



**Consolidated Financial Statements with Report of
Independent Certified Public Accountants**

San Francisco Ballet Association

June 30, 2017

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Report of Independent Certified Public Accountants

To the Board of Trustees
San Francisco Ballet Association

Grant Thornton LLP
101 California Street, Suite 2700
San Francisco, CA 94111

T 415.986.3900
F 415.986.3916
www.GrantThornton.com

We have audited the accompanying consolidated statement of financial position of the San Francisco Ballet Association (the “Ballet”) as of June 30, 2017, and the related consolidated statement of activities and changes in net assets and the consolidated statement of cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management’s responsibility

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

Auditor’s responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the San Francisco Ballet Association as of June 30, 2017, and its changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating supplementary information on the 2017 consolidated statement of activities and changes in net assets is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Report on 2016 summarized comparative information

We have previously audited the Ballet's 2016 consolidated financial statements, and expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 18, 2016. The summarized comparative information presented herein as of and for the year ended June 30, 2016 is derived from those consolidated financial statements.

Grant Thornton LLP

San Francisco, California
October 18, 2017

June 30, 2017

(With summarized financial information as of June 30, 2016)

(In thousands of dollars)

Consolidated statement of financial position

	June 30, 2017	June 30, 2016
ASSETS		
Cash and cash equivalents	\$ 11,288	\$ 10,052
Accounts receivable	231	287
Prepaid expenses and deposits	2,183	1,598
Pledges receivable, net	1,386	2,436
Receivables from split interest agreements, net	5,795	5,490
Other investments	683	660
Other assets	435	326
Restricted cash	5,877	8,397
Property and equipment, net	24,368	26,316
Endowment investments	119,021	100,633
Total assets	<u>\$ 171,267</u>	<u>\$ 156,195</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 6,768	\$ 7,017
Current portion loans payable	1,844	1,831
Deferred compensation and postretirement benefit obligation	1,416	1,274
Deferred performance and school revenue	6,910	6,602
Gift annuity payment liability	1,628	1,548
Interest rate swap liability	6,419	9,045
Non-current loans payable, net	40,445	42,271
Total liabilities	<u>65,430</u>	<u>69,588</u>
NET ASSETS:		
Unrestricted	16,201	10,694
Temporarily restricted	14,670	12,504
Permanently restricted	74,966	63,409
Total net assets	<u>105,837</u>	<u>86,607</u>
	<u>\$ 171,267</u>	<u>\$ 156,195</u>

See accompanying notes to consolidated financial statements.

San Francisco Ballet Association

June 30, 2017

(With summarized financial information as of June 30, 2016)

(In thousands of dollars)

Consolidated statement of activities and changes in net assets

	For the year ended June 30, 2017							
	Unrestricted				Temporarily Restricted	Permanently Restricted	Total	For the year ended June 30, 2016
	Operating	Property	Board-Designated	Total				
	Consolidating supplementary information							
OPERATING REVENUES:								
San Francisco performance	\$ 23,985	\$ -	\$ -	\$ 23,985	\$ -	\$ -	\$ 23,985	\$ 21,980
Touring	643	-	-	643	-	-	643	542
School and student housing, net of scholarships of \$1,183	2,283	-	-	2,283	-	-	2,283	2,097
Other income, net	330	64	2	396	-	-	396	742
Total operating revenues	<u>27,241</u>	<u>64</u>	<u>2</u>	<u>27,307</u>	<u>-</u>	<u>-</u>	<u>27,307</u>	<u>25,361</u>
OPERATING EXPENSES:								
Program services:								
Ballet production	30,431	2,241	-	32,672	-	-	32,672	31,344
Touring	820	-	-	820	-	-	820	1,330
School and student housing	2,835	358	-	3,193	-	-	3,193	3,148
Education and outreach	627	25	-	652	-	-	652	515
Total program services	<u>34,713</u>	<u>2,624</u>	<u>-</u>	<u>37,337</u>	<u>-</u>	<u>-</u>	<u>37,337</u>	<u>36,337</u>
Support services:								
Marketing, publicity and audience development	5,987	62	-	6,049	-	-	6,049	6,163
General and administrative	4,400	232	414	5,046	-	-	5,046	4,876
Total support services	<u>10,387</u>	<u>294</u>	<u>414</u>	<u>11,095</u>	<u>-</u>	<u>-</u>	<u>11,095</u>	<u>11,039</u>
Debt service	-	1,062	-	1,062	-	-	1,062	959
Total operating expenses	<u>45,100</u>	<u>3,980</u>	<u>414</u>	<u>49,494</u>	<u>-</u>	<u>-</u>	<u>49,494</u>	<u>48,335</u>
Operating revenues less operating expenses	<u>(17,859)</u>	<u>(3,916)</u>	<u>(412)</u>	<u>(22,187)</u>	<u>-</u>	<u>-</u>	<u>(22,187)</u>	<u>(22,974)</u>
SUPPORT:								
Contributions	13,710	-	474	14,184	4,300	10,777	29,261	20,524
Special events and other activities	4,038	-	-	4,038	416	-	4,454	4,266
Net assets released:								
From donor restriction	3,496	860	3,663	8,019	(8,019)	-	-	-
By appropriation	4,324	566	(4,890)	-	-	-	-	-
Total contributions in support of operations	<u>25,568</u>	<u>1,426</u>	<u>(753)</u>	<u>26,241</u>	<u>(3,303)</u>	<u>10,777</u>	<u>33,715</u>	<u>24,790</u>
Fundraising expenses	(3,511)	(58)	(545)	(4,114)	-	-	(4,114)	(2,561)
Fundraising expenses for special events	(1,332)	-	-	(1,332)	-	-	(1,332)	(1,231)
Costs of direct benefits to donors for special events	(502)	-	-	(502)	-	-	(502)	(467)
Support, net	<u>20,223</u>	<u>1,368</u>	<u>(1,298)</u>	<u>20,293</u>	<u>(3,303)</u>	<u>10,777</u>	<u>27,767</u>	<u>20,531</u>
CHANGE IN NET ASSETS FROM OPERATIONS	<u>2,364</u>	<u>(2,548)</u>	<u>(1,710)</u>	<u>(1,894)</u>	<u>(3,303)</u>	<u>10,777</u>	<u>5,580</u>	<u>(2,443)</u>
NON-OPERATING:								
Endowment investment income (loss), net	-	-	5,562	5,562	5,469	780	11,811	(1,860)
Change in post-retirement benefit obligation	(31)	-	-	(31)	-	-	(31)	(136)
Net realized and unrealized gain (loss) on interest rate sw ap	-	1,870	-	1,870	-	-	1,870	(3,428)
INCREASE (DECREASE) IN NET ASSETS	<u>2,333</u>	<u>(678)</u>	<u>3,852</u>	<u>5,507</u>	<u>2,166</u>	<u>11,557</u>	<u>19,230</u>	<u>(7,867)</u>
NET ASSETS (DEFICIT) - Beginning of Year	5,608	(28,833)	33,919	10,694	12,504	63,409	86,607	94,474
NET ASSETS (DEFICIT) - End of Year	<u>\$ 7,941</u>	<u>\$ (29,511)</u>	<u>\$ 37,771</u>	<u>\$ 16,201</u>	<u>\$ 14,670</u>	<u>\$ 74,966</u>	<u>\$ 105,837</u>	<u>\$ 86,607</u>

See accompanying notes to consolidated financial statements.

