
EXHIBIT 2

THE SHAKESPEARE THEATRE

**Consolidated Financial Statements and Supplemental Schedules
Together With Report of Independent Public Accountants**

For the Years Ended July 31, 2016 and 2015



SB & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

JULY 31, 2016 AND 2015

CONTENTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS	1
Consolidated Financial Statements	
Consolidated Statements of Financial Position	3
Consolidated Statements of Activities and Changes in Net Assets	4
Consolidated Statements of Cash Flows	6
Notes to the Consolidated Financial Statements	7
Supplemental Information	
Schedules of the Operating Fund	24
Note to the Schedules of the Operating Fund	25



SB & COMPANY, LLC
KNOWLEDGE · QUALITY · CLIENT SERVICE

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Trustees of
The Shakespeare Theatre

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated statements of financial position of The Shakespeare Theatre and its subsidiary (together the Theatre), as of July 31, 2016 and 2015, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.



S B & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Shakespeare Theatre and its subsidiary as of July 31, 2016 and 2015, and the changes in their net assets and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental schedules of the operating fund are presented for purposes of additional analysis and are not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Washington, DC
December 27, 2016

S B & Company, LLC

THE SHAKESPEARE THEATRE

**Consolidated Statements of Financial Position
As of July 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and cash equivalents	\$ 505,667	\$ 805,711
Restricted cash	334,394	450,621
Investments	3,987,602	4,290,856
Pledges receivable, net	4,241,796	5,050,482
Accounts receivable, net	278,000	422,632
Prepaid expenses and deferred costs	759,514	663,151
Deposits and other assets	543,107	490,195
Property and equipment, net	63,695,595	65,378,163
Deferred financing costs, net	310,466	257,325
Total Assets	<u>\$ 74,656,141</u>	<u>\$ 77,809,136</u> <i>on Form 990</i>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable	\$ 1,911,583	\$ 2,320,822
Accrued salaries and benefits	252,525	253,723
Deferred revenue	5,398,732	4,891,862
Notes payable	16,193,129	17,148,745
Capital lease payable	188,194	340,427
Total Liabilities	<u>23,944,163</u>	<u>24,955,579</u>
Net Assets		
Unrestricted	46,740,218	49,114,642
Temporarily restricted	2,085,698	1,852,853
Permanently restricted	1,886,062	1,886,062
Total Net Assets	<u>50,711,978</u>	<u>52,853,557</u>
Total Liabilities and Net Assets	<u>\$ 74,656,141</u>	<u>\$ 77,809,136</u>

The accompanying notes are an integral part of these consolidated financial statements.

THE SHAKESPEARE THEATRE

Consolidated Statement of Activities and Changes in Net Assets
For the Year Ended July 31, 2016, with Comparative Totals for 2015

	2016			Total	2015 Totals
	Unrestricted	Temporarily Restricted	Permanently Restricted		
Support					
Contributions and grants	\$ 7,342,833	\$ 1,507,585	\$ -	\$ 8,850,418	\$ 10,962,121
Net assets released from restrictions	1,356,115	(1,356,115)	-	-	-
Total Support	8,698,948	151,470	-	8,850,418	10,962,121
Revenue					
Productions	6,888,717	-	-	6,888,717	6,853,060
Tour income and bookings	1,119,058	-	-	1,119,058	845,055
Educational programs	875,918	-	-	875,918	839,300
Concessions and other sales	353,218	-	-	353,218	346,594
Investment income not to exceed spending policy	9,546	38,705	-	48,251	147,554
Other	1,966,880	-	-	1,966,880	1,051,686
Total Revenue	11,213,337	38,705	-	11,252,042	10,083,249
Total Support and Revenue	19,912,285	190,175	-	20,102,460	21,045,370
Expenses					
Program services	13,555,812	-	-	13,555,812	12,698,153
Fundraising	1,697,079	-	-	1,697,079	1,705,866
General and administrative	1,315,556	7,215	-	1,322,771	1,076,716
Operations	2,728,549	-	-	2,728,549	2,765,707
Interest expense	655,648	-	-	655,648	687,130
Total Expenses before Other Income (Expenses)	19,952,644	7,215	-	19,959,859	18,933,572
Changes in net assets before other income (expenses)	(40,359)	182,960	-	142,601	2,111,798
Other Income (Expenses)					
Provision for doubtful pledges	(19,858)	-	-	(19,858)	(135,349)
Depreciation	(2,050,513)	-	-	(2,050,513)	(2,108,543)
Amortization of financing costs	(113,160)	-	-	(113,160)	(105,652)
Realized and unrealized loss on investments	(28,756)	(71,893)	-	(100,649)	(63,148)
Endowment transfer	(121,778)	121,778	-	-	-
Changes in Net Assets	(2,374,424)	232,845	-	(2,141,579)	(300,894)
Net assets, beginning of year	49,114,642	1,852,853	1,886,062	52,853,557	53,154,451
Net Assets, End of Year	\$ 46,740,218	\$ 2,085,698	\$ 1,886,062	\$ 50,711,978	\$ 52,853,557

The accompanying notes are an integral part of this consolidated financial statement.

