

Alley Theatre

Consolidated Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2016 and 2015

Alley Theatre

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Independent Auditors' Report

To the Board of Governing Directors of
Alley Theatre:

We have audited the accompanying financial statements of Alley Theatre, which comprise the consolidated statements of financial position as of June 30, 2016 and 2015 and the related consolidated 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 consolidated financial position of Alley Theatre as of June 30, 2016 and 2015 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.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. Supplementary information in the supplemental fund accounting information for the year ended June 30, 2016, supplemental statement of financial position by fund as of June 30, 2016, and the supplemental statement of activities by fund for the year ended June 30, 2016 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in our audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Blazek & Vetterling

September 15, 2016

Alley Theatre

Consolidated Statements of Financial Position as of June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and cash equivalents (<i>Note 2</i>)	\$ 568,700	\$ 1,055,980
Other receivables	119,351	132,880
Prepaid expenses and other assets	532,479	347,745
Pledges receivable, net (<i>Note 3</i>)	11,036,167	17,397,600
Investments (<i>Notes 4 and 5</i>)	24,541,439	25,031,522
Cash and cash equivalents designated for capital reserves (<i>Note 2</i>)	283,647	364,003
Cash and cash equivalents held for capital expenditures (<i>Note 2</i>)		118,148
Property, net (<i>Note 6</i>)	<u>53,537,856</u>	<u>47,035,083</u>
TOTAL ASSETS	<u>\$ 90,619,639</u>	<u>\$ 91,482,961</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 569,328	\$ 480,031
Construction accounts payable		7,038,853
Deferred revenue	3,330,135	3,596,036
Construction loan payable (<i>Note 7</i>)	<u>10,288,414</u>	<u>2,372,953</u>
Total liabilities	<u>14,187,877</u>	<u>13,487,873</u>
Commitments (<i>Note 8</i>)		
Net assets:		
Unrestricted	55,090,171	21,490,608
Temporarily restricted (<i>Note 11</i>)	8,359,448	43,522,337
Permanently restricted (<i>Note 12</i>)	<u>12,982,143</u>	<u>12,982,143</u>
Total net assets	<u>76,431,762</u>	<u>77,995,088</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 90,619,639</u>	<u>\$ 91,482,961</u>

See accompanying notes to consolidated financial statements.

Alley Theatre

Consolidated Statement of Activities for the year ended June 30, 2016

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Contributions	\$ 5,285,271	\$ 2,927,848		\$ 8,213,119
Ticket sales	7,511,284			7,511,284
Special events	1,309,042	10,000		1,319,042
Cost of direct donor benefits	(500,447)			(500,447)
Ticket and surcharge fees	711,197			711,197
Co-production and other income	727,121			727,121
Concessions and store income	252,512			252,512
Cost of goods sold	(82,516)			(82,516)
Investment return, net (<i>Note 4</i>)	<u>3,530</u>	<u>373,845</u>		<u>377,375</u>
Total revenue	15,216,994	3,311,693		18,528,687
Net assets released from restrictions:				
Contributed revenue releases:				
Capital campaign	36,801,963	(36,801,963)		
Expiration of time restrictions	612,705	(612,705)		
Endowment distributions	<u>1,059,914</u>	<u>(1,059,914)</u>		
Total	<u>53,691,576</u>	<u>(35,162,889)</u>		<u>18,528,687</u>
EXPENSES:				
Production and artistic programs	12,505,053			12,505,053
Marketing and advertising	2,905,355			2,905,355
Management and general	3,038,711			3,038,711
Fundraising	<u>1,642,894</u>			<u>1,642,894</u>
Total expenses	<u>20,092,013</u>			<u>20,092,013</u>
CHANGES IN NET ASSETS	33,599,563	(35,162,889)		(1,563,326)
Net assets, beginning of year	<u>21,490,608</u>	<u>43,522,337</u>	<u>\$ 12,982,143</u>	<u>77,995,088</u>
Net assets, end of year	<u>\$ 55,090,171</u>	<u>\$ 8,359,448</u>	<u>\$ 12,982,143</u>	<u>\$ 76,431,762</u>

See accompanying notes to consolidated financial statements.