San Francisco Ballet Association

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Year ended June 30, 2017

(With summarized financial information as of June 30, 2016)

(In thousands of dollars)

Consolidated statement of cash flows

	<u>2017</u>	<u>2016</u>
OPERATING ACTIVITIES:		
Increase (decrease) in net assets	\$ 19,230	\$ (7,867)
Adjustments to reconcile increase in net assets to cash provided/(used) by operating activities:		
Permanently restricted contributions received	(11,023)	(1,458)
Depreciation	2,988	2,716
Loss on asset disposals	-	9
Amortization of loan issuance costs	18	18
Net realized and unrealized (gain) loss on investments	(2,755)	3,669
Limited partnership investment gains, net	(7,232)	(86)
Proceeds from sales of donated securities	(447)	(1,701)
Change in allowance for doubtful pledges receivable	(50)	42
Change in discount of pledges receivable	(66)	(11)
Change in fair value of the interest rate swap	(2,626)	2,614
Net effect of changes in:		
Accounts receivable	56	209
Prepaid expenses and deposits	(585)	(101)
Pledges receivable	1,166	2,139
Receivables from split-interest agreements	(305)	334
Other assets	(109)	(61)
Gift annuity payment liability	80	(178)
Deferred compensation and postretirement benefit obligation	142	196
Accounts payable and accrued expenses	(246)	902
Deferred performance and school revenue	308	591
Net cash (used in) provided by operating activities	<u>(1,456)</u>	<u>1,976</u>
INVESTING ACTIVITIES:		
Purchases of endowment investments	(20,734)	(14,838)
Proceeds from sales of endowment investments	12,333	17,632
Increase in operating cash in endowment portfolio	(23)	(25)
Decrease (increase) in restricted cash	2,520	(2,580)
Purchase of property and equipment	(1,040)	(1,307)
Net cash used in investing activities	<u>(6,944)</u>	<u>(1,118)</u>
FINANCING ACTIVITIES:		
Proceeds from sales of donor restricted securities	447	1,701
Permanently restricted contributions received	11,023	1,458
Principal payments on bond payable	(1,831)	-
Principal payments on capital lease obligation	(3)	(10)
Net cash provided by financing activities	<u>9,636</u>	<u>3,149</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,236	4,008
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	10,052	6,044
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 11,288</u>	<u>\$ 10,052</u>
SUPPLEMENTAL DISCLOSURES:		
Cash paid during the year for interest	<u>\$ 1,799</u>	<u>\$ 1,753</u>

See accompanying notes to consolidated financial statements.

June 30, 2017

(In thousands of dollars)

Notes to consolidated financial statements

Note 1 - Summary of significant accounting policies

Organization

San Francisco Ballet Association (the "Association") operates both a dance company and a ballet school. As America's oldest professional ballet company and one of the three largest ballet companies in the United States with its year-end roster of sixty-eight dancers, the Association has enjoyed a long and rich tradition of artistic "firsts" since its founding in 1933. It performed the first American productions of *Swan Lake* and *Nutcracker*; as well as the first production of *Coppelia* choreographed by an American choreographer. Guided in its early years by American dance pioneers and brothers Lew, Willam, and Harold Christensen, the Association currently presents more than 100 performances annually in San Francisco, California, and other communities in the Bay Area, as well as annual tours to domestic and international locations. San Francisco Ballet Endowment Foundation (the "Foundation"), a separate legal entity, holds the majority of the assets of the endowment for the benefit of the Association. The Association and the Foundation (collectively, the "Ballet") are California not-for-profit corporations founded in 1933 and 1980, respectively.

Principles of consolidation

The accompanying consolidated financial statements include the statement of financial position, statement of activities and changes in net assets, and statement of cash flows of the Association and the Foundation because the Association has both control of and economic interest in the Foundation. Intercompany transactions and accounts have been eliminated in consolidation.

Basis of presentation

The accompanying consolidated financial statements are presented on the basis of unrestricted, temporarily restricted, and permanently restricted net assets.

The consolidated financial statements include certain prior year summarized comparative information in total but not by asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles general accepted in the United States of America ("GAAP"). Accordingly, such information should be read in conjunction with the Ballet's consolidated financial statements for the year ended June 30, 2016, from which the summarized information was derived.

Cash and cash equivalents

Cash and cash equivalents consist of demand deposits and highly liquid investments, including certificates of deposit, with remaining maturities of three months or less.

June 30, 2017

(In thousands of dollars)

Note 1 - Summary of significant accounting policies (continued)**Pledges receivable**

Pledges receivable consist of unconditional promises to give that are expected to be collected in future years. Such receivables are recorded at the present value of their estimated future cash flows. The discount on pledges receivable pledged during the year ended June 30, 2017 utilized a risk-adjusted rate of 2.700%. For pledge receivables pledged prior to the year ended June 30, 2017, the discounts on these amounts were computed using risk-adjusted rates applicable in the years in which those promises were received ranging from 0.095% to 2.262%. Amortization of the discounts is included in contributions in the accompanying consolidated statement of activities and changes in net assets.

Receivables from split interest agreements and gift annuity payment liability

Receivables from split interest agreements represent the Ballet's irrevocable remainder interests in a pooled income fund and various trusts primarily held by third-party trustees. The pooled income fund and trusts are stated at estimated fair value, which is measured as the present value of the estimated future distributions expected to be received over the expected terms of the agreements. Trusts contributed by donors under charitable gift annuity agreements and controlled by the Ballet are recognized at estimated fair value with a corresponding liability to beneficiaries of the annuity agreements. Such liability is calculated as the present value of the estimated future cash flows to be distributed to the income beneficiaries over their expected lives. In determining the present value, the Ballet considers single or joint life expectancy for new gifts from the 2000CM Combined Healthy Mortality Table and prior gifts using the same mortality table as used in prior years, the estimated return on the invested assets during the expected term of the agreements, the contractual payment obligations under the agreements, and a discount rate reflective of current market conditions.

Other investments

Other investments consists of a fund invested in mutual funds established by a collective bargaining agreement between the American Guild of Musical Artists and the Association restricted to support dancer career transitions.

Other assets

Other assets consist of a voluntary salary deferral plan for certain highly compensated employees under Internal Revenue Code Section 457(b) (See Note 9).

Restricted cash

Restricted cash is invested in cash and cash equivalents that are held by third parties in restricted accounts in accordance with an interest rate swap agreement and requirements set forth in an agreement for collateral posting. The decrease in restricted cash during the year ended June 30, 2017, of \$2,520 relates primarily to the decrease in the interest rate swap liability.

Loan issuance costs

Loan issuance costs are being amortized over the term of the related loans payable. Costs associated with previous loan issuances are amortized in the year in which a refinancing occurs.

June 30, 2017

(In thousands of dollars)

Note 1 - Summary of significant accounting policies (continued)**Property and equipment**

Property and equipment are stated at cost. Donated property and equipment is recorded at estimated fair value at the date of receipt. The building and improvements are being depreciated on a straight-line basis over 20-40 years. Depreciation of furniture and equipment is computed on the straight-line basis over the estimated useful life of the assets, generally 3-10 years.

Fixed assets that are acquired with resources restricted for such acquisition are considered to be temporarily restricted and are released from restrictions over the estimated useful life of the asset.

Maintenance expenses and all costs for new productions, including sets, costumes, and choreography, are charged to Operating expense as incurred or in the year of initial performance with the exception of costs associated with full-length works. Full-length works are capitalized and depreciated on a straight-line basis within the Property Fund over the first two years the new works are presented. The Ballet's production of *Nutcracker*, including the costs for sets, costumes, staging, and choreography, completed in 2005 and updated in 2007, is being depreciated on a straight-line basis over 15 years, beginning in 2005. The Ballet's production of *Swan Lake*, which was last performed in 2016, including the costs for sets, costumes, staging, and choreography, completed in 2009 and updated in 2016, is being depreciated on a straight-line basis over the first five years the work is presented, beginning in 2009.