THE SHAKESPEARE THEATRE

**Consolidated Statement of Activities and Changes in Net Assets
For the Year Ended July 31, 2015**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Unrestricted Support				
Contributions and grants	\$ 9,697,216	\$ 1,264,905	\$ -	\$ 10,962,121
Net assets released from restrictions	1,139,453	(1,139,453)	-	-
Total Support	<u>10,836,669</u>	<u>125,452</u>	<u>-</u>	<u>10,962,121</u>
Revenue				
Productions	6,853,060	-	-	6,853,060
Tour income and bookings	845,055	-	-	845,055
Educational programs	839,300	-	-	839,300
Concessions and other sales	346,594	-	-	346,594
Investment income not to exceed spending policy	96,542	51,012	-	147,554
Other	1,051,686	-	-	1,051,686
Total Revenue	<u>10,032,237</u>	<u>51,012</u>	<u>-</u>	<u>10,083,249</u>
Total Support and Revenue	<u>20,868,906</u>	<u>176,464</u>	<u>-</u>	<u>21,045,370</u>
Expenses				
Program services	12,698,153	-	-	12,698,153
Fundraising	1,705,866	-	-	1,705,866
General and administrative	1,068,717	7,999	-	1,076,716
Operations	2,765,707	-	-	2,765,707
Interest expense	687,130	-	-	687,130
Total Expenses before Other Income (Expenses)	<u>18,925,573</u>	<u>7,999</u>	<u>-</u>	<u>18,933,572</u>
Changes in net assets before other income (expenses)	1,943,333	168,465	-	2,111,798
Other Income (Expenses)				
Provision for doubtful pledges	(135,349)	-	-	(135,349)
Depreciation	(2,108,543)	-	-	(2,108,543)
Amortization of financing costs	(105,652)	-	-	(105,652)
Realized and unrealized gain on investments	(66,891)	3,743	-	(63,148)
Endowment transfer	(35,763)	35,763	-	-
Changes in Net Assets	<u>(508,865)</u>	<u>207,971</u>	<u>-</u>	<u>(300,894)</u>
Net assets, beginning of year	49,623,507	1,644,882	1,886,062	53,154,451
Net Assets, End of Year	<u>\$ 49,114,642</u>	<u>\$ 1,852,853</u>	<u>\$ 1,886,062</u>	<u>\$ 52,853,557</u>

The accompanying notes are an integral part of this consolidated financial statement.

THE SHAKESPEARE THEATRE

**Consolidated Statements of Cash Flows
For the Years Ended July 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating Activities		
Changes in net assets	\$ (2,141,579)	\$ (300,894)
Adjustments to reconcile changes in net assets to net cash from operating activities:		
Depreciation	2,050,513	2,108,543
Amortization of deferred financing fees	113,160	105,653
Realized and unrealized loss on investments, net	100,649	63,148
Effect of changes in non-cash operating assets and liabilities:		
Pledges receivable, net	763,586	(638,039)
Accounts receivable, net	144,632	(248,424)
Prepaid expenses and deferred costs	(96,363)	(183,330)
Deposits and other assets	(52,912)	17,438
Accounts payable	(409,239)	(8,537)
Accrued salaries and benefits	(1,198)	48,078
Deferred revenue	506,870	(8,063)
Other liabilities	-	(18,812)
Net Cash from Operating Activities	<u>978,119</u>	<u>936,761</u>
Cash Flows from Investing Activities		
Purchases of property and equipment	(367,945)	(449,252)
Purchases of investments	-	(1,708,329)
Proceeds from sale of investments	202,605	1,732,635
Net Cash from Investing Activities	<u>(165,340)</u>	<u>(424,946)</u>
Cash Flows from Financing Activities		
Proceeds from contributions restricted for capital purposes	45,100	105,300
Proceeds from line of credit	900,000	-
Payments on notes payable	(1,855,616)	(315,281)
Deferred financing costs	(166,301)	(98,481)
Principal payments on capital lease obligations	(152,233)	(128,939)
Net Cash from Financing Activities	<u>(1,229,050)</u>	<u>(437,401)</u>
Net change in cash and cash equivalents	(416,271)	74,414
Cash and cash equivalents, beginning of year	1,256,332	1,181,918
Cash and Cash Equivalents, End of Year (including restricted cash of \$334,394 and \$450,621, respectively)	<u>\$ 840,061</u>	<u>\$ 1,256,332</u>
Supplemental Cash Flow Information		
Cash paid for interest	<u>\$ 655,648</u>	<u>\$ 615,126</u>
Capital lease	<u>\$ -</u>	<u>\$ 49,862</u>

