Merola Opera Program

Financial Statements

For the year ended
September 30, 2019
With Independent Auditors' Report Thereon

Contents

Merola Opera Program
601 Van Ness Avenue, Suite S
San Francisco, California 94102
Phone: (415) 936-2324 Fax: (415) 508-3665
Email: mop@merola.org
Web Site Address: www.merola.org

R&A CPA
Regalia& Associates
OFFICE: 925.314.0390
WEB: WWW.MRCPA.COM

CERTIFIED PUBLIC ACCOUNTANTS
103 TOWN & COUNTRY DRIVE, SUITE K, DANVILLE, CALIFORNIA 94526
DOUGLAS REGALIA, CPA
LISA PARKER, CPA [inactive]
JEANNINE REGALIA, CPA
LISA CLOVEN, CPA
JENNY SO, CPA
JENNIFER JENSEN
ANITA EVANS
DANA CHAVARRIA, CPA
TRICIA WILSON
VALERIE REGALIA, CPA
WENDY THOMAS, CPA
SUSAN REGALIA, CPA
RACHEL BERGER, CPA
ROELEEN JOOSTE, CPA

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Merola Opera Program

We have audited the accompanying financial statements of Merola Opera Program (a California nonprofit organization) which comprise the statement of financial position as of September 30, 2019 and the related statements of activities and changes in net assets, cash flows, and functional expenses for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 Merola Opera Program as of September 30, 2019, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

We have previously audited Merola Opera Program's September 30, 2018 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 20, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2018 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Regalia & Associates

Danville, California
December 22, 2019

Statement of Financial Position
September 30, 2019
(with Summarized Financial Information for the Year Ended September 30, 2018)

ASSETS

	2019				
	Without Donor Restrictions	*With Donor* Restrictions - Time/purpose	*With Donor* Restrictions - In perpetuity	Total 2019	Total 2018
Current assets:					
Cash and cash equivalents	$ 813,348	$ 9,000	$ -	**$ 822,348**	$ 730,247
Contributions receivable	23,842	-	-	**23,842**	192,541
Accounts receivable	-	-	-	**-**	22,608
Prepaid expenses	110,617	-	-	**110,617**	306,212
Investments	1,233,543	-	-	**1,233,543**	1,635,888
Total current assets	2,181,350	9,000	-	**2,190,350**	2,887,496
Noncurrent assets:					
Investments	12,774,708	1,841,422	13,882,674	**28,498,804**	27,861,720
Assets held in charitable remainder trusts	-	-	551,997	**551,997**	563,199
Property and equipment, net	11,560	-	-	**11,560**	16,620
Deposits	15,700	-	-	**15,700**	15,700
Right of use asset - premises	615,470	-	-	**615,470**	-
Total noncurrent assets	13,417,438	1,841,422	14,434,671	**29,693,531**	28,457,239
Total assets	$ 15,598,788	$ 1,850,422	$ 14,434,671	**$ 31,883,881**	$ 31,344,735

LIABILITIES AND NET ASSETS

	Without Donor Restrictions	*With Donor* Restrictions - Time/purpose	*With Donor* Restrictions - In perpetuity	Total 2019	Total 2018
Current liabilities:					
Accounts payable and accrued liabilities	$ 15,989	$ -	$ -	**$ 15,989**	$ 6,640
Accrued payroll liabilities	39,160	-	-	**39,160**	27,722
Unearned revenue	3,206	-	-	**3,206**	-
Fiscal sponsorship payable	-	-	-	**-**	14,026
Lease payable - current portion	88,552	-	-	**88,552**	-
Total current liabilities	146,907	-	-	**146,907**	48,388
Noncurrent Liability:					
Lease payable - noncurrent portion	526,918	-	-	**526,918**	-
Total liabilities	673,825	-	-	**673,825**	48,388
Net assets:					
Without donor restrictions					
Undesignated operating fund	1,616,766	-	-	**1,616,766**	1,239,762
Board-designated endowment funds	13,308,197	-	-	**13,308,197**	13,328,810
Total	14,924,963	-	-	**14,924,963**	14,568,572
With donor restrictions - time/purpose					
Operating	-	9,000	-	**9,000**	698,519
Endowment funds	-	1,841,422	-	**1,841,422**	1,881,586
Total	-	1,850,422	-	**1,850,422**	2,580,105
With donor restrictions - in perpetuity					
Charitable remainder trusts	-	-	551,997	**551,997**	563,199
Endowment funds	-	-	13,882,674	**13,882,674**	13,584,471
Total	-	-	14,434,671	**14,434,671**	14,147,670
Total net assets	14,924,963	1,850,422	14,434,671	**31,210,056**	31,296,347
Total liabilities and net assets	$ 15,598,788	$ 1,850,422	$ 14,434,671	**$ 31,883,881**	$ 31,344,735

Statement of Activities and Changes in Net Assets
For the Year Ended September 30, 2019
(with Summarized Financial Information for the Year Ended September 30, 2018)

