Main Street Theater Houston

Financial Statements
and Independent Auditors' Report
for the years ended August 31, 2018 and 2017

Main Street Theater Houston

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Independent Auditors' Report

To the Board of Directors of
Main Street Theater Houston:

We have audited the accompanying financial statements of Main Street Theater Houston, which comprise the statements of financial position as of August 31, 2018 and 2017 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 Houston as of August 31, 2018 and 2017 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.

Emphasis of Matter

The accompanying financial statements have been prepared assuming that Main Street Theater Houston will continue as a going concern. As discussed in Note 8 to the financial statements, Main Street Theater Houston has debt due within the next 12 months in excess of available cash and has experienced an operating deficit. These circumstances raise substantial doubt about Main Street Theater Houston'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

November 14, 2018

Main Street Theater Houston

Statements of Financial Position as of August 31, 2018 and 2017

	2018	2017
ASSETS		
Cash	$ 21,737	$ 8,622
Prepaid expenses and other assets	109,373	145,125
Pledges receivable	95,578	182,499
Investments *(Note 2)*		39,668
Cash restricted for capital expenditures	30,000	
Property, net *(Note 3)*	3,011,509	3,170,723
TOTAL ASSETS	$ 3,268,197	$ 3,546,637
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	$ 70,423	$ 65,761
Deferred revenue	156,341	138,861
Notes payable *(Note 4)*	1,085,000	1,035,000
Total liabilities	1,311,764	1,239,622
Net assets:		
Unrestricted	1,926,433	2,216,446
Temporarily restricted *(Note 5)*	30,000	60,569
Permanently restricted *(Note 6)*		30,000
Total net assets	1,956,433	2,307,015
TOTAL LIABILITIES AND NET ASSETS	$ 3,268,197	$ 3,546,637

See accompanying notes to financial statements.

Main Street Theater Houston

Statement of Activities for the year ended August 31, 2018

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
REVENUE:				
Contributions	$ 564,386	$ 84,000		$ 648,386
Ticket sales	1,207,273			1,207,273
Tuition	506,391			506,391
Special events	119,188			119,188
Cost of direct donor benefits	(17,071)			(17,071)
Investment return *(Note 2)*		1,274		1,274
Other income	38,461			38,461
Total revenue	2,418,628	85,274		2,503,902
Net assets released from restrictions:				
Satisfaction of program restrictions	145,843	(145,843)		
Release of permanent restriction		30,000	$ (30,000)	
Total	2,564,471	(30,569)	(30,000)	2,503,902
EXPENSES:				
Program services	2,256,027			2,256,027
Marketing and sales	304,673			304,673
Management and general	214,201			214,201
Fundraising	79,583			79,583
Total expenses	2,854,484			2,854,484
CHANGES IN NET ASSETS	(290,013)	(30,569)	(30,000)	(350,582)
Net assets, beginning of year	2,216,446	60,569	30,000	2,307,015
Net assets, end of year	$ 1,926,433	$ 30,000	$ 0	$ 1,956,433

See accompanying notes to financial statements.

Main Street Theater Houston

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	2,184,674			2,184,674
Marketing and sales	251,930			251,930
Management and general	205,935			205,935
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 Houston

Statements of Functional Expenses for the years ended August 31, 2018 and 2017

	PROGRAM SERVICES	MARKETING AND SALES	MANAGEMENT AND GENERAL	FUNDRAISING	2018 TOTAL
Compensation and related expense	$ 1,402,870	$ 164,620	$ 57,254	$ 55,065	$ 1,679,809
Rent	326,426	3,800	11,693	6,080	347,999
Depreciation	163,898				163,898
Production supplies	141,690				141,690
Royalties	117,167				117,167
Postage and printing	51,456	51,456	1,125	2,626	106,663
Advertising		79,594		2,827	82,421
Interest			53,401		53,401
Bank service fees			43,397		43,397
Insurance	12,571	1,020	19,208	341	33,140
Supplies	10,576	2,150	3,435	10,324	26,485
Professional services			21,566		21,566
Utilities	17,325	2,033	707	680	20,745
Repairs	9,393				9,393
Other	2,655		2,415	1,640	6,710
Total expenses	$ 2,256,027	$ 304,673	$ 214,201	$ 79,583	$ 2,854,484

	PROGRAM SERVICES	MARKETING AND SALES	MANAGEMENT AND GENERAL	FUNDRAISING	2017 TOTAL
Compensation and related expense	$ 1,397,597	$ 115,509	$ 59,565	$ 71,097	$ 1,643,768
Rent	263,549	6,000	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	43,364	43,364	788	8,508	96,024
Advertising		83,357		4,657	88,014
Interest			47,606		47,606
Bank service fees			29,587		29,587
Insurance	17,990	1,175	18,657	723	38,545
Supplies	9,063	1,274	7,055	13,536	30,928
Professional services			20,038		20,038
Utilities	15,124	1,251	645	769	17,789
Repairs	9,647				9,647
Other	4,593		4,881	4,181	13,655
Total expenses	$ 2,184,674	$ 251,930	$ 205,935	$ 113,071	$ 2,755,610

See accompanying notes to financial statements.