The accompanying notes are an integral part of these consolidated financial statements.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

1. ORGANIZATION

The Shakespeare Theatre and its subsidiary (the Theatre) is a not-for-profit organization incorporated in the District of Columbia in 1985. The Theatre was organized to operate exclusively for charitable, educational, and literary purposes with the following objectives: to present public performances of theatrical drama; to encourage and promote public interest in the arts, particularly in drama; to provide education, instruction and experience in the theatrical arts and theatre management; and to publish newsletters, programs and other works relating to drama and theatre management. The Theatre is located in Washington, DC and draws support primarily from the surrounding area.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accompanying consolidated financial statements for the Theatre and its 100% owned subsidiary, Harman Center, LLC, are consolidated and presented on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. All intercompany activity has been eliminated.

Use of Estimates

The preparation of consolidated 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 disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenue, support, and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include amounts in short-term investments with original maturities of 90 days or less. Cash equivalents consist of money market accounts and overnight purchase agreements.

Restricted Cash

As of July 31, 2016 and 2015, there was \$150,849 and \$150,471, respectively, of restricted cash, related to the debt requirements of the note payable. As of July 31, 2016 and 2015, there was \$183,545 and \$300,150, respectively, of restricted cash related to the Lansburgh maintenance reserve.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments

Investments are recorded at their estimated fair value. Investment income, including unrealized gains or losses, is reported through the change in net assets as unrestricted unless restricted by the donor or by law.

Fair Value of Financial Instruments

Financial instruments consist of cash equivalents, investments, receivables, payables and debt. The carrying value of the Theatre's financial instruments in the accompanying consolidated statements of financial position approximated their respective estimated fair values as of July 31, 2016 and 2015.

Receivables

The Theatre provides an allowance for doubtful accounts equal to estimated losses that will be incurred in the collection of receivables. The estimated losses are based on historical collection experience and a review of the current status of the existing receivables. For pledges expected to be collected in over one year, the Theatre discounts these pledges using a 2.97% discount rate for the year ended July 31, 2016, and a 2.44% discount rate for the year ended July 31, 2015. The rates are based on the 12 month LIBOR rate plus 1.65%.

Property and Equipment

Property and equipment are carried at cost. The Theatre capitalizes all costs over \$5,000 with an estimated useful life of more than one year. Depreciation is recorded using the straight-line method over the estimated life of the assets. Depreciation is calculated based on the following useful lives:

	<u>Useful Lives</u>
Buildings and improvements	30 years
Equipment	5-7 years
Scene shop	7 years

Deferred Financing Costs

As of July 31, 2016 and 2015, deferred financing cost was \$973,074 and \$806,773, respectively, and accumulated amortization was \$662,608 and \$549,448, respectively, for the years ended July 31, 2016 and 2015. Amortization expense was \$113,160 and \$105,651 for the years ended July 31, 2016 and 2015, respectively. The deferred financing costs are amortized using the effective interest method over the remaining life of the debt.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred Revenue and Costs

The Theatre recognizes revenue from production subscriptions and future show ticket sales in the period the production occurs. Therefore, payments received for future shows are recorded as deferred revenue. The direct costs incurred related to the sale of subscriptions are deferred until the revenue is earned and are recorded as deferred costs. A \$1.5 million contingent grant was received from a board member during the year ended July 31, 2014. During the year ended July 31, 2015, \$400,000 of this amount was contributed to the Theatre. The conditional grant is recorded in deferred revenue in the accompanying consolidated statements of financial position until the condition has been met.

Net Assets

Unrestricted net assets are assets and contributions that are not restricted by donors or for which restrictions have expired.

Temporarily restricted net assets are those whose use by the Theatre has been limited by donors primarily for a specific time period or purpose. When a donor restriction is met, temporarily restricted net assets are reclassified to unrestricted net assets.