	2019				
	Without Donor Restrictions	*With Donor* Restrictions - Time/purpose	*With Donor* Restrictions - In perpetuity	Total 2019	Total 2018
Revenue, Support, and Other Income:					
Earned Revenue:					
Production, performance and other programs	$ 208,661	$ -	$ -	**$ 208,661**	$ 165,973
Appropriation of endowment assets	1,519,547	-	-	**1,519,547**	1,480,811
Total earned revenue	1,728,208	-	-	**1,728,208**	1,646,784
Contributed Income:					
Contributions, sponsorships and memberships	1,792,837	9,000	21,955	**1,823,792**	2,840,521
In-kind contributions	314,128	-	-	**314,128**	296,274
Appropriation of endowment assets	(1,198,030)	(321,517)	-	**(1,519,547)**	(1,480,811)
Net assets released from restrictions	698,519	(698,519)	-	**-**	-
Total contributed income	1,607,454	(1,011,036)	21,955	**618,373**	1,655,984
Events:					
Ticket and auction revenue	380,464	-	-	**380,464**	337,015
Less costs of direct benefits to attendees	(132,158)	-	-	**(132,158)**	(106,992)
Net event income	248,306	-	-	**248,306**	230,023
Other Income:					
Change in value of charitable remainder trust	-	-	(11,202)	**(11,202)**	23,629
Investment income, net of fees	734,133	171,769	(57,299)	**848,603**	652,143
Realized gains on investments (net)	236,718	106,932	(35,638)	**308,012**	1,459,103
Unrealized gains (losses) on investments (net)	(50,654)	(12,317)	369,185	**306,214**	(470,890)
Total other income	920,197	266,384	265,046	**1,451,627**	1,663,985
Total revenue, support, and other income	4,504,165	(744,652)	287,001	**4,046,514**	5,196,776
Expenses:					
Programs and performances	3,374,988	-	-	**3,374,988**	2,597,387
Fundraising and special events	459,915	-	-	**459,915**	399,189
General and administrative	297,902	-	-	**297,902**	319,967
Total expenses	4,132,805	-	-	**4,132,805**	3,316,543
Increase (decrease) in net assets	371,360	(744,652)	287,001	**(86,291)**	1,880,233
Reclassifications - Endowment	(14,969)	14,969	-	**-**	-
Prior period adjustment	-	-	-	**-**	57,421
Net assets at beginning of year	14,568,572	2,580,105	14,147,670	**31,296,347**	29,358,693
Net assets at end of year	$ 14,924,963	$ 1,850,422	$ 14,434,671	**$ 31,210,056**	$ 31,296,347

Statements of Cash Flows
For the Years Ended September 30, 2019 and 2018

	2019	2018
Operating activities:		
Increase (decrease) in net assets	**$ (86,291)**	$ 1,880,233
Adjustments to reconcile to cash provided by (used for) operating activities:		
Depreciation	**9,402**	8,933
Unrealized losses (gains), net	**(306,214)**	470,890
Realized losses (gains), net	**(308,012)**	(1,459,103)
Change in value of assets held in charitable remainder trusts	**11,202**	(23,629)
Contributions received restricted for long-term investment	**(21,955)**	(114,539)
Changes in:		
Contributions receivable	**168,699**	(192,541)
Accounts receivable	**22,608**	105,222
Prepaid expenses	**195,595**	(114,938)
Accounts payable and accrued liabilities	**9,349**	(33,867)
Accrued payroll liabilities	**11,438**	27,722
Unearned revenue	**3,206**	-
Fiscal sponsorship payable	**(14,026)**	(62,808)
Cash provided by (used for) operating activities	**(304,999)**	491,575
Investing activities:		
Purchase of investments	**(300,759)**	(1,146,725)
Disposition of investments	**1,524,507**	1,246,459
Dividends and earnings reinvested into investments	**(848,603)**	(652,143)
Cash provided by (used for) investing activities	**375,145**	(552,409)
Financing activities:		
Contributions received restricted for long-term investments	**21,955**	114,539
Cash provided by financing activities	**21,955**	114,539
Increase in cash and cash equivalents	**92,101**	53,705
Cash and equivalents at beginning of year	**730,247**	676,542
Cash and equivalents at end of year	**$ 822,348**	$ 730,247
Additional cash flow information:		
Taxes paid	**$ 150**	$ 150
Interest paid	**$ -**	$ -

Statement of Functional Expenses
For the Year Ended September 30, 2019
(with Summarized Financial Information for the Year Ended September 30, 2018)

	Programs and Performances	Fundraising and Special Events	General and Admin-istrative	Total Expenses 2019	Total Expenses 2018
Contracted artist development	$ 2,215,039	$ -	$ -	**$ 2,215,039**	$ 2,059,246
Salaries, taxes and benefits	348,306	199,453	192,066	**739,825**	617,916
Commission	402,040	-	-	**402,040**	-
Grants and awards	228,509	-	-	**228,509**	182,064
Printing and graphic design	61,906	44,064	-	**105,970**	71,334
Advertising and promotion	-	92,018	-	**92,018**	38,086
Rental expense	49,134	28,226	-	**77,360**	71,052
Hospitality	35,557	37,796	-	**73,353**	57,721
Miscellaneous	19,097	15,094	28,789	**62,980**	78,394
Occupancy	3,552	6,339	27,180	**37,071**	41,967
Utilities and minor equipment	10,248	5,887	17,272	**33,407**	17,881
Service charges	-	14,309	7,506	**21,815**	25,354
Accounting	-	-	14,637	**14,637**	19,525
Professional services and other fees	1,600	7,743	1,050	**10,393**	15,255
Depreciation	-	-	9,402	**9,402**	8,933
Postage	-	8,986	-	**8,986**	11,815
Totals	$ 3,374,988	$ 459,915	$ 297,902	**$ 4,132,805**	$ 3,316,543

Notes to Financial Statements
September 30, 2019

1. Organization

Merola Opera Program ("Merola") was organized in 1957 as a California tax-exempt, non-profit corporation. Merola was established to develop young operatic talent. Merola provides operatic training in 11-week and 12-week summer programs based in the San Francisco Bay Area to young singers, apprentice stage directors and apprentice coaches selected through a series of rigorous nationwide auditions. Merola derives its support from contributions received from government agencies along with support from individuals and foundations located primarily in the greater San Francisco Bay Area.

