Main Street Theater

Financial Statements
and Independent Auditors' Report
for the years ended August 31, 2017 and 2016

Main Street Theater

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Independent Auditors' Report

To the Board of Directors of
Main Street Theater:

We have audited the accompanying financial statements of Main Street Theater, which comprise the statements of financial position as of August 31, 2017 and 2016 and the related statements of activities, of functional expenses, and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audits 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 auditors' 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 Main Street Theater as of August 31, 2017 and 2016 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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Emphasis of Matter

The accompanying financial statements have been prepared assuming that Main Street Theater will continue as a going concern. As discussed in Note 8 to the financial statements, Main Street Theater has debt due within the next 12 months in excess of available cash and has experienced an operating deficit and negative cash flow. These circumstances raise substantial doubt about Main Street Theater's ability to continue as a going concern. Management's plans regarding these matters are described in Note 8. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Blazek & Vetterling

December 20, 2017

Main Street Theater

Statements of Financial Position as of August 31, 2017 and 2016

	2017	2016
ASSETS		
Cash	$ 8,622	$ 43,033
Prepaid expenses and other assets	145,125	96,708
Pledges receivable	182,499	54,882
Investments *(Note 2)*	39,668	47,662
Cash restricted for capital projects		1,399
Property, net *(Note 3)*	3,170,723	3,334,697
TOTAL ASSETS	$ 3,546,637	$ 3,578,381
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	$ 65,761	$ 49,371
Deferred revenue	138,861	144,008
Notes payable *(Note 4)*	1,035,000	935,000
Total liabilities	1,239,622	1,128,379
Net assets:		
Unrestricted	2,216,446	2,372,403
Temporarily restricted *(Note 5)*	60,569	47,599
Permanently restricted *(Note 6)*	30,000	30,000
Total net assets	2,307,015	2,450,002
TOTAL LIABILITIES AND NET ASSETS	$ 3,546,637	$ 3,578,381

See accompanying notes to financial statements.

Main Street Theater

Statement of Activities for the year ended August 31, 2017

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
REVENUE:				
Contributions	$ 400,098	$ 444,325		$ 844,423
Ticket sales	1,188,596			1,188,596
Tuition	544,408			544,408
Investment return *(Note 2)*		4,525		4,525
Other income	30,671			30,671
Total revenue	2,163,773	448,850		2,612,623
Net assets released from restrictions:				
Satisfaction of program restrictions	210,880	(210,880)		
Satisfaction of time restrictions	225,000	(225,000)		
Total	2,599,653	12,970		2,612,623
EXPENSES:				
Program services	2,325,745			2,325,745
Management and general	316,794			316,794
Fundraising	113,071			113,071
Total expenses	2,755,610			2,755,610
CHANGES IN NET ASSETS	(155,957)	12,970		(142,987)
Net assets, beginning of year	2,372,403	47,599	$ 30,000	2,450,002
Net assets, end of year	$ 2,216,446	$ 60,569	$ 30,000	$ 2,307,015

See accompanying notes to financial statements.

Main Street Theater

Statement of Activities for the year ended August 31, 2016

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
REVENUE:				
Contributions	$ 302,097	$ 511,561		$ 813,658
Ticket sales	1,075,043			1,075,043
Tuition	544,847			544,847
Investment return *(Note 2)*	47	5,282		5,329
Other income	39,557			39,557
Total revenue	1,961,591	516,843		2,478,434
Net assets released from restrictions:				
Satisfaction of capital restrictions	2,254,288	(2,254,288)		
Satisfaction of program restrictions	127,455	(127,455)		
Satisfaction of time restrictions	77,000	(77,000)		
Total	4,420,334	(1,941,900)		2,478,434
EXPENSES:				
Program services	2,049,024			2,049,024
Management and general	297,740			297,740
Fundraising	57,824			57,824
Total expenses	2,404,588			2,404,588
CHANGES IN NET ASSETS	2,015,746	(1,941,900)		73,846
Net assets, beginning of year	356,657	1,989,499	$ 30,000	2,376,156
Net assets, end of year	$ 2,372,403	$ 47,599	$ 30,000	$ 2,450,002

See accompanying notes to financial statements.