Alley Theatre

Consolidated Statement of Activities for the year ended June 30, 2015

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Contributions	\$ 4,306,123	\$ 9,378,475	\$ 5,000	\$ 13,689,598
Ticket sales	4,199,054			4,199,054
Special events	1,400,206	125,335		1,525,541
Cost of direct donor benefits	(585,650)			(585,650)
Ticket and surcharge fees	343,296			343,296
Co-production and other income	310,077			310,077
Concessions and store income	170,071			170,071
Cost of goods sold	(72,599)			(72,599)
Investment return, net (<i>Note 4</i>)	<u>14,827</u>	<u>149,718</u>		<u>164,545</u>
Total revenue	10,085,405	9,653,528	5,000	19,743,933
Net assets released from restrictions:				
Contributed revenue releases:				
Capital campaign	3,771,083	(3,771,083)		
Expiration of time restrictions	728,249	(728,249)		
Endowment distributions	<u>1,020,587</u>	<u>(1,020,587)</u>		
Total	<u>15,605,324</u>	<u>4,133,609</u>	<u>5,000</u>	<u>19,743,933</u>
EXPENSES:				
Production and artistic programs	10,087,164			10,087,164
Marketing and advertising	1,920,221			1,920,221
Management and general	2,577,989			2,577,989
Fundraising	<u>1,828,161</u>			<u>1,828,161</u>
Total expenses	<u>16,413,535</u>			<u>16,413,535</u>
CHANGES IN NET ASSETS	(808,211)	4,133,609	5,000	3,330,398
Net assets, beginning of year	<u>22,298,819</u>	<u>39,388,728</u>	<u>12,977,143</u>	<u>74,664,690</u>
Net assets, end of year	<u>\$ 21,490,608</u>	<u>\$ 43,522,337</u>	<u>\$ 12,982,143</u>	<u>\$ 77,995,088</u>

See accompanying notes to consolidated financial statements.

Alley Theatre

Consolidated Statement of Functional Expenses for the year ended June 30, 2016

	PRODUCTION AND ARTISTIC PROGRAMS	MARKETING AND ADVERTISING	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 5,497,104	\$ 960,954	\$ 1,663,377	\$ 850,933	\$ 8,972,368
Fringe benefits	1,457,600	244,441	433,094	193,850	2,328,985
Depreciation	1,845,918		58,630	11,726	1,916,274
Professional fees	546,488	291,434	75,639	168,748	1,082,309
Advertising		766,318		150	766,468
Stage set materials	763,250				763,250
Housing and travel	683,949			4,589	688,538
Utilities	496,576		94,860	18,711	610,147
Royalties	509,627				509,627
Conferences, meetings and social events	13,610		110,104	231,697	355,411
Insurance	226,958		62,108	8,303	297,369
Printing and reproduction	23,971	206,911		45,547	276,429
Bank and credit card fees		253,243	15,694		268,937
Supplies	89,579	38,593	33,617	81,476	243,265
Interest			170,512		170,512
Housekeeping services	130,122		23,803	4,761	158,686
Postage and delivery	18,395	119,034	5,091	13,130	155,650
Equipment rental and maintenance	8,411		114,625		123,036
Computer software support			117,589		117,589
Space rental	105,645				105,645
Building repair and maintenance	63,568	201	11,630	2,326	77,725
Dues, fees and subscriptions	3,586		41,624	3,039	48,249
Subscriber services		24,226			24,226
Leased labor	2,176				2,176
Outside theatrical production fees	1,847				1,847
Other	16,673		6,714	3,908	27,295
Total expenses	<u>\$ 12,505,053</u>	<u>\$ 2,905,355</u>	<u>\$ 3,038,711</u>	<u>\$ 1,642,894</u>	20,092,013
Cost of direct donor benefits					500,447
Cost of goods sold					82,516
Investment management fees					87,914
Total					<u>\$ 20,762,890</u>

See accompanying notes to consolidated financial statements.