Endowment investments

Endowment investments consist of fixed income investments, mutual fund investments, alternative investments, real estate, and cash and cash equivalent balances restricted by donors or designated by the Association's Board of Trustees for long-term investment. Investments in fixed income investments and mutual fund investments are stated at estimated fair value. Fair value is the amount 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 (i.e., the exit price). Other investments, such as alternative investments, are also recorded at estimated fair value. The fair values of alternative investments have been estimated using the net asset value per share of the investment. Investments in real estate partnerships are based primarily on third party appraisals of the underlying real estate. Gains or losses that result from market fluctuations are recognized in the period such fluctuations occur. Dividend and interest income are recognized when earned.

Deferred compensation and postretirement benefit obligations

The Ballet's deferred compensation and postretirement benefit obligation arises from an individual contract with provisions for postretirement health benefits and salary continuance. In determining the fair value of the salary continuance, the Ballet considers the present value of expected future cash commitments. In determining the fair value of the postretirement health benefits, the Ballet considers the RP-2014 White Collar Healthy Mortality Table projected generationally with Scale MP-2016, makes assumptions about future increases in health care premiums, and employs a discount rate based on the Citigroup Pension Discount Curve. Due to uncertainties inherent in the estimation process, it is possible that future events in either the near or long term could materially affect the amounts reported in the consolidated statement of financial position.

June 30, 2017

(In thousands of dollars)

Note 1 - Summary of significant accounting policies (continued)**Deferred performance and school revenue**

Deferred performance and school revenue as of June 30, 2017 primarily consists of advance ticket sales for performances scheduled in the Ballet's 2018 repertory season, which opens in January 2018 as well as advance tuition payments for school classes to be conducted in the year ending June 30, 2018.

Derivative instruments

Derivative financial instruments are used by the Ballet on a limited basis to manage interest rate risk associated with its tax-exempt loans. Derivative financial instruments, which for the Ballet consist of one interest rate swap agreement discussed further in Note 7, are recorded at their fair market value in the liabilities section in the accompanying consolidated statement of financial position. Changes in the underlying value of derivative financial instruments are recorded in net realized and unrealized loss on interest rate swap agreement in the accompanying consolidated statement of activities and changes in net assets. The Ballet does not enter into derivative contracts for the purpose of speculation.

Unrestricted net assets

Unrestricted net assets are available to support all activities of the Ballet and are not subject to donor-imposed stipulations:

Property— The Property fund represents funds raised through loan fundraising or allocated by the Board of Trustees to acquire long-lived assets which include property and equipment assets. Assets and/or liabilities related to loan financing and derivative agreements are also included within this fund. Depreciation, amortization and debt-related activity associated with long-lived assets, loan financing and derivative agreements are incurred within the fund, including realized and unrealized gains and losses on the Ballet's interest swap agreements. Depreciation and facilities related expenses are allocated to both program and support services using the Ballet's functional expense allocation methodology as disclosed below.

Board-Designated— The Board-Designated fund represents funds designated by the Association's Board of Trustees to function as part of the endowment pool of investments. An annual allocation of funds based on 5% of the Ballet's endowment funds' average fair value over the prior twelve quarters years as of June 30, preceding the fiscal year in which the distribution is planned is made by the Foundation's Board of Directors (see Note 10). This allocation is reflected as net assets released for appropriation within Support. General and administrative support services are comprised of the operating costs of the endowment funds and bad debt expense. The Board of Trustees can approve the movement of funds from board-designated funds to other unrestricted funds in accordance with their policies and procedures.

Operating— The Operating fund represents the core operating activity of the Ballet. Revenues and expenses from performances, touring, school and student housing are earned/incurred within the operating fund.

June 30, 2017

(In thousands of dollars)

Note 1 - Summary of significant accounting policies (continued)**Temporarily restricted net assets**

Temporarily restricted net assets represent contributions whose use is limited by donor-imposed stipulations that expire by the passage of time or can be fulfilled and removed by actions of the Ballet pursuant to those stipulations. Temporarily restricted net assets also include accumulated appreciation of permanently restricted endowment funds that have not been appropriated by the Board in accordance with the California Uniform Prudent Management of Institutional Funds Act of 2008 ("UPMIFA").

Permanently restricted net assets

Permanently restricted net assets represent contributions whose use is limited by donor-imposed stipulations that require the gift to be invested in perpetuity. The income from such invested assets, including realized and unrealized gains, is generally available to support the activities of the Ballet. Donors may also restrict all or part of the income and/or appreciation from these investments to permanently restricted net assets, resulting in increases/decreases to these net assets.

Other income

Other income is presented net of costs of approximately \$725 relating to sales and rentals for the year ended June 30, 2017.

Revenue recognition

All contributions are recognized as revenue when received or unconditionally promised to the Ballet. The Ballet classifies gifts of cash and other assets as temporarily or permanently restricted support if received with donor stipulations that limit the use of the contributions. When such restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions. Temporarily restricted contributions are reported as unrestricted support when the restriction is met in the same period as the contribution is received or when appropriated for expenditure by the Board. Conditional promises to give are not recognized as revenue until the conditions are substantially met. Investments received as gifts are initially recorded at estimated fair value at the date of donation. The Ballet's irrevocable interest in split interest agreements is recognized as revenue at the time such agreements are made known to the Ballet.

Contribution of services

Contributions of services are recognized when received if such services (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not donated. During the year ended June 30, 2017, the value of contributed services recognized as revenues and expenses in the accompanying consolidated financial statements was \$2,374 and consisted primarily of \$1,253 in donated advertising services and \$296 for special events and other activities. In addition, a substantial number of volunteers have donated significant amounts of time in the Ballet's program services and fundraising activities through participation in the Auxiliary, Encore!, Allegro Circle, and BRAVO (Ballet Resource and Volunteer Organization). The value of donated volunteer services has not been recognized in the accompanying consolidated financial statements because such volunteer services do not meet the criteria described above.

June 30, 2017

(In thousands of dollars)

Note 1 - Summary of significant accounting policies (continued)**Functional expense allocations**

Expenses applicable to more than one activity, such as facilities-related depreciation, supplies, travel, personnel, and occupancy costs, are allocated among program services and support services on the basis of usage and management estimates.

Estimated fair value of financial instruments

The Ballet's financial instruments include cash, cash equivalents, investments, split-interest agreements, real estate, and a swap agreement. For cash and cash equivalents, the carrying amounts approximate fair value because of the short maturity of these items. The swap agreement is reflected at its estimated fair value using the methodology described in Note 7.

The Ballet adopted guidance which defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures about fair value measurements. This guidance also allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value ("NAV") per share or its equivalent.

Enhanced disclosures about financial instruments that are measured and reported at fair value are required under the guidance. A fair value hierarchy has been established which prioritizes and ranks the level of market price observability used in measuring fair value. Market price observability is impacted by a number of factors, including the type of instrument, the characteristics specific to the instrument, and the state of the marketplace (including the existence and transparency of transactions between market participants). Instruments with readily available actively quoted prices or for which fair value can be measured from actively quoted prices in an orderly market will generally have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Instruments measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

Level 1 — Quoted prices are available in active markets for identical instruments as of the reporting date. The types of instruments which would generally be included in Level 1 include listed equity securities and fixed income mutual funds. The Ballet, to the extent that it holds such instruments, does not adjust the quoted price for these instruments, even in situations where the Ballet holds a large position and a sale could reasonably impact the quoted price.