Permanently restricted net assets are those that are restricted by donors to be maintained by the Theatre in perpetuity. Investment income on these assets is temporarily restricted until expended for its restricted purpose.

Contributions

Contributions received and unconditional promises to give are measured at fair value and are reported as increases in net assets. The Theatre reports support received with donor imposed time or use stipulations as permanently or temporarily restricted support. When the restriction is satisfied, the temporarily restricted net assets are reclassified to unrestricted net assets. Donor-restricted contributions with restrictions that are met in the same reporting period are reported as unrestricted support.

Donated Goods and Services

The Theatre records the value of donated goods and services requiring specialized skills when there is an objective basis to measure their value. Such items are reflected in the accompanying consolidated statements of activities and changes in net assets as contributions and expenses at their estimated fair market values. The Theatre recognized \$524,366 and \$541,926, in donated goods and services during the years ended July 31, 2016 and 2015, respectively.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Advertising Costs

Advertising costs are expensed when incurred. Advertising expense for the years ended July 31, 2016 and 2015 was \$890,292 and \$730,320, respectively. Included in these balances are in-kind advertising expense of \$306,325 and \$334,000 for the years ended July 31, 2016 and 2015, respectively.

Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the consolidated statements of activities and changes in net assets. Accordingly, certain costs have been allocated among the program and supporting services that benefit from those costs. General and administrative expenses include those expenses that are not directly identified with any other specific function but provide for the overall support and direction of the Theatre.

Income taxes

The Theatre is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable District of Columbia income tax laws and qualifies for charitable contribution deductions.

Accounting principles generally accepted in the United States of America provide consistent guidance for the accounting for uncertainty in income taxes recognized in an entity's financial statements and prescribe a threshold of "more likely than not" for recognition of tax positions taken or expected to be taken in a tax return. The Theatre performed an evaluation of uncertain tax positions for the fiscal year ended July 31, 2016, and determined that there were no matters that would require recognition in the consolidated financial statements or which may have any effect on its tax-exempt status. As of July 31, 2016, the statute of limitations for fiscal years 2013 through 2016 remains open with the U.S. Federal jurisdiction or the various states and local jurisdictions in which the Theatre files tax returns. It is the Theatre's policy to recognize interest and/or penalties related to uncertain tax positions, if any, in income tax expense.

Subsequent Events

The Theatre evaluated the accompanying consolidated financial statements for subsequent events and transactions as of December 27, 2016, the date these consolidated financial statements were available for issue and have determined that no material subsequent events have occurred that affect the information presented in the accompanying consolidated financial statements or require additional disclosure.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

3. INVESTMENTS

Accounting standards generally accepted in the United States of America establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under generally accepted accounting principles are described below:

- Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Theatre has the ability to access.
- Level 2 Inputs to the valuation methodology include:
- Quoted prices for similar assets or liabilities in active markets;
 - Quoted prices for identical or similar assets or liabilities in inactive markets;
 - Inputs other than quoted prices that are observable for the asset or liability; and
 - Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

- Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for investments measured at fair value. There have been no changes in the methodologies used as of July 31, 2016.

Fixed income funds, common stock, equity mutual funds and exchange traded funds: Valued at the closing price reported on the active market on which the individual securities are traded.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

3. INVESTMENTS (continued)

Trust managed investments: Valued on underlying investments of the fund as valued by the fund's management.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Theatre believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, the fair value hierarchy of the Theatre's investments at fair value as of:

	July 31, 2016			
	Level 1	Level 2	Level 3	Total
Fixed income funds				
Balanced total return	\$ 515,151	\$ -	\$ -	\$ 515,151
Floating rate high income	271,064	-	-	271,064
Common stocks				
Consumer discretionary	134,061	-	-	134,061
Consumer staples	97,001	-	-	97,001
Energy	66,081	-	-	66,081
Financial	120,007	-	-	120,007
Healthcare	133,184	-	-	133,184
Industrials	80,863	-	-	80,863
Information technology	182,385	-	-	182,385
Materials	30,337	-	-	30,337
Telecommunication svcs	23,497	-	-	23,497
Utilities	20,064	-	-	20,064
Equity mutual funds				
Foreign large blend	11,317	-	-	11,317
Large growth	62,832	-	-	62,832
Large value	41,810	-	-	41,810
Mid-cap blend	16,965	-	-	16,965
Small blend	12,107	-	-	12,107
Exchange traded funds				
Balanced total return	690,436	-	-	690,436
Trust managed investments	-	1,478,440	-	1,478,440
Total	\$ 2,509,162	\$ 1,478,440	\$ -	\$ 3,987,602