Main Street Theater

Statements of Functional Expenses for the years ended August 31, 2017 and 2016

	PROGRAM SERVICES	MANAGEMENT AND GENERAL	FUNDRAISING	2017 TOTAL
Compensation and related expense	$ 1,486,170	$ 86,502	$ 71,097	$ 1,643,769
Rent	269,549	17,113	9,600	296,262
Depreciation	167,856			167,856
Production supplies	142,304			142,304
Royalties	113,587			113,587
Postage and printing	86,727	788	8,508	96,023
Advertising		83,357	4,657	88,014
Interest		47,606		47,606
Insurance	18,891	18,931	723	38,545
Supplies	10,337	7,055	13,536	30,928
Bank service fees		29,587		29,587
Professional services		20,038		20,038
Utilities	16,084	936	769	17,789
Repairs	9,647			9,647
Other	4,593	4,881	4,181	13,655
Total expenses	$ 2,325,745	$ 316,794	$ 113,071	$ 2,755,610

	PROGRAM SERVICES	MANAGEMENT AND GENERAL	FUNDRAISING	2016 TOTAL
Compensation and related expense	$ 1,285,868	$ 98,956	$ 39,648	$ 1,424,472
Rent	268,119	17,453	394	285,966
Depreciation	146,661			146,661
Production supplies	116,281			116,281
Royalties	101,075			101,075
Postage and printing	68,285	1,216	9,730	79,231
Advertising		46,459	3,418	49,877
Interest		45,750		45,750
Insurance	14,982	17,884	355	33,221
Supplies	9,960	5,001	3,279	18,240
Bank service fees		26,214		26,214
Professional services		31,096		31,096
Utilities	19,470	1,498	600	21,568
Repairs	12,543			12,543
Other	5,780	6,213	400	12,393
Total expenses	$ 2,049,024	$ 297,740	$ 57,824	$ 2,404,588

See accompanying notes to financial statements.

Main Street Theater

Statements of Cash Flows for the years ended August 31, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$ (142,987)	$ 73,846
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Depreciation	167,856	146,661
Net realized and unrealized gain on investments	(2,074)	(2,251)
Contributions restricted for capital projects		(374,106)
Donated securities	(31,022)	
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(48,417)	(37,523)
Pledges receivable	(127,617)	68,750
Accounts payable and accrued expenses	16,390	13,701
Deferred revenue	(5,147)	30,961
Net cash used by operating activities	(173,018)	(79,961)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in cash restricted for capital projects	1,399	319,243
Purchases of property	(3,882)	(944,158)
Proceeds from sale of investments	43,541	
Change in money market mutual fund held as investments	(2,451)	3,802
Net cash provided (used) by investing activities	38,607	(621,113)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable	265,000	100,000
Repayments of notes payable	(165,000)	
Proceeds from contributions restricted for capital projects		586,279
Net cash provided by financing activities	100,000	686,279
NET CHANGE IN CASH	(34,411)	(14,795)
Cash, beginning of year	43,033	57,828
Cash, end of year	$ 8,622	$ 43,033

Supplemental disclosure of cash flow information:

Interest paid	$47,606	$45,750

See accompanying notes to financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – Main Street Theater (the Theater) is a nonprofit theatrical organization located in Houston, Texas. The Theater was organized in 1975 to provide a wide variety of dramatic literature and theatrical innovation. In addition, the Theater provides an opportunity for artists living in the Houston area to showcase and develop their talents.

Federal income tax status – The Theater is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(2).