Level 2 — Pricing inputs are observable for the instruments, either directly or indirectly, as of the reporting date, but are other than quoted prices in active markets as in Level 1. Fair value is determined through observable trading activity reported at net asset value or through the use of models or other valuation methodologies. The types of instruments which would generally be included in this category include unlisted derivative financial instruments and alternative investments for which an exit price has been observed.

June 30, 2017

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Estimated fair value of financial instruments, continued**

Level 3— Pricing inputs are unobservable for the instrument and include situations where there is little, if any, market activity for the instrument. The inputs into the determination of fair value require significant judgment or estimation by the Ballet. The types of instruments which would generally be included in this category include split interest agreements, real estate, and limited partnerships with designated investments, lock up periods or gates extending more than three months beyond the statement of financial position date.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for any given instrument is based on the lowest level of input that is significant to the fair value measurement. The Ballet'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 instrument.

See Note 3 for fair value measurement disclosures.

Concentrations of credit risk

Financial instruments that potentially subject the Ballet to credit risk consist primarily of cash, cash equivalents, accounts and pledges receivable, and endowment investments. The Ballet maintains cash and cash equivalents with major financial institutions. During the year ended June 30, 2017, such amounts have exceeded Federal Deposit Insurance Corporation (FDIC) limits. The Ballet's endowment investments have been placed with a major custodian, First Republic Trust Company. The Ballet closely monitors these endowment investments and its accounts and pledges receivable and has not experienced significant credit losses. As of June 30, 2017, the following endowment investments equal or exceed 5% of the fair market value of total endowment investments:

Dodge & Cox Income Fund	14%
Dreyfus US Government Fund	7
Dodge & Cox Global Stock Fund	7
Dreyfus US Govt Prime Cash Mgt	6
D & C Osterweis Strategic Income Fund	6
250 Post Street LLP	6
Cevian Capital II Ltd.	6
Cash Equivalents	5
Aurelius Capital International Ltd.	5
Abrams Capital Partners II, L.P. Fund	5
Bracebridge LTD	5
Canyon Value Realization Fund	5
Generation IM Global Equity Fund	5

Income tax status

The Ballet follows guidance that clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to financial statement recognition and measurement. This guidance provides that the tax effects from an uncertain tax position can only be

June 30, 2017

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Income tax status, continued**

recognized in the financial statements if the position is “more-likely-than-not” to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position, without regard to the likelihood that the tax position may be challenged

The Association and the Foundation are exempt from federal income tax under IRC section 501(c)(3) of the Internal Revenue Code, though it is subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the Code. The Association and the Foundation are also exempt from California franchise taxes under Revenue and Taxation Code Section 23701d on its income other than unrelated business income. The Ballet has processes presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; to determine its filing and tax obligations in jurisdictions for which it was nexus; and to identify and evaluate other matters that may be considered tax positions. The Ballet has determined that there are no material uncertain tax positions that require recognition or disclosure in the financial statements. Tax penalties and interest of \$1 are classified as tax expense for the year ended June 30, 2017.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. As disclosed above, estimates are used for, but not limited to, accounts and pledges receivable valuation, split interest agreement receivables and liabilities valuation, depreciable lives of property and equipment, fair value of endowment investments, postretirement benefits liabilities, and fair value of the loan and swap agreements and the related credit valuation adjustments. Actual results could differ from those estimates.

New accounting pronouncements

In February 2016, the FASB issued ASU 2016-02 – *Leases (Topic 842)*. The amendments in this update will supersede much of the existing authoritative guidance for leases. This guidance requires lessees, among other things, to recognize right-of-use assets and liabilities on their statement of financial position for all leases with lease terms longer than twelve months. The amendments in the update are effective for fiscal years beginning after December 15, 2019 with early application permitted. The Ballet is currently evaluating the impact of this pronouncement on its financial statements.

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 amendments in this update make improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB’s improvements to net asset classification requirements and the information presented about a not-for-profit entity’s liquidity, financial performance, and cash flows. The amendments in the update are effective for annual financial statements issued for fiscal years beginning after December 15, 2017 with early application permitted. Amendments should be applied on a retrospective basis in the year the update is first applied. The Ballet is currently evaluating the impact of this pronouncement on its financial statements.

June 30, 2017

(In thousands of dollars)

Note 1 - Summary of significant accounting policies (continued)

New accounting pronouncements, continued

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of 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. This guidance is effective for fiscal years beginning after December 15, 2017. The Ballet is evaluating the impact this update will have on its financial statements.

Note 2 - Pledges receivable

Pledges receivable as of June 30, 2017 are due as follows:

2018	\$	1,319
2019		95
2020		57
2021		50
Total pledges receivable		<u>1,521</u>
Less allowance for doubtful pledges receivable		(88)
Less discount for amounts expected to be collected after June 30, 2017		(47)
Pledges receivable, net	<u>\$</u>	<u>1,386</u>

At June 30, 2017, pledges receivable included pledges of \$800 from members of the Association's Board of Trustees and the Foundation's Board of Directors (see Note 14).

June 30, 2017

(In thousands of dollars)

Note 3 – Fair value measurements

As of June 30, 2017, the Ballet's investments are classified by levels within the valuation hierarchy as follows:

	Level 1	Level 2	Level 3	Total
Assets				
Assets held for and in split interest agreements				
Mutual funds				
Fixed income-US	\$ 198	\$ -	\$ -	\$ 198
Fixed income-global	224	-	-	224
Equity-US	1,236	-	-	1,236
Equity-global	596	-	-	596
Complementary strategies	270	-	-	270
Real Assets	158	-	-	158
Beneficial interest in charitable remainder trusts	-	-	2,011	2,011
Total assets held for and in from split interest agreements, net	<u>2,682</u>	<u>-</u>	<u>2,011</u>	<u>4,693</u>
Other Investments:				
Money market funds	\$ 161	\$ -	\$ -	\$ 161
Mutual funds				
Fixed income-government	235	-	-	235
Fixed income-other	245	-	-	245
Cash in Transit	41	-	-	41
Total other investments	<u>\$ 683</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 683</u>
Endowment Investments:				
Money market funds	\$ 13,530	\$ -	\$ -	\$ 13,530
Fixed income securities				
US Government agencies	616	425	-	1,041
Government bonds and notes	-	2,049	-	2,049
Corporate bonds	5,115	277	-	5,392
Foreign income securities	-	198	-	198
Mutual funds				
Fixed income	22,258	-	-	22,258
Equity-US	2,572	-	-	2,572
Equity-global	10,303	-	-	10,303
Subtotal investments	<u>\$ 40,863</u>	<u>\$ 2,948</u>	<u>\$ -</u>	<u>\$ 57,343</u>
Alternative investments				
Real estate partnership fund	\$ -	\$ -	\$ 7,426	\$ 7,426
Valued at NAV				
Credit strategies hedge fund	-	-	-	1,293
Event-driven hedge fund	-	-	-	12,117
Multi-strategy hedge fund	-	-	-	9,166
Long-biased hedge fund	-	-	-	25,705
Relative value hedge fund	-	-	-	5,971
Alternative investments valued at NAV	<u>-</u>	<u>-</u>	<u>7,426</u>	<u>61,679</u>
Total endowment investments				<u>119,021</u>
Total Assets				<u><u>\$ 124,397</u></u>
Total Liability				
Interest rate swap	\$ -	\$ 6,419	\$ -	\$ 6,419
Total liability	<u>\$ -</u>	<u>\$ 6,419</u>	<u>\$ -</u>	<u>\$ 6,419</u>

Note 3 – Fair value measurements (continued)

For the year ended June 30, 2017, the changes in investments classified as Level 3 are as follows:

Level 3 rollforward	Real estate	Split interest agreements	Total
Balance- Beginning of year	\$ 7,383	\$ 1,985	\$ 9,368
Change in discount	-	26	26
Partnership unrealized gain	43	-	43
Balance- End of year	\$ 7,426	\$ 2,011	\$ 9,437

Changes in unrealized gains including investment returns relating to instruments that are classified as Level 3 still held as of June 30, 2017 are \$69.