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements
July 31, 2016 and 2015

3. INVESTMENTS (continued)

	July 31, 2015			
	Level 1	Level 2	Level 3	Total
Fixed income funds				
Balanced total return	\$ 537,647	\$ -	\$ -	\$ 537,647
Floating rate high income	288,702	-	-	288,702
Common stocks				
Consumer discretionary	169,477	-	-	169,477
Consumer staples	97,192	-	-	97,192
Energy	100,558	-	-	100,558
Financial	123,504	-	-	123,504
Healthcare	157,277	-	-	157,277
Industrials	89,888	-	-	89,888
Information technology	200,504	-	-	200,504
Materials	34,426	-	-	34,426
Telecommunication svcs	26,434	-	-	26,434
Utilities	10,613	-	-	10,613
Equity mutual funds				
Foreign large blend	12,632	-	-	12,632
Large growth	61,218	-	-	61,218
Large value	40,752	-	-	40,752
Mid-cap blend	16,579	-	-	16,579
Small blend	12,296	-	-	12,296
Exchange traded funds				
Balanced total return	708,643	-	-	708,643
Trust managed investments	-	1,602,514	-	1,602,514
Total	\$ 2,688,342	\$ 1,602,514	\$ -	\$ 4,290,856

The following schedule summarizes investment income included in the consolidated statements of activities and changes in net assets:

	2016	2015
Dividends and interest	\$ 48,251	\$ 147,554
Net realized and unrealized loss	(100,649)	(63,148)
Total	\$ (52,398)	\$ 84,406

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

4. PLEDGES RECEIVABLE

Included in pledges receivable were the following as of July 31:

	<u>2016</u>	<u>2015</u>
Capital campaign	\$ 84,912	\$ 130,012
Irrevocable pledges	1,500,000	1,500,000
Restricted to future periods	<u>3,104,663</u>	<u>3,885,656</u>
Total	4,689,575	5,515,668
Less: allowance for uncollectible pledges	<u>130,599</u>	130,599
Less: unamortized discount	<u>317,180</u>	<u>334,587</u>
Pledges receivable, net	<u>\$ 4,241,796</u>	<u>\$ 5,050,482</u>
Amounts due in:		
Less than one year	\$ 2,658,874	\$ 2,741,968
One to five years	530,701	1,273,700
Irrevocable pledges	<u>1,500,000</u>	<u>1,500,000</u>
Total	<u>\$ 4,689,575</u>	<u>\$ 5,515,668</u>

During 2012, the Theatre received an irrevocable pledge whereby the donor has agreed to bequeath \$1,000,000, to the Theatre upon his or her death. The pledge has been recorded in unrestricted net assets in the consolidated financial statements, discounted to its estimated present value by using the estimated expected life per the actuary table and an interest rate of 2.97% and 2.44% as of July 31, 2016 and 2015, respectively. The present value was \$791,251 and \$820,758, as of July 31, 2016 and 2015, respectively.

During 1998, the Theatre received an irrevocable pledge whereby the donor has agreed to bequeath \$500,000 to the Theatre upon his or her death. The pledge has been recorded in unrestricted net assets in the consolidated financial statements, discounted to its estimated present value by using the estimated expected life per the actuary table and an interest rate of 2.97% and 2.44% as of July 31, 2016 and 2015, respectively. The present value was \$444,761 and \$448,035, as of July 31, 2016 and 2015, respectively.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following as of July 31:

	<u>2016</u>	<u>2015</u>
Land	\$ 12,548,037	\$ 12,548,037
Building and improvements (311 East Capitol Street)	958,967	958,967
Building and improvements (Harman Theatre)	62,187,117	62,006,909
Office equipment	2,319,428	2,314,463
Transportation equipment	117,783	93,380
Theatre equipment	3,910,425	3,752,056
Office improvements	113,083	113,083
Rehearsal hall improvements	609,389	609,389
Scene shop	475,685	475,685
Acquisition and renovation costs, at 516-518 Eighth Street	<u>3,221,844</u>	<u>3,221,844</u>
Total property and equipment	86,461,758	86,093,813
Less: accumulated depreciation	<u>22,766,163</u>	<u>20,715,650</u>
Property and Equipment, Net	<u><u>\$ 63,695,595</u></u>	<u><u>\$ 65,378,163</u></u>

*No mention of
501 Eye St SW*

Depreciation expense was \$2,050,513 and \$2,108,543, for the years ended July 31, 2016 and 2015, respectively.