Pledges receivable that are expected to be collected within one year are reported at net realizable value. Amounts expected to be collected in more than one year are discounted, if material, to estimate the present value of future cash flows. At August 31, 2017, pledges receivable are due to be received as follows: $102,499 within one year and $80,000 in one to five years. At August 31, 2017, 82% of the Theater's total pledges receivable balance was from one donor.

Investments are reported at fair value. Investment return is reported in the statement of activities as an increase or decrease in unrestricted net assets unless the use of the income is limited by donor-imposed restrictions. Investment return whose use is restricted by the donor is reported as an increase in temporarily restricted net assets.

Property is reported at cost if purchased or at fair value at the date of gift if donated. The Theater capitalizes additions and improvements with a cost of more than $1,000. Depreciation is provided on a straight-line basis over estimated useful lives of 39 years for buildings and 3 to 15 years for furniture and equipment.

Net asset classification – Contributions, investment return and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.
- *Temporarily restricted net assets* include contributions and investment return restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity.

Contributions are recognized as revenue at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are classified as restricted support. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Ticket sales are recognized as revenue when the performance occurs. Amounts received for future season performances are reported as deferred revenue.

Tuition is recognized in the period in which the services are provided. Amounts received in advance are deferred until earned.

Advertising costs are expensed as incurred.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts of reported revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Recent financial accounting pronouncements – In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* Under this ASU, net assets will be presented in two classes: *net assets with donor restrictions* and *net assets without donor restrictions* and underwater endowments will be grouped with *net assets with donor restrictions.* New or enhanced disclosures will be required about the nature and composition of net assets, and the liquidity and availability of resources for general operating expenditures within one year of the balance sheet date. Expenses will be required to be presented by both nature and function and investment return will be presented net of external and direct internal investment expenses. Absent explicit donor stipulations, restrictions on long-lived assets will expire when assets are placed in service. The ASU is effective for fiscal periods beginning after December 15, 2017, but early adoption is permitted. Adoption of this ASU will impact the presentation and disclosures of the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* Under this ASU, a lessee should recognize in the statement of financial position a lease liability and a lease asset representing its right to use the underlying asset for the term of the lease for both finance and operating leases. An entity may make an accounting policy election not to recognize lease assets and lease liabilities for leases with a term of 12 months or less. Recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not changed significantly. Qualitative and quantitative disclosures are required by lessees and lessors to enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. The ASU is effective for fiscal periods beginning after August 31, 2020. This change will require recording as a liability future leases such as the lease disclosed in Note 8.

NOTE 2 – INVESTMENTS AND FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- *Level 2* – Inputs are other than quoted prices included in Level 1, which are either directly observable or can be derived from or corroborated by observable market data at the reporting date.
- *Level 3* – Inputs are not observable and are based on the reporting entity's assumptions about the inputs market participants would use in pricing the asset or liability.

Assets measured at fair value at August 31, 2017 are as follows:

	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Equity mutual funds	$ 34,379			$ 34,379
Money market mutual funds	5,289			5,289
Total assets measured at fair value	$ 39,668	$ 0	$ 0	$ 39,668

Assets measured at fair value at August 31, 2016 are as follows:

	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Equity mutual funds	$ 44,824			$ 44,824
Money market mutual funds	2,838			2,838
Total assets measured at fair value	$ 47,662	$ 0	$ 0	$ 47,662

Mutual funds are valued at reported net asset value. This valuation method may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Theater believes its valuation method is appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date.

Investments are exposed to various risks such as interest rate, market, and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of financial position and statement of activities.

Investment return includes earnings on cash and consists of the following:

	2017	2016
Net realized and unrealized gain	$ 2,074	$ 2,251
Interest and dividends	2,451	3,078
Total investment return	$ 4,525	$ 5,329

NOTE 3 – PROPERTY

Property is comprised of the following:

	2017	2016
Land	$ 216,000	$ 216,000
Buildings	3,320,246	3,320,246
Furniture and equipment	146,789	142,907
Total property, at cost	3,683,035	3,679,153
Accumulated depreciation	(512,312)	(344,456)
Property, net	$ 3,170,723	$ 3,334,697

NOTE 4 – NOTES PAYABLE

Notes payable consist of the following:

	2017	2016
Mortgage note payable to an individual with interest at 5%. Monthly interest-only payments with balance due November 30, 2019. Collateralized by the property purchased.	$ 600,000	$ 600,000
Mortgage note payable to an individual with interest at 5%. Monthly interest-only payments with balance due August 12, 2018. Collateralized by the property purchased.	235,000	235,000
Unsecured bank line of credit with a limit of $250,000; interest at prime (5.5% at August 31, 2017). Monthly interest-only payments with balance due January 18, 2019.	200,000	100,000
Total notes payable	$ 1,035,000	$ 935,000

NOTE 5 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	2017	2016
Costume connection	$ 31,920	$ 25,000
Accumulated endowment earnings	9,668	22,599
Development personnel	18,981	
Total temporarily restricted net assets	$ 60,569	$ 47,599

NOTE 6 – ENDOWMENT FUNDS

Changes in endowment net assets are as follows:

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
Endowment net assets, August 31, 2015	$ 0	$ 17,317	$ 30,000	$ 47,317
Investment return:				
Interest and dividends		3,031		3,031
Net realized and unrealized gain		2,251		2,251
Total investment return		5,282		5,282
Endowment net assets, August 31, 2016	0	22,599	30,000	52,599
Investment return:				
Interest and dividends		2,451		2,451
Net realized and unrealized gain		2,074		2,074
Total investment return		4,525		4,525
Appropriation for expenditure		(17,456)		(17,456)
Endowment net assets, August 31, 2017	$ 0	$ 9,668	$ 30,000	$ 39,668

Endowment Spending Policy

The Theater has a policy of appropriating funds for distribution only when the donor-restricted endowment exceeds the original endowment by 10%. In establishing this policy, the Theater considered the long-term expected return on its endowment. This is consistent with the Theater's objectives to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment return.

Return Objectives and Risk Parameters

The Theater has adopted investment guidelines and spending policies for endowment assets that have the primary objective of achieving a long-term rate of return that will provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the assets. Under these guidelines, the endowment assets are invested in a manner that is intended to produce results that meet or exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk. The Theater expects its endowment funds to provide an average rate of return of approximately 6% to 8% annually. Actual returns in any given year may vary from this expectation.

Strategies Employed for Achieving Objectives

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

The Board of Directors of the Theater has interpreted the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA) 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 Theater classifies the original value of gifts donated to the permanent endowment as permanently restricted net assets. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Theater in a manner consistent with the standard of prudence prescribed by TUPMIFA. In accordance with TUPMIFA, the Theater considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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

NOTE 7 – COMMITMENTS

The Theater leases certain office and theater space under noncancellable operating leases. Future minimum lease payments are due as follows:

2018	$ 238,000
2019	101,400
2020	48,400
Total	$ 387,800

Lease expense of approximately $296,000 and $286,000 was recognized in 2017 and 2016, respectively.

NOTE 8 – MANAGEMENT'S PLANS

In 2013, the Theater purchased land and a building for approximately $1,200,000, which was financed with short-term notes payable. The mortgage note payable with a balance of $235,000 is due within the next 12 months. The Theater does not currently have resources on hand to meet this debt obligation at maturity. Management plans to renew and extend the mortgage note.

Moreover, the Theater experienced an operating deficit and negative cash flows from activities in 2017. At August 31, 2017, approximately $139,000 had been collected from ticket sales and tuition for the fiscal year 2018 and expended on fiscal year 2017 operations. In order to increase liquidity, the Theater plans to reduce expenses and to develop a comprehensive plan to engage new donors and increase contributed revenue.

NOTE 9 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through December 20, 2017, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.