The following schedules discusses the nature and risks of alternative investments which calculate net asset value per share or its equivalent and whether those investments are probable of being sold at amounts different from net asset value per share:

Alternative investments schedule	Fair value	Unfunded commitments	Redemption period	Redemption notice period
Credit Strategies (a)	\$ 99	\$ -	Quarterly	90 days
Event-driven (b)	5,912	-	Semi-annually	65 days
Multi-strategy (c)	5,952	-	Quarterly	60 days
Multi-strategy (d)	3,214	-	Anniversary annually	65 days
Relative Value (e)	5,971	-	Anniversary annually	60 days
Special Situations (f)	6,205	-	Annually	90 days
Real Estate (g)	7,426	-	n/a	n/a
Long-Only/Long-Biased (h)	4,465	-	Annually	90 days
Long-Only/Long-Biased (i)	6,691	-	Annually	90 days
Long-biased (j)	3,524	-	Annually	120 days
Long-Only/Long-Biased (k)	3,999	-	Monthly	30 days
Long-Only/Long-Biased (l)	7,026	-	Quarterly	30 days
Credit Strategies (m)	1,194	1,806	n/a	n/a
	\$ 61,679			

- a) This class includes an investment in a hedge fund that takes a bottom-up, credit oriented approach to investing in various fixed income and equity securities, derivative transactions and other instruments. The fund looks for complex situations where risk might be misunderstood and rigorous research or active involvement may enhance returns and limit risk. The fair value of the investment in this category has been estimated using the net asset value per share of the investment. In November 2015, the fund decided to return capital to all investors and has been making regular distributions to achieve full wind-down. The fund continues to take advantage of strong credit markets to sell positions. They intend to continue to sell positions deliberately, but without urgency. The fund has currently returned between 70% and 78% of total year-end capital. As of June 30, 2017, the Ballet had authorized the full liquidation of this hedge fund.

Note 3 – Fair value measurements (continued)

- b) This class includes an investment in a hedge fund focusing on perceived distressed and event-driven situations with definable catalysts, including stressed and distressed credits, equity transactions, litigation, and capital structure arbitrage. Value drivers typically revolve around legal and/or accounting issues at a given company. The fund has a diversified portfolio with moderate concentration, and distressed investments typically comprise approximately 50% of total exposure. The fund may contain some activist positions and is primarily invested in domestic companies. The fair value of the investment in this category has been estimated using the net asset value per share of the investment. The lock up period expired on March 2015.
- c) This class includes an investment in a hedge fund that seeks to generate stable, predictable returns with a low correlation to the broader debt and equity markets. The fund attempts to capitalize on perceived market inefficiencies surrounding areas like complex capital structures, businesses in transition or orphaned equities by calculating intrinsic value according to three fundamental criteria: creditworthiness, value creation and optionality. The fund will pursue this value investment strategy in primarily domestic situations in distressed debt, bank loans, high yield bonds, direct investment, turnaround equities, convertible arbitrage, and risk arbitrage. The fair value of the investment in this category has been estimated using the net asset value per share of the investments.
- d) This class includes an investment in a hedge fund that seeks to generate superior risk-adjusted returns with an absolute return orientation without limiting itself to a pre-defined strategy. To achieve these returns, the fund employs a multi-strategy approach to capture perceived inefficiencies in public and private market situations. The fund's focus is on event oriented investing, credit/distress debt, capital structure arbitrage and equity derivatives. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. Additionally, the fund manager may impose a gate restriction on redemption at their discretion which could limit the Ballet's ability to liquidate its full investment in the fund.
- e) This class includes an investment in a hedge fund that seeks to generate consistent above average return with limited systemic market risk. To achieve these returns, the fund seeks arbitrage in volatility, mortgage security, yield curve, intramarket bond and cash bond/future. The fund will also employ leverage to enhance return. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The last lock up period for this investment expired December 2015. The fund has a 20% side pocket allowance but gate restrictions. Redemption requires a 60-day notification.
- f) This class includes an investment in a hedge fund that seeks to invest in equities perceived to be undervalued, event driven securities and distressed securities. The strategy is value driven and pursues opportunities in inefficient markets where estimated intrinsic value exceeds the market price of the securities. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment had a 25 month lock up period expiring February 2017. The fund has a 25% side pocket allowance but no gate restrictions and redemption requires a 90-day notification.

Note 3 – Fair value measurements (continued)

- g) This class includes a restricted interest in a limited partnership. The underlying asset of the partnership is the fair value of the retail building located on 250 Post Street in the city of San Francisco. The building is approximately 33,000 square feet and was appraised at \$86,000 in August of 2016 with a mortgage obligation balance of \$1,576 at June 30, 2017. San Francisco Ballet's interest is approximately 8.8% with fair market value of \$7,426 at June 30, 2017.
- h) This class includes an investment in a fund with a long-biased hedge fund that seeks to invest in domestic U.S. equities. It has an activist-oriented investment strategy based on small and mid-cap companies perceived to be undervalued. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a lock up period expiring December 2017. The fund has a 10% side pocket allowance but no gate restrictions and redemption requires 90-day notification.
- i) This class includes an investment in a hedge fund which seeks significant appreciation by investing in companies perceived to be undervalued. Their strategy is long-biased, focusing on European equities. They constructively work with management teams and identify situations that have the potential to double in value over a 3-year period. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a lock up period which expired October 2016. The fund has a 40% side pocket allowance and a 20% gate restriction based on available capital.
- j) This class includes investments in a mixture of hybrid and emerging markets and has a long-biased strategy. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a lock up period expiring June 2017. The fund has a no gate or side pocket restrictions.
- k) This category includes an investment in a hedge fund with a long-biased approach that seeks to invest in undervalued emerging market equities. Investments are generally made in companies with market caps greater than \$5,000. The fund holds its positions for an average of four to five years and seeks a minimum of 50% upside over two to three years. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. Redemption requires a 30-day notification.
- l) This category includes an investment in a hedge fund with a long-biased approach that seeks to integrate sustainability research with rigorous fundamental equity analysis. This fund specifically seeks investments in companies with management teams who recognize that economic, social, environmental, and political issues can affect business opportunities and risks. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a lock up period which expired October 2016. The fund has a no gate or side pocket restrictions. Redemption requires 30-day notice.

June 30, 2017

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

- m) This category includes an investment in a private fund which primarily invests in unrated or below investment-grade commercial mortgage-backed securities. The fund plans to hold its investments for a long duration. The investment term of the fund is 144 months, subject to two consecutive one-year extensions. The investment has a lock up period expiring June 2018. The fund has a no gate or side pocket restrictions.