6. NOTES PAYABLE

Notes payable consisted of the following as of July 31:

<u>Notes Payable</u>	<u>Maturity</u>	<u>Payment terms</u>	<u>Interest rate</u>	<u>2016</u>	<u>2015</u>
Eagle Bank Term Loan	25-Apr-17	Principal and interest payments due monthly with remaining balance due at maturity	5%	\$ 2,610,365	\$ 4,243,088
Eagle Bank Loan	1-Sep-16	Principal and interest due quarterly	Greater of 5-year TCM plus 1.25% or 3.875% annually	9,372,764	9,595,657
Note payable to board member	31-Dec-18	Principal due at maturity	0.25%	3,310,000	3,310,000
Eagle Bank Line of Credit		Interest payments due monthly with principle due on demand	Prime Rate plus 1.75%	900,000	-
Total Notes Payable				<u><u>\$ 16,193,129</u></u>	<u><u>\$ 17,148,745</u></u>

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

6. NOTES PAYABLE (continued)

Included in the notes payable balance on the consolidated statements of financial position for the years ended July 31, 2016 and 2015, was \$3,310,000, due to a board member. The note requires quarterly interest and principal payments and is due in full on December 31, 2018. Imputed interest of \$60,000 at a rate of 2.97% was recorded in the consolidated financial statements as of July 31, 2016. Imputed interest of \$63,729 at a rate of 2.44% was recorded in the consolidated financial statements as of July 31, 2015.

Theatre Loans

In September 2010, the Theatre entered into a note payable with Eagle Bank for \$10,500,000. As of July 31, 2016 and 2015, the interest rate on the Eagle Bank note was 3.875%.

The Theatre loan contains certain financial covenants. The Theatre shall provide Eagle Bank with audited financial statements within 150 days after fiscal year end, quarterly financial statements and maintain a debt service coverage ratio no less than 1.15. The Theatre did not meet the debt service coverage ratio as of July 31, 2016. The Theatre obtained a waiver from Eagle Bank for this covenant.

Interest expense on this loan for the years ended July 31, 2016 and 2015, was \$386,892 and \$397,217, respectively.

In October 2012, the Theatre modified the line of credit from \$3,650,000 to \$4,500,000 and converted the line of credit to a term loan. The term loan accrues interest at 5%. Monthly principal and interest payments are due on the line of credit with the entire outstanding balance payable on April 25, 2017. The term loan is subject to annual renewal. The Theatre paid interest expense of \$208,756 and \$211,231, for the years ended July 31, 2016 and 2015, respectively.

Minimum future principal payments as of July 31, 2016, were as follows:

<u>Year Ending July 31,</u>	<u>Amount</u>
2016	\$ 12,883,129
2017	3,310,000
Total	\$ 16,193,129

7. LINE OF CREDIT

In December of 2015, the Theatre established an operating line of credit in the amount of \$1,000,000. The line was increased to \$1,500,000 in July of 2016. Under the terms of this agreement, the Theatre is to pay interest monthly at the Prime Rate plus 1.75%, until the line of credit is paid in full. The line of credit is due on demand. There was an outstanding balance of \$900,000 as of July 31, 2016. There was no outstanding balance as of July 31, 2015.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

8. COMMITMENTS AND CONTINGENCIES

Grants and Contracts

Most grants and cost-reimbursable contracts specify the types of expenditures for which the grant or contract funds may be used. The expenditures made by the Theatre under these grants and contracts are subject to audit. In the opinion of management, adjustments for unallowable costs, if any, resulting from such audits would not have a material effect on the accompanying consolidated financial statements.

Operating Leases

The Theatre leases the Lansburgh Theatre at a base rate of \$10,000 per year, plus actual costs for utilities and maintenance and a fee for use of common areas, through 2033. The Theatre believes that its rent for the Lansburgh Theatre is at market value. Rent expense for all operating leases was \$1,028,320 and \$990,720, for the years ended July 31, 2016 and 2015, respectively.

The required future lease payments were as follows as of July 31, 2016:

<u>Years Ending July 31,</u>	<u>Amount</u>
2017	\$ 442,931
2018	437,199
2019	436,000
2020	70,900
2021	130,000
Total	\$ 1,517,030

Capital Lease

The Theatre entered into a capital lease agreement for a phone system, copier, and server over a five year period through March, 2018. The required future lease payments as of July 31, 2016, were as follows:

<u>Years Ending July 31,</u>	<u>Amount</u>
2017	\$ 160,283
2018	47,612
Total payments	207,895
Less: interest at 4.5%	19,701
Present Value of Lease Payments	\$ 188,194

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

8. COMMITMENTS AND CONTINGENCIES (continued)

Commitments

The Theatre is planning to obtain financing to purchase and develop a property for actor housing and other Theatre related activities subsequent to year end. As of July 31, 2015, \$300,000 has been recorded in deposits related to the property and is included in deposits and other assets on the consolidated statements of financial position. During the years ended July 31, 2016, and 2015 the Theatre incurred \$79,963 and \$98,481, respectively, in legal costs related to the financing of the property, and they are included in deferred financing costs on the consolidated statements of the financial position.

