709**	**37,228**	379,495	22,977	402,472
Total Revenues, Gains and Other Support, before net assets released from restrictions	**413,682**	**171,056**	**584,738**	5,554,778	1,006,337	6,561,115
Net Assets Released from Restrictions	**100,178**	**(100,178)**	**-**	1,305,991	(1,305,991)	-
Total Revenues, Gains and Other Support	**513,860**	**70,878**	**584,738**	6,860,769	(299,654)	6,561,115
Expenses						
Program services	**576,682**	**-**	**576,682**	4,784,067	-	4,784,067
Administration	**177,890**	**-**	**177,890**	1,143,551	-	1,143,551
Development	**95,289**	**-**	**95,289**	499,967	-	499,967
Total Expenses	**849,861**	**-**	**849,861**	6,427,585	-	6,427,585
Change in Net Assets, before gain (loss) on investments	**(336,001)**	**70,878**	**(265,123)**	433,184	(299,654)	133,530
Realized and Change in Unrealized Gain on Investments	**1,312,953**	**-**	**1,312,953**	454,935	-	454,935
Change in Net Assets	**976,952**	**70,878**	**1,047,830**	888,119	(299,654)	588,465
Net Assets, beginning of year	**18,228,881**	**10,601,820**	**28,830,701**	17,340,762	10,901,474	28,242,236
Net Assets, end of year	**$ 19,205,833**	**$ 10,672,698**	**$ 29,878,531**	$ 18,228,881	$ 10,601,820	$ 28,830,701

See independent auditor's report on supplementary information.