Main Street Theater Houston

Statements of Cash Flows for the years ended August 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$ (350,582)	$ (142,987)
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Depreciation	163,898	167,856
Net realized and unrealized gain on investments	(1,132)	(2,074)
Donated securities	(41,173)	(31,022)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	35,752	(48,417)
Pledges receivable	86,921	(127,617)
Accounts payable and accrued expenses	4,662	16,390
Deferred revenue	17,480	(5,147)
Net cash used by operating activities	(84,174)	(173,018)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in cash restricted for capital projects		1,399
Purchases of property	(4,684)	(3,882)
Proceeds from sale of investments	76,684	43,541
Change in money market mutual funds held as investments	5,289	(2,451)
Net cash provided by investing activities	77,289	38,607
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable	200,000	265,000
Repayments of notes payable	(150,000)	(165,000)
Net cash provided by financing activities	50,000	100,000
NET CHANGE IN CASH	43,115	(34,411)
Cash, beginning of year	8,622	43,033
Cash, end of year	$ 51,737	$ 8,622

Reconciliation of cash reported in the statements of financial position with cash reported in the statements of cash flows:

	2018	2017
Cash	$ 21,737	$ 8,622
Cash restricted for capital expenditures	30,000	
Total cash	$ 51,737	$ 8,622

Supplemental disclosure of cash flow information:

	2018	2017
Interest paid	$53,401	$47,606

See accompanying notes to financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – Main Street Theater Houston (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, 2018, pledges receivable are due to be received as follows: $90,578 within one year and $5,000 in one to five years. At August 31, 2018, 78% of the Theater's total pledges receivable balance was from one donor. 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 5 to 39 years for building and improvements, 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.* The amendments in this ASU are aimed at providing more useful information to users of not-for-profit financial statements. 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 Theater is required to adopt this ASU for fiscal year 2019. 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 7.

In fiscal year 2018, the Theater adopted ASU 2016-18, *Statement of Cash Flows – Restricted Cash,* which requires the statement of cash flows to explain the change in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Prior to adoption, restricted cash was excluded from beginning and ending cash in the statement of cash flows. This change had no impact on net assets or changes in net assets.

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

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:

	2018	2017
Net realized and unrealized gain	$ 1,132	$ 2,074
Interest and dividends	142	2,451
Total investment return	$ 1,274	$ 4,525

NOTE 3 – PROPERTY

Property is comprised of the following:

	2018	2017
Land	$ 216,000	$ 216,000
Building and improvements	3,324,930	3,320,246
Furniture and equipment	146,789	146,789
Total property, at cost	3,687,719	3,683,035
Accumulated depreciation	(676,210)	(512,312)
Property, net	$ 3,011,509	$ 3,170,723

NOTE 4 – NOTES PAYABLE

Notes payable consist of the following:

	2018	2017
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
Unsecured bank line of credit with a limit of $250,000; interest at prime (5% at August 31, 2018). Monthly interest-only payments with balance due January 18, 2019.	250,000	200,000
Mortgage note payable to an individual with interest at 5%. Monthly interest-only payments with balance due August 12, 2020. Collateralized by the property purchased.	235,000	235,000
Total notes payable	$ 1,085,000	$ 1,035,000

NOTE 5 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	2018	2017
The Charles and Betti Saunders Green Room	$ 30,000	
Costume connection		$ 31,920
Development personnel		18,981
Accumulated endowment earnings		9,668
Total temporarily restricted net assets	$ 30,000	$ 60,569

NOTE 6 – ENDOWMENT FUNDS

Changes in endowment net assets are as follows:

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
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
Investment return:				
Interest and dividends		142		142
Net realized and unrealized gain		1,132		1,132
Total investment return		1,274		1,274
Release of permanent restriction			(30,000)	(30,000)
Appropriation for expenditure		(10,942)		(10,942)
Endowment net assets, August 31, 2018	$ 0	$ 0	$ 0	$ 0

Strategies Employed for Achieving Objectives

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

During 2018, the Theater received permission from the endowment donor to convert the original permanently restricted gift of $30,000 to temporarily restricted net assets for building-out the loft space at the Main Stage Theater and creating a Green Room.

NOTE 7 – COMMITMENTS

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

2019	$ 244,400
2020	51,400
Total	$ 295,800

Lease expense of approximately $348,000 and $296,000 was recognized in 2018 and 2017, 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 Theater also has a bank line of credit for operating purposes. The Theater currently does not have resources on hand to meet this debt as it comes due. Management plans to renew and extend the line of credit.

The Theater also has experienced operating deficits. At August 31, 2018, approximately $156,000 had been collected from ticket sales and tuition for the fiscal year 2019 and expended on fiscal year 2018 operations. In order to increase liquidity, the Theater plans to reduce expenses and develop a comprehensive plan to engage new donors and increase contributed revenue.

NOTE 9 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through November 14, 2018, 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.