9. RETIREMENT PLAN

The Theatre has a defined contribution retirement plan for all employees who meet certain service requirements. The Theatre contributes 4% of compensation for employees who have completed 2 years of service, and matches up to 2% of deferred salary amounts for employees who elect to participate. Contributions are fully vested when made. The Theatre contributed to other retirement plans on behalf of the Theatre's union members during the years ended July 31, 2016 and 2015. Contributions made by the Theatre during the years ended July 31, 2016 and 2015, were \$214,474 and \$185,343, respectively.

10. NET ASSETS

Temporarily restricted net assets represent time restricted pledges and other assets available for the following as of July 31:

	<u>2016</u>	<u>2015</u>
Academy	\$ 2,319	\$ 8,260
Programs	2,083,379	1,844,593
Total	<u>\$ 2,085,698</u>	<u>\$ 1,852,853</u>

Permanently restricted net assets as of July 31, 2016 and 2015, represent actual endowment funds of the Duke endowment which are restricted in perpetuity. The requirements of the Duke endowment stipulate that no less than 5% of the average fair market value of the fund be made available to the Theatre solely for the Theatre's artistic programming expenses. In September of 2004, the Theatre adopted a spending policy in compliance with this requirement, specifically stating that 5% of the average endowment value on June 30 of the prior three years will be available for spending in the following fiscal year.

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

11. NET ASSETS RELEASED FROM RESTRICTIONS

Net assets were released from restrictions during the years ended July 31, 2016 and 2015, by incurring expenses that satisfied the restricted purposes or by the occurrence of other events specified by donors are as follows:

	<u>2016</u>	<u>2015</u>
Academy	\$ 28,925	\$ 23,629
Endowment funds	81,376	82,519
Programs	<u>1,245,814</u>	<u>1,033,305</u>
Total	<u>\$ 1,356,115</u>	<u>\$ 1,139,453</u>

12. ENDOWMENT

The Theatre's endowment consists of one fund established for support of the performing arts. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Trustees of the Theatre has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) 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 Theatre classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA.

In accordance with SPMIFA, the Theatre considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- the duration and preservation of the fund
- the purposes of the Theatre 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 Theatre
- the investment policies of the Theatre

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

12. ENDOWMENT (continued)

Return Objectives and Risk Parameters

The Theatre 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 include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, as approved by the Board of Trustees, the primary objective in the investment management for fund assets is the preservation of purchasing power after spending to achieve returns throughout budgetary and economic cycles commensurate with the investment risk constraints and cash flow requirements established in its investment policy. Achieving these objectives will require a moderate and prudent level of risk, a long-term investment horizon and diversification of assets. Actual returns in any given year may vary from this amount.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Theatre has a policy of appropriating for the distribution of 5% of the average endowment value as of June 30 of the prior three years. In establishing this policy, the Theatre considered the long-term expected return on its endowment. Accordingly, over the long term, the Theatre expects the current spending policy to allow its endowment to grow at the Standard and Poor 500 Index as a benchmark for the equity investments; the Lehman Aggregate Bond Index as a benchmark for the fixed income investments; and the 90-day Treasury Bill Index as a benchmark for the cash and cash equivalents investments. This is consistent with the Theatre's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specific term as well as to provide real growth through new gifts and investment return.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Theatre 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). For donor-restricted and Board designated endowments, the Theatre 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 SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements
July 31, 2016 and 2015

12. ENDOWMENT (continued)

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 SPMIFA requires the Theatre to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$345,702 and \$188,161 as of July 31, 2016 and 2015, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred after the continued appropriation for certain programs that were deemed prudent by the Board.