2. Summary of Significant Accounting Policies

Basis of Presentation – The financial statements of Merola have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles ("US GAAP").

Measure of Operations – The statement of activities reports all changes in net assets, including changes in net assets from operating and nonoperating activities. Operating activities consist of those items attributable to Merola's ongoing operations which include a variety of programmatic activities. Nonoperating activities are limited to resources that generate return from interest-bearing deposits and other activities considered to be of a more unusual or nonrecurring nature.

Cash and Cash Equivalents – Cash and cash equivalents include all monies in FDIC-insured bank accounts and highly liquid investments with maturity dates of less than three months. Cash equivalents include short-term interest-bearing investments in money market and liquid asset accounts. The carrying value of cash and cash equivalents approximates fair value because of the short maturities of those financial instruments.

Concentrations of Credit Risk – Financial instruments that potentially subject Merola to concentrations of credit risk consist principally of cash and cash equivalents and deposits. Merola maintains its cash and cash equivalents in various bank accounts that, at times, may exceed federally insured limits. Merola manages deposit concentration risk by placing cash and money market accounts with financial institutions believed to be creditworthy.

To date, Merola has not experienced losses in any of these accounts. Credit risk associated with accounts receivable and grants receivable is considered to be limited due to high historical collection rates and because substantial portions of the outstanding amounts are due from reputable organizations and foundations supportive of Merola's mission.

Receivables and Credit Policies – Merola determined that no allowance for doubtful uncollectible accounts receivable is needed based on historical experience, an assessment of economic conditions, and a review of subsequent collections. It is the policy of the organization to periodically assess receivables to determine proper carrying value.

Notes to Financial Statements
September 30, 2019

2. Summary of Significant Accounting Policies *(continued)*

Contributions and Accounts Receivable – Merola records receivables that are expected to be collected within one year at net realizable value. When material, receivables expected to be collected in future years are initially recorded at fair value using present value techniques incorporating risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the asset.

In subsequent years, amortization of the discounts (when applicable) will be included in contribution revenue on the statement of activities and changes in net assets. The allowance for uncollectible receivables is based on historical experience, an assessment of economic conditions, and a review of subsequent collections. Receivables are written off when deemed uncollectible.

Comparative Financial Information – The accompanying financial statements include certain prior-year summarized comparative information in total but not by functional category. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America (GAAP). Accordingly, such information should be read in conjunction with the audited financial statements for the year ended September 30, 2018, from which the summarized information was derived.

In-Kind Contributions – In-kind contributions are reflected at the fair value of the contribution received in accordance with *ASC 958.605.30-11*. The contributions of services, equipment, and other materials are recognized if they (a) create or enhance nonfinancial assets or (b) require specialized skills that are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation.

Contributed Services – Volunteers donate a substantial amount of time to Merola. While significant in value, these services are not recorded in the financial statements since they are not susceptible to objective measurement or valuation.

Functional Allocation of Expenses – The costs of providing program and other activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among services and supporting services benefited. Such allocations are determined by management on an equitable basis. A majority of expenses (such as salaries and wages, occupancy, telephone and other utilities) have been allocated based on time and effort using Merola's payroll allocations. Other expenses (such as professional services, advertising and promotion and other direct costs) have been allocated in accordance with the specific services received from vendors.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Accordingly, actual results could differ from those estimates.

2. Summary of Significant Accounting Policies *(continued)*

Fair Value Measurements – Fair value is defined as the price that would be received to sell an asset in the principal or most advantageous market for the asset in an orderly transaction between market participants on the measurement date. Fair value should be based on the assumptions market participants would use when pricing an asset. US GAAP establishes a fair value hierarchy that prioritizes investments based on those assumptions.

The fair value hierarchy gives the highest priority to quoted prices in active markets (observable inputs) and the lowest priority to an entity's assumptions (unobservable inputs). Merola groups assets at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1
Unadjusted quoted market prices for identical assets or liabilities in active markets as of the measurement date.

Level 2
Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar assets/liabilities in active markets;
- Quoted prices for identical or similar assets in non-active markets;
- Inputs other than quoted prices that are observable for the asset/liability; and,
- Inputs that are derived principally from or corroborated by other observable market data.

Level 3
Unobservable inputs that cannot be corroborated by observable market data.

In some cases, the inputs used to measure the fair value of an asset or a liability might be categorized within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to entire measurement requires judgment, taking into account factors specific to the asset or liability. The categorization of an asset within the hierarchy is based upon the pricing model of the asset and does not necessarily correspond to our assessment of the quality, risk or liquidity profile of the asset or liability.