The quantitative information about significant unobservable inputs related to Level 3 alternative investments in real estate used at June 30, 2017 is as follows:

	Fair value	Valuation techniques	Unobservable inputs	Assumptions
Commercial real estate	\$ 7,426	Income capitalization	Terminal cap rate	5.50%
			Rent growth rate	3.00%

Note 4 – Property and equipment

The Ballet's property and equipment as of June 30, 2017 is as follows:

Land	\$ 4,519
Buildings and improvements	34,539
Furniture and equipment	8,148
Capitalized sets and costumes	15,981
Construction in progress	72
Total property and equipment	<u>63,259</u>
Accumulated depreciation	<u>(38,891)</u>
Property and equipment, net	<u>\$ 24,368</u>

The Property fund on the accompanying consolidated statement of activities and changes in net assets includes the following types of depreciation expense on the Ballet productions line: \$572 allocated occupancy; \$1,402 sets and costumes; and \$267 other, primarily stage and theatrical equipment.

Note 5 – Credit facilities

The Ballet has a line of credit with First Republic Bank of \$5,500, which together with an outstanding undrawn standby letter of credit of \$300 to support its workers' compensation insurance policies (see Note 8), is secured by certain investment securities in the Foundation's portfolio and are subject to a collective limit of 85% of the market value of those securities. At June 30, 2017, that limit would not have further constrained the Ballet's secured line of credit limit. Interest on the secured line of credit is charged at the greater of the prime rate, minus 0.25% or 4%. The Ballet had no outstanding borrowings under the secured line of credit as of June 30, 2017. The secured line of credit expires on November 30, 2017 and will automatically renew for a one-year period on that date subject to the approval of the bank.

Note 6 - Loans payable

On June 6, 2013, the Ballet borrowed \$44,510 in four tax-exempt series: \$12,000 California Infrastructure and Economic Development Bank (“CIEDB”) Revenue Loans Series 2013A (San Francisco Ballet Association), \$11,000 each in CIEDB Variable Rate Revenue Loans Series 2013B and 2013C (San Francisco Ballet Association), and \$10,510 CIEDB Revenue Loans Series 2013D (San Francisco Ballet Association) (collectively, \$44,510 and the “Series 2013 Loan”). First Republic Bank entered into an Assignment Agreement with CIEDB, whereby the First Republic Bank agreed to purchase CIEDB’s rights in connection with the issuance of the Series 2013 Loans. The Ballet and First Republic Bank entered into a Master Loan Agreement governing the private placement.

Proceeds from the Series 2013 Loans were used to refinance the Ballet’s existing indebtedness (the Series 2010 and Series 2008 Bonds) and to fund costs of issuance of the Series 2013 Loans. In connection with the Series 2013 Loans, the Ballet has agreed that it will not obtain additional financing in excess of \$250 from any lender other than First Republic Bank.

The Ballet’s tax-exempt debt was originally issued for the renovation of the Ballet’s headquarters building, the purchase and renovation of a warehouse and a student residence, certain technology hardware upgrades, construction of ballet sets and costumes, new theatrical equipment, the payment of interest and fees, and certain loan issuances costs.

The interest rate on the Series 2013A Loans is fixed. The interest rates on the Series 2013B Loans reset at a LIBOR-based floating rate plus a spread. The Ballet had the option, which ultimately expired without being exercised, to convert Series 2013B, 2013C or 2013D to a fixed rate prior to July 1, 2016. All four series have interest-only payments through and including the payment due on June 1, 2016, at which time payments will be interest and principal.

Note 6 - Loans payable (continued)

The following is a summary of each series outstanding as of June 30, 2017:

Issue name	Amount issued	Final maturity	Interest rate	Amount outstanding
Series 2013A	\$ 12,000	August, 1, 2038	3.45%	\$ 11,635
Series 2013B	11,000	August, 1, 2038	2.31%	10,504
Series 2013C	11,000	August, 1, 2038	2.31%	10,504
Series 2013D	10,510	August, 1, 2038	2.31%	10,036
Total	\$ 44,510			42,679
Loan issuance costs, net				(390)
Total loans payable, net				\$ 42,289

The Series 2013 Loans are secured by a continuing security interest in the Association's right, title and interest in personal property as defined in the Security Agreement with CIEDB, and are guaranteed by the Foundation, as defined in the Guaranty Agreement between the Foundation, First Republic Bank and CIEDB.

As guarantor, the Foundation guarantees the due and punctual payment of any and all amounts due pursuant to the Master Loan Agreement relating to the Series 2013 Loans among First Republic Bank, CIEDB and the Ballet.

Interest payments are payable and due on the first of each month. Interest expense related to loans payable for the year ended June 30, 2017 was approximately \$1,043. In connection with the Master Loan Agreement with First Republic Bank for the Series 2013 Loans, the Ballet was required to be and was in compliance with certain financial covenants as of June 30, 2017.

Principal amounts are due as follows:

	Series				
	2013A	2013B	2013C	2013D	Total
2018	\$ 378	\$ 496	\$ 496	\$ 474	\$ 1,844
2019	391	496	496	474	1,857
2020	404	496	496	474	1,870
2021	420	496	496	474	1,886
2022	436	496	496	474	1,902
Thereafter	9,606	8,024	8,024	7,666	33,320
	\$ 11,635	\$ 10,504	\$ 10,504	\$ 10,036	\$ 42,679

June 30, 2017

(In thousands of dollars)

Note 7 – Interest rate swap agreement

The Ballet utilizes an interest rate swap agreement to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness. Under the terms of the agreement, the Ballet pays a fixed rate of 3.92% to the swap counterparty in exchange for a variable rate of 68.50% of 1-month LIBOR on the notional amount. The swap agreement does not qualify as a cash flow hedge, and as a result, changes in the fair value of the interest rate swap agreement during a period are recognized immediately in change in unrestricted net assets. The fair value of the interest rate swap agreement is based on quotes from the market makers and, therefore, is classified as Level 2 in the fair value hierarchy as shown in Note 3.

The fair value of the swap agreement is estimated based on mid-market rates and industry standard valuation models. A credit risk spread (in basis points) is added as a flat spread to the discount curve used in the valuation model. Each leg is discounted and the difference between the present value of each leg's cash flows equals the market value of the swap. The fair value also considers the risk of each counterparty by including a "credit valuation adjustment" determined by taking into account the nonperformance risk of each counterparty to the swap. The estimated fair value of the swap agreement was \$6,419 as of June 30, 2017, including a credit valuation adjustment of \$208, which reduced the Ballet's liability, and is included in the interest rate swap liability in the accompanying consolidated statement of financial position. Payments made to the counterparty of the swap agreement for interest were approximately \$755 during the year ended June 30, 2017. The swap agreement contains certain collateral requirements based on the credit rating of the Ballet and the current fair market value of the swap agreement. During the year ended June 30, 2017, the Ballet was required to post collateral on the swap agreement and \$5,877 was posted as of June 30, 2017, and is included in restricted cash in the accompanying consolidated statement of financial position.

In August 2011, the Board of Directors of the Foundation agreed to loan the Association a portion of the Foundation's unrestricted board-designated endowment investments to assist in meeting such collateral postings. As of June 30, 2017, \$1,095 had been borrowed from the Foundation. Such borrowings reduce the value of endowment investments and increase restricted cash in the accompanying consolidated statement of financial position.