Alley Theatre

Consolidated Statement of Functional Expenses for the year ended June 30, 2015

	PRODUCTION AND ARTISTIC PROGRAMS	MARKETING AND ADVERTISING	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 4,345,575	\$ 783,776	\$ 1,577,777	\$ 777,283	\$ 7,484,411
Fringe benefits	1,129,272	199,292	365,805	151,095	1,845,464
Depreciation	1,017,421		88,146	17,629	1,123,196
Professional fees	330,060	207,194	51,219	363,053	951,526
Advertising		301,878			301,878
Stage set materials	908,657				908,657
Housing and travel	432,120			2,605	434,725
Utilities	365,327		77,912	14,854	458,093
Royalties	251,839				251,839
Conferences, meetings and social events	7,618		110,886	196,675	315,179
Insurance	147,535		47,052	5,398	199,985
Printing and reproduction	30,931	92,233		43,482	166,646
Bank and credit card fees		216,058	10,783		226,841
Supplies	62,258	14,097	45,852	151,092	273,299
Housekeeping services	52,822		9,662	1,933	64,417
Postage and delivery	11,398	75,899	4,798	17,212	109,307
Equipment rental and maintenance	35,542		29,560		65,102
Computer software support			71,451		71,451
Space rental	347,164				347,164
Building repair and maintenance	59,990	5,946	10,973	2,194	79,103
Dues, fees and subscriptions	3,848		34,436	3,997	42,281
Leased labor	84,041				84,041
Outside theatrical production fees	426,025				426,025
Other	<u>37,721</u>	<u>23,848</u>	<u>41,677</u>	<u>79,659</u>	<u>182,905</u>
Total expenses	<u>\$ 10,087,164</u>	<u>\$ 1,920,221</u>	<u>\$ 2,577,989</u>	<u>\$ 1,828,161</u>	16,413,535
Cost of direct donor benefits					585,650
Cost of goods sold					72,599
Investment management fees					<u>92,425</u>
Total					<u>\$ 17,164,209</u>

See accompanying notes to consolidated financial statements.

Alley Theatre

Consolidated Statements of Cash Flows for the years ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ (1,563,326)	\$ 3,330,398
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Net realized and unrealized loss on investments	104,442	338,346
Depreciation	1,916,274	1,123,196
Contributions restricted for long-term purposes	(2,312,953)	(9,024,484)
Changes in operating assets and liabilities:		
Other receivables	13,529	(24,188)
Prepaid expenses and other assets	(184,734)	(10,808)
Pledges receivable	(228,570)	351,487
Accounts payable and accrued expenses	89,297	(351,065)
Deferred revenue	<u>(265,901)</u>	<u>1,266,025</u>
Net cash used by operating activities	<u>(2,431,942)</u>	<u>(3,001,093)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(3,916,671)	(7,584,850)
Proceeds from sale of investments	5,002,534	8,006,899
Net change in cash and cash equivalents held as investments	(700,222)	(1,280,793)
Net change in cash and cash equivalents held for capital reserves	80,356	(32,520)
Net change in cash and cash equivalents held for capital expenditures	118,148	13,876,567
Purchases of property	<u>(15,457,900)</u>	<u>(22,944,297)</u>
Net cash used by investing activities	<u>(14,873,755)</u>	<u>(9,958,994)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions restricted for long-term purposes	8,902,956	10,368,943
Payments on construction loan	(9,545,483)	
Drawdowns on construction loan	<u>17,460,944</u>	<u>2,372,953</u>
Net cash provided by financing activities	<u>16,818,417</u>	<u>12,741,896</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(487,280)	(218,191)
Cash and cash equivalents, beginning of year	<u>1,055,980</u>	<u>1,274,171</u>
Cash and cash equivalents, end of year	<u>\$ 568,700</u>	<u>\$ 1,055,980</u>
<i>Supplemental disclosure of cash flow information:</i>		
Contributed securities	\$1,027,039	\$1,071,865
Interest paid	\$154,544	

See accompanying notes to consolidated financial statements.

Alley Theatre

Notes to Consolidated Financial Statements for the years ended June 30, 2016 and 2015

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – Alley Theatre (the Alley) is a professional resident theatre company located in Houston, Texas and incorporated in 1948 under the provisions of the Texas Nonprofit Corporation Act. It exists to deepen the understanding of ourselves, one another, and the world we share by uniting theatre artists and audiences to experience the power of stories that illuminate the breadth and complexities of the human condition.

In March 1997, the Board of Governing Directors established a subsidiary of the Alley, Alley Theatre Productions (ATP), to handle income and production fees for productions in which the Alley has subsidiary rights.