Reclassifications – Certain prior year amounts have been reclassified to conform to fiscal year 2019 presentation. These changes had no impact on previously reported changes in net assets.

Unearned Revenue – Audition fees for the subsequent season are recorded as unearned revenue and are recognized as revenue in the subsequent fiscal year.

Advertising – Advertising revenue and expenses are recognized in the period in which advertising appears in the performance programs.

2. Summary of Significant Accounting Policies *(continued)*

Net Assets - Net assets, revenues, gains, and losses are classified based on the existence or absence of donor or grantor-imposed restrictions. Thus, net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions
Net assets available for use in general operations and not subject to donor (or certain grantor) restrictions. The governing board has the ability to designate, from net assets without donor restrictions, net assets for an operating reserve and board-designated endowment, and it has opted to do so as of September 30, 2019.

Net Assets With Donor Restrictions
Net assets subject to donor- (or certain grantor-) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions can be perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Gifts of long-lived assets and gifts of cash restricted for the acquisition of long-lived assets are recognized as revenue when the assets are placed in service. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both.

Revenue and Revenue Recognition - Contributions are recognized when cash, securities or other assets, an unconditional promise to give, or notification of a beneficial interest is received. Conditional promises to give are not recognized until the conditions on which they depend have been substantially met. A transfer of funds with a conditional promise to contribute them are accounted for as a refundable advance until the conditions have been substantially met. When applicable, revenue earned under a contractual arrangement (an “exchange transaction”) is recognized when earned and therefore measured as services are provided.

Contributions received are recorded as net assets without donor restrictions or net assets with donor restrictions, depending on the existence and/or nature of any donor-imposed restrictions. Contributions that are restricted by the donor are reported as an increase in net assets without donor restrictions if the restriction expires in the reporting period in which the contribution is recognized.

Investments and Endowment – Investments are reported at fair value with gains and losses included in the statement of activities and changes in net assets. Merola follows the provisions of *ASC 958.320, Investments – Debt and Equity Securities of Not-for-Profit Entities* and has estimated the fair value of its investments using available market information and other valuation methodologies. Accordingly, the estimates presented are not necessarily indicative of the amounts that Merola could realize in a current market exchange.

The use of different assumptions and/or estimation methods may have a material effect on the estimated fair value amounts. The estimates are based on pertinent information available to management as of September 30, 2019 and 2018. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, current estimates of fair value may differ significantly from the statements presented.

(continued)

2. Summary of Significant Accounting Policies (*continued*)

Investments and Endowment *(continued)*
Merola's endowment consists of a diverse mixture of funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. As required by ASC 958.320, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. Merola has interpreted the Uniform Prudent Management of Institutional Funds Act (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, Merola classifies as net assets with donor restrictions – in perpetuity (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 net assets with donor restrictions – in perpetuity is classified as net assets with donor restrictions – time/purpose until those amounts are appropriated for expenditure by Merola in a manner consistent with the standard of prudence prescribed by UPMIFA.

Property and Equipment – Merola's policy is to record acquisitions of property and equipment at cost or, if donated, at fair market value on the date of donation. Depreciation expense is calculated using the straight-line method over the estimated useful lives of the assets. When assets are sold or otherwise disposed of, the cost and related depreciation or amortization are removed from the accounts, and any resulting gain or loss is included in the statements of activities.

Costs of maintenance and repairs are expensed currently. Merola reviews the carrying values of all assets for impairment whenever events or circumstances indicate that the carrying value of an asset may not be recoverable from the estimated economic utility and/or future cash flows expected to result from its use and eventual disposition. When considered impaired, an impairment loss is recognized to the extent carrying value exceeds the fair value of the asset. Merola has determined that no long-lived assets were impaired during the years ended September 30, 2019 and 2018.

Income Taxes – Merola is organized as California nonprofit corporation and has been recognized by the IRS as exempt from federal income taxes under IRC Section 501(a) as organizations described in IRC Section 501(c)(3), qualify for the charitable contribution deduction under IRC Sections 170(b)(1)(A)(vi) and (viii), and has been determined not to be private foundations under IRC Sections 509(a)(1) and (3), respectively. Merola is annually required to file a Return of Organization Exempt from Income Tax (Form 990) with the IRS. Merola is not required to file an Exempt Organization Business Income Tax Return (Form 990-T) because it had no unrelated business taxable income for the year ended September 30, 2019.

(continued)

2. Summary of Significant Accounting Policies *(continued)*

Income Taxes *(continued)*
Merola has received notification from the Internal Revenue Service and the State of California that it qualifies for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and Section 23701d of the California Revenue and Taxation Code. The exemptions are subject to periodic review by the federal and state taxing authorities and management is confident that Merola continues to satisfy all federal and state statutes in order to qualify for continued tax exemption status.

Recent and Relevant Accounting Pronouncements – The following pronouncements became effective for fiscal years beginning subsequent to December 15, 2017:

In August 2016, the FASB issued *ASU 2016-14, Not-for-Profit Entities (Topic 958) – Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. Merola has adjusted the presentation of these statements accordingly.

In February 2016, the FASB issued *ASU 2016-02, Leases (Topic 842) Accounting for Leases*, which requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. Topic 842 was subsequently amended by *ASU No. 2018-01*, *ASU No. 2018-10*, and *ASU No. 2018-11*. This new pronouncement is effective for fiscal years beginning after December 15, 2020, but Merola has elected early implementation.