The following table shows the outstanding notional amount of derivative instruments measured at fair value as reported in the consolidated statement of financial position as of June 30, 2017:

	Statement of financial position location	Maturity date of derivative	Notional fixed rate	Amount outstanding	Fair value
Interest rate swap	Liability under interest rate swap agreement	July 1, 2036	3.92%	\$ 22,000	\$ 6,419

Note 7 - Interest rate swap agreement (continued)

Amounts reflected in the change in value of the interest rate swap agreement for the year ended June 30, 2017 was as follows:

	Statements of activities and changes in net assets location	Realized and unrealized gain
Interest rate swap agreement	Non-operating: Net realized and unrealized losses on interest rate swap agreements	\$ 1,870

Note 8 - Workers' compensation

The Ballet's workers' compensation insurance policies include self-insured retention limits and fully insured coverage above such limits. Accruals for claims under the Ballet's self-insured retention limits are recorded on a claim-incurred basis. The estimated liability for workers' compensation claims incurred but unpaid as of June 30, 2017, \$2,704 is included in accounts payable and accrued expenses in the accompanying consolidated statement of financial position. As of June 30, 2017, the Ballet had unused letters of credit totaling \$2,500 as required by the Ballet's insurance carriers.

Note 9 - Postretirement and health and welfare plans

The Ballet has a defined contribution retirement plan that covers all eligible nonunion employees and includes a 401(k) component.

Substantially all theatrical employees are covered under collective bargaining agreements that require payments to multiemployer pension, health, and welfare plans. Contributions to these plans approximated \$2,054 for the year ended June 30, 2017.

The Ballet has an agreement with a key employee to provide postretirement salary continuance and employee and spousal health benefits for a fixed period of time dependent on the number of years served under the agreement and on the absence of certain types of postretirement employment and benefits available to the employee. The fair value of the salary continuance of \$740 has been calculated based on the net present value of the expected payments. The total present value as of June 30, 2017, of the future health benefits, or the expected postretirement benefit obligation for health, is approximately \$240. The accumulated postretirement benefit obligation of the future health benefits, as of June 30, 2017, is \$240. The income for the year ended June 30, 2017, for future health benefits is \$5.

Note 9 – Postretirement and health and welfare plans (continued)

The following table sets forth the health benefits agreement's benefit obligations, fair value of plan assets, and status as of June 30, 2017, which liability is included in the consolidated statement of financial position

Benefit obligation	\$	240
Fair value of plan assets		-
Unfunded status – end of year	\$	<u>240</u>

Amounts recognized for health benefits in unrestricted net assets consist of unrecognized prior service costs of \$240 as of June 30, 2017. The periodic net benefit income for the year ended June 30, 2017 was \$5. The weighted-average assumption used to determine benefit obligations as of June 30, 2017 was 3.14%.

Assumed health care trend rates have significant effect on the amounts reported for health care premiums. A 1% change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
Effect of the health care component on:		
Accumulated postretirement benefit obligation	\$ 17	\$ (15)
Service cost and interest cost for fiscal year 2017	1	(1)
Total	<u>\$ 18</u>	<u>\$ (16)</u>

For measurement purposes, a 7.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year ended June 30, 2017. This annual rate is based on market conditions for similar benefits and was assumed to decrease gradually to 5% through the year ending June 30, 2020 and remain at that level thereafter.

No benefits are expected to be paid from the postretirement benefit plan in the year ending June 30, 2018. The aggregate benefits expected to be paid in the seven years from 2017 to 2022 are approximately \$159. The expected benefits are based on the same assumptions used to measure the Ballet's benefit obligation as of June 30, 2017 and include future employee service.

The Ballet also has a voluntary salary deferral plan for highly compensated employees under Internal Revenue Code Section 457(b). Eligible employees may elect to contribute to the plan and the Ballet may make qualified non-elective discretionary contributions. Matching contributions were made during the year ended June 30, 2017.

June 30, 2017

(In thousands of dollars)

Note 9 – Postretirement and health and welfare plans (continued)**Multiemployer pension plans**

The Ballet contributes to several multiemployer defined benefit pension plans under the terms of collective bargaining agreements that cover certain union-represented employees. The Ballet's collective bargaining agreements do not require that a minimum contribution be made to these plans. As of June 30, 2017 the Ballet contributed to union trust and charged to expense \$1,215.

The risks of participating in multiemployer pension plans are different from single employer pension plans in the following aspects:

- a) Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.
- b) If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.

If the Ballet stops participating in its multiemployer pension plan, the Ballet may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The Ballet's participation in these plans for the year ended June 30, 2017 is outlined in the table below. All information in the table is as of June 30, 2017. The "EIN-PN" column provides the Employer Identification Number ("EIN") and the Plan Number ("PN"). The most recent Pension Protection Act ("PPA") zone status available in 2014 is for the plan year ended June 30, 2017. The zone status is based on information that the Ballet received from the plan. Among other factors, generally, plans in critical status ("red", respectively) are less than 65% funded, and plans at least 80% funded are said to be in the "green zone". The "FIP/RP status pending/implemented" column indicates plans for which a funding improvement plan (FIP) or a rehabilitation plan ("RP") is either pending or has been implemented by the trustees of each plan. Information related to the impact of utilization of extended amortization periods on zone status is either not available or not obtainable without undue cost and effort.

Note 9 – Postretirement and health and welfare plans (continued)

Multiemployer pension plans, continued

Pension fund	EIN - PN	Expiration Date	Pension protection act zone status	Are the Company's contributions more than 5% of Total Plan Contributions as of Plan year –per Form 550	Pending / Implemented	Plan's year end	Ballet contribution as of plan year end	Surcharge on plan?	Total Plan Contributions	5% Contributions? Calculated per FE-use Form 5500
The AGMA Retirement Plan	13-3826401-Plan No. 001	6/30/2021	Green	No	N/A	8/31/2015	\$ 196	No	\$ 4156	4%
American Federation of Musicians and Employer's Pension Fund and Subsidiary	51-6120204 - Plan No. 001	11/30/2020	Red	No	Implemented	3/31/2015	846	Yes	61,227	1%
I.A.T.S.E. Local 16 Pension Plan	94-6296420 - Plan No. 001	6/30/2017	Red	No	Implemented	12/31/2014	375	Yes	7,895	4%
I.A.T.S.E. Local 16 Pension Plan	94-6296420 - Plan No. 001	7/31/2016	Red	No	Implemented	12/31/2014	21	Yes	7,895	0%
I.A.T.S.E. National Pension Fund	13-1849172 - Plan No. 001	7/31/2016	Green	No	N/A	12/31/2014	41	No	23,297	0%
I.A.T.S.E. National Pension Fund	13-1849172 - Plan No. 001	6/30/2017	Green	No	N/A	12/31/2014	37	No	23,297	0%

Note 10 – Endowment

The Ballet's endowment consists of over 200 individual funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by the Board to function as endowments or Board-designated endowment funds.

The endowment consists of the following components: (a) permanently restricted investments, which represent the historic dollar value of contributions restricted by donors for permanent investment, (b) earnings on permanently restricted investments that are also permanently restricted, (c) temporarily restricted investments whose earnings have been restricted by donors for specific purposes or have not yet been appropriated for expenditure by the Board, and (d) unrestricted endowment investments, which represent funds directed for investment in the endowment by the Board, losses on underwater donor-restricted investments, and the expenses associated with raising and managing the endowment funds. The Ballet's endowment investments represent the Ballet's complete endowment fund. Pledge receivables and trust receivables are excluded from the Ballet's endowment until received.