Composition of the Endowment by Net Assets

As of July 31, the composition of the endowment is as follows:

	2016			
	Unrestricted	Temporarily	Permanently	Total
Donor-restricted endowment	\$ (345,702)	\$ -	\$ 1,886,062	\$ 1,540,360

	2015			
	Unrestricted	Temporarily	Permanently	Total
Donor-restricted endowment	\$ (188,161)	\$ -	\$ 1,886,062	\$ 1,697,901

Changes in Endowment Net Assets

	2016			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ (223,924)	\$ -	\$ 1,886,062	\$ 1,662,138
Investment return:				
Investment income	-	31,491	-	31,491
Net depreciation (realized and unrealized)	-	(71,893)	-	(71,893)
Total investment return	-	(40,402)	-	(40,402)
Appropriation of endowment assets for expenditure	-	(81,376)	-	(81,376)
Endowment transfer	(121,778)	121,778	-	-
Endowment Net Assets, End of Year	\$ (345,702)	\$ -	\$ 1,886,062	\$ 1,540,360

THE SHAKESPEARE THEATRE

Notes to the Consolidated Financial Statements July 31, 2016 and 2015

12. ENDOWMENT (continued)

	2015			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of year	\$ (188,161)	\$ -	\$ 1,886,062	\$ 1,697,901
Investment return:				
Investment income	-	51,012	-	51,012
Net appreciation (realized and unrealized)	-	(4,256)	-	(4,256)
Total investment return	-	46,756	-	46,756
Appropriation of endowment assets for expenditure	-	(82,519)	-	(82,519)
Endowment transfer	(35,763)	35,763	-	-
Endowment Net Assets, End of Year	\$ (223,924)	\$ -	\$ 1,886,062	\$ 1,662,138

13. OPERATING RESULTS

As shown in the Supplemental Information, Schedules of the Operating Fund, activity which is exclusive of building and capital campaign funds and includes cash receipts on collections from operating pledges received on prior year receivables, the Theatre had incurred losses before other expenses of \$44,093 for the year ended July 31, 2015. For the year ended July 31, 2016, the Theatre had a positive change in net assets before other expenses of \$41,209, which includes a transfer from the Harman Center and Campaign of \$829,000 and net assets released from restriction of \$1,356,115. In response to this, the Theatre's Board of Trustees formed a Strategic Planning Committee to develop a Strategic Business Plan. The committee seeks to identify a path to financial solvency which creates a sustainable business model and eliminates the Theatre's structural deficit while maintaining fidelity to its mission and core values. Work began in the year ending July 31, 2014 and continues in the year ending July 31, 2016.

The strategic plan encompasses programming, debt reduction, and facility efficiency improvements to aid in the reduction of expenses and increased revenue sources during fiscal year 2015 through to the fiscal year ending July 31, 2018. The Theatre began implementing these actions during the year ended July 31, 2015. The Theatre met its strategic plan goals for the year ended July 31, 2015. The Theatre also has plans to refinance its notes payables.

SUPPLEMENTAL INFORMATION

THE SHAKESPEARE THEATRE

**Schedules of the Operating Fund
For the Years Ended July 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
Unrestricted Support		
Contributions and grants	\$ 5,827,179	\$ 6,146,323
Transfers from Harman Center and Campaign	829,000	979,000
Net assets released from restriction	<u>1,356,115</u>	<u>1,139,453</u>
Total Support	<u>8,012,294</u>	<u>8,264,776</u>
Revenue		
Productions	6,888,717	6,853,060
Tour income and bookings	1,119,058	845,055
Educational programs	875,918	839,300
Concessions and other sales	353,218	346,594
Investment income not to exceed spending policy	9,546	105,439
Other	<u>1,966,880</u>	<u>1,051,686</u>
Total Revenue	<u>11,213,337</u>	<u>10,041,134</u>
Total Support and Revenue	<u>19,225,631</u>	<u>18,305,910</u>
Expenses		
Program services	13,555,813	12,698,153
Fundraising	1,575,208	1,705,866
General and administrative	1,225,571	1,068,717
Operations	2,728,549	2,760,093
Interest expense	<u>112,445</u>	<u>117,174</u>
Total Expenses before Other Income (Expenses)	<u>19,197,586</u>	<u>18,350,003</u>
Change in net assets before other income (expenses)	28,045	(44,093)
Other Income (Expenses)		
Provision for doubtful pledges	(19,858)	(135,349)
Depreciation	(293,581)	(281,336)
Realized and unrealized loss on investments	<u>(27,756)</u>	<u>(14,869)</u>
Change in Net Assets for Operating Fund	<u>\$ (313,150)</u>	<u>\$ (475,647)</u>

THE SHAKESPEARE THEATRE

Note to the Schedules of the Operating Fund July 31, 2016 and 2015

The operating fund schedules are presented for additional analysis and to provide a more detailed accounting of operational activities more directly related to the Theatre's core mission of presenting classical theatre. They are not a required part of the consolidated financial statements.