The new standard establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the statement of financial position for all leases with a term longer than 12 months. Leases are required to be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the statements of activities and changes in net assets.

In August 2014, the FASB issued *ASU 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40) Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, which requires an organization's management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). As of December 22, 2019 (the date of the Independent Auditors' Report), Merola management has made this evaluation and has determined that Merola has the ability to continue as a going concern.

3. Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2019 and 2018 consist of funds in multiple accounts at local financial institutions. The composition of cash and cash equivalents is as follows at September 30:

		2019		2018
Checking and petty cash (noninterest-bearing)	**$**	**595,986**	$	504,595
Money market (bearing interest at 0.2% at September 30, 2019)		**226,362**		225,652
Total cash and cash equivalents	**$**	**822,348**	$	730,247

4. Contributions and Accounts Receivable

Contributions receivable of $23,842 and $192,541 at September 30, 2019 and 2018, respectively, represent funds due from various individuals, foundations, and other organizations. Accounts receivable of $22,608 at September 30, 2018 represent refunds due from San Francisco Opera Association (SFOA) for excess amounts paid by Merola to SFOA under the contractual arrangement between the two organizations. There were no accounts receivable at September 30, 2019. Contributions and accounts receivable are classified as Level 2 hierarchy as of September 30, 2019 and 2018. See Note 10 for further information regarding the relationship with SFOA.

Merola uses the direct write-off method with regards to receivables deemed uncollectible. Management has evaluated the receivables as of September 30, 2019 and determined that such amounts are fully collectible based on the financial health of the donors. Accordingly, there is no allowance for doubtful accounts as of September 30, 2019.

5. Investments and Endowment

Investments consist of the following at September 30:

		2019		2018
Investments: cash equivalents	**$**	**1,233,543**	$	1,635,888
Equities		**16,301,569**		16,237,217
Fixed Income		**11,153,767**		10,620,478
Alternative Asset – Real Estate		**1,043,468**		1,004,025
Total investments	**$**	**29,732,347**	$	29,497,608

Investments in equity securities with readily determinable fair value and all investments in debt securities are reported at fair value or amounts that approximate fair value. Cash and cash equivalents include funds held in highly liquid investments with maturity dates of three months or less.

(continued)

Notes to Financial Statements
September 30, 2019

5. Investments and Endowment *(continued)*

Merola has a Finance Committee which has the responsibility for establishing the organization's return objectives (generally lower rates of return associated with more stable and safer investments) and to define the risk parameters (generally low risk securities, certificates of deposit and mutual funds). The committee routinely oversees investment performance and reviews cash flows necessary to sustain Merola's operating activities.

Endowment net asset composition by type of fund is summarized as follows as of September 30, 2019:

	Net Assets *Without* Donor Restrictions	Net Assets *With* Donor Restrictions: Time / Purpose	Net Assets *With* Donor Restrictions: Perpetual	Total
Donor-restricted endowment funds	$ -	$1,841,422	$13,882,674	$15,724,096
Board-designated endowment funds	13,308,197	-	-	13,308,197
Charitable remainder trusts	-	-	551,997	551,997
Total funds	**$ 13,308,197**	**$1,841,422**	**$14,434,671**	**$29,584,290**

Changes in endowment net assets for the fiscal year ended September 30, 2019 is summarized as follows:

	Net Assets *Without* Donor Restrictions	Net Assets *With* Donor Restrictions: Time / Purpose	Net Assets *With* Donor Restrictions: Perpetual	Total
Endowment net assets at beginning of year	$ 13,328,810	$1,881,586	$14,147,670	$29,358,066
Investment return:				
Investment income, net of fees	718,641	171,769	(57,299)	833,111
Net realized gains (losses)	236,718	106,932	(35,638)	308,012
Net unrealized gains (losses)	(49,682)	(12,317)	369,185	307,186
Total investment return	905,677	266,384	276,248	1,448,309
Contributions	286,709	-	21,955	308,664
Change in value of assets held in CRTs	-	-	(11,202)	(11,202)
Appropriation of endowment assets	(1,198,030)	(321,517)	-	(1,519,547)
Reclassifications	(14,969)	14,969	-	-
Endowment net assets at end of year	**$ 13,308,197**	**$1,841,422**	**$14,434,671**	**$29,584,290**

(continued)

5. Investments and Endowment *(continued)*

Endowment net asset composition by type of fund is summarized as follows as of September 30, 2018:

	Net Assets *Without* Donor Restrictions	Net Assets *With* Donor Restrictions: Time / Purpose	Net Assets *With* Donor Restrictions: Perpetual	Total
Donor-restricted endowment funds	$ -	$1,881,586	$13,584,471	$15,466,057
Board-designated endowment funds	13,328,810	-	-	13,328,810
Charitable remainder trusts	-	-	563,199	563,199
Total funds	$ 13,328,810	$1,881,586	$14,147,670	$29,358,066

Changes in endowment net assets for the fiscal year ended September 30, 2018 is summarized as follows:

	Net Assets *Without* Donor Restrictions	Net Assets *With* Donor Restrictions: Time / Purpose	Net Assets *With* Donor Restrictions: Perpetual	Total
Endowment net assets at beginning of year	$ 12,329,262	$1,735,892	$13,968,345	$28,033,499
Investment return:				
Investment income, net of fees	566,187	133,131	(52,183)	647,135
Net realized gains	422,983	195,551	840,569	1,459,103
Net unrealized gains (losses)	170,243	105,770	(747,229)	(471,216)
Total investment return	1,159,413	434,452	41,157	1,635,022
Contributions	1,032,187	-	114,539	1,146,726
Change in value of assets held in CRTs	-	-	23,629	23,629
Appropriation of endowment assets	(1,154,482)	(326,328)	-	(1,480,810)
Reclassifications	(37,570)	37,570	-	-
Endowment net assets at end of year	$ 13,328,810	$1,881,586	$14,147,670	$29,358,066

During the years ended September 30, 2019 and 2018, earnings on investments were reinvested. Endowment investment income, net of fees, amounted to $833,111 and $647,135 for the years ended September 30, 2019 and 2018, respectively. Endowment net realized gains amounted to $308,012 and $1,459,103 for the years ended September 30, 2019 and 2018, respectively. Endowment net unrealized gains (losses) amounted to $307,186 and ($471,216) for the years ended September 30, 2019 and 2018, respectively. The change in value of assets held in charitable remainder trusts amounted to ($11,202) and $23,629 for the years ended September 30, 2019 and 2018, respectively.

Operating investment income, net of fees, amounted to $15,492 and $5,008 for the years ended September 30, 2019 and 2018, respectively.

(continued)

5. Investments and Endowment *(continued)*

Merola has a Finance Committee which has the responsibility for establishing Merola's return objectives (generally lower rates of return associated with more stable and safer investments) and to define the risk parameters. The committee routinely oversees investment performances and reviews cash flows necessary to sustain Merola's operating activities.

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the Uniform Prudent Management of Institutional Funds Act (UPMIFA) requires Merola to retain as a fund of perpetual duration. In accordance with *ASC 958.205.55.31*, there are no deficiencies of this nature that are required to be reported in net assets with donor restrictions – time/purpose at September 30, 2019. Such future deficiencies could result from unfavorable market fluctuations occurring after the investment of new restricted contributions and continued appropriation for certain programs which are deemed prudent by the Board of Directors.

Merola's investments may decline below their original basis due to market fluctuations and unrealized losses which are beyond the control of Merola's management. Although there were none at September 30, 2019 and 2018, future deficiencies of this nature (if applicable) would be reported in net assets with donor restrictions – time/purpose in accordance with ASU 2016-14.

Return Objectives and Risk Parameters

Merola has adopted 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 the endowment assets. Endowment assets consist of donor and board-designated funds. Under this policy, as approved by the Investment Committee and the Board of Directors, the endowment assets are invested in a manner that is intended to (1) produce results that approximate the price and yield results of the general market conditions (2) subject Merola to a moderate level of investment risk and (c) maintain sufficient liquidity to meet planned expenditures

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, Merola 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). Merola targets a diversified asset allocation that places a greater emphasis on equity-based investments (mutual funds) to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Spending Policy for Investments is set by the Board. The amount of the annual draw is analyzed, calculated, and then recommended by the Finance Committee for approval of the Board as part of the annual budgeting process for the forthcoming year. Under the provisions of UPMIFA, annual endowment spending may exceed 100% of the endowment income accumulated since the last distribution plus any income not distributed in the preceding years.

6. Liquidity

Merola regularly monitors liquidity required to meet its operating needs and other contractual commitments, while also striving to maximize the safeguarding of its available funds. Merola has various sources of liquidity at its disposal, including cash and cash equivalents, access to potential lines of credit (if necessary), and other sources (including funds held in reserves).

For purposes of analyzing resources available to meet general expenditures over a 12-month period, Merola considers all expenditures related to its ongoing activities of providing opera training, including support, performance and individualized coaching to be general expenditures.

In addition to financial assets available to meet general expenditures over the next 12 months, Merola operates with a balanced budget and anticipates collecting sufficient revenue to cover general expenditures. Merola utilizes a multi-year strategy to ensure financial liquidity. When operating revenues exceed expenses during a given fiscal year, these revenues are placed in reserves to be utilized if the subsequent fiscal year is budgeted with an operating deficit.

Merola's expenditures and revenues tend to be on a three-year cycle. Merola's reserves and endowment continue to grow each year, providing the organization with stable reserves to ensure continued operations.

As of September 30, 2019, the following table shows the total financial assets held by Merola and the amounts of those financial assets readily available within one year of the balance sheet date to meet general expenditures:

Cash and cash equivalents	$	813,348
Contributions receivable		23,842
Investments – current portion		1,233,543
Less: amounts not available to be used within one year:		
Net assets with donor restrictions for programs		(9,000)
Financial assets available to meet general expenditures over the next twelve months	$	2,061,733

Merola's goal is generally to maintain financial assets equal to or in excess of 90 days of operating expenses (approximately $891,000). As part of its liquidity plan, 30% of all undesignated bequests (not included in the operating budget) are routinely transferred to reserve accounts. As of September 30, 2019, funds held in reserve accounts amounted to $700,049.