Basis of presentation – The financial statements present the consolidated statements of financial position, activities, functional expenses, and cash flows of the Alley and ATP. All balances and transactions between these consolidated entities have been eliminated.

Federal income tax status – The Alley and ATP are exempt from federal income tax under §501(c)(3) of the Internal Revenue Code. The Alley is classified as public charity under §509(a)(2). ATP is classified as a Type I supporting organization under §509(a)(3).

Cash and cash equivalents include bank deposits, certificates of deposit and money market mutual funds. Bank deposits exceed the federally insured limit per depositor per institution.

Investments are reported at fair value. Investment return is reported in the statement of activities as an increase in unrestricted net assets unless its use 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.

Pledges receivable that are expected to be collected within one year are reported at net realizable value. Pledges receivable that are expected to be collected in future years are discounted to estimate the present value of future cash flows. Discounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of discounts is included in contribution revenue. An allowance for uncollectible pledges is estimated based on management's periodic evaluation of past loss experience, known adverse situations that may affect the donor's ability to pay, and current economic conditions. It is possible that management's estimate regarding the collectability of these balances will change in the near term resulting in a change in the carrying value of pledges receivable.

Property is reported at cost if purchased and at fair value at the date of gift if donated. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets, as follows:

Building shell of the Alley Theatre Center for Theatre Production	60 years
Building shell of the Alley and other major renovations	40 years
Building improvements	10 years
Equipment	3 to 10 years

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. Donor-restricted contributions that are received and expended in the same year are classified as unrestricted.
- *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. Investment return may be used to support the operations of the Alley.

Ticket sales and related fees are recognized when the performance occurs. Amounts received but unearned for subsequent performance seasons are included in the statement of financial position as deferred revenue.

Contributions are recognized as revenue at fair value when an unconditional commitment is received from the donor. Generally, contributions received with donor stipulations that limit their use are classified as restricted support. Restricted contributions whose purpose is met in the same reporting period are recognized as unrestricted contributions and increase unrestricted net assets. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Production costs related to future seasons are deferred as prepaid expenses when incurred and charged to expense when the performances are conducted.

Advertising costs are expensed as incurred, except for expenditures related to future seasons, which are reported as prepaid expenses. In 2016 and 2015, the Alley expensed \$766,468 and \$301,878, respectively, for advertising costs.

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 reported as revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2016</u>	<u>2015</u>
Bank deposits	\$ 618,967	\$ 1,352,577
Certificates of deposit	222,889	175,031
Money market mutual fund	<u>10,491</u>	<u>10,523</u>
Total cash and cash equivalents	<u>\$ 852,347</u>	<u>\$ 1,538,131</u>

NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable are as follows:

	<u>2016</u>	<u>2015</u>
Capital campaign	\$ 9,930,508	\$ 16,525,511
Annual fund	1,504,395	1,286,982
Endowment	<u>20,000</u>	<u>35,000</u>
Total pledges receivable	11,454,903	17,847,493
Unamortized discount (at rates ranging from .72% to 1.63%)	(168,333)	(293,334)
Allowance for uncollectible pledges receivable	<u>(250,403)</u>	<u>(156,559)</u>
Pledges receivable, net	<u>\$ 11,036,167</u>	<u>\$ 17,397,600</u>

Pledges receivable at June 30, 2016 are expected to be collected as follows:

Receivable in less than one year	\$ 5,532,143
Receivable in one to five years	<u>5,922,760</u>
Pledges receivable, net	<u>\$ 11,454,903</u>

NOTE 4 – INVESTMENTS

Investments consist of the following:

	<u>2016</u>	<u>2015</u>
Equity securities	\$ 14,068,861	\$ 14,607,779
Corporate bonds	5,624,019	6,270,504
Mutual funds	<u>4,848,559</u>	<u>4,153,239</u>
Total investments	<u>\$ 24,541,439</u>	<u>\$ 25,031,522</u>

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, cash equivalents, and certificates of deposit and consists of the following:

	<u>2016</u>	<u>2015</u>
Interest and dividends	\$ 569,731	\$ 595,316
Net realized and unrealized loss on investments	(104,442)	(338,346)
Investment management fees	<u>(87,914)</u>	<u>(92,425)</u>
Investment return, net	<u>\$ 377,375</u>	<u>\$ 164,545</u>