Note 10 – Endowment (continued)

The Ballet 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, the Ballet classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Ballet in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Ballet considers the following factors in making a determination to appropriate or accumulate endowment funds:

- a) The duration and preservation of the fund
- b) The purposes of the Ballet and the donor-restricted portion of the endowment fund
- c) General economic conditions
- d) The possible effect of inflation and deflation
- e) The expected total return from income and appreciation of investments
- f) Other resources of the Ballet
- g) The investment policies of the fund

Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. Certain Board-designated endowment funds have donor restrictions on the appropriation of the earnings generated by the fund. The principal of such gifts is considered Board-designated and the accumulated earnings are considered donor-restricted.

Endowment net asset composition by type of fund as of June 30, 2017 consists of the following:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	\$ (3,832)	\$ 6,700	\$ 70,471	\$ 73,339
Board-designated endowment funds	45,709	-	-	45,709
Total funds	<u>\$ 41,877</u>	<u>\$ 6,700</u>	<u>\$ 70,471</u>	<u>\$ 119,048</u>

Note 10 – Endowment (continued)

Changes in endowment by net asset class for the year ended June 30, 2017 are as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment assets, beginning of year	\$ 36,785	\$ 4,464	\$ 58,973	\$ 100,222
Investment return:				
Investment return - investment income	2,133	(708)	128	1,553
Net realized and unrealized appreciation	2,909	6,176	1,177	10,262
Total investment return	5,042	5,468	1,305	11,815
Additions to endowment funds from contributions and pledge payments	885	-	10,719	11,604
Reclassifications of Board-designated endowments	2,480	-	-	2,480
Appropriation of endowment assets for expenditure	(3,315)	(3,232)	(526)	(7,073)
Endowment assets, end of year	\$ 41,877	\$ 6,700	\$ 70,471	\$ 119,048

Totals differ from total Endowment Investments on pages 5 and 17 by approximately \$27 as they do not reflect contributions yet to be transferred from the Association to the Foundation.

Description of amounts classified as permanently restricted net assets and temporarily restricted net assets at June 30, 2017 (endowment only) are as follows:

Permanently Restricted Net Assets

(1) The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA	\$ 70,471
Total endowment funds classified as permanently restricted net assets	<u>\$ 70,471</u>

Temporarily Restricted Net Assets

(1) The portion of perpetual endowment funds subject to a time restriction under UPMIFA:	
Without purpose restrictions	\$ 2,142
With purpose restrictions	4,558
Total endowment funds classified as temporarily restricted net assets	<u>\$ 6,700</u>

From time to time, the fair value of assets associated with individual donor endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. Deficits associated with funds functioning as endowments, when they exist, are likewise classified as a reduction of unrestricted net assets. Deficits reported in unrestricted net assets were \$(3,832) as of June 30, 2017. These deficits resulted from unfavorable market fluctuations and continued appropriation for certain programs and expenditures that were deemed prudent. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

Note 10 – Endowment (continued)

Return objectives and risk parameters

The Ballet has adopted endowment investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Endowment assets include those assets of donor-restricted funds that the Ballet must hold in perpetuity or for a donor-specified period as well as the Board-Designated fund. Endowment assets are invested in a manner that is intended to produce results that exceed the total return of a benchmark composed of 60% of the MSCI All Country World Index (ACWI), and 40% of the Barclays U.S. Aggregate Bond Index, while assuming a moderate level of investment risk. The Ballet expects its endowment funds, over a complete market cycle, to provide an average annual real rate of return of approximately 5% annually. Actual returns in any given year may vary from this amount.

Strategies employed for achieving investment objectives

To achieve its long-term rate of return objectives, the Ballet relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The Ballet targets a diversified asset allocation that places greater emphasis on investments in cash and fixed income, equities, real estate, and alternative investment strategies in a 15-40-10-35 percentage ratio, with discretion to make tactical adjustments to those ratios, to achieve its long-term objectives within prudent risk constraints.

Relationship of spending policy to investment objectives

The Ballet has a policy of appropriating for distribution each year up to a maximum of 5% of its endowment funds' average fair value over the prior twelve quarters years as of June 30, preceding the fiscal year in which the distribution is planned. In establishing this policy, the Ballet considered the expected return on its endowment. Accordingly, the Ballet expects the current spending policy to allow its endowment to maintain its purchasing power by growing at a rate equal to or greater than planned payouts, plus inflation over a complete market cycle. Additional real growth will be provided through new gifts and investment returns in excess of appropriations. Depending upon market conditions and the needs and available resources of the Association, appropriations for expenditure from individual endowments may be temporarily suspended to facilitate preservation of the endowment.

Note 11- Temporarily restricted net assets and net assets released from restrictions

As of June 30, 2017, temporarily restricted net assets were available for the following purposes:

New Ballet Production	\$	6,650
Ballet School Support		2,771
Accumulated appreciation of endow ment funds not appropriated for expenditure		2,142
Property and equipment		1,655
Passage of time, including unpaid pledges		97
Touring		123
Special Events		416
Education and outreach		736
Miscellaneous		80
Total temporarily restricted net assets	<u>\$</u>	<u>14,670</u>

Temporarily restricted net assets released during the year ended June 30, 2017 were as follows:

For use in ensuing fiscal years/due to expiration of time	\$	2,418
Property and equipment		1,300
Accumulated appreciation of endow ment funds appropriated for expenditure		1,656
Pledge payments received		432
New Ballet Production		677
Touring		228
Ballet School Support		552
Education and outreach		139
Special Events		585
Artistic and Production		32
Total temporarily restricted net assets released	<u>\$</u>	<u>8,019</u>

Note 12 - Lease commitments

The Ballet rents performance space, office space, office equipment, and event venues under various operating leases. The following is a schedule of approximate future minimum rental payments required under the leases as of June 30, 2017, that have an initial noncancelable lease term in excess of one year:

	Year ending June 30,
2018	\$ 121
2019	111
2020	86
2021	72
Total	<u>\$ 390</u>

Rent expense from operating leases approximated \$755 for the year ended June 30, 2017.

Note 13 – Collective bargaining agreements

Approximately 73% (441 employees) of the Ballet's employees are covered by collective bargaining agreements. The following is a schedule of agreements expiring within twelve months of June 30, 2017, the number of employees covered under such agreements, and the status of negotiations with each bargaining unit:

Union	# of employees	Contract expiration date at June 30, 2017	Status
IATSE, Local 800	3	6/30/2017	Negotiations pending

Note 14 – Related parties

As of June 30, 2017, undiscounted pledges receivable includes approximately \$800 due from members of the Association's Board of Trustees and of the Foundation's Board of Directors.

A fixed income mutual fund managed by a member of the Association's Board of Trustees and the Foundation's Board of Directors' investment management company was valued at \$6,829 as of June 30, 2017. A member of the Association's Board of Trustees is the Chairman and Founding Chief Executive Officer of the bank with which the Association has its operating accounts, credit facilities and loans payable, First Republic Bank, of the Foundation's investment custodian, First Republic Trust Company and of the Association's investment broker, First Republic Securities.

A member of the Foundation's Board of Directors sits on a committee of the investment manager which oversees the fixed income investment strategy, monitoring implementation of that strategy, and overseeing the research process for two of the Ballet's mutual fund holdings. The collective value of the Ballet's investments in those mutual funds was \$18,113 at June 30, 2017.

Of the value of contributed services recognized as revenues in the accompanying consolidated financial statements, \$80 was received from related parties, primarily for legal services.

These transactions were subject to customary arrangements regarding fees and, for the limited partnership, allocation of investment gains.

Note 15 – Contingencies

The Ballet is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Ballet's financial position or its changes in net assets.

Note 16 – Subsequent events

The Ballet evaluated subsequent events through October 18, 2017, the date on which the consolidated financial statements were issued and determined there were none to report.



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