7. Assets Held in Charitable Remainder Trusts

During the years ended September 30, 1995 and September 30, 2002, Merola was the named remainder beneficiary of certain irrevocable charitable remainder trusts. During the lifetimes of the income beneficiaries, a certain percentage of the fair market value of the trusts will be paid annually by the trustees to such income beneficiaries as designated by the donors. The amounts paid to the income beneficiaries may be different than the income earned by the trusts during any given year, with any difference being added to or subtracted from the trusts' corpus. The trusts terminate upon the death of the income beneficiaries and remaining corpus at that time will be distributed to Merola for establishment of permanent endowment funds in the names of the donors.

The value of the gifts at the time of donation was based on the then-present values of the estimated benefits to be received by Merola at the termination of the trusts. The present values were calculated based on the fair values of the trust assets at the time of donation, the actuarially determined life expectancies of the income beneficiaries, the income distribution percentage rates as specified in the trust instruments (ranging between 6% and 7%), and the assumed discount rates ranging between 6% and 7% (as determined by IRS tables). The present value of the estimated benefits to be received by Merola are recalculated annually based on the current value of the trust assets as provided by the trustees, discounted using the current actuarially determined life expectancies of the income beneficiaries and income distribution percentages and discount rates as originally determined. Annual changes in the value of the trusts are reported as increases or decreases in permanently restricted net assets.

Merola has estimated that the present value of the receivables from remainder trusts amounted to $551,997 and $563,199 at September 30, 2019 and 2018, respectively.

8. Property and Equipment

Property and equipment consist of the following at September 30:

	2019	2018
Furniture and equipment	**$ 91,353**	$ 87,011
Less: accumulated depreciation	**(79,793)**	(70,391)
Property and equipment, net	**$ 11,560**	$ 16,620

Depreciation expense amounted to $9,402 and $8,933 for the years ended September 30, 2019 and 2018, respectively.

9. Fair Value Measurements

Fair value measurements establish a fair value hierarchy that prioritizes the input used to measure fair value. This hierarchy consists of three broad levels: (a) Level 1 measurement reflects the value of the investments at quoted prices in active markets for identical assets, generally without any adjustments, (b) Level 2 assets and liabilities are valued based on "observable inputs" other than quoted active market prices, including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, and interest rates and yield curves, and (c) Level 3 assets and liabilities are valued based on “unobservable inputs," such as a company’s own estimates and pricing models. Net asset value (NAV) per share, or its equivalent, is used as a practical expedient to estimate the fair market value of certain hedge funds, private equity funds, funds of funds, and limited partnerships, which do not have readily determinable fair values. Investments that are measured at fair value using NAV per share as a practical expedient are not classified in the fair value hierarchy.

Composition of assets utilizing fair value measurements at September 30, 2019 is as follows:

	Totals	Level 1	Level 2	Level 3	NAV
Investments: cash equivalents	**$ 1,233,543**	$ 1,233,543	$ -	$ -	$ -
Equities	**16,301,569**	16,301,569	-	-	-
Fixed income	**11,153,767**	11,153,767	-	-	-
Alternative asset – real estate	**1,043,468**	-	-	-	1,043,468
Assets held in charitable remainder trusts	**551,997**	-	-	551,997	-
Contributions receivable	**23,842**	-	23,842	-	-
Totals	**$ 30,308,186**	$28,688,879	$ 23,842	$ 551,997	$1,043,468

Composition of assets utilizing fair value measurements at September 30, 2018 is as follows:

	Totals	Level 1	Level 2	Level 3	NAV
Investments: cash equivalents	$ 1,635,888	$ 1,635,888	$ -	$ -	$ -
Equities	16,237,217	16,237,217	-	-	-
Fixed income	10,620,478	10,620,478	-	-	-
Alternative asset – real estate	1,004,025	-	-	-	1,004,025
Assets held in charitable remainder trusts	563,199	-	-	563,199	-
Contributions and accounts receivable	215,149	-	215,149	-	-
Totals	$ 30,275,956	$28,493,583	$ 215,149	$ 563,199	$1,004,025

Assets Classified as Level 3

The significant unobservable inputs used in the fair value measurement of Level 3 assets are: charitable remainder trust: management’s calculation utilizing present value formulas.

10. Contractual Arrangement with San Francisco Opera Association

Under a contractual arrangement, the San Francisco Opera Association (SFOA) performs certain services for Merola's programs and performances, including production of performances, providing faculty and guest artists for the summer programs, and conducting auditions. The fees for these services amounted to $2,148,079 (including $235,168 of in-kind services) and $2,039,426 (including $230,601 of in-kind services) for the years ended September 30, 2019 and 2018, respectively.

11. Related Party Transactions

Merola board members made monetary contributions totaling $339,124 and $340,799 during the years ended September 30, 2019 and 2018, respectively.

12. Right of Use Asset and Leases

Merola leases its corporate office premises in San Francisco under an operating lease agreement which expires May 31, 2020, with an option to extend for an additional five years. The lease requires a monthly payment of $8,835 as of September 30, 2019. The lease payment increases by 3% each year, and Merola management fully intends to sign the five-year option to extend when the renewal takes effect May 31, 2020.

In accordance with *ASU 2016-02, Leases*, Merola is required to reflect the present value of future operating lease payments (discounted at an appropriate borrowing rate) as a "Right of Use" asset and a corresponding lease liability. Accordingly, Merola has recorded a total lease liability in the amount of $615,470 (split between current amount of $88,552 and noncurrent amount of $526,918) and a corresponding right of use asset for the premises in the amount of $615,470. The weighted average discount rate associated with the calculation of the present value of the future lease payments as of September 30, 2019 was 4.0%.