NOTE 5 – 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 June 30, 2016 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Investments:				
Equity securities:				
Large-cap	\$ 11,998,727			\$ 11,998,727
International	1,891,994			1,891,994
Mid-cap	178,140			178,140
Corporate bonds		\$ 5,624,019		5,624,019
Mutual funds:				
Money market	4,457,045			4,457,045
Small-cap equity	<u>391,514</u>			<u>391,514</u>
Total investments at fair value	18,917,420	5,624,019		24,541,439
Cash equivalents:				
Money market mutual fund	<u>10,491</u>			<u>10,491</u>
Total assets measured at fair value	<u>\$ 18,927,911</u>	<u>\$ 5,624,019</u>	<u>\$ 0</u>	<u>\$ 24,551,930</u>

Assets measured at fair value at June 30, 2015 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Investments:				
Equity securities:				
Large-cap	\$ 12,374,670			\$ 12,374,670
International	2,153,621			2,153,621
Mid-cap	79,488			79,488
Corporate bonds		\$ 6,270,504		6,270,504
Mutual funds:				
Money market	3,756,823			3,756,823
Small-cap equity	<u>396,416</u>			<u>396,416</u>
Total investments at fair value	18,761,018	6,270,504		25,031,522
Cash equivalents:				
Money market mutual fund	<u>10,523</u>			<u>10,523</u>
Total assets measured at fair value	<u>\$ 18,771,541</u>	<u>\$ 6,270,504</u>	<u>\$ 0</u>	<u>\$ 25,042,045</u>

Valuation methods used for assets measured at fair value are as follows:

- *Equity securities* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Corporate bonds* are valued using prices obtained from independent quotation bureaus that use computerized valuation formulas which may include market-corroborated inputs for credit risk factors, interest rate and yield curves and broker quotes to calculate fair values.
- *Mutual funds* are valued at the reported net asset value of shares held.

These valuation methods may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Alley believes its valuation methods are appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date.

NOTE 6 – PROPERTY

Property consists of the following:

	<u>2016</u>	<u>2015</u>
Land	\$ 970,675	\$ 970,675
Construction in progress		35,216,502
Building and improvements	60,168,607	20,429,136
Equipment	<u>6,392,544</u>	<u>2,496,466</u>
Total property, at cost	67,531,826	59,112,779
Accumulated depreciation	<u>(13,993,970)</u>	<u>(12,077,696)</u>
Property, net	<u>\$ 53,537,856</u>	<u>\$ 47,035,083</u>

NOTE 7 – CONSTRUCTION LOAN PAYABLE

In January 2014, the Alley obtained a revolving line of credit with a financial institution for up to \$20,000,000 that matures July 1, 2021. The purpose is to provide funds to finance a portion of theatre renovation costs and artistic enhancements until the capital campaign pledges are raised and received. The loan is collateralized by the Alley's capital campaign pledges of \$9,536,878 at June 30, 2016, and certain cash deposits held at the financial institution totaling \$470,331 at June 30, 2016. In addition, no real estate or improvements of the Alley can be used to grant a lien, mortgage, or other encumbrance to any other party. Certain loan covenants are outlined in the agreement. The Alley is in compliance with all the covenants at June 30, 2016.

Interest is at a floating rate equal to the overnight LIBOR plus 1.10% (1.51% at June 30, 2016). The revolving line of credit had an interest-only two-year draw period, converting to a five-year term loan with monthly payments of interest plus principal payments from collections of capital campaign pledges as received.

The scheduled maturities of long-term debt are as follows:

2017	\$ 3,635,265
2018	2,484,080
2019	2,184,873
2020	1,213,373
2021	<u>770,823</u>
Total	<u>\$ 10,288,414</u>

NOTE 8 – CAPITAL CAMPAIGN AND CONSTRUCTION COMMITMENTS

In January 2014, the Alley’s Board of Directors approved a project to renovate the theater facility at a total cost of \$46.5 million. The renovation was complete in September 2015 and the Alley resumed performing in its home theater in October 2015. The Alley has met all outstanding construction contracts.

A capital campaign continues to raise the necessary funds to pay for the renovation project and to fund efforts to enhance the artistic product on the Alley stages at a cost of approximately \$10 million over a 10-year period. By June 30, 2016, the campaign had generated \$55.3 million in pledge commitments and earned interest toward that goal.

NOTE 9 – ALLEY RETIREMENT PLANS

The Alley maintains the Alley Theatre §401(k) Retirement Plan covering employees who work at least 1,000 hours per year and are not covered by the Equity-League Pension Trust Fund. This plan is a contributory, defined contribution plan. Eligible employees may elect to defer pre-tax compensation to the plan, subject to certain Internal Revenue Service limitations. The Alley matched 100% of each participant’s contribution, up to 5% of compensation in 2016 and 2015. The Alley also maintains a §457 plan for certain employees. Contributions to these plans were \$244,411 in 2016 and \$239,651 in 2015.

NOTE 10 – MULTIEMPLOYER PENSION PLANS

The Alley is a participating employer in three trustee-managed, multiemployer defined benefit pension plans for employees who are covered under collective bargaining agreements. The plans generally provide retirement benefits to employees based on years of service. The multiemployer pension plans are managed by boards of trustees with equal representation from the union and employers. Contributions totaling \$125,623 in 2016 and \$69,063 in 2015 were charged to pension expense for ongoing participation in these pension plans. The Alley’s contributions to these plans are less than 5% of each plan’s total contributions.

The risks of participating in a multiemployer defined benefit pension plan are different from single-employer plans because: (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 required to be borne by the remaining participating employers, and (c) if the Alley chooses to stop participating in the multiemployer plan, it may be required to pay a withdrawal liability to the plan. In connection with ongoing renegotiation of the collective bargaining agreements, the Alley may discuss and negotiate for the complete or partial withdrawal from the multiemployer pension plan. Depending on the number of

employees withdrawn in any future period and the financial condition of the multiemployer plan at the time of withdrawal, the associated withdrawal liabilities could be material to the Alley's consolidated change in net assets in the period of the withdrawal. The Alley has no plans to withdraw from its multiemployer pension plan.

The following presents information about the Alley's multiemployer pension plans as of June 30, 2016 and 2015 and the years ended June 30, 2016 and 2015:

NAME OF PENSION PLAN	EIN AND PLAN NUMBER, IF AVAILABLE	PENSION PROTECTION ACT ZONE STATUS		FIP/RP STATUS	CONTRIBUTIONS FOR THE YEAR ENDED JUNE 30		SURCHARGE IMPOSED	EXPIRATION OF COLLECTIVE BARGAINING AGREEMENT
		2016	2015		2016	2015		
Equity-League Pension Trust Fund	13-6696817 Plan No. 001	Green 6/1/16	Green 6/1/15	N/A	\$93,726	\$52,078	No	2/17/18
SDC-League Pension Fund	13-6634482 Plan No. 001	Yellow 9/1/16	Yellow 9/1/14	N/A	\$7,273	\$3,703	No	4/14/17
Pension Fund of United Scenic Artists, Local 829	13-1982707 Plan No. 001	Green 1/1/16	Green 1/1/15	N/A	\$24,625	\$13,281	No	6/30/17

The Alley also participates in three multiemployer defined contribution health and welfare plans. Total contributions to these plans were approximately \$216,000 in 2016 and \$113,000 in 2015.

NOTE 11 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	2016	2015
Unappropriated endowment earnings	\$ 7,849,553	\$ 8,535,622
Use in future seasons	509,895	622,705
Capital improvements and artistic enhancement		34,364,010
Total temporarily restricted net assets	<u>\$ 8,359,448</u>	<u>\$ 43,522,337</u>

NOTE 12 – ENDOWMENT

Changes in net assets of the endowment funds are as follows:

	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
Endowment net assets, June 30, 2014	<u>\$ 9,406,491</u>	<u>\$ 12,977,143</u>	<u>\$ 22,383,634</u>
Contribution		<u>5,000</u>	<u>5,000</u>
Investment return:			
Interest and dividends	584,920		584,920
Net realized and unrealized loss	(338,346)		(338,346)
Investment management fees	<u>(96,856)</u>		<u>(96,856)</u>
Net investment return	<u>149,718</u>		<u>149,718</u>
Distributions to the Alley	<u>(1,020,587)</u>		<u>(1,020,587)</u>
Endowment net assets, June 30, 2015	<u>8,535,622</u>	<u>12,982,143</u>	<u>21,517,765</u>
Investment return:			
Interest and dividends	556,955		556,955
Net realized and unrealized loss	(95,196)		(95,196)
Investment management fees	<u>(87,914)</u>		<u>(87,914)</u>
Net investment return	<u>373,845</u>		<u>373,845</u>
Distributions to the Alley	<u>(1,059,914)</u>		<u>(1,059,914)</u>
Endowment net assets, June 30, 2016	<u>\$ 7,849,553</u>	<u>\$ 12,982,143</u>	<u>\$ 20,831,696</u>

The Board of Governing Directors of the Alley 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 Alley 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 Alley in a manner consistent with the standard of prudence prescribed by TUPMIFA. In accordance with TUPMIFA, the Alley considers the following factors in making a determination to appropriate accumulated donor-restricted endowment funds:

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

Return Objectives and Risk Parameters

The Alley has adopted investment and spending policies for endowment assets that have the primary objective of achieving a long-term rate-of-return that will assist the Alley in meeting its operating needs

while maintaining its ability to provide for future needs without subjecting the endowment funds to imprudent risks.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Alley 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 Alley currently targets an asset allocation that includes fixed-income investments, but places a greater emphasis on equity-based investments to achieve its long-term return objectives with target allocation parameters.

As different asset classes produce different returns during the course of the year, the portfolio's asset allocation changes accordingly. The Alley reviews the portfolio's actual asset allocation, relative to established policy target and ranges. If deemed necessary and with the advice of a qualified investment manager, the Alley will rebalance the portfolio between the various asset classes based on market values.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Alley uses earnings from the endowment to support operations. The Alley transfers a percentage of the average fair value of the assets in the endowment based on the value at the end of each of the prior twelve quarters. The Alley calculates this transfer quarterly based on the rate approved by the investment committee each year. The approved rate for 2016 and 2015 was 5%.

NOTE 13 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through September 15, 2016, 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.

Alley Theatre

Supplemental Fund Accounting Information for the year ended June 30, 2016

The Alley's accounts are maintained in accordance with the principles of fund accounting. Resources are classified for internal accounting purposes into funds established according to the nature and purpose of the resources. The accounting records of the Alley are classified internally in the Operating Fund, Capital Campaign, Plant Fund, and Endowment Fund as follows:

- *Operating Fund* includes the principal functions of the Alley's operations.
- *Capital Campaign* includes the amounts designated for the purpose of building and equipping the Alley theatre renovations.
- *Plant Fund* includes the completed facilities and equipment of the existing theatre, as well as the building reserve fund.
- *Endowment Fund* includes funds invested to generate income that may be used for the Alley's general operations and for purposes specified by the donor.

All funds in the Endowment Fund are pooled for investment purposes. The Endowment Fund transferred \$1,059,914 to the Operating Fund in 2016.

Alley Theatre

Supplemental Statement of Financial Position by Fund as of June 30, 2016

	OPERATING FUND	CAPITAL CAMPAIGN	PLANT FUND	ENDOWMENT FUND	TOTAL
ASSETS					
Cash and cash equivalents	\$ 801,200	\$ 35,235	\$ 15,912		\$ 852,347
Amounts due to (from) another fund	(428,500)	435,096	267,735	\$ (274,331)	
Other receivables	46,106			73,245	119,351
Prepaid expenses and other assets	532,479				532,479
Pledges receivable, net	1,479,289	9,536,878		20,000	11,036,167
Investments	3,506,973			21,034,466	24,541,439
Property, net	<u> </u>	<u>41,948,296</u>	<u>11,589,560</u>	<u> </u>	<u>53,537,856</u>
TOTAL ASSETS	<u><u>\$ 5,937,547</u></u>	<u><u>\$ 51,955,505</u></u>	<u><u>\$ 11,873,207</u></u>	<u><u>\$ 20,853,380</u></u>	<u><u>\$ 90,619,639</u></u>
LIABILITIES AND NET ASSETS					
Liabilities:					
Accounts payable and accrued expenses	\$ 547,644			\$ 21,684	\$ 569,328
Deferred revenue	3,330,135				3,330,135
Construction loan payable	<u> </u>	<u>\$ 10,288,414</u>		<u> </u>	<u>10,288,414</u>
Total liabilities	<u>3,877,779</u>	<u>10,288,414</u>		<u>21,684</u>	<u>14,187,877</u>
Net assets:					
Unrestricted	1,549,873	41,667,091	\$ 11,589,560		54,806,524
Unrestricted – capital improvement reserve			283,647		283,647
Temporarily restricted	509,895			7,849,553	8,359,448
Permanently restricted	<u> </u>	<u> </u>	<u> </u>	<u>12,982,143</u>	<u>12,982,143</u>
Total net assets	<u>2,059,768</u>	<u>41,667,091</u>	<u>11,873,207</u>	<u>20,831,696</u>	<u>76,431,762</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 5,937,547</u></u>	<u><u>\$ 51,955,505</u></u>	<u><u>\$ 11,873,207</u></u>	<u><u>\$ 20,853,380</u></u>	<u><u>\$ 90,619,639</u></u>

Alley Theatre

Supplemental Statement of Activities by Fund for the year ended June 30, 2016

	OPERATING FUND	CAPITAL CAMPAIGN	PLANT FUND	ENDOWMENT FUND	TOTAL
CHANGES IN UNRESTRICTED NET ASSETS:					
REVENUE:					
Contributions	\$ 5,386,346	\$ (101,075)			\$ 5,285,271
Ticket sales	7,511,284				7,511,284
Special events	1,309,042				1,309,042
Cost of direct donor benefits	(500,447)				(500,447)
Ticket and surcharge fees	711,197				711,197
Co-production and other income	727,121				727,121
Concessions and store income	252,512				252,512
Cost of goods sold	(82,516)				(82,516)
Investment return, net	<u>2,621</u>	<u>909</u>			<u>3,530</u>
Total revenue	15,317,160	(100,166)			15,216,994
Net assets released from restrictions:					
Contributed revenue releases for capital campaign	700,000	36,101,963			36,801,963
Contributed revenue releases of time restrictions	612,705				612,705
Distributions from Endowment Fund	<u>1,059,914</u>				<u>1,059,914</u>
Total	<u>17,689,779</u>	<u>36,001,797</u>			<u>53,691,576</u>
EXPENSES:					
Production and artistic programs	10,582,765	76,370	\$ 1,845,918		12,505,053
Marketing and advertising	2,902,470	2,885			2,905,355
Management and general	2,809,569	170,512	58,630		3,038,711
Fundraising	<u>1,493,565</u>	<u>137,601</u>	<u>11,728</u>		<u>1,642,894</u>
Total expenses	<u>17,788,369</u>	<u>387,368</u>	<u>1,916,276</u>		<u>20,092,013</u>
Changes in unrestricted net assets	<u>(98,590)</u>	<u>35,614,429</u>	<u>(1,916,276)</u>		<u>33,599,563</u>

(continued)

Alley Theatre

Supplemental Statement of Activities by Fund for the year ended June 30, 2016

(continued)

	OPERATING FUND	CAPITAL CAMPAIGN	PLANT FUND	ENDOWMENT FUND	TOTAL
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:					
REVENUE:					
Contributions	489,893	2,437,955			2,927,848
Special events	10,000				10,000
Investment return, net				\$ 373,845	373,845
Total	499,893	2,437,955		373,845	3,311,693
Net assets released from restrictions:					
Contributed revenue releases for capital campaign		(36,801,963)			(36,801,963)
Expiration of time restrictions	(612,705)				(612,705)
Distributions from Endowment Fund				(1,059,914)	(1,059,914)
Changes in temporarily restricted net assets	(112,812)	(34,364,008)		(686,069)	(35,162,889)
TOTAL CHANGES IN NET ASSETS	(211,402)	1,250,421	(1,916,276)	(686,069)	(1,563,326)
Net assets, beginning of year	2,271,170	40,416,670	13,789,483	21,517,765	77,995,088
Net assets, end of year	\$ 2,059,768	\$ 41,667,091	\$ 11,873,207	\$ 20,831,696	\$ 76,431,762