Occupancy and rental expense for all facilities amounted to $114,431 and $113,019 for the years ended September 30, 2019 and 2018, respectively. At September 30, 2019, minimum future lease payments for operating leases with terms of one year or more are as follows: Year ending September 30, 2020: $109,518; Year ending September 30, 2021: $117,673; Year ending September 30, 2022: $121,203; Year ending September 30, 2023: $124,839; Year ending September 30, 2024: $128,585; and thereafter: $87,421.

13. In-Kind Contributions

Merola recognizes donated services which create and enhance non-financial assets or that require specialized skills (such as professional services which would otherwise need to be purchased if not provided by donation). During the years ended September 30, 2019 and 2018, Merola was the recipient of $314,128 and $296,274, respectively, in various in-kind contributions. These donated items were recorded at their estimated fair market values as in-kind expenses on the statement of functional expenses.

14. Net Assets

Net Assets without Donor Restrictions
Net assets without donor restrictions represent the cumulative retained surpluses of the organization's operating activities since its inception. Net assets without donor restrictions consist of the following as of September 30:

	2019	2018
Undesignated net assets from operating activities	**$ 1,616,766**	$ 1,239,762
Board-designated endowment funds	**13,308,197**	13,328,810
Total net assets without donor restrictions	**$ 14,924,963**	$ 14,568,572

Net Assets with Donor Restrictions – Time/Program
Merola recognizes support from net assets with donor restrictions imposed by the donors have been satisfied or expired. Net assets with donor restrictions – time/program consist of the following as of September 30:

	2019	2018
Individuals for "If I Were You" Commission	**$ -**	$ 478,519
Getty Foundation for "If I Were You" Commission	**-**	200,000
Board member restricted for following fiscal year	**5,500**	15,000
Membership contributions for following fiscal year	**3,500**	-
Fee for acting as fiscal sponsor	**-**	5,000
Endowment funds	**1,841,422**	1,881,586
Total net assets with donor restrictions – time/purpose	**$ 1,850,422**	$ 2,580,105

During the years ended September 30, 2019 and 2018, contributions of net assets with donor restrictions – time/program amounted to $9,000 and $422,684, respectively. Net assets released from restriction amounted to $698,519 and $21,750 during the years ended September 30, 2019 and 2018, respectively. Such amounts are reflected on the statement of activities and changes in net assets as transfers from net assets with donor restrictions to net assets without donor restrictions.

Net Assets with Donor Restrictions – Perpetual
Net assets with donor restrictions – perpetual consist of the following as of September 30:

	2019	2018
Charitable remainder trusts	**$ 551,997**	$ 563,199
Endowment funds	**13,882,674**	13,584,471
Total net assets with donor restrictions – perpetual	**$ 14,434,671**	$ 14,147,670

Endowment funds, classified as net assets with donor restrictions – perpetual, represent donor contributions which are subject to restrictions of gift instruments requiring that the principal be invested in perpetuity. Earnings from investments (interest, dividends, realized and unrealized gains) may be transferred to net assets without donor restrictions and net assets with donor restrictions – time/purpose and used for general operating purposes.

Notes to Financial Statements
September 30, 2019

15. Compensated Absences (Accrued Payroll and Related Benefits)

Financial statement presentation follows the recommendations of *ASC 710.25, Compensated Absences.* Under ASC 710.25, Merola is required to record a liability for the estimated amounts of compensation for future absences. Employees are permitted to accrue a specific number of hours of vacation which is payable upon termination of the employee. Sick leave is not paid upon termination. Annual leave accruals are recorded in the financial statements as an accrued liability on the statement of financial position based on hourly rates in effect at the end of the fiscal year. At September 30, 2019 and 2018, Merola reflected $39,160 and $27,722, respectively, in accrued payroll and related benefits.

16. Retirement Plan

Merola offers employees the opportunity for participation in a retirement plan qualified under Internal Revenue Code Section 401(k). The plan is discretionary but permits employees to contribute pre-tax earnings subject to statutory limitations. Contributions to the plan amounted to $25,775 and $25,620 during the years ended September 30, 2019 and 2018, respectively.

17. Commitments and Contingencies

In the normal course of business there are outstanding various commitments and contingent liabilities, such as commitments to enter into contracts and future projects, which are not reflected in the financial statements. Such commitments and contingencies also include risks associated with various economic and operating factors, which include (a) Grant restrictions and donor conditions which obligate Merola to fulfill certain requirements as set forth in grant instruments, (b) Funding levels which vary based on factors beyond Merola's control, such as generosity of donors and general economic conditions, (c) Employment and service agreements with key management personnel, and (d) Financial risks associated with funds on deposit at bank and investment brokerage accounts. Management believes that such commitments, contingencies and risks will not have a material adverse effect on the financial statements. Certain of the grants and contracts (including current and prior costs) are subject to audit and final acceptance by the various granting agencies. Management believes that such commitments, contingencies and risks will not have a material adverse effect on the financial statements.

18. Subsequent Events

In compliance with *ASC 855, Subsequent Events*, Merola has evaluated subsequent events through December 22, 2019, the date the financial statements were available to be issued and, and in the opinion of management, there are no subsequent events which need to